

Chapter 7 PUBLIC FINANCE ^{1/1}

(2 marks)

(Unit -1 :- fiscal functions :- Overview)

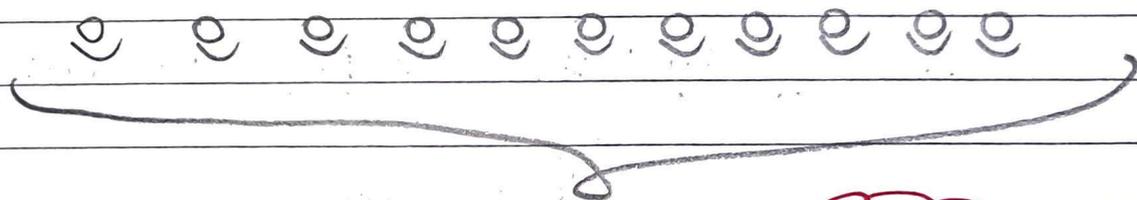
① Introduction

RBI

Monetary
policy

Govt.

fiscal
policy

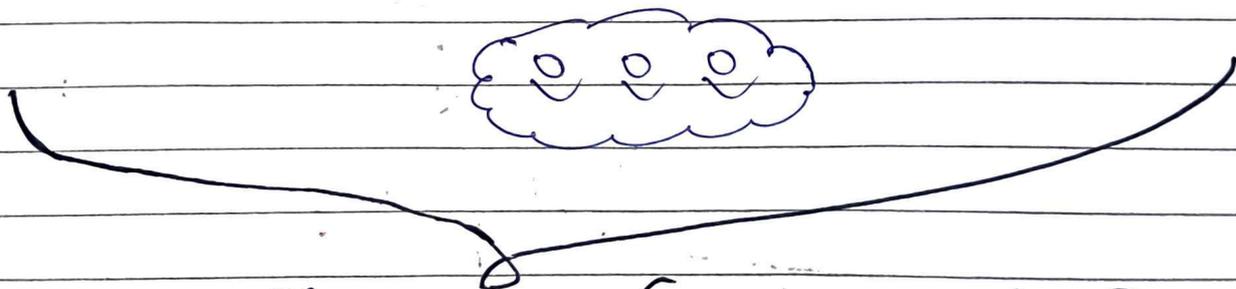


→ The actions of government have Impact on the Economy.

Borrow money

public welfare

Increases Expenditure



Three Main Macro Economic goals for any nation.

1) Economic Growth

2) High level of Employment

3) Stable Price levels.

* Government has to Intervene in all above matters and take decisions.

② Role of Government in Economic System.

Economic System

(It is a System which provides means to work & Earn a living)

↓
SCARCITY

(Unlimited human needs with limited Resources)

