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OBJECTIVES AND INSTRUMENTS OF FISCAL POLICY TO STIMULATE ECONOMIC GROWTH IN DEVELOPING COUNTRIES

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Abstract. *In this paper, there is analyzed the influence of fiscal policy in the developing countries. I start with brief explanation the general meaning or an overview image of a developing country. Then, there are shown general objectives and role of the fiscal policy for developing countries in comparison with those for developed countries. At the end, there are presented fiscal policy instruments, which are used in the framework of fiscal policy in developing countries.*
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Introduction

According to a well-known definition, a developing country is also called a less developed country or underdeveloped country; it's a nation with a less developed industrial base and a low Human Development Index (HDI) relative to other countries. Or, according to Kofi Annan, former Secretary General of the United Nations, a developed country is defined as "one that allows all its citizens to enjoy a free and healthy life in a safe environment [3].

The achievement of sustainable development objectives is impossible without the application of a system of economic mechanism and instruments, thanks to which the market subjects can be adjusted. Fiscal policy is one of the main tools to reach the economic objectives because it enables direct intervention into the problem, which should be solved [5].

Fiscal policy is explained as a process of adjusting government taxation and expenditure to attain the wanted economic and social goals. The objectives of fiscal policy can vary from country to country. Fiscal policy is considered an essential method for achieving the objectives of development both in developed and underdeveloped countries of the world [8]. Fiscal policy is a powerful instrument in the hands of the government to intervene into the economy. It relates to a variety of measures, which are broadly classified, as: (a) taxation, (b) public expenditure and (c) public borrowing.

The most important instrument of government operation in the economy today is that of fiscal or budgetary policy. Fiscal policy refers to the taxation, expenditure and borrowing by the Government. The economists now hold the government intervention through fiscal policy; it's essential in the matter of overcoming recession and inflation as well as of promoting and accelerating economic growth. There is no doubt that the Government budgetary or fiscal policy must be transparent, keeping in mind the needs and demands of a developing economy.

Fiscal policy has been defined in a number of ways. According to Samuelson, "under fiscal policy we mean the process of shaping taxation and public expenditure in order to (a) help dampen the swings of the business cycle and (b) to contribute to the maintenance of a growing high employment economy".

In the words of Arthur Smithies, "fiscal policy under which the government uses its expenditure and revenue programs to produce desirable effects and to avoid undesirable effects on the national income, production and employment" [8].

General objectives and role of fiscal policy

The main goal of fiscal policy is to raise the rate of production and employment without inflation. So, in all the countries, the fiscal policy major aim is to ensure the economic stability in the country [8].

One of the important objectives of fiscal policy is to use taxation as an instrument for dealing with inflationary or deflationary situations. In developing countries, there is a tendency of the general prices to go up due to expenditure on development projects, pressure of wages on prices, long gestation period between investment expenditure and production etc. Fiscal measures are used to counter act the inflationary pressure.

The tax structure is devised in such a manner that it purifies up a major proportion of the rise in income. The Government also tries to reduce its own spending and achieve budgetary surplus. If helps in reducing inflationary pressure in the economy.

Fiscal policy must be designed to be performed in two ways:

(1) by expanding investment in public and private enterprises and

(2) by diverting resources from socially less desirable to more desirable investment channels.

Generally speaking, the fiscal policy in under-developed countries has a different objective to that of advanced countries.

The fiscal measures, to a larger extent, promote economic stability in the face of short-run international cyclical fluctuations. These fluctuations cause variations in terms of trade, making the most favorable to the developed and unfavorable to the developing economies. So, for the purpose of bringing economic stability, fiscal methods should incorporate built-in-flexibility in the budgetary system so that income and expenditure of the Government may automatically provide compensatory effect on the rise or fall of the nation's income. Below, there are outlined the main objectives:

1. Increase in savings:

This policy is also applied to raise the rate of savings in the country. In the developing countries, rich class spends a lot of money on luxuries. The government can impose taxes on them, therefore assuring the basic need for life to the poor class on low rate.

