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REVIEW OF LITERATURE THE NEW ECONOMIC STRATEGIES ON THE EFFECTS FOR UNEMPLOYMENT & POVERTY REDUCTION IN INDIA

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Abstract: Classical economists believed that full employment always prevailed in the economy. Unemployment, according to them, can occur only under conditions like excess supply of labour. If the economy moves beyond full employment equilibrium, a decline in money wage rate would increase both the level of output and employment. Therefore, fiscal policy according to classicists was not essential for full employment in the economy. Fiscal operations were only needed to provide the pubic goods. Their main concern was equitable system of taxation and balanced budget. Borrowing of funds was considered undesirable. They advocated minimum amount of taxation and government expenditure. The principle of marginal of 1870's provided a theoretical justification for limiting public expenditure and taxation as the principle of maximum social advantage. They did not point out that the disadvantage of taxation to the tax payer is a macro problem, while the advantage of public expenditure is a collective or macro problem.

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INTRODUCTION:

The key fiscal tools have been forged by general theorists rather than fiscal specialists ranging from classicists to Keynesian to today's neo-liberal economists. Although our analysis begins systematically with Smith's 'Wealth of Nations', this is not the beginning of fiscal doctrine (Musgrave, 1985). The public sector of most countries expanded at great extent between 1945 and 1980 despite differences in their economic systems. As economies grew, the tasks of the government towards regulation, allocation and distribution became more complex. The state, vas regarded essential to promote development, macroeconomic stability and redistribution of wealth.

Some of the central ideas of the eighteenth and nineteenth centuries have been important to economic policies in the twentieth century and continued to be important today. Today, many believe that market-oriented economic policies and privatization of enterprises is the major elements for successful economy. The government should play an important role as a complement to the market.

In the long history of economic doctrine there has been a wide range of debate concerning the role of the government. In ancient times, before the systematic economic doctrines emerged, not much role was assigned for the government. Plato, an ancient philosopher believed that the government should organize both economic and noneconomic activities to secure wisdom in rulers, bravery in soldiers and temperance in common people. A great change in thinking on the economic role of the government emerged with Mercantilists view-one dominant view in the eighteenth century which was particularly influential economists. They elevated the view of ancient philosophers and came with the view that the government should act so as to expand exports and reduce imports to establish new industries in order to make the nation wealthy. They believed that government intervention was essential to expand exports and in turn to accumulate reserve of the nation.

In opposition to the mercantilists view, classicists advocated for limiting the role of government and promoting private economic activities for development. Adam Smith. a leading economist of classical school advocated a limited role for the government. He argued three duties of the government: defence, maintenance of internal security and establishment and maintenance of certain essential public institutions which private persons would always find unprofitable. In all the other cases government should leave the individuals free to pursue his own interest in his own way (Maxwell, 1968). Adam Smith in his work the 'Wealth of Nations' published in 1776 provided profound basis for limiting role of the government and promoting private economic activities to maximize national wealth. Most of the nineteenth century economists promulgated the doctrine known as laissez-faire.

Review of Literature:

The economists and social thinkers in the nineteenth century were not convinced by the doctrine of Laissez Faire. Many economic problems like inequalities in income and wealth, unemployment among working class and evils in society due to excess private ownership of capital prevailed in the economy. Marx, the most influential among them advocated a greater role of the state to control the means of production which became a driving force for international political economy in the twentieth century embodied in the cold war. The fiscal policy of classical economists remained unchanged till 1929. In the eve of great depression of 1930's, the unemployment rate reached 25 percent and national output fell by about a third from its peak in 1929 (Stiglitz, 2000). Many individuals lost their money when banks failed. The prices of agricultural products were very low, so that farmers could not make their mortgage payments. There was a widespread observation that market had failed and the government had to takeover for addressing the problem.

