DEFICIT FINANCING

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Meaning

When the revenue of the govt. is shorter than its expenditure then this situation is dealt by printing more currency or by borrowing. This temporary arrangement of money is known as deficit financing.

Definitions

Indian Planning Commission: the term deficit finance is used to denote the direct addition to gross national expenditure through budget deficit, whether the deficit are on revenue or on capital account.

Dr. Varadaraja Rao: the financing of a deliberately created gap between public revenue and public expenditure or a budgetary deficit, the method of financing resorted to being borrowing or a type that results in a net addition to national outlay or aggregative expenditure.

Objectives

1. To Finance War Expenditure
2. To promote Economic Development
3. To uplift the economy out of depression

4. To mobilise surplus, unutilized and underutilized resources
5. To prevent unemployment
6. To exploit natural resources
7. To finance economic plans

Role of Deficit financing

1. Helps to meet war expenditure

- Alternative source of financing

- Simplest and quickest method

- Leads to inflation

2. Reduces the problem of unemployment

- Increases purchasing power
- increases effective demand during recession
- To finance public work programmes

3. Accelerates economic Development

- Helpful in backward economies

- For financing development plans

- Tool to increase saving and investment

4. Mobilise the surplus resources

- Mobilises idle, unutilized, underutilized resources
- Contributes increase in income, employment
- Manufacturing operation

5. Helps in capital formation

- Leads inflationary rise in prices

- Business classes are gainers

- Have high propensity to save

7. Creates socio-economic Overheads

- Power projects, schools, hospitals, transport etc.
- Breaks bottlenecks and structural rigidities

Limitations

1. Adverse effect on BOP
2. Inflationary in Nature
3. Adverse political consequences
4. Change in pattern of investment

5. Adverse effect on saving
6. Collapse of monitory system
7. Encourages speculations
8. Effects on distribution

Safe Limits of Deficit Financing

1. Growth Rate of Economy
2. Supply of Money
3. Control over wages and Prices
4. Increase and savings and Taxes

5. Increase in the supply of goods
6. Growth of monetized sector
7. Creation of trade surplus
8. Restriction on bank credit

9. Increase in private investment
10. Reduction in Unproductive expenditure
11. Spirit of public sacrifice
12. Extent of existence of unutilized capacity