2. To stimulate investment:

The government can promote the investment by securing different stimulant like the tax in the various sectors of the economy. The capital can be replaced from less productive areas to more productive branches of the economy. So, the resources of the country can be used at maximum rate.

3. To obtain equal distribution of wealth:

The fiscal policy is very helpful for the realization of equal distribution of wealth. When the wealth is equally distributed among the various classes then their acquiring power grows, which guarantee the elevated level of employment and production.

4. To supervise inflation:

The fiscal policy is very useful tool for inspection the rate of inflation. When the expenses on nonproductive projects decrease or the rate of taxes increase then the purchasing power of the people is minimized.

5. To lower the regional disproportion:

In the less developing countries, the regional disproportion is a common feature. Some areas are more developed while the others are less developed. Government delivers the infrastructure facilities in less developed territories.

6. Stabilization of price level:

The fiscal policy is also used to obtain wanted level of prices in the country. It means the cost and price should be at such level that production and employment may grow.

7. Increase in agriculture and industrial productivity:

The fiscal policy is also used that the output of various sectors of the economy must increase. The demand inside and outside the country should be satisfied.

8. To achieve maximum prosperity of the people:

The fiscal policy main objective is to achieve maximum welfare of the people. The quality of life must improve in the country.

9. To reach economic stability:

Therefore, the fiscal policy plays a leading role in maintaining economic stability in the face of internal and external forces. The instability caused by external forces is corrected by a policy, popularly known as 'tariff policy' rather than aggregative fiscal policy. In the period of boom, export and import duties should be imposed to minimize the impact of international cyclical fluctuations.

To curb the use of additional purchasing power, heavy import duty on consumer goods and luxury import restrictions are essential. During the period of recession, government should undertake public works programs through deficit financing. Fiscal policy should be viewed from a larger perspective keeping in view the balanced growth of various sectors of the economy [4].

Objectives of fiscal policy in developing countries

In developing countries, the taxation, Government expenditure and borrowing play a major role in accelerating economic development. In fact, fiscal policy is a powerful instrument in the hands of the Government by means of which it can achieve the objectives of development.

There are several specific features of a developing country, which need the adoption of a special fiscal policy which ensures a rapid economic increase. There are large and various resources, human and material, which are staying without being used.

Developing countries have weak infrastructure, they are in need of adequate means of transport and communications, roads, ports, highways, irrigation and power. Their population is increasing at an explosive rate which requires rapid economic development to meet the demands of the rapidly growing population. Above all, these countries suffer from deficiency of capital. They are caught up in a vicious circle of poverty. To overcome these gaps, a suitable fiscal and taxation policy is needed [7].

The role of fiscal policy in less developed countries differs from that in developed countries. In the developed countries, the role of fiscal policy is to promote full employment without inflation through its spending and taxing powers. Whereas the position of the developing countries is very much different. The LDC's (Less Developed Countries) or backward countries are caught in a vicious circle of poverty. The vicious circle of low income, low consumption, low savings, low rate of capital formation and therefore low income has to be broken by a suitable fiscal policy.

The principal objectives of fiscal policy in a developing country economy are:

1. Full Employment:

The first and foremost objective of fiscal policy in a developing economy is to achieve and maintain full employment in an economy. In such countries, even if full employment is not achieved, the main motto is to avoid unemployment and to achieve a state of near full employment.

Therefore, to reduce unemployment and under-employment, the state should spend sufficiently on social and economic overheads. These expenditures would help to create more employment opportunities and increase the productive efficiency of the economy.

In this context, Prof. Keynes made the following recommendations to achieve full employment in an economy:

(a) To capture the excessive purchasing power and to curb private spending:
(b) Compensate the deficiency in private investment through public investment;
(c) Cheap money policy or lower interest rates to attract more and more private entrepreneurs.

Below, there is a graph showing the decrease of unemployment rate worldwide, indicator according to the WB data [9].

