International Journal of Management and Humanities (IJMH)
ISSN: 2394-0913 (Online), Volume-11 Issue-12, August 2025

Fiscal Deficit & its Impact on Economic Growth

Pratyush Kumar, Maariyah Ghaswala, Chrisanne Gomes, Mohammed Aadil Khan, Vidit Kohli, Ansh Maheshwari

Abstract. The paper examines the fiscal deficit in India, its components, and historical trends across both pre- and post-liberalisation eras. It explores the dual role of fiscal deficits as tools for economic growth and potential barriers to financial stability. Positive impacts include economic stimulus, job creation, and infrastructure development, while negative aspects involve inflation, debt sustainability, and crowding out of private investments. The analysis encompasses key drivers, including government spending, subsidies, and tax policies, as well as the impact of external shocks such as the COVID-19 pandemic. Our findings conclude with policy recommendations for sustainable fiscal management and future research directions.

***Keywords:** Historical Trends, Fiscal Management, Economic Stimulus, Job Creation*

Abbreviations:
LPG: Liberalisation, Privatization and Globalization
FDI: Foreign Direct Investment

I. INTRODUCTION

A. Meaning of Fiscal Deficit

A fiscal deficit, also referred to as a national deficit, occurs when a country's government spends more money than it earns in a fiscal year. In other words, expenditures exceed revenue. Governments may increase spending on social programs, such as social security and healthcare, or allocate funds to other areas, including military spending and infrastructure development. The size of a fiscal or national deficit depends entirely on a few factors, including:

- The state of a country's economy (unemployment, business revenue, prices)
- Fiscal policies (government spending and the collection of revenue)

$$\textbf{\textit{Fiscal Deficit}} = \textbf{\textit{Total Expenditure}} - \textbf{\textit{Total Revenue}}\ (\textbf{\textit{Excluding the borrowings}})$$

The total expenditure includes all government spending, including capital and revenue expenditures. The total income consists of all government earnings from taxes, duties, fees, and other non-borrowing sources.

B. Components of Fiscal Deficit

The fiscal deficit consists of two key components: revenue and expenditure.

- *Government Revenue:* It combines tax revenue (e.g., GST, customs duties, corporation tax) collected by the centre, and non-tax revenue like dividends, profits, and interest receipts.
- *Government Expenditure:* It includes capital spending, revenue expenditure (salaries, pensions), infrastructure, healthcare, interest payments, and grants for capital asset creation.

C. Historical Trends in India's Fiscal Deficit

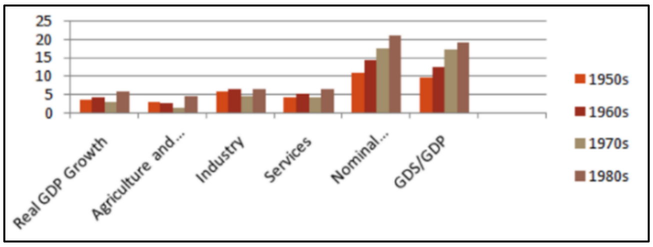
i. Pre-Liberalisation Period (1950-1990)

- *Economic Policy:* India's economic approach was focused on self-reliance through public sector control over major industries, state-driven planning and import substitution. The government prioritised heavy industries, with significant involvement from the public sector. Agriculture, although crucial, did not receive the same level of attention in early development plans, which later contributed to food shortages until the advent of the Green Revolution in the late 1960s.
- *Growth Rates:* GDP growth during this period was slow. From 1950 to 1980, India's GDP grew at an average *annual* rate of approximately 3.5%, a period known as the 'Hindu rate of growth'. The growth rate of per capita income was even slower at 1.4% per annum.
- *Fiscal Deficit:* The government had a large fiscal deficit due to heavy subsidies for industries, agriculture and social programs. This was financed through borrowing and led to rising debt, with an average deficit of 8–9% of GDP before the 1991 crisis.
- *Structural Inefficiencies:* Bureaucracy slowed decision-making, and high import taxes restricted access to modern technology. This

Manuscript Received on 20 January 2025 | First Revised Manuscript Received on 12 July 2025 | Second Revised Manuscript Received on 12 August 2025 | Manuscript Accepted on 15 August 2025 | Manuscript published on 30 August 2025.

*Correspondence Author(s)
Pratyush Kumar*, Department of Technology Management (Finance), Mukesh Patel School of Technology Management and Engineering, NMIMS University, Mumbai (Maharashtra), India. Email ID: pratyush.kumar90@nmims.in, ORCID ID: 0009-0006-3273-9071
Maariyah Ghaswala, Department of Technology Management (Finance), Mukesh Patel School of Technology Management and Engineering, NMIMS University, Mumbai (Maharashtra), India. Email ID: maariyah.ghaswala92@nmims.in
Chrisanne Gomes, Department of Technology Management (Finance), Mukesh Patel School of Technology Management and Engineering, NMIMS University, Mumbai (Maharashtra), India. Email ID: chrisanneara.gomes28@nmims.in
Mohammed Aadil Khan, Department of Technology Management (Finance), Mukesh Patel School of Technology Management and Engineering, NMIMS University, Mumbai (Maharashtra), India. Email ID: mohammadaadil.khan37@nmims.in
Vidit Kohli, Department of Technology Management (Finance), Mukesh Patel School of Technology Management and Engineering, NMIMS University, Mumbai (Maharashtra), India. Email ID: vidit.kohli16@nmims.in
Ansh Maheshwari, Department of Technology Management (Finance), Mukesh Patel School of Technology Management and Engineering, NMIMS University, Mumbai (Maharashtra), India. Email ID: ansh.maheshwari81@nmims.in

reduced business competitiveness and slowed economic growth.

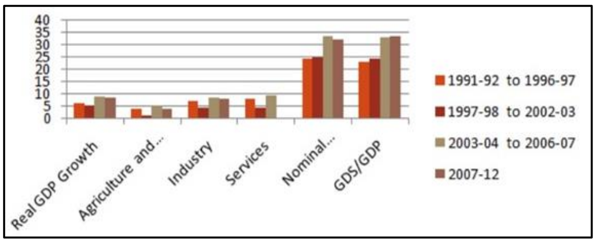


[Fig.1: Growth Trends in India's Fiscal Deficit During the Pre-Liberalisation Period [1]]

ii. Post-Liberalisation Period (1991 Onwards)

In 1991, India introduced major economic reforms called the Liberalisation, Privatization and Globalization (LPG) program to reduce government control over the economy.