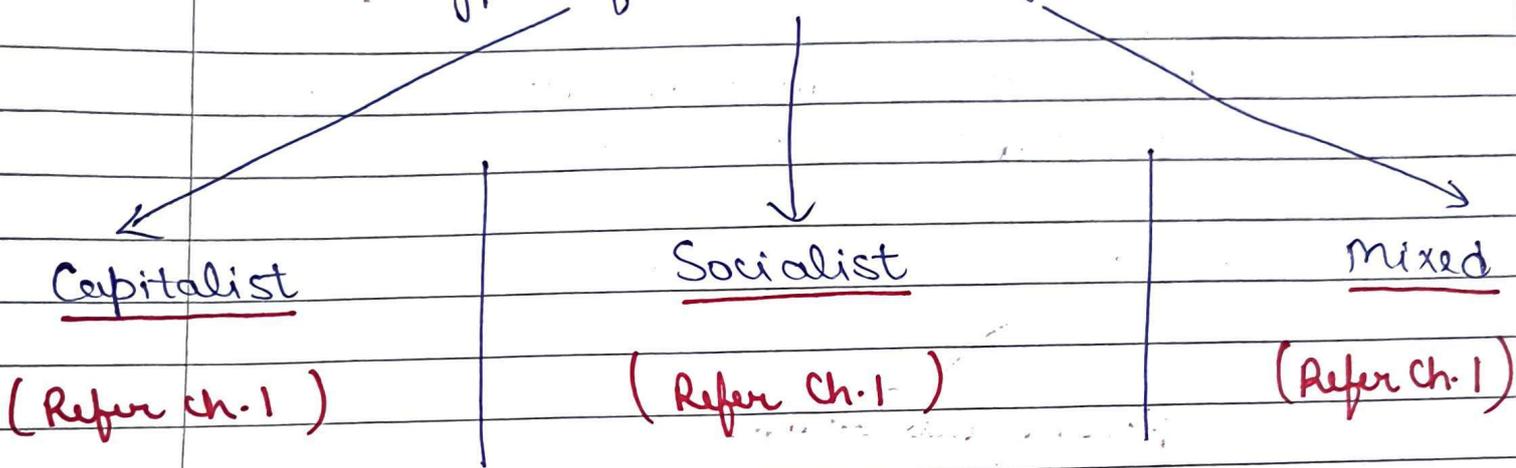
↓
Problems

what to produce

How to produce

for whom to produce.

Three types of Economic System.



*

ADAM SMITH

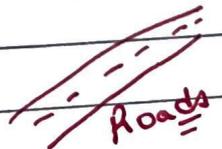
favoured FREE MARKET
(i.e., Capitalist)

but role of government should be in:-

a) national defence

b) Justice System

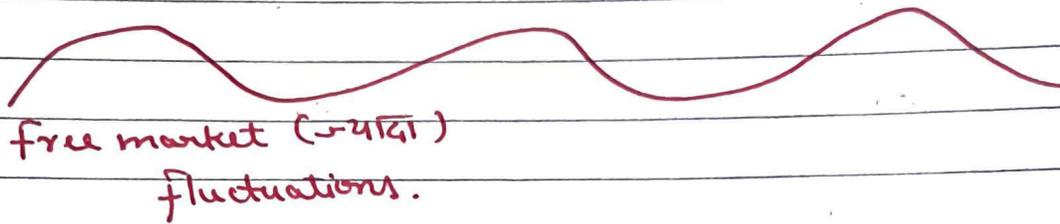
c) Public Institutions & public works.



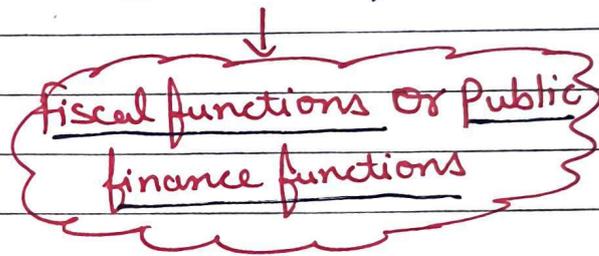
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* 1930 - Great Depression

After this government's role in Economy gained importance.

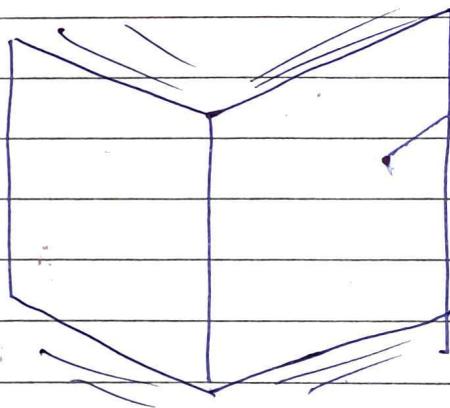


Government performs Economic functions



* Richard Musgrave ☺

1959



→ Theory of public finance

Introduced three branch taxonomy of the role of government in market Economy.

DOMS

Resource
allocation



to ensure
Efficiency.