2. Price Stability:

There is a general agreement that economic growth and stability are joint objectives for underdeveloped countries. In a developing country, economic instability is manifested in the form of inflation.

Therefore, in developing economies, inflation is a permanent phenomenon where there is a tendency to the rise in prices due to expanding trend of public expenditure. As a result of rise in income, aggregate demand exceeds aggregate supply. Capital goods and consumer goods fail to keep pace with rising income.

Thus, these result in inflationary gap. The price rise generated by demand pull reinforced by cost push inflation leads to further widening the gap. The rise in prices raises demand for more wages. This further gives rise to repeated wage-price spirals. If this situation is not effectively controlled, it may turn into hyperinflation.

In short, fiscal policy should try to remove the bottlenecks and structural rigidities which cause imbalance in various sectors of the economy. Moreover, it should strengthen physical controls of essential commodities, granting of concessions, subsidies and protection in the economy. In short, fiscal measures as well as monetary measures go side by side to achieve the objectives of economic growth and stability.

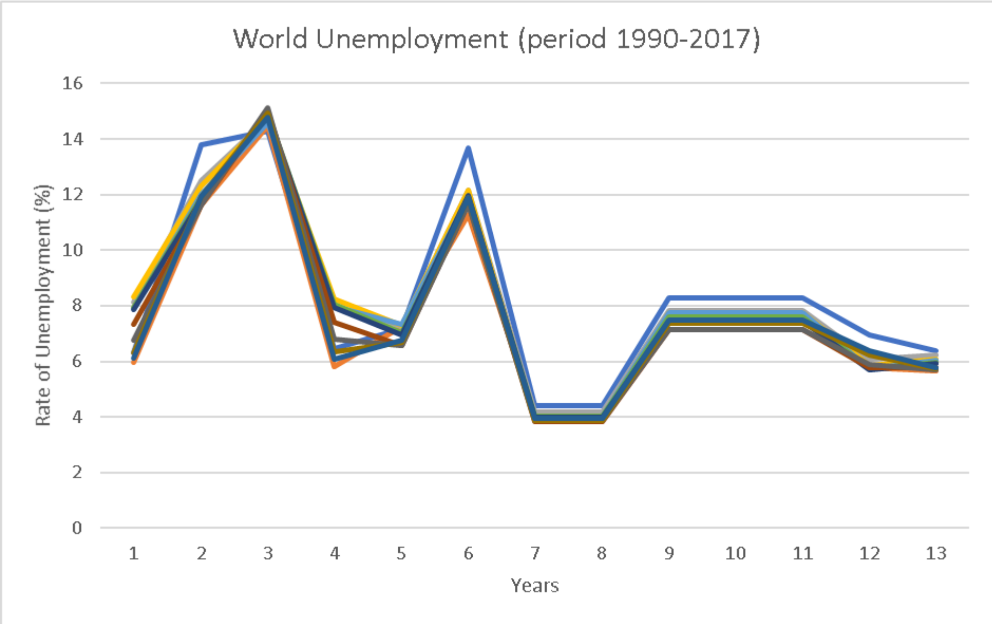

Figure 1. The world unemployment rate for period of 1990-2017
Source: World Bank Indicator for Unemployment per total (%)

3. To accelerate the rate of economic growth:

Primarily, fiscal policy in a developing economy, should aim at achieving an accelerated rate of economic growth. But a high rate of economic growth cannot be achieved and maintained without stability in the economy.

Therefore, fiscal measures such as taxation, public borrowing and deficit financing etc. should be used properly so that production, consumption and distribution may not adversely affect. It should promote the economy as a whole which in turn helps to raise national income and per capita income.

In this connection it is significant to understand that fiscal policy has been developed as an established economic function of a government, every country is anxious to gear its public finance in pursuit of the twin aims of stability and growth, but their relative importance is very differently regarded from one country to another… A steady rate of expansion will tend to reduce the violence of such fluctuations as may occur; a successful full employment policy will provide an atmosphere which is congenial for growth."