- *Import Tariffs:* High taxes on imported goods were reduced to encourage competition and increase foreign trade.
- *Privatization:* The government sold parts of public sector companies to private investors and allowed private companies to enter industries that were previously controlled only by the government.
- *Impact on Fiscal Deficit:* Before the 1991 reforms, India's fiscal deficit was very high at 8.4% of GDP. After the reforms, it was reduced to 5.7% by 1992-93. This occurred because the government reduced unnecessary spending, cut subsidies, and improved tax collection.
- *Economic Growth:* After the reforms, India's economy grew much faster. GDP growth averaged 6-8% per year, with peaks of 8-9% between 2003 and 2012. Before the reforms, growth was much slower, around 3.5%. Sectors such as services, IT, industry, and agriculture benefited the most from the reforms.



[Fig.2: Growth Trends in India's Fiscal Deficit During the Post-Liberalisation Period [1]]

D. Recent Trends in India's Fiscal Deficit

i. Fiscal Policies (2010-2020): Pre-COVID

- In fact, in the last decade, Indian fiscal deficit oscillated between 3.5 % and 4% of GDP, which the government has tried to reduce under the FRBM Act.
- Yet, persistent challenges in the form of GST implementation and structural issues within public sector enterprises left the deficit hanging above government targets.
- However, the deficit in expenditure and revenue was considerable despite attempts to reduce subsidies and optimize revenue collection (mainly driven by defence spendings, social schemes like NREGA 2.0) and infrastructure spending.

ii. COVID-19 (2020–2021):

- The fiscal deficit increased substantially due to the COVID-19 pandemic, when the government initiated multiple stimulus packages to support the economy.
- In 2020-2021, the fiscal deficit skyrocketed to 9.5% of GDP, primarily due to increased spending on healthcare, social support programs, and a massive fall in tax revenues as economic activity slowed down.
- To support recovery, the government rolled out relief packages like 'Atmanirbhar Bharat,' further increasing expenditure while revenue generation dropped due to lockdowns.

iii. Current Fiscal Policies (Post-COVID):

- Post-pandemic, India has aimed at fiscal consolidation but continues to prioritize spending on sectors like healthcare, infrastructure and social welfare to drive recovery.
- The fiscal deficit target for 2023-2024 is set at around 5.9%, with long-term plans to gradually bring it back under 4% in the coming years, as economic growth picks up.

II. POSITIVE IMPACT OF FISCAL DEFICIT AS A TOOL FOR GROWTH

The fiscal deficit emerges as a key driver of growth for any country, especially in times of economic recession. According to Keynes' theory of macroeconomics, government expenditures help bridge the aggregate expenditure gap. Auerbach and Gorodnichenko (2012) [1] argue in their study of fiscal multipliers that employing government expenditures can enhance the change in the employment or production level of the economy during recessions. Furthermore, their empirical studies justify the use of fiscal tools by demonstrating that government expenditure has efficient and high multipliers during recession periods.

In practice, many developed countries have used fiscal deficits to promote growth. For instance, during the 2008 financial crisis, the United States undertook large-scale government-sponsored activities funded by deficits, which ultimately stimulated the recovery. Evidence provided by Romer and Romer shows that the Stimulus Bill expenditure during the Great Recession prevented an even deeper downturn in economic activity by increasing consumption and creating jobs.

On the other hand, fiscal deficits can be regarded as counter-cyclical by governments, helping to reduce business cycle variations. Blanchard and Leigh (2013) state that fiscal deficits, when used appropriately, can temper economic shocks rather than aggravate them, thereby normalizing growth. Their research further reveals that countries employing

Retrieval Number: 100.1/ijmh.F178511060225
DOI: 10.35940/ijmh.F1785.11120825
Journal Website: www.ijmh.org

Published By:
Blue Eyes Intelligence Engineering
& Sciences Publication (BEIESP)

counter-cyclical policies during recessions experienced milder recessions and faster recovery than those adhering strictly to budgetary balance.

A. Negative Impact of Fiscal Deficit as a Barrier

However, the prolonged accumulation of a budget deficit can be detrimental to economic growth. Neoclassical critics contend that high government debt leads to crowding out of investments through elevated interest rates. The problem, however, stems from the fact that excessive government debt may entail expectations of higher taxes in the future, which will work against the desire to invest or consume today, as explained by Barro.

Reinhart and Rogoff, in their paper 'Growth in a Time of Debt,' show that, for example, any time public debt reaches and exceeds 90% of GDP, that period is usually associated with low levels of growth. The reason is that, since there are higher levels of debt, the rate at which one borrows increases, which in turn restricts private investment and enhances the inflationary capacity.

This is no different in the case of most developing nations. For instance, in countries such as Argentina, high levels of government borrowing have led to significant fiscal crises, culminating in currency depreciation, inflation, and stagnation. As Fisher (1993) persuasively suggests, the persistent carrying of budgetary deficits and inflation spells a vicious cycle for countries, as debt will always have to be financed, and governments will seek to do this through trade and debt monetisation, which will further aggravate the situation.

B. Neutral or Conditional Views

Several researchers have studied the effects of fiscal deficits on economic development, suggesting that they are neither inherently good nor bad, but rather a feature that varies based on specific constraints: the size of the deficit, the state of the economy, and how that deficit is spent. Baldacci and Kumar provide evidence that although inflationary deficits are harmful, rich countries with better institutions and good fiscal foundations can tolerate deficits without compromising growth.

Along those lines, Perotti talks about 'expansionary fiscal contractions' – the phenomenon where a decrease in fiscal deficits, especially in the case of a large debt, such as in the US, would bolster investors' confidence and enhance the economic performance driven by lower interest rates and more private investments. Besides, Hemming, Kell, and Mahfouz contend that it is not only the existence of fiscal deficits that matters, but the way those funds are put to use; policies that direct deficit financing towards productive sectors, say infrastructure building or education, would create growth in the long run, but unwarranted spending would cause stagnation of the economy.

III. KEY DRIVERS OF FISCAL DEFICIT IN INDIA

A. Government Expenditure and Subsidies:

Government expenditure, or spending, consists of all government consumption, investment, and transfer payments. It refers to the money spent by the public sector on the acquisition of goods and the provision of services, such as healthcare and education. Government Expenditure plays a significant role in widening the fiscal deficit. Expenditure includes both capital and revenue. Capital Expenditure is the money spent by the government for the development of machinery, buildings, health facilities, education, and other similar purposes. Revenue expenditures of the government are those that do not lead to the creation of fixed assets and include paying interest on loans, salaries and pensions, as well as subsidies. Government expenditure and subsidies affect the fiscal deficit. A budgetary deficit exists when government expenditure exceeds revenue. Some of the factors that widen this deficit are subsidies, welfare programs and public sector expenditure.