The theory of fiscal policy developed by Keynes (1936) played an important role in this regard. Hansen's fiscal policy and business cycle was also important in this shift. Keynes rejected the conclusion of classical economists of self-correcting mechanism of unemployment in the economy. He advocated that involuntary unemployment was also possible due to fluctuations in investments. He suggested the necessity of government intervention in the economy by the use of fiscal measures to achieve the objectives of full employment, stability, growth and social welfare.

Up to 1930's, fiscal economics, with few exceptions, dealt with the effects of budget policy on alternative uses of resources and the distribution of income. With Keynesian revolution, the stabilization function was added and fiscal policy moved into the centre of macro-economic (Musgrave, 1985). During World War II, most of the countries involved in the war used Keynesian fiscals to combat inflation and allocation of resources for war purposes. Keynesian fiscals held a profound influence to solve the short as well as long-term problems of both developed and underdeveloped countries. After Second World War, most countries throughout the world experienced an unprecedented level of prosperity. But the fruits of prosperity were not enjoyed by everyone. Many were bound to live below poverty line. They receive inadequate education, health care and social and economic security. According to Stiglitz (2000), there are four major reasons for systematic failure of the government to achieve its stated objectives. They are: the government's limited information, its limited control over private responses to its actions, its limited control over bureaucracy, and the limitations imposed by political processes.

The monetarists' doctrine shifted the emphasis from fiscal to monetary policy in the management of stagfactionary situation which occurred during 1970s and early 19805 in the world economy. Milton Friedman, the chief exponent of monetarism, prescribed to control the money supply in order to control the economy. According to him, reduction in monetary growth was only the solution to eliminate inflation in the long run, without higher unemployment. Kalecki showed the importance of fiscal policy as in achieving and maintaining full employment in a capitalist economy. He argued that investment by the government is required to control the private investment and thereafter private gross profit. He believed that monetary as well as real variables could be controlled if appropriate fiscal policy is applied.

There are two major types of policies which the government adopt to influence the level of economic activities: monetary policy and fiscal policy. Monetary policy is mainly conducted by the central bank through altering money supply and interest rate as the policy instrument. Inflation targeting is mainly associated with monetary policy. Fiscal policy, on the other side, emphasizes to change in public spending, taxation and debt management. A change in fiscal instruments affect the aggregate demand, output and hence inflation which has substantial effect on monetary side of the economy. Fiscal policy affects aggregate demand through changes in public spending and taxation structures. The aggregate demand affects allocation of resources

and the productive capacity of the economy. It affects the development of human capital, the allocation of capital spending and investment in technological innovations. Tax rates also influence both the magnitude and allocation of productive capacity.

Kalecki analyses the economy in terms of social classes (capitalists and workers) and defines different kinds of expenses for each class. Workers are assumed to earn wages and spend all their income immediately without any savings. Capitalists are assumed to earn profit and to spend on consumption and investment. Kalecki emphasizes the role of capitalists' expenses because according to him fluctuations in national income are caused by fluctuations in capitalists' expenses on consumption and investment. Thus investment is the most important variable in the dynamic of the business cycle. What determines investment and what influences investment exerts upon profits and national income?

The qualitative difference between workers and capitalists consists the fact that worker's expenses are restricted by their income, while capitalists' are not. This leads to the well-known proposition that workers spend what they earn and capitalists earn what they spend. Consider that the identity between national income (profit and wages) and aggregate expenditure (workers' consumption, capitalists' consumption and investment). Since workers' consumption equals wages, it follows that the amount of profits is equivalent to capitalists' expenses on consumption and investment. According to principle of effective demand, causality would run from expenses to income. Kalecki's point is that capitalists cannot individually decide how much to earn, but they can decide how much to spend.

Kumar (1999) has linked all fiscal as well as economic variables with black economy. The fiscal deficit, investment, consumption, and balance of payments are all affected by the black economy. According to him by ignoring the black part of the economy, analysis of an economy becomes incomplete and it makes policy failure at both the macro and micro levels. He has extended and modified the Kaleckian National Income Identity by incorporating the black income in the model to show the impact of black income on the macroeconomic indicators of an economy.