Income
redistribution



to guarantee
"fairness"

Macro
Economic
Stabilization.



to ensure
price
stability.

③ "THE ALLOCATION FUNCTION"

- optimal allocation of resources for MAXIMUM SATISFACTION.
- minimum waste
- minimum inefficiency.

Private sector (Market Economy)	State (Socialist Economy)
<ul style="list-style-type: none"> • Role of Demand & Supply. • Consumer Sovereignty. • Public goods. (↓) • merit goods (↓) 	<ul style="list-style-type: none"> • Government decides • Public goods (↑) • merit goods (↑)

• Efficient allocation takes place in perfectly Competitive market, but in reality markets are never perfectly competitive.

• Some reasons for Inefficient allocations:-

a) Imperfect competition.

b) Lack of public goods.

c) Incomplete market - i.e, lack of merit goods.

d) over use of resources (Environment)

e) Externalities (eg. pollution)

f) factor immobility.

g) Inequalities of Income.

- o According to Richard, government should intervene in market to bring about improvement in social welfare.



(Eg. production & consumption of demerit goods are controlled by government)

- o The resource allocation role of government's policy focuses on the potential for the government to improve economic performance through its expenditure & tax policies. It determines :-

a) who and what will be taxed.

b) How much and on what government revenue will be spent.

c) optimum mix of various social goods.

Public goods + merit goods

~~d) A variety of allocation~~

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• A variety of allocation instruments are available by which government can influence resource allocation in the Economy. for Eg:-

a) government may directly produce an Economic good like Electricity.

b) government may influence allocation through legislation & force.

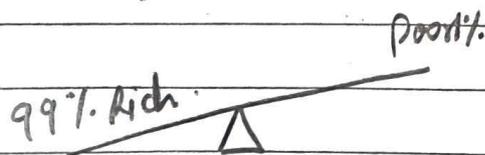
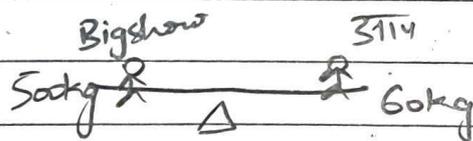
↳ ban on single use plastic

c) government is regulatory activities
Eg. licensing.

④ "REDISTRIBUTION FUNCTION"

• Generally : distribution of Income & wealth is SKEWED.

←
"Skewness"

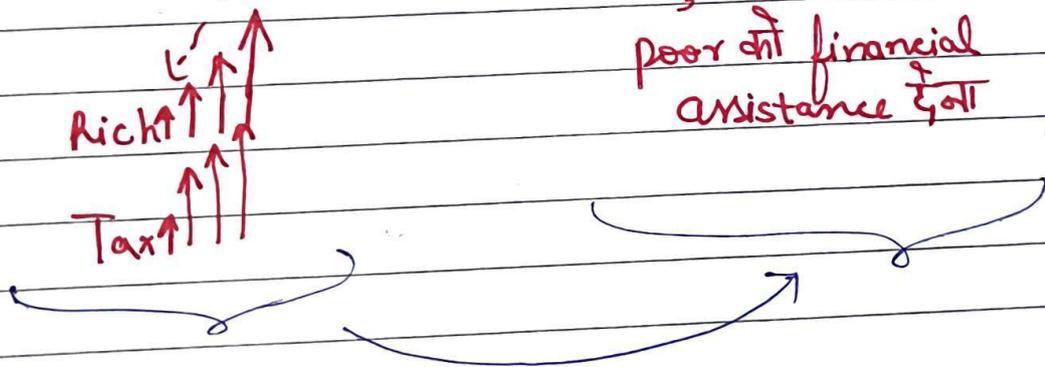


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- This function relates to the basic question of FOR WHOM TO PRODUCE

- This function also relates to the manner in which effective demand over the Economic goods is divided among the various Individuals.

- Progressive taxes & Subsidies.