Table-I: Effect on Fiscal Deficit Due to Government Expenditure [2]

Fiscal Year	Total Expenditure (₹ Crore)	Revenue Receipts (₹ Crore)	Fiscal Deficit (₹ Crore)	Fiscal Deficit (% of GDP)
2016-17	₹ 20,14,407	₹ 14,23,562	₹ 5,34,277	3.50%
2017-18	₹ 21,46,735	₹ 15,15,771	₹ 5,91,064	3.50%
2018-19	₹ 24,42,213	₹ 17,29,682	₹ 6,49,418	3.40%
2019-20	₹ 26,98,552	₹ 20,20,926	₹ 9,34,351	4.60%
2020-21	₹ 35,09,681	₹ 16,32,207	₹ 18,18,291	9.20%
2021-22	₹ 37,70,000	₹ 20,78,936	₹ 15,91,260	6.70%
2022-23	₹ 41,93,157	₹ 24,55,402	₹ 17,37,755	6.40%
2023-24 (BE)	₹ 45,03,097	₹ 26,32,281	₹ 16,85,494	5.10%

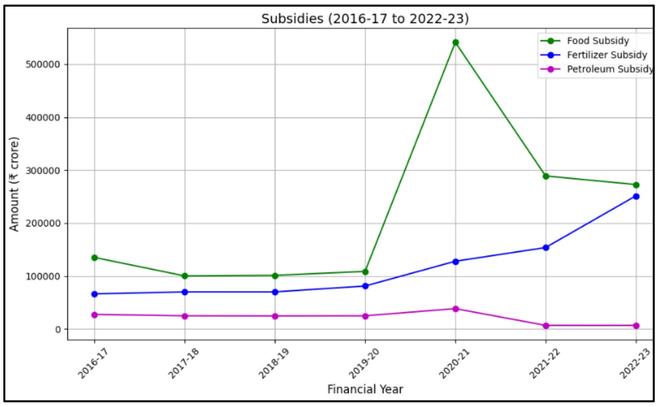
B. Subsidies:

The government spends heavily on subsidies, including those for food, fuel, and fertiliser. These subsidies are used to support vulnerable populations in India. Although these subsidies are socially beneficial, they increase the government's fiscal burden.

Table-II: Effect on Fiscal Deficit due to Government Subsidies [10][11]

Financial Year	Fiscal Deficit (₹ crore)	Food Subsidy (₹ crore)	Fertilizer Subsidy (₹ crore)	Petroleum Subsidy (₹ crore)
2016-17	5,32,791	1,35,173	66,302	27,500
2017-18	5,33,904	1,00,282	70,080	24,932
2018-19	5,34,274	1,01,327	70,088	24,747
2019-20	5,46,532	1,08,688	81,124	24,931
2020-21	17,37,755	5,41,330	1,27,921	38,480

2021-22	17,86,816	2,88,969	1,53,758	6,864
2022-23	17,37,755	2,72,802	2,51,339	6,817



[Fig.4: The Above Data Provides Information on Fiscal Deficit, Food Subsidy, Fertilizer Subsidy and Petroleum Subsidy Over the Financial Years 2016-17 to 2022-23 [3]]

C. Observations:

- Sharp *increase in fiscal deficit (2020-21):* The fiscal deficit remained relatively stable from 2016-17 to 2019-20, increasing from ₹5.32 lakh crore in 2016-17 to ₹5.46 lakh crore in 2019-20, indicating controlled fiscal spending. In the financial year 2020-21, a sharp increase was observed in the fiscal deficit, rising to ₹18.18 lakh crore. The growth is attributed to extraordinary circumstances caused by the COVID-19 pandemic. The economic downturn caused by the pandemic forced the government to increase spending on social welfare schemes.
- Food *subsidy trend:* From ₹1.35 lakh crore in 2016-17, the food subsidy gradually decreased to ₹1.00 lakh crore in 2017-18 before rising slightly to ₹1.08 lakh crore in 2019-20. The food subsidy then jumped to ₹5.41 lakh crore in 2020-21. This was a result of increased spending for supporting the vulnerable population during the pandemic. The Pradhan Mantri Garib Kalyan Anna Yojana (PMGKAY), which provided free food grains to millions of citizens, was a key driver of the initiative.
- Post *pandemic:* The food subsidy significantly reduced to ₹2.88 lakh crore in 2021-22 and ₹2.72 lakh crore in 2022-23, still above pre-pandemic levels.

D. Welfare Programs

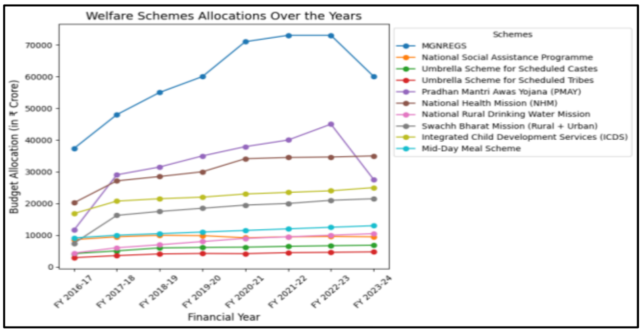
Government welfare schemes, such as MNREGA, PM Kisan, and healthcare programs, provide crucial support but require significant financial resources, thereby contributing to fiscal imbalances.

Table-III: Government Expenditure on Key Welfare Schemes [4]

Welfare Scheme	FY 2016-17	FY 2017-18	FY 2018-19	FY 2019-20	FY 2020-21	FY 2021-22	FY 2022-23	FY 2023-24
Mgnregs	₹37,341 crore	₹48,000 crore	₹55,000 crore	₹60,000 crore	₹71,002 crore	₹73,000 crore	₹73,000 crore	₹60,000 crore
National Social Assistance Programme	₹8,616 crore	₹9,500 crore	₹9,975 crore	₹9,865 crore	₹9,197 crore	₹9,500 crore	₹9,600 crore	₹9,500 crore
Umbrella Scheme for Scheduled Castes	₹4,201 crore	₹5,061 crore	₹6,000 crore	₹6,150 crore	₹6,242 crore	₹6,500 crore	₹6,700 crore	₹6,850 crore
Umbrella Scheme for Scheduled Tribes	₹2,934 crore	₹3,573 crore	₹4,100 crore	₹4,250 crore	₹4,191 crore	₹4,500 crore	₹4,600 crore	₹4,750 crore
Pradhan Mantri Awas Yojana (PMAY)	₹11,603 crore	₹29,043 crore	₹31,500 crore	₹35,000 crore	₹37,920 crore	₹40,000 crore	₹45,000 crore	₹27,500 crore
National Health Mission (NHM)	₹20,213 crore	₹27,131 crore	₹28,500 crore	₹30,000 crore	₹34,115 crore	₹34,500 crore	₹34,651 crore	₹35,000 crore
National Rural Drinking Water Mission	₹4,370 crore	₹6,050 crore	₹7,000 crore	₹8,000 crore	₹9,000 crore	₹9,500 crore	₹10,000 crore	₹10,500 crore
Swachh Bharat Mission (Rural + Urban)	₹7,469 crore	₹16,248 crore	₹17,500 crore	₹18,500 crore	₹19,500 crore	₹20,000 crore	₹21,000 crore	₹21,500 crore
Integrated Child Development Services (ICDS)	₹16,835 crore	₹20,755 crore	₹21,500 crore	₹22,000 crore	₹23,000 crore	₹23,500 crore	₹24,000 crore	₹25,000 crore
Mid-Day Meal Scheme	₹9,145 crore	₹10,000 crore	₹10,500 crore	₹11,000 crore	₹11,500 crore	₹12,000 crore	₹12,500 crore	₹13,000 crore

