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FISCAL POLICY

Concept and Definition of Fiscal Policy

Fiscal policy is a policy which is concerned with Government Revenues and Government Expenditures. According to Prof. Lindhalm, "Fiscal policy is attached with the determination of time, type and procedure to be followed in making Revenues and Government Expenditures".

According to Samuelson, "Fiscal policy is concerned with all those arrangements which are adopted by government to collect the revenue and make the expenditures so that economic stability could be attained/maintained without inflation and deflation". According to M. W. Lee, fiscal policy considers:

(1) Imposition of taxes, (2) Government expenditures,
(3) Public debt, (4) Management of public debt".

It must be remembered that it is the government which manipulates the fiscal policy.

Instruments or Tools of Fiscal Policy

(1) Government expenditures (G), (2) Taxes (T), both direct and indirect, (3) Deficit financing, i.e., government borrowing and printing of new notes, (4) Subsidies, (5) Transfer payments like unemployment allowances, stipends and scholarships

OBJECTIVES OF FISCAL POLICY

1. Price Stability

Inflation and deflation are the big vices which the capitalist world has to face. During the inflation, there are economic sufferings for the fixed income groups. Moreover, the inflation creates so many long-run social and economic problems. Therefore, with fiscal medicines —, i.e., government expenditures and taxes we can check inflation. If government expenditures are reduced and taxes are increased —all they will reduce NI many a time through multiplier effect. Thus, when excess demand is controlled —the inflation will be controlled. On the other hand, during deflation, if government expenditures are increased and taxes are reduced —then NI will go up through multiplier effect and economic depression will come to an end.

But in most of the poor countries, government expenditures are rigid downward. Moreover the government expenditures and imposition of taxes are influenced by political decisions. The curtailment of government expenditures and raising of the taxes will obstruct economic activities — producers will be disappointed and foreign private investment is discouraged.

2. Influencing the Consumption Pattern

In capitalist economies, governments normally do not interfere in the consumption matters of people. However, for collective betterment, it can do so. That is, if, government wants to reduce the consumption of some particular product, it can be done by imposing tax on that commodity. For example, if government wants to reduce the consumption of petrol, tax will be imposed on petrol. If government wants to raise the consumption of any commodity, government can give subsidy on its production and consumption. As if government wants to increase the consumption of corn oil, subsidies can be given to the producers of the corn oil. Moreover, imports can be checked by imposing higher duties on the luxurious imports, etc. But in UDCs the ruling elites are fond of consuming imported luxuries. They never favour imposing taxes on luxuries. Again, the media has made the demand for consumer goods inelastic. Thus heavy taxation on consumer durables etc. will not reduce their demand.

3. To Raise the Level Of Employment

The developing countries, due to population growth, shortage of resources, etc. are clutched into the hands of unemployment and underemployment. To remove this situation, fiscal policy helps us. If government expenditures, on the basis of deficit financing, are increased and taxes are lowered, through multiplier effect NI will increase many a time. The multiple expansion in NI will have an impact on the level of employment. In this way, the easy fiscal policy will have the effect of raising employment.

4. Redistribution of Income

In UDCs low per capita income is accompanied by great inequalities in income distribution. Thus, there is need of redistribution of income. In this connection, progressive system of taxation is advocated. This system will affect the increased incomes of the rich people. On the other hand, the flow of expenditures to the poor be increased. They be provided with free housing, medical and educational facilities. Again, the poor be given subsidies, and tax exemptions. This will reduce inequalities in income distribution.

But the policy of imposing greater taxes on rich and exempting the poor from taxes may not be adopted in developing countries, where the feudals and rich dominate the parliament. Moreover, giving subsidies to the poor on basic amenities of life is out of question in poor countries.

5. Economic Development

It is a process whereby the real national and per capita income of the country increases over a long period of time. The developing countries are over-ambitious of attainment of economic development. But they have shortage of financial resources. In this connection, easy fiscal policy, consequent upon reduction in taxes, increase in government expenditures and granting of subsidies to the producers can be adopted. This will provide incentives to the producers to increase investment. Once the process of increased investment starts, through multiplier effect NI will increase many a time.

The persistent increase in NI means economic development. But it must be remembered that the process of development cannot merely be started with easy fiscal policy. To attain economic development, there is need of natural resources, technology, human skill and management. Moreover, economic development may result in inflation and unequal income distribution. Again, the economic development and social justice often conflict as far as UDCs are concerned.

6. Removal of Deficit inBalance of Payments (BOP)

If a country's foreign payments exceeds its foreign receipts then the country faces a deficit in BOP. In other words, if at fixed exchange rate the demand for foreign exchange is more than supply of foreign exchange, deficit in BOP rises.

This situation shatters the economic life of the country. Accordingly, need is to remove it. In this connection, if government pursues a strict fiscal policy —desirable results can be obtained. This strict fiscal policy means reduction in government expenditures and increase in taxes——which will reduce NI through multiplier. Hence, there will be deflationary tendencies in the economy —prices will fall and exports will increase. On the other hand, due to deflation, a country's income falls. It will reduce imports of the country. Ultimately, BOP position is improved.

But a strict fiscal policy will have negative effect on country's investment, production and employment.