Kalecki's National Income Identity (1971) has been modified by Kumar (1988) to analyze fiscal policy. He called it the fiscal policy regime in which various fiscal variables can be analyzed all together in a single macroeconomic framework. This was in contrast to the usual analysis in which each fiscal variable is analyzed separately. Kumar (1999) has further modified this analysis to incorporate the black economy in the model. As argued by him, this is essential because each of the fiscal variables is significantly affected by the black economy. He characterizes the black economy as the missing dimension of policy making.

Kumar concludes that black economy lowers the rate of economic growth and prevents it from reaching its potential. It affects the estimates of employment generation and number of people below the poverty line (Kumar, 1999). Therefore, it can be concluded that Kumar's modified National Income Identity over Kaleckian National Income Identity seems to be more realistic because it separates fiscal variables in the identity and also gives the actual concept of an economy by dividing the whole economy into two parts black and white.

Economic globalization of India is synonymous with the advent of the New Economic Policies (NEP) and may be defined as the integration of the national economy with the global economy in terms of free flow of ideas, goods and services, technology and information. Actually, the Indian economy has been globalizing for a long time. India virtually had free trade policy even before 1935. There was no intervention in trade and investment activities before an agency called Udyog Parishad was created in 1935 to develop the basic industries. Another attempt at opening up the Indian economy was initiated in 1950. This was the period of Rana regime when the country was opened to tourists and merchandise imports from overseas countries. International trade relation was established with India and China. India began to accept foreign aid, in terms of grants and loans, for the purpose of development. India started developing and expanding international relations and became a member of a number of multilateral institutions.

The Panchayat government after the political referendum of 1980 followed an expansionary fiscal policy to accelerate the pace of economic growth in the country. As a result, India suffered three consecutive years of BOP deficits around early 1980's. The budget deficit reached as high as 12 per cent of GDP. It was largely financed by printing money. This process accelerated the inflation. The foreign exchange reserves started to decline. To improve the situation, the government approached IMF for support in 1985. In December 1985, the IMF suggested the implementation of Stabilization Programme and subsequently a series of measures were undertaken.

First the government started its NEP programme with a three-year loan agreement the IMF and contracting for a structural adjustment credit, popularly known as SAL I, from the World Bank covering the period from 1986/87 to 1988/89. The

purpose was to accelerate the growth rate, stabilize the price levels and correct the balance of payment. Following this, the World Bank provided a Second Structural Adjustment Loan (SAL II) of Rs. 4.1 billion (US$ 60 million) for a three year period effective from August1989. Its main purpose was to improve the allocation of public and financial resources and increase the participation of private sector.

After restoration of multi-party democracy in India in 1990, India accelerated the process of economic globalization. The newly elected government of the India Congress implemented NEP with a new arrangement with the IMF and the World Bank under Enhanced Structural Adjustment Facility (ESAF) in 1992 which is generally known as Second Generation of Economic Reform. After that the government has been launching a comprehensive programme of NEP in almost all the sectors of the economy as advocated by Washington Consensus.

During 1960's after the inception of planned economic development in India, the trade policy was towards import substituting industrialization. India used to impose high tariff rates to control imports with the aim of to raise government revenue, protect infant industries, and reduce consumption of luxury commodities and to check BOP deficits. Under NEP, India started to reduce the tariff rates. Additional duties were also eliminated. Earlier peak tariffs rates were as high as 300 percent. The rate was reduced to 80 percent in the fiscal year1997 -98. Now the tariffs rates have been brought down to 5- 20 percent. The average custom duty is brought down to 13.7 percent in 2006 (Economic Survey, Ministry of Finance, 2007). The NEP in financial sector was initiated in Mid-1980's under the liberal economic policy of the government. Until mid-1980's, only two commercial banks -India Bank Limited and Rastriya Banijya Bank and few financial institutions were in India. To make competition among commercial banks, the commercial bank act, 1974 was amended in 1984. This amendment removed the entry and exit barrier. As a result, many commercial

Fiscal policies play a crucial role in promoting economic growth and enhancing social welfare. Public spending which is the major fiscal instrument can foster human development through education, health care, nutrition, drinking water and other basic facilities. On the other hand, taxation can help in resource mobilization for the promotion of investment and redistribution of income. Ultimately, this sector has greater role in employment generation and poverty alleviation.