Retrieval Number: 100.1/ijmh.F178511060225
DOI: 10.35940/ijmh.F1785.11120825
Journal Website: www.ijmh.org

Published By:
Blue Eyes Intelligence Engineering
& Sciences Publication (BEIESP)



[Fig.5: The Above Data Provides Details of Expenditure on Key Welfare Schemes in India from the Financial Year 2016-17 to 2023-24 [4]]

E. Observations:

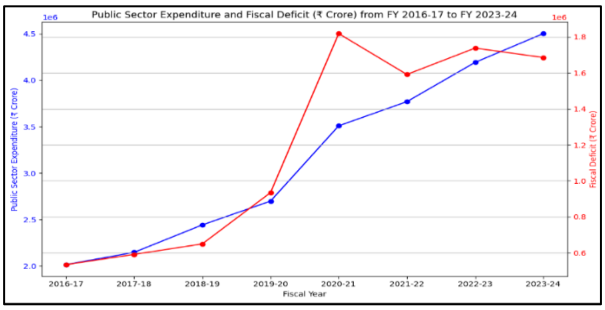
- *Pandemic-Era Expenditure:* Spending on welfare schemes surged during FY 2020-21 and 2021-22, particularly in MGNREGS, PMAY and health-related schemes like NHM. These were necessary relief measures to help the vulnerable population during the pandemic. This, however, also had a significant impact on the fiscal deficit.
- *Fiscal Consolidation Efforts (2023-24):* Allocations were reduced towards some programs like PMAY, MGNREGS, to control public spending and bring down the deficit.

1. Public Sector Expenditure

Large infrastructure projects or defence spending are critical for growth, but without sufficient revenue generation, they may exacerbate the fiscal deficit.

Table-IV: Effect on Fiscal Deficit Due to Government Expenditure on the Public Sector [7]

Fiscal Year	Public Sector Expenditure (₹ Crore)	Fiscal Deficit (₹ Crore)
2016-17	₹ 20,14,407	₹ 5,34,277
2017-18	₹ 21,46,735	₹ 5,91,064
2018-19	₹ 24,42,213	₹ 6,49,418
2019-20	₹ 26,98,552	₹ 9,34,351
2020-21	₹ 35,09,681	₹ 18,18,291
2021-22	₹ 37,70,000	₹ 15,91,260
2022-23	₹ 41,93,157	₹ 17,37,755
2023-24	₹ 45,03,097	₹ 16,85,494



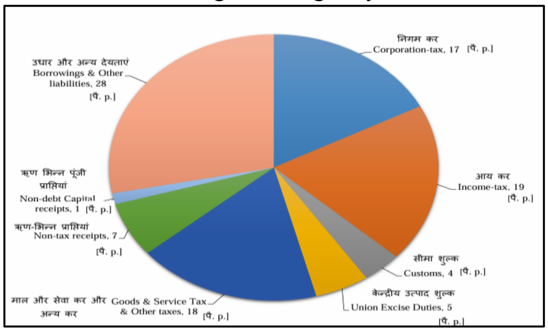
[Fig.6: Public Sector Expenditure and Fiscal Deficit from FY 2016-17 to FY 2023-24 [5]]

F. Observations:

- *Steady growth:* From FY 2016-27 to FY 2023-24, public sector expenditure has increased, growing from ₹20,14,407 crore to ₹45,03,097 crore.
- *Pandemic Impact:* Public sector expenditure surged by about ₹8,11,129 crore between FY 2019-20 and FY 2020-21, while the fiscal deficit almost doubled, increasing by ₹8,83,940 crore. This added to the widening of the fiscal deficit during the pandemic period.
- *Post pandemic:* Fiscal deficit has declined post FY 2020-21; however, the public expenditure continues to rise, indicating that the government is balancing its expenditure and has a focus on fiscal discipline.

G. Revenue Collection and Taxation Policies:

The fiscal deficit is linked to the revenue collection efficiency and the taxation policies. Revenue collection plays a vital role in determining the budgetary deficit.



[Fig.7: Pie Chart Showing Sources of Rupee in the Budget FY 2024–25 [8]]

H. Observations:

- *Direct Taxes:* Direct taxes include income tax and corporate tax, both of which contribute significantly as a source of income for the Indian government. Income taxes are levied based on earnings. Corporate taxes are a substantial portion of direct tax revenue. In a developing economy, direct taxes typically account for a small portion of total tax revenue.
- *Indirect Taxes:* GST was intended to improve tax collection, narrow the fiscal deficit, and widen the tax base by unifying various indirect taxes. However, due to issues like evasion and refund delays, its potential is still not fully realised.
- *Tax Evasion:* Tax evasion is a significant concern and obstacle that opposes the efficient collection of taxes. This, in turn, puts stress on the fiscal deficit. Even though the government has taken steps such as demonetization and linking Aadhar with PAN, tax evasion continues to remain a challenge
- *Tax-to-GDP Ratio:* The tax-to-GDP ratio is used to measure the efficiency of revenue collection. India's expected tax-to-GDP ratio is expected to reach 11.7%, which is lower than similar-sized economies like the UK, France, and Italy, which have ratios of 24.9%, 24.6%, and 24.6%, respectively. South Africa, a smaller economy, has a higher ratio at 24.2%.

I. Economic Factors and External Influences

Economic conditions and external shocks can also shape India's fiscal deficit. These shocks often affect government spending or expenditure, as well as revenue collection. This affects the ability to maintain a balanced budgetary position. The fiscal deficit is influenced by factors such as fluctuations in oil prices, economic cycles, and global economic conditions [6].