- This function aims at:-

a) redistribution of Income

b) Social welfare

c) provide Equality of Income.

d) provide security (In terms of fulfillment of basic needs:-)

o few Examples

a) progressive taxes

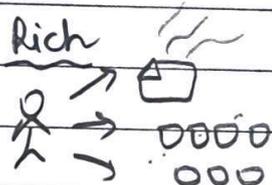
b) food grains at subsidised prices to BPL households.

c) Employment reservations.

d) Unemployment benefits. Etc

*

o Efficiency V/s Equity



upliftment of poor

→ Greater Equity can be achieved through high taxes on Rich, but this could act as disincentive to Entrepreneurship & discourage people from making Savings & Investments.

→ Therefore Redistribution measures should be accomplished with minimal Efficiency Costs.

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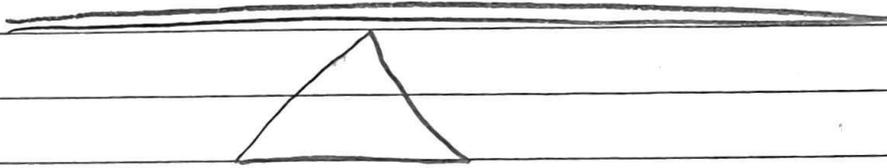
⑤ "STABILIZATION FUNCTION"

Output = Production Capacity.

Spending (Demand) = total output (Supply)

Labour = fully Employed

Inflation is low & Stable

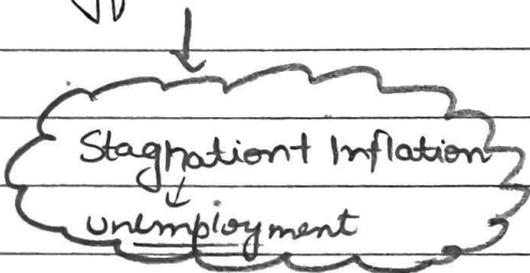


◦ Keynes believe that Economy does not automatically generate fully Employment, therefore government has to Interfere.

◦ for Stability

- Monetary policy (i.e., Money supply & Interest Rates)
- fiscal policy (government Expenditure & govt. Revenue)

◦ Stagflation is also problem.



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• Stabilization issue also become more complex due to CONTAGION EFFECT

(i.e. increased International Interdependence & financial integration causes forces of instability.)

• Stabilization function is concerned with.

a) labour Employment

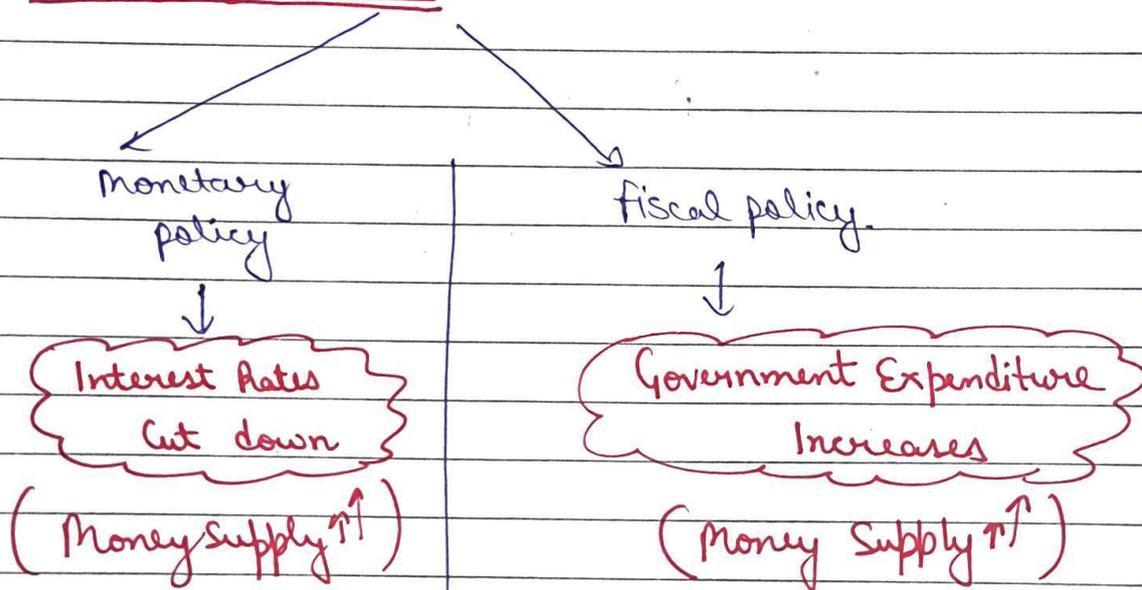
b) Capital utilisation.