4. Optimum allocation of resources:

Fiscal measures like taxation and public expenditure programs, can greatly affect the allocation of resources in various occupations and sectors. As it is true, the national income and per capita income of underdeveloped countries is very low. In order to gear the economy, the government can push the growth of social infrastructure through fiscal measures. Public expenditure, subsidies and incentives can favorably influence the allocation of resources in the desired channels [6].

Tax exemptions and tax concessions may help a lot in attracting resources towards the favored industries. On the contrary, high taxation may draw away resources in a specific sector. Above all, direct curtailment of consumption and socially unproductive investment may be helpful in mobilization of resources and the further check of the inflationary trends in the economy.

Sometimes, the policy of protection is a useful tool for the growth of some socially desired industries in an under-developed country.

The goal of the fiscal policy is to maintain the condition of full employment, economic stability and to stabilize the rate of growth. For an under-developed economy, the main purpose of fiscal policy is to accelerate the rate of capital formation and investment.

Fiscal policy instruments

In the developed nations, fiscal policy is effective in maintaining economic stability while in the developing countries it is important in achieving economic growth, development and also in solving the employment issue. The instruments of fiscal policy serve goals of stimulating economic prosperity and growth, reducing poverty and destitution and chipping away at income inequality.

To implement fiscal policy, the government has several instruments:

- *Taxation*

Taxation is an important instrument for fiscal policy. The first tool is taxation. That includes income, capital gains from investments, property, sales or just about anything else. Taxes provide the major revenue source that funds the government. The downside of taxes is that whatever or whoever is taxed has less income to spend on themselves.

That includes income, capital gains from investments, property, sales or just about anything else. Taxes provide the major revenue source that funds the government. The downside of taxes is that whatever or whoever is taxed has less income to spend on themselves [8]. It is widely used to mobilize the available resources for capital formation in the country. There are two type of taxes which are levied to transfer funds from private to public use (i) The direct taxes are levied on the income, profits and wealth of the people who have potential economic surplus. (ii) The indirect taxes such as excise duty, sales tax etc., are imposed mostly on goods which have higher income elasticity of demand. The mopping up of surplus resources through taxation is an effective means of raising resources for capital formation. A rise in tax rates causes a reduction in aggregate demand for three reasons (i) it reduces consumption (ii) It reduces investment and (iii) it reduces net exports. A fall in the tax rates has the opposite effect.

- *Government expenditure*

The second tool is government spending. That includes subsidies, transfer payments including welfare programs, public works projects and government salaries. Whoever receives the funds has more money to spend. That increases demand and economic growth. Public expenditures include normal government expenditures, capital expenditures on public works, relief expenditures, subsidies of various types, transfer payments and social security benefits.

Government expenditures are income-creating while taxes are primarily income-reducing. Management of public debt in most countries has also become an important tool of fiscal policy. It aims at influencing aggregate spending through changes in the holding of liquid assets [8]. In this way, public expenditure and public-sector investment have a special role to play in a modern state. A properly planned investment will not only expand income, output and employment but will also step up effective demand through multiplier process and the economy will march automatically towards full employment. Besides public investment, private investment can also be encouraged through tax holidays, concessions, cheap loans, subsidies etc.

In the rural areas attempts can be made to encourage domestic industries by providing them training, cheap finance, equipment and marketing facilities. Expenditure on all these measures will help in eradicating unemployment and under-employment.

- *Redistribution of income*

When the government pays out Social Security, unemployment and welfare benefits, it expects nothing such as a product or service in return. As suggested by the International Monetary Fund's staff note Income Inequality and Fiscal Policy, the government employs these and other forms of income redistribution to do more than grow the gross national product.

According to the IMF report, income transfers are tools for reducing the gap between rich and poor and removing barriers to health care and political and other resources. Social Security, which began in 1935 during the Great Depression, was created as a safety net to protect retired workers against swings -- especially downward ones -- in the economy [1].