J. Key Points to Explore:

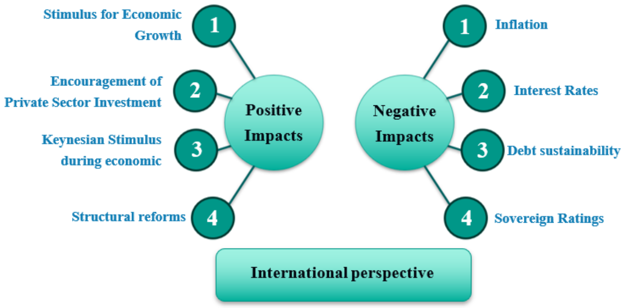
- *Economic Cycles:* During periods of economic downturns, such as the COVID-19 pandemic, Government expenditure increased, particularly for welfare schemes and stimulus packages. This was a key factor in widening the fiscal deficit during the pandemic.
- *External Shocks:* External shocks related to global commodity prices influence India's fiscal deficit. One such commodity is oil, and its cost. India imports around 85% of its crude oil, indicating that the country is highly vulnerable to fluctuations in global oil prices. India's fiscal position was impacted in 2021 due to rising oil prices and the recovery from the COVID-19 pandemic. The situation was further exacerbated in 2022 by the Russia-Ukraine conflict, resulting in increased import costs and additional fiscal pressures.
- *Global Economic Conditions:* India's fiscal position is affected by global economic trends and its interactions with the world economy through trade and foreign direct investment (FDI), and foreign exchange earnings. Conflicts like the Russia-Ukraine war have resulted in global supply chain disruptions, complicating the management of fiscal deficits as the costs of imports, such as fuel, fertilisers, and edible oils, have increased.

IV. IMPACT OF FISCAL DEFICIT AS A TOOL FOR GROWTH

Economic growth refers to an increase in the production and consumption of goods and services within an economy over a specified period of time. On the other hand, a Fiscal Deficit occurs when a government's total expenditure exceeds its total revenue, resulting in a budget shortfall that needs to be financed through borrowing.

As different economists hold varying perspectives, it's essential to consider both the positive and negative impacts of fiscal deficits on economic growth. While some argue that budgetary deficits can stimulate economic growth, others highlight the negative consequences of excessive borrowing and its impact on long-term financial stability.

The following are the key points that shed light on the positive and negative impact of fiscal deficit on economic growth [7].



A. Positive Impacts

i. Stimulus for Economic Growth:

A budget deficit stimulates GDP growth since the Government is injecting more money into the economy than it is taking out, thus supporting outputs and income. One perspective suggests that fiscal deficits can stimulate economic growth if Government borrowing is directed towards productive investments, such as infrastructure/construction (like roads, ports, bridges, and power plants), education, and healthcare, which boosts economic activity and creates jobs. In India's case, fiscal deficit-financed spending on infrastructure has the potential to drive long-term growth by enhancing productivity and alleviating logistical bottlenecks. If managed well, such investments can generate a higher future income, thereby offsetting the current fiscal deficit. When the Government spends more than it collects in revenue, it injects money into the economy, which can increase aggregate demand and boost economic activity. For example, during an economic downturn, increased Government spending on infrastructure projects or social welfare programs can create jobs and stimulate consumer spending, thus contributing to economic growth [13].

ii. Encouragement of Private Sector Investment

A higher fiscal deficit may bring about a positive fiscal multiplier effect, which in turn may stimulate private sector investment. Public spending on infrastructure and services can reduce bottlenecks in the economy, encouraging private sector participation. In India, significant public investments in roads, ports, and digital infrastructure have enhanced business efficiency, boosting private investments.

iii. Short-term fiscal deficit during economic downturn (Keynesian Stimulus in times of economic recession or slowdown):

A fiscal stimulus by borrowing more can help prevent an economy from falling into a deflationary depression. During periods of economic downturn, increasing the budgetary deficit through Government spending on infrastructure and social programs can act as a Keynesian stimulus to revive demand and boost economic activity. For example, during the COVID-19 pandemic, India increased fiscal spending to provide relief to vulnerable sections of society and revive economic activity. Therefore, budgetary deficits can give a stimulus to economic growth by increasing government spending during economic recessions or slowdowns. In this way, the Government can boost aggregate demand, leading to higher GDP growth. According to the Keynesian perspective, Keynesian economists favour the active use of fiscal policy to manage aggregate demand, stabilise output, confidence and investment after an external economic shock [9] [13].

B. Negative Impacts

i. Impact on Inflation:

Excessive government borrowing can lead to higher demand in the economy, resulting in demand-pull and cost-push inflation. A high fiscal deficit leads to unnecessary expenditure, primarily when financed by printing money or borrowing from the central bank, thereby increasing the money supply and contributing to inflationary pressure on the economy. This erodes consumers' purchasing power, destabilises the economy, and can negatively impact overall demand and growth. In India,

Published By:
Blue Eyes Intelligence Engineering
& Sciences Publication (BEIESP)

high fiscal deficits have historically been linked to inflation, particularly in food and fuel prices [9].

For example, in India, fiscal deficits have occasionally led to inflation, especially when deficits were monetised through printing more currency. During the 1990s, India witnessed high inflation in tandem with its rising fiscal deficit.

ii. *Impact on Interest Rates (Crowding out effect):*

A high fiscal deficit may lead to higher borrowing by the Government, reducing the availability of funds for the private sector. This phenomenon, known as the crowding-out effect, can hinder private investment and impede economic growth. A high fiscal deficit can push up interest rates as the Government competes with the private sector for financial resources, leading to the "crowding out" effect. This reduces the availability of funds for private businesses, increasing their borrowing costs and stifling investment. Printing more currency by the RBI to meet the deficit, also known as deficit financing, leads to increased market liquidity, which can lead to inflation and further interest rate increases, ultimately raising production costs and hindering private investment.

In India, periods of high fiscal deficits have often led to higher interest rates, which in turn have dampened private sector growth and economic expansion. For instance, when the Government continues borrowing and stops printing currency notes, there is upward pressure on interest rates. Increased interest rates then result in higher production costs, which in turn lead to higher prices [8].

iii. *Long-term Impact of Fiscal Deficit on Debt Sustainability:*

A persistent fiscal deficit leads to increased borrowing, which, in turn, increases the Government's debt burden and increases the debt-to-GDP ratio, undermining investor confidence, increasing borrowing costs, and risking a debt crisis. It adds to the national debt, raises the Government's debt servicing costs, and could lead to higher future taxes and reduced spending on public services. Continuous borrowing hinders economic growth, as more revenue is allocated to debt payments. If not managed well, rising public debt can lead to concerns over debt sustainability, triggering credit downgrades, higher borrowing costs, and reduced foreign investment.