c) Overall output

d) balance of International payments and

e) rate of Economic growth.

• "COVID Scenario"

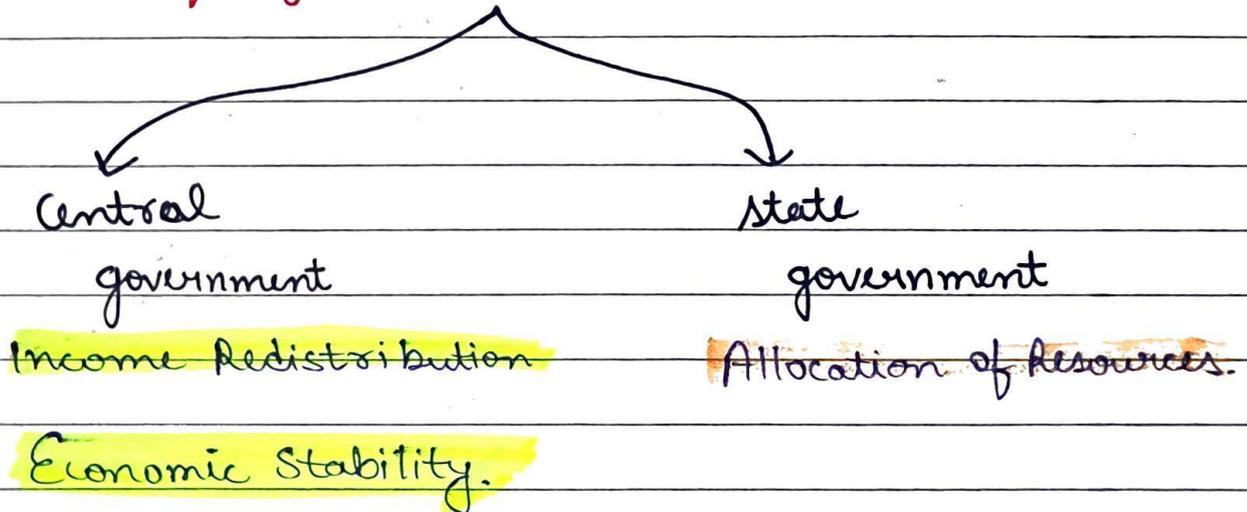


* This is Expansionary fiscal policy.

* To control Inflation, government adopts Contractionary fiscal policy.

*  Richard introduced a term "fiscal federalism"

Division of Economic functions and resources among different layers of government.



* In India, Article 246 of Constitution demarcates the powers of the Union & the State by classifying their powers into three lists:-

