**Role of Fiscal Policy in Developing Countries**

The fiscal policy in developing countries should apparently be conducive to rapid economic development. In a poor country, fiscal policy can no longer remain a compensatory fiscal policy. It has a tough role to play in a developing economy and has to face the problem of growth-cum-stability.

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 shy in these countries, the government has to fill up the lacuna. A mounting 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.

An important aim of fiscal policy in a developing economy is to create an equitable distribution of income and wealth in the society. Here, however, a difficulty arises. 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.

As such, if high economic growth is the objective, the question arises as to what extent inequalities should be reduced. Of course, many a time, under the goal of socialism, the government unduly resorts to reduction of inequalities at the cost of growth which may lead to the distribution of poverty rather than prosperity. A reconciliation of these two contradictory goals of growth and reduction of inequalities can definitely bring forth better results.

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

(i) To increase the rate of investment and capital formation, so as to accelerate the rate of economic growth.

(ii) To increase the rate of savings and discourage actual and potential consumption.

(iii) To diversify the flow of investments and spending from unproductive uses to socially most desirable channels.

(iv) To check sectoral imbalances.

(v) To reduce widespread inequalities of income and wealth.

(vi) To improve the standard of living of the masses by providing social goods on a large scale.

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.

Public borrowing also is an important means of getting resources for development of the public sector. External loans are useful to some extent when the country has to import machines, capital goods, etc., from a foreign country and the country has a scarcity of foreign exchange.

Anyway 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.

It must be noted that fiscal policy in a developing economy has to operate within a framework influenced by social, cultural and political conditions and institutions, which may inhibit the formulation and implementation of good economic policies.

Further, fiscal policy in a poor country may be used to reduce inequalities in income and wealth distribution by means of taxes and government expenditure. Taxation has to be progressive and government spending must be welfare-oriented.

In short, for promoting economic growth, the fiscal policy must be first formulated in such a way that it will increase the rate of volume of investment in the public and private sectors. The tax policies must discourage unproductive and speculative investment. Second, fiscal policy must mobilise more and more resources for capital formation. Hence, taxation must be used to curb excessive consumption. Third, it must encourage an inflow of foreign capital.

Fiscal policy, however, cannot be effective when there are loopholes in the taxation laws and the tax administration is corrupt so that there is large-scale tax evasion. Again, if the government is extravagant in spending on non-developmental items, then a technique such as deficit financing may prove to be inflationary. Again, market imperfections, bottlenecks, shortages of raw materials, and lack of entrepreneurial skills, do not allow fiscal policy to be effective.

A high population growth, and an orthodox society also come in the way of development and without a coordinated, sound, physical plan and its proper implementation, fiscal policy cannot be very effective in reaching its goal of rapid economic development with stability.

Nonetheless, of all economic policies, fiscal policy today assumes unique importance in realising general economic goals, depending on the size of the fiscal measures adopted and their timing. The exact change effected in the national economy will depend on the form and the magnitude of public revenue, especially, the rates and structure of taxation and the mode of public spending by the government.

Further, when prices are rising, government has to adopt a surplus budget at an appropriate time in order to avoid secular inflation. But, there is practical difficulty in knowing the changing conditions or appearance of price stability; hence it is very difficult to forecast perfect timing.

Political and administrative delays tend to aggravate the problem and the desired effect of fiscal programme may not be realised. Sometimes, even if the fiscal action is taken at a right time, in quantitative or qualitative terms, it may not be adequate or appropriate.

Quite often, trade union activities come in the way of operating fiscal measures. The workers may resent certain taxation measures or may demand high wages during inflation, and when the government is forced to raise the wage level on account of demand- pull inflation, cost-push inflation may also emerge to make the situation worse.