For example, a significant portion of India's budget is now allocated to servicing past debt, limiting the resources available for productive investment and social programs. India's public debt as a percentage of GDP has been rising, raising concerns about debt sustainability. Greece's debt crisis in the early 2010s serves as a stark example of how unsustainable fiscal deficits can have severe consequences on economic growth and stability.

iv. *Impact on Sovereign Ratings:*

High fiscal deficits can raise concerns about the sustainability of a country's fiscal policies, potentially leading to downgrades in sovereign ratings. This can increase borrowing costs, reduce investor confidence, and negatively impact foreign investment inflows. If India's ratings are downgraded due to large deficits, it could worsen the economic outlook and raise the cost of financing infrastructure and public services [12].

C. International Perspective

The relationship between economic growth and fiscal deficit is not limited to individual countries; it also applies to the global level. In a globalized world, budgetary deficits of one country can have spillover effects on others. Excessive deficits in one nation can lead to higher borrowing costs, which may impact international capital flows, exchange rates, and global financial stability. Therefore, countries must consider the broader implications of their fiscal policies and coordinate with international institutions to ensure sustainable economic growth.

Additionally, if domestic resources are insufficient to finance deficits, the Government may rely on foreign borrowing, which increases vulnerability to external shocks. A significant portion of India's deficit is funded by foreign investments in government securities, which can be volatile and add risk to economic stability.

V. FISCAL DEFICIT AND EMPLOYMENT GENERATION

There is considerable scrutiny in the field of economics, particularly regarding the contribution of fiscal deficits to employment generation, which is more pronounced given that India is still considered a developing nation. Fiscal deficits, in everyday practice, appear as a means of boosting economic activity, which is achieved by stimulating employment both directly and indirectly in various sectors of an economy. In this section, we examine the significance of fiscal deficits in promoting public-private employment generation and skill development.

A. Government Jobs & Fiscal Deficit

Most of India's fiscal deficits typically go into government-led infrastructure projects, which are very labour-intensive. The emergence of these projects, which included the Pradhan Mantri Gram Sadak Yojana (PMGSY) and Bharatmala — both large-scale infrastructure initiatives, had considerable cascading benefits in terms of facilitating employment opportunity creation. Building infrastructure, in addition to creating direct jobs in the public sector, also generates downstream demand for steel, cement, and other related materials, as well as the transportation of these materials.

Government employment schemes, especially the MGNREGA, have been heavily dependent on deficit financing. MGNREGA has played a crucial role in providing wage employment in rural areas, particularly during economic downturns. This program, financed by fiscal deficits, has been in place for a long time as a key component of India's safety net for its poorer citizens, guaranteeing employment to millions of rural households, especially in the country's poorer states. The idea is that this type of employment can serve as an essential countercyclical buffer against economic downturns, mitigating the adverse consequences of unemployment.

Similarly, like developing countries, deficits in public finance are often justified as a means of maintaining and expanding essential services. Education, healthcare, and defence are significant sectors where fiscal deficits increasingly impact employment. Public service hiring in these areas is not just about jobs, but also has a positive effect of creating an essential ecosystem of workforce and nurturing productive competencies in the larger economy.

B. Private Sector Employment Fall and the Crowding-Out Effect

Therefore, fiscal deficits lead to the creation of jobs in the public sector; however, the link between fiscal deficits and private sector employment generation is somewhat more open to various interpretations. Moreover, you have to worry about what is called the crowding-out effect: the fallacy that government borrowing diminishes the availability of capital to the private sector, leading to higher interest rates. This increases the cost of credit for private companies, thereby slowing the growth of private sector investment and, consequently, employment. In a system dominated by government borrowing, private firms may experience limited access to capital, which can impact their plans for expansion and job growth.

But Keynes further argued that, in times of economic slump or general financial instability, government can also play a counter-cyclical role, and so it is justified for the public sector to spend more to stimulate the economy; It also employs support in the private sector and acts as a stimulus to keep demand for goods and services. For instance, in the aftermath of the 2008 financial crisis and the COVID-19 pandemic, the Indian government's fiscal measures, including stimulus packages, averted the collapse of key employment-generating sectors such as micro, small, and medium enterprises (MSMEs), manufacturing, and services. These measures, funded by a deficit, avoided more severe reductions in employment and economic activity.

C. Fiscal Deficit & Skill Development

A less direct way in which fiscal deficits impact employment is through government spending on education and skill development. Initiatives like Skill India and the National Skill Development Mission, which engage deficit funding, are a clear example of the same. They are designed to enhance the employability of India's workforce, particularly in sectors such as IT, healthcare, and green energy.

For emerging economies, where a vast proportion of employed people will remain in informal sectors with relatively fewer opportunities for skill development, fiscal deficits are especially crucial when it comes to funding skills development. These deficits enable investment in education and training, which in turn improve both immediate employment prospects and future economic growth.

Additionally, the resources invested by the public sector in skill development can fill such a gap (between labour force skills and market demand). This is particularly important in industries such as manufacturing and infrastructure, where jobs are evolving due to the advent of technology. Fiscal deficits can help expand the skill base of the workforce and increase sustainable job creation in fast-growing sectors: budgetary policy as a tool for growing real wages (& at this point, labour becomes skilled).

D. Policy Responses to Fiscal Deficits and Employment

Fiscal deficits can indeed be a trigger for employment creation, but persistently elevated fiscal deficits pose risks. Large deficits on a persistent basis can create inflationary pressures, reducing purchasing power and undermining real wages and employment. Moreover, such a high fiscal deficit is unsustainable. It can potentially erode investor confidence, thereby leading to lower domestic private investment and Foreign Direct Investment (FDI), which are essential for the growth of private sector employment.

Therefore, policymakers are left with the delicate task of balancing creating deficit-driven public investment in employment creation with enforcing fiscal prudence. In India, a range of measures has been initiated to address this scenario. Take the case of the Fiscal Responsibility and Budget Management (FRBM) Act, which mandates a glide path for reducing fiscal deficits over time at the Centre and States to ensure that such stimulus does not become medium-term demand drivers, cumbersome and impinging on long-term economic growth and employment generation.