In hard times, government will spend more on unemployment benefits and other welfare programs because the numbers of eligible recipients will rise. During expansion of the economy, the public's need for income assistance will decline and spending on this assistance will go down as well. According to the IMF, these automatic stabilizers hold more sway in larger economies [2].

In a mixed economy, private sector constitutes an important part of the economy. While framing fiscal policy, the interests of the private sector should not be ignored. The private sector should make significant contribution to the development of the economy.

A wider measure of equality in income and wealth is an integral part of economic development and social advance. The fiscal operations if carefully worked out can bring about a redistribution of income in favor of the poorer sections of the society.

The government can reduce the high bracket incomes by imposing progressive direct taxes. For raising the income of the poor above the poverty line and narrowing the gap between rich and poor, the government can take direct investment on economic and social overheads.

Summing up, the principal aim of the fiscal policy in underdeveloped countries is to provide incentives for promoting saving and investment and thereby high rate of economic growth [4].

It is needless to emphasize the significance of equitable distribution of income and wealth in a growing economy. Generally, inequality in wealth persists in such countries as in the early stages of growth, it concentrates in few hands. It is also because private ownership dominates the entire structure of the economy. Besides, extreme inequalities create political and social discontentment which further generate economic instability. For this, suitable fiscal policy of the government can be devised to bridge the gap between the incomes of the different sections of the society.

To reduce inequalities and to do distributive justice, the government should invest in those productive channels which incur benefit to low income groups and are helpful in raising their productivity and technology. Therefore, redistributive expenditure should help economic development and economic development should help redistribution.

Thus, well-planned fiscal program, public expenditure can help development of human capital which in turn possesses positive effects on income distribution. Regional disparities can also be removed by providing incentives to backward regions. A redistributive tax policy should be highly progressive and aim at imposing heavy taxation on the richer and exempting poorer sections of the community. Similarly, luxurious items, which are consumed by the higher section, may be subject to heavy taxation.

This policy will help to raise the level of aggregate savings in the economy and create capital for bringing about a qualitative improvement in it. Capital formation, however, can also be facilitated by taxation, deficit spending and foreign borrowing. In fact, fiscal measures of the government can induce the private entrepreneurs to take active participation for mobilizing resources at least in the long run.

Fiscal policy aims at the acceleration of the rate of investment in the public as well as in private sectors of the economy. Fiscal policy, in the first instance, should encourage investment in public sector which in turn effect to increase the volume of investment in private sector. In other words, fiscal policy should aim at rapid economic development and must encourage investment in those channels which are considered most desirable from the point of view of society.

It should be aimed at reducing apparent consumption and investment in unproductive channels. In the early stages of economic development, the government must try to build up economic and social overheads such like transport and communication, irrigation, flood control, power, ports, technical training, education, hospital and school facilities, so that they may provide external economies to induce investment in industrial and agricultural sectors of the economy.

Conclusions

Thus, the fiscal policy encompasses two separate but related decisions; public expenditures and the level and structure of taxes. It occupies the central place for maintaining full employment without inflationary forces in the economy [6].

With its various instruments it influences the economic stability of an economy. The fiscal policy implemented by government has been very focused in several fields such as mobilization of resources for economic development, increasing rate of savings and capital formation, developing cottage and small-scale industries, reducing the incidence of poverty.

To be ready to step into the system of reform and implementation of fiscal policies it is needed to educate and cultivate experts, the investment should be done in the education sector.

Once it is invested, there with time the result will emerge itself, in form of qualified and educated people who can response for the future of the country.

Through years international financial institutions have provided considerable resources and expertise with aim to help to reduce poverty and strengthen social and gender equality. As the result, the social sector development and poverty reduction has been thoroughly covered by various international multilateral and bilateral donors.

The donor activities can be identified in form of interventions at the policy level, such as development of poverty reduction programs, contributions to capacity building and direct technical and financial assistance.

Based on all the information read from different sources of information, the conclusion outlined is that fiscal policy, being a component in economic policy has a major and vital role in evolution and development of a society from developing country.

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