Q. Discuss the Fiscal Function of the Government & feasibility of the functions in developing economy.

Ans: There are *four major* fiscal functions of *government*; **Allocation, Distribution, Economic Growth and Stabilization**.

Allocation:

The provision for social goods, or the process by which total resource use is divided between private and social goods and by which the mix of social goods is chosen. This provision may be termed as the allocation function of budget policy. Social goods, as distinct from private goods, cannot be provided for through the market system. The basic reasons for the market failure in the provision of social goods are: firstly, because consumption of such products by individuals is non rival, in the sense that one person's partaking of benefits does not reduce the benefits available to others. The benefits of social goods are externalized. Secondly, the exclusion principle is not feasible in the case of social goods. The application of exclusion is frequently impossible or prohibitively expensive. So, the social goods are to be provided by the government.

Distribution:

Adjustment of the distribution of income and wealth to assure conformance with what society considers a 'fair' or 'just' state of distribution. The distribution of income and wealth determined by the market forces and laws of inheritance involve a substantial degree of inequality. Tax transfer policies of the government play an important role in reducing the inequalities in income and wealth in the economy.

Stabilization:

Fiscal policy is needed for stabilization, since full employment and price level stability do not come about automatically in a market economy. Without it the economy tends to be subject to substantial fluctuations, and it may suffer from sustained periods of unemployment or inflation. Unemployment and inflation may exist at the same time. Such a situation is known as stagflation.

The overall level of employment and prices in the economy depends upon the level of aggregate demand, relative to the potential or capacity output valued at prevailing prices. Government expenditures add to total demand, while taxes reduce it. This suggests that budgetary effects on demand increase as the level of expenditure increases and as the level of tax revenue decreases.

Economic Growth:

Moreover, the problem is not only one of maintaining high employment or of curtailing inflation within a given level of capacity output. The effects of fiscal policy upon the rate of growth of potential output must also be allowed for. Fiscal policy may affect the rate of saving and the willingness to invest and may thereby influence the rate of capital formation.

Capital formation in turn affects productivity growth, so that fiscal policy is a significant factor in economic growth.

Fiscal Functions in a developing country:

The **main goal** of fiscal policy in a *newly* developing economy is the promotion of the highest possible rate of capital formation. Underdeveloped countries are encompassed by *vicious circle of poverty* on account of capital deficiency; in order to break this vicious circle, a balanced growth is needed. It needs accelerated rate of capital formation. Since private capital is generally low in these countries, the government has to fill up the gap. A high public expenditure is also required in building social overhead capital. To accelerate the rate of capital formation, the fiscal policy has to be designed to raise the level of aggregate savings and to reduce the actual and potential consumption of the people.

Another objective of fiscal policy, in a poor country is to divert existing resources from unproductive to productive and socially more desirable uses. Hence, fiscal policy must be blended with planning for development.

The aims of rapid growth and attainment of equality in income are two paradoxical goals because growth needs more savings and equitable distribution causes reduction of aggregate savings as the propensity to save of the richer section is always high and that of the poor income group low. a difficulty arises in government fiscal function for equitable distribution of Income.

Fiscal policy in a poor country has an additional role of protecting the economy from high inflation domestically and unhealthy developments abroad. Though inflation to some extent is inevitable in the process of growth, fiscal measures must be designed to curb inflationary forces. Relative price stability constitutes an important objective.

The approach to fiscal policy in an economy which is developing must be aggregative as well as segmental. The former may lead to overall economic expansion and reduce the general pressure of unemployment; but due to the existence of bottlenecks though general price stability may be maintained, sectoral price rise may inevitably be found.

These sectoral imbalances are to be corrected by appropriate segmental fiscal measures which would remove frictions and immobility's turn demands into proper directions, seek to eliminate bottlenecks and other obstacles to growth.

For the purpose of development, not only an expansionary budget but a deficit is desirable too in a developing country. The government expenditure on developmental planning projects must be increased. It may be financed even by means of deficit financing. Deficit financing, here, refers to the creation of new money by printing additional notes by the government or by borrowing from the central bank which ultimately means creation of additional money supply. However, the government must use the technique of deficit financing cautiously. An excessive dose of deficit financing may lead to inflation which may endanger economic growth.

The effectiveness of fiscal measures in promoting development in a poor country depends on the incentives administered to the strategic points in the productive set up by virtue of the consequences of taxation and public spending.

For less developed countries such as India the following main objectives of fiscal policy may be restated as:

- ✓ To increase the rate of investment and capital formation, so as to accelerate the rate of economic growth.
- ✓ To increase the rate of savings and discourage actual and potential consumption.
- ✓ To diversify the flow of investments and spending from unproductive uses to socially most desirable channels.
- ✓ To check sectoral imbalances.
- ✓ To reduce widespread inequalities of income and wealth.
- ✓ To improve the standard of living of the masses by providing social goods on a large scale.

Side Note:
This comes under Role of government. But Mam has covered this separately as an important topic. So there were Three topics for Internal Written Test for Public Economics:
Role of Government in organized society (will try to upload soon, if possible).
Public Goods and Private Goods(club goods too) (Already Uploaded)
Fiscal Function of Government (Done Here)