To summarise, fiscal deficits play a multifaceted yet essential role in generating employment in India. The investment and services in public sector projects that are financed are immediately creating jobs, which is a job-creating trend that sets an upward trend. Still, most importantly, it provides training for the labour force, making them more employable so that when the private sector recovers, they can hire people who have been trained for various enterprises that are needed (e.g., transformation businesses), thus employing those workers in careers/jobs. That being the case, rational and responsible fiscal deficit management could lock in these benefits by keeping short-term employment gains from manifesting into long-term economic imbalances. Balancing the need to stimulate employment with deficit spending and effective fiscal management is a challenging task for policymakers seeking sustainable economic growth.

VI. GROWTH GOVERNMENT POLICIES TO MANAGE FISCAL DEFICIT

A. Fiscal Responsibility and Budget Management (FRBM) Act, 2003 and Amendments

It was introduced in 2000 as a solution to balance the budget and manage expenditures. In the year 2003, India added the FRBM Act to the bookshelf of Indian legislation with the main motive to ensure fiscal discipline by setting targets for the government to reduce fiscal deficits. It was brought into effect on July 5, 2004, to eliminate the revenue deficit by 2008-2009 and reduce the fiscal deficit to no more than 3% of the GDP.

Amendments over the years, particularly the most significant ones in 2012 and 2018, introduced flexibility and thus set a more realistic path with feasible prospects of fiscal consolidation. More importantly, amendments in these years further underscored the need to maintain the quality of budgetary adjustments, targeting revenue enhancement and expenditure rationalisation. Controlling the fiscal deficit is the objective of the FRBM Act and its amendments. The steady decline in central government deficits from more

A decrease from more than 5% of GDP in 2001-02 to an estimated 3.4% in 2019-20 is a good indication of the effectiveness of the FRBM Act and its amendments.

Published By:
Blue Eyes Intelligence Engineering
& Sciences Publication (BEIESP)

B. Public Debt Management and Borrowing Policies

Public debt management is crucial for India in controlling the fiscal health of the economy. Prudent borrowing practices should accompany the efficient management of cash and the development of the domestic debt market. All these would form a coordinated platform under the Middle Office of the Ministry of Finance, which has significantly improved the government's debt portfolio, mainly through the extension of maturity and reduction in the cost of borrowing. India's borrowing policies have been adjusted to align with broader fiscal consolidation goals, ensuring sustainability and macroeconomic stability.

C. Current Initiatives and Future Roadmap

Over the past few years, the Indian government has initiated several initiatives aimed at reducing the fiscal deficit and promoting sound fiscal management practices. The most recent initiative is a targeted subsidy reduction, especially on fuel and fertilisers, through direct benefit transfers that minimise leakage. Another critical step was revenue enhancement through disinvestment in public sector enterprises. There are also policy directions and future courses of action, such as promoting better tax compliance and widening the tax base to strengthen GST collections, rationalising government spending, and utilising digital technologies to enhance public financial management.

VII. CONCLUSION & POLICY RECOMMENDATIONS

While fiscal deficits are inevitable for promoting growth, especially in developing nations like India, their management plays a crucial role in ensuring sustainable economic progress. India has experienced varying levels of fiscal deficit, particularly during critical periods such as the pre-liberalisation era, the 1991 reforms, and most recently during the COVID-19 pandemic, where the deficit reached record highs. This reflects the government's efforts to boost growth through public spending, while also emphasising the importance of fiscal discipline to avoid long-term economic challenges, such as debt accumulation, inflation, and rising interest rates.

A. Synthesis of Key Findings:

i. *Positive Impacts*

- Fiscal deficits can serve as a stimulus for economic growth when directed towards productive investments like infrastructure, education, and healthcare. This can generate jobs and improve long-term productivity.
- During downturns, fiscal deficits play a counter-cyclical role, boosting aggregate demand through government spending.

ii. *Negative Impacts*

- Prolonged fiscal deficits can lead to inflation, crowding out private investment due to higher interest rates, and challenges to debt sustainability.
- Excessive reliance on borrowing can weaken sovereign ratings, leading to increased borrowing costs and reduced investor confidence.

iii. *Key Drivers*

- Public sector spending, subsidies, and welfare programs significantly contribute to the fiscal deficit.
- The COVID-19 pandemic exacerbated fiscal challenges, necessitating high public spending on relief programs, further widening the deficit.

iv. *External Shocks*

- India's fiscal deficit is heavily influenced by global economic factors like oil prices, geopolitical conflicts, and global recessions, making external economic conditions critical to budgetary management.

B. Recommendations for Sustainable Fiscal Policy:

To ensure that fiscal deficits continue to contribute positively to growth and employment generation without destabilizing the economy, the following recommendations are proposed:

- Fiscal Consolidation: Focus on bringing the fiscal deficit down to sustainable levels by gradually reducing subsidies, rationalizing public expenditure, and enhancing revenue collection through improved tax compliance and broadening the tax base.
- Productive Investments: Prioritize deficit spending on sectors that generate long-term returns, such as infrastructure, education, and healthcare, rather than on recurrent expenditures like subsidies.
- Debt Management: Develop prudent public debt management strategies, ensuring that debt-financed projects contribute to sustainable economic growth and prevent long-term fiscal imbalances.
- International Cooperation: Coordinate fiscal policies with global institutions and explore avenues for foreign borrowing in a way that mitigates vulnerability to external shocks and currency volatility.

C. Future Research Directions:

The role of fiscal deficits in fostering growth and employment remains a dynamic field of study, particularly as the global economy becomes more interconnected. Future research could explore the following areas:

- *Impact of Fiscal Deficits on Employment:* Investigate the long-term impact of deficit-financed public projects on employment generation, especially in sectors like infrastructure and services.
- *Fiscal Multipliers in Developing Economies:* Study the efficiency of fiscal multipliers in emerging markets like India to determine the optimal use of deficit spending during recessions.
- *Global Shocks and Fiscal Responses:* Explore how external economic factors such as commodity price fluctuations and geopolitical tensions impact fiscal deficits and the best policy responses to mitigate these challenges.
- *Sustainability of Welfare Programs:* Evaluate the fiscal sustainability of India's key welfare programs and propose strategies to balance social benefits with fiscal prudence.

DECLARATION STATEMENT

After aggregating input from all authors, I must verify the accuracy of the following information as the article's author.

- **Conflicts of Interest/ Competing Interests:** Based on my understanding, this article has no conflicts of interest.
- **Funding Support:** This article has not been funded by any organizations or agencies. This independence ensures that the research is conducted with objectivity and without any external influence.
- **Ethical Approval and Consent to Participate:** The content of this article does not necessitate ethical approval or consent to participate with supporting documentation.
- **Data Access Statement and Material Availability:** The adequate resources of this article are publicly accessible.
- **Author's Contributions:** The authorship of this article is contributed equally to all participating individuals.