India has implemented major fiscal reforms over the past several years to reduce fiscal deficit at sustainable levels. It is claimed that the objectives of fiscal reforms have been focused to raise present revenue levels in a more efficient and equitable manner. The major elements in fiscal reforms are cutting public expenditures and raising revenues. Recently the government has begun to improve administrative efficiency in tax and revenue collection and the management and control of public expenditures.

The reformers argue that with the objective of broadening and diversifying the tax base in order to expand revenue, to enhance the stability of tax base and to reduce the distortion effects arising from concentrating taxation on a narrow base such as imports, the tax policy has been changed in favour of broad based consumption taxes i.e. VAT. Such reforms have emphasized on trade liberalization measures as discussed above i.e. switch from trade taxes to a broader tax base and replacement of sales and excise taxes by VAT. They argue that the principal benefits of the VAT lie in its potentially broad tax base, its relatively high tax elasticity and buoyancy, and its ability to raise revenues without distortionary cascading effects. It is also argued that VAT encourages proper record keeping by traders and that as this practice spreads the tax base will broaden and revenues increase.

However, many of the hypothesized advantages of VAT have not been realized because of various reasons like lack of proper accounting system by the tax payers, administrative difficulties involved in tax collection and equity concerns, narrow coverage and so on.

Both the personal income tax and corporate income tax have also been subject to reform. The government has attempted to reduce nominal marginal tax rates, broaden the tax rates, encouraging the tax compliance by reducing incentives and opportunities to evade tax and facilitating administrative efficiency. However, it is argued that the low tax rate hypothesis in developing countries has not been successful to collect more revenues.

After adoption of NEP in India, many fiscal policy changes have taken place. The Industrial Enterprises Act, 1992 has abolished industrial licensing except for few industries which are related to national security, public health and environment related industries. The government has made free entry of private sector for investment m education, health and infrastructure development. India has

gradually started to withdraw subsidy for certain social and economic areas. The government has recognized privatization of public enterprises as an integral part of its NEP. Reduction in the fiscal deficit has been taken as a major strategy for the success of the ongoing fiscal reform. The emphasis has been to cut expenditures through withdrawal of state support/subsidies and privatization of public sector. Major policy instruments introduced after inception of NEP in the fiscal sector of India are described below:

The industrial enterprises act and the industrial policy, 1992 were the centrepieces of the government new economic policy. The policy included a diverse set of issues i.e. custom duties, taxation, registration and licenses. The act abolished industrial licensing except for few industries, which are related to national security, public health and environment related industries. A company registrar's office was opened for the purpose. The government made separate policy for private sector participation in the various industries as well as social sectors.

Investing in development of physical infrastructure is considered to be a primary responsibility of the government. However, with the inception of NEP in India, the government opened for private sector investment in the areas of electricity, telecommunication, civil aviation, health care, education etc. The logic was that the government effort was not sufficient to fulfil the demands for those facilities.

A revised civil aviation policy was adopted in 1993 that allowed for the entry of private airlines. Before that only the India Airlines Corporation (NAC) was operating in domestic as well as international flights. Now, out of licenses issued to 33 airlines, 16 of them are currently operating. Cosmic Air has been issued license to operate long distance international flights and it is operating international flights. Similarly, a new hydropower development policy was adopted in 1992 that opened up the electricity generation, transmission and distribution to the private sector. Regarding communication, handling of STO and ISTO has been made in private sector. Many FM stations are operating in the private sector. The government has given a call for private sector involvement in Malachi water project, the biggest water project in India.

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