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WHAT A FISCAL POLICY CAN DO?

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The role of fiscal policy in the process of economic development occupies a dominant place among all the special tools of the government employed to direct and control the economic affairs of the country. But fiscal theories propounded with reference to developed countries do not, generally, suit to the requirements of under-developed economies, mainly due to peculiar economic conditions prevailing in these countries. The classical economists followed the principles of 'fiscal neutrality' and advocated to slim the size of public sector and to reduce the functions of the government to the minimum possible extent in order to have a free play of market mechanism. They advocated a tax structure which disturbed the pricing system as little as possible including the pricing of factors of production. In modern times, classical ideas are irrelevant in case of advanced as well as developing countries as fiscal policy has to play an important role in the fields of economic growth and economic stabilization in these countries.

The fiscal policies advocated by Keynes and Lerner are, generally, concerned with achieving 'short-term stability' in the economy. Keynes regarded fiscal policy "as a balancing factor" which would "bring about an adjustment between the propensity to consume an inducement to invest." He visualized the operation of fiscal policy in the context of a static model in which skill and quantity of labour, technique, degree of competition and tastes and habits of consumers, etc. were assumed constant and a certain rate of growth was assumed. According to him, "the economy tends to fall below this rate of growth because investments do not equate themselves with the potential savings of the system." Keynes advocated increase in effective demand and reduction in savings and these factors made his theory irrelevant to economic development in developing countries. According to A.P. Lerner's theory of 'functional finance', the volume of employment depends on the rate of spending. If there is unemployment in the economy, volume of spending should be increased. But the maxim of functional finances do not fit into the criteria of fiscal policy suited to the economic development of developing economy.

In the words of RagnarNurkes, "For achieving economic development in developing countries, it is necessary to use fiscal policy for retraining propensity to consume and thus raising propensity to save. According to Tripathi, "the requirement of economic growth demand that fiscal policy has to be used for progressively raising the level of investments and savings and thus the criteria of fiscal policy in developing economy are different from those of functional finance."

It is not obvious that the factors leading to growth acceleration will lead to growth maintenance as well. Igniting economic growth and sustaining it are somewhat different enterprise argued by Rodrik (2005). Igniting economic growth requires a limited range of reforms that need not overly tax the institutional capacity of the economy. But sustaining it is in many ways a challenge and harder, as it requires constructing a sound institutional underpinning to maintain productive dynamism and endow the economy with resilience to shocks over the longer term. So, maintaining fiscal stability or macroeconomic stability is not easier task.

The major contribution of fiscal policy to poverty alleviation has to come through an effective programme for financing the anti-poverty programmes for improving the social and economic services on which the poor mainly rely and for financing the heavy investments in infrastructure, which are necessary for sustaining growth in agriculture and industry. Fiscal policy has to be so formulated that adequate resources are available to the government for funding social expenditure which benefit the poor. Another important way in which fiscal policy can contribute to the reduction of poverty is to encourage rapid economic growth and fast expansion of productive employment opportunities. Taxation has significant effects on savings and investment in the economy on the allocation of resources between alternative sectors and uses and on the efficiency with which resources are utilized. We must ensure that the long-term fiscal policy creates an environment conducive to rapid growth in production and employment, so that the burden of poverty can be progressively reduced. Taxes and subsidies have direct consequences for the poor to the extent that they bear the burden of taxes or benefit from the subsidies.

The long-term fiscal policy is intended to serve as an effective vehicle for strengthening the operation linkages between the fiscal and financial objectives. Any scheme of fiscal policy cannot be successful until and unless the policy of meaningful expenditure is adopted side by side. Public expenditure is the harbinger of innovations in the economy through the creative role of entrepreneur. Thus, the checking of wasteful and nugatory expenditure is also an attempt to enlarge the margin of resources in the economy.

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