REFERENCES

1. Devi, K. (2015). Economic Growth in India: Pre- and Post-Liberalization Era [Journal Article]. Scholars Journal of Economics, Business and Management, 2–8A, 811–815. http://saspjournals.com/sjebm
2. Ministry of Finance, Government of India. (2023). Budget at a glance 2023–24 (English). https://dea.gov.in/sites/default/files/2Budget%20at%20a%20Glance%202023-24%20%28English%29.pdf
3. PRS Legislative Research & Institute for Policy Research Studies. (2022). Union Budget 2022-23 analysis. In PRS Legislative Research (pp. 1–3) [Report]. https://prsindia.org/files/budget/budget_parliament/2022/Union%20Budget%20Analysis%20-%202022-23.pdf
4. ACCOUNTABILITY INITIATIVE, CENTRE FOR POLICY RESEARCH. (2023). The Evolution of India's Welfare System from 2008-2023: A Lookback. https://accountabilityindia.in/wp-content/uploads/2023/01/The-Evolution-of-Indias-Welfare-System-from-2008-2023.pdf
5. Ministry of Finance, Government of India. (2023). Status Paper on Government Debt for 2022–23. https://dea.gov.in/sites/default/files/Status%20Paper%20on%20Government%20Debt%20for%202022-23.pdf
6. Rahman, A., & Pingali, P. (2024). Social welfare 'Schemes' to an economic security 'System.' In Palgrave studies in agricultural economics and food policy (pp. 357–425). DOI: https://doi.org/10.1007/978-3-031-50747-2_10
7. Union Budget 2023-24 analysis. (n.d.). PRS Legislative Research. https://prsindia.org/budgets/parliament/union-budget-2023-24-analysis
8. Expenditure in '24-25 estimated at Rs 47,65,768 cr. (n.d.). https://www.fintechbiznews.com/fintech/expenditure-in-24-25-estimated-at-rs4765768-cr
9. Chakraborty, L. & National Institute of Public Finance and Policy. (2024). RBI's Monetary Policy, Fiscal Deficits and Financial Crowding Out in India: An Empirical Investigation. In NIPFP Working Paper Series (No. 414; p. 2). https://nipfp.org.in/media/medialibrary/2024/07/WP_414_2024.pdf
10. Press Information Bureau (PIB), Government of India. (2024, February 1). Union Budget 2024–25 highlights. https://www.pib.gov.in/PressReleasePage.aspx?PRID=2001122
11. Ministry of Finance, Government of India. (2024). Economic survey 2023–24: Table 2.3. https://www.indiabudget.gov.in/economicsurvey/doc/stat/tab2.3.pdf
12. PRS Legislative Research. (2023). Union budget 2023–24: Analysis of major demands. https://prsindia.org/budgets/parliament/union-budget-2023-24-analysis-of-major-demands
13. FasterCapital. (2025, April 7). Social welfare: Unilateral transfers: Boosting social welfare programs. Retrieved August 18, 2025, from FasterCapital website: https://fastercapital.com/content/Social-welfare--Unilateral-Transfers--Boosting-Social-Welfare-Programs.html

AUTHOR'S PROFILE

Pratyush Kumar, B. Tech (CE), MBA (Finance), from Mukesh Patel School of Technology Management and Engineering, NMIMS University, Mumbai. Authored academic and literary works, with recent work on 'Credit Score Prediction using Multi-Modal Deep Learning with Intermediate Fusion', presented at AITA 2025. Academic interests span machine learning, microservices, and product design. Committed to advancing responsible financial practices through innovative computational approaches.

Maariyah Ghaswala is an MBA Tech candidate at MPSTME, NMIMS, Mumbai, specialising in Computer Engineering. She has authored research presented at the PAN IIM World Management Conference 2023 and published in IEEE Xplore, with interests spanning innovation strategies and digital transformation. Her professional experience includes internships at Barclays, where she contributed to UI/UX optimisation and advanced data analytics. Skilled in tools such as Tableau, SQL, Python, and Figma, she is also an active member of the Rotaract Club, leading educational and environmental initiatives. She enjoys reading non-fiction, the culinary arts, and creative projects.

Chrisanne Gomes is pursuing an MBA in Technology at NMIMS Mumbai, specialising in Finance and Business Intelligence & Analytics, with a strong foundation in computer engineering. My journey blends financial acumen with hands-on experience in data analysis, AI, and web development. I've published research on depression detection using deep learning (IEEE, Scopus Indexed) and built projects in AI-driven stock analysis and economic modelling. Internships across cybersec and healthtech startups have equipped me with practical skills in stakeholder communication, market research, and product design. I thrive on solving complex business problems, adapting quickly, and driving tech-led innovation in the finance sector.

Mohammed Aadil Khan is a final-year MBA Tech student specializing in Finance, with a background in Computer Engineering. I have a strong interest in artificial intelligence, data science, and fintech, and I enjoy coding, research, and building practical projects. My experience includes developing applications and exploring how emerging technologies can transform financial systems. I am particularly drawn to the intersection of finance and technology, where I aim to contribute through innovative, data-driven solutions. With a growing foundation in both domains, I am keen to publish and collaborate on research or industry projects that advance understanding and application in AI, finance, and digital innovation.

Vidit Kohli is a final-year MBA Tech student with a background in Finance and Computer Science. Over the years, I've built a strong interest in solving business problems by combining data, logic, and technology. I've worked with tools such as Excel, Java, MySQL, and front-end web technologies (HTML, CSS, JavaScript), and I enjoy utilising these skills to make sense of complex situations. I value teamwork, clear communication, and working efficiently to achieve results. I'm now seeking opportunities where I can apply this combination of skills in areas such as finance, strategy, or product management.

Ansh Maheshwari is a final-year MBA Tech student specializing in Finance with a background in Computer Science, driven by a passion for solving complex business problems through a blend of financial insight, structured thinking, and data-led strategy. With hands-on experience in investment banking, research, and Python-based analytics, I enjoy roles that require logical thinking, analytical rigour, and cross-functional thinking — whether in finance, consulting, or product development domains. As a CFA Level 1 candidate (Aug 2025), I'm committed to

continuous learning and excited to contribute meaningfully in fast-paced, high-impact environments.

Disclaimer/Publisher's Note: The statements, opinions and data contained in all publications are solely those of the individual author(s) and contributor(s) and not of the Blue Eyes Intelligence Engineering and Sciences Publication (BEIESP)/ journal and/or the editor(s). The Blue Eyes Intelligence Engineering and Sciences Publication (BEIESP) and/or the editor(s) disclaim responsibility for any injury to people or property resulting from any ideas, methods, instructions, or products referred to in the content.