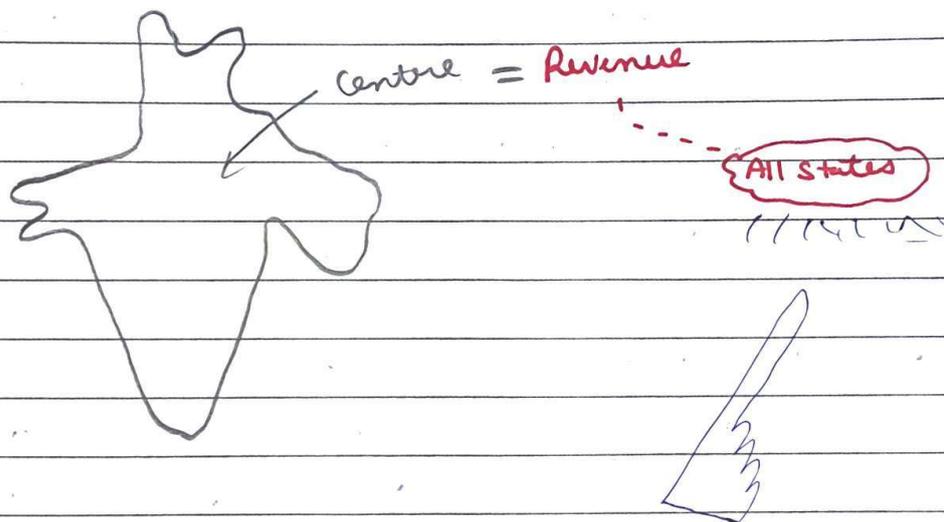
- a) Union list
- b) State list
- c) Concurrent list

- In case of conflicting legislation in Concurrent list, the law passed by Centre prevails.

* TAXES

- by Centre :- Income Tax, Corporate tax, wealth Tax, Export duties, STT, Customs, CGST
- by state :- Tax on Agricultural Income, Tax on Electricity, Toll Tax.

- * Article 268 to 281 of Constitution contain specific provision in respect of distribution of finances among state.



- * Finance Commission facilitate Such transfers

- It makes Recommendations to president as well.
- 15th Finance Commission was constituted on 27 Nov. 2017.
- It also CONSIDER issues related to:-

a) Vertical Equity:- share of all states in revenue collected by centre.

b) Horizontal Equity:- allocation among states

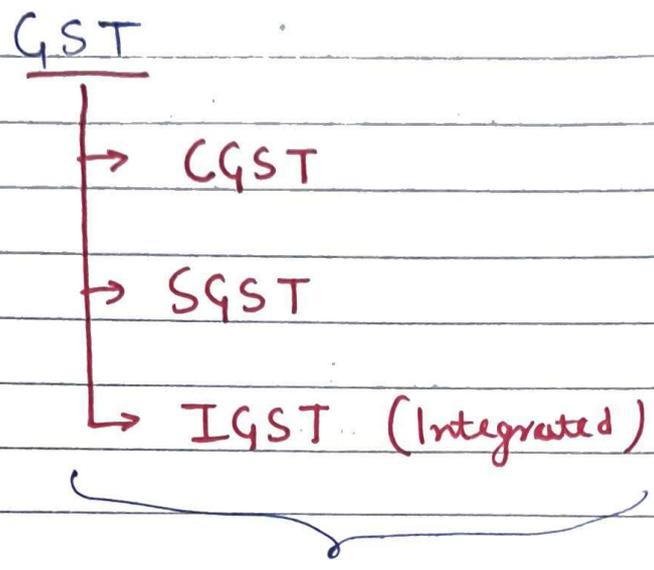
*	Gross Tax Revenue (of Union)	xxx
	(-) <u>Cesses</u> ↳ Tax	(xxx)
	(-) <u>Surcharges</u>	(xxx)
	(-) <u>Non Tax Revenues</u>	(xxx)

Net Divisible Pool (NDP) 2222

Some Share to states

Remaining with Centre

*



GST **Compensation** is given to **state** to compensate for loss of revenue due to introduction of GST.

*

In may 2022, Supreme Court said that Union & State government have "EQUAL Simultaneous & Unique powers" to make laws on GST.

*

for 2021-26, % share of states in central taxes is 41%. Criteria for determining this distribution includes:-

- 1) Income distance Highest MP 1600
- up - 1000
- 600
- 1400
- publ - 200
- 2) population
- 3) Area
- 4) Demographic performance
- 5) forest & Ecology
- 6) Tax & Fiscal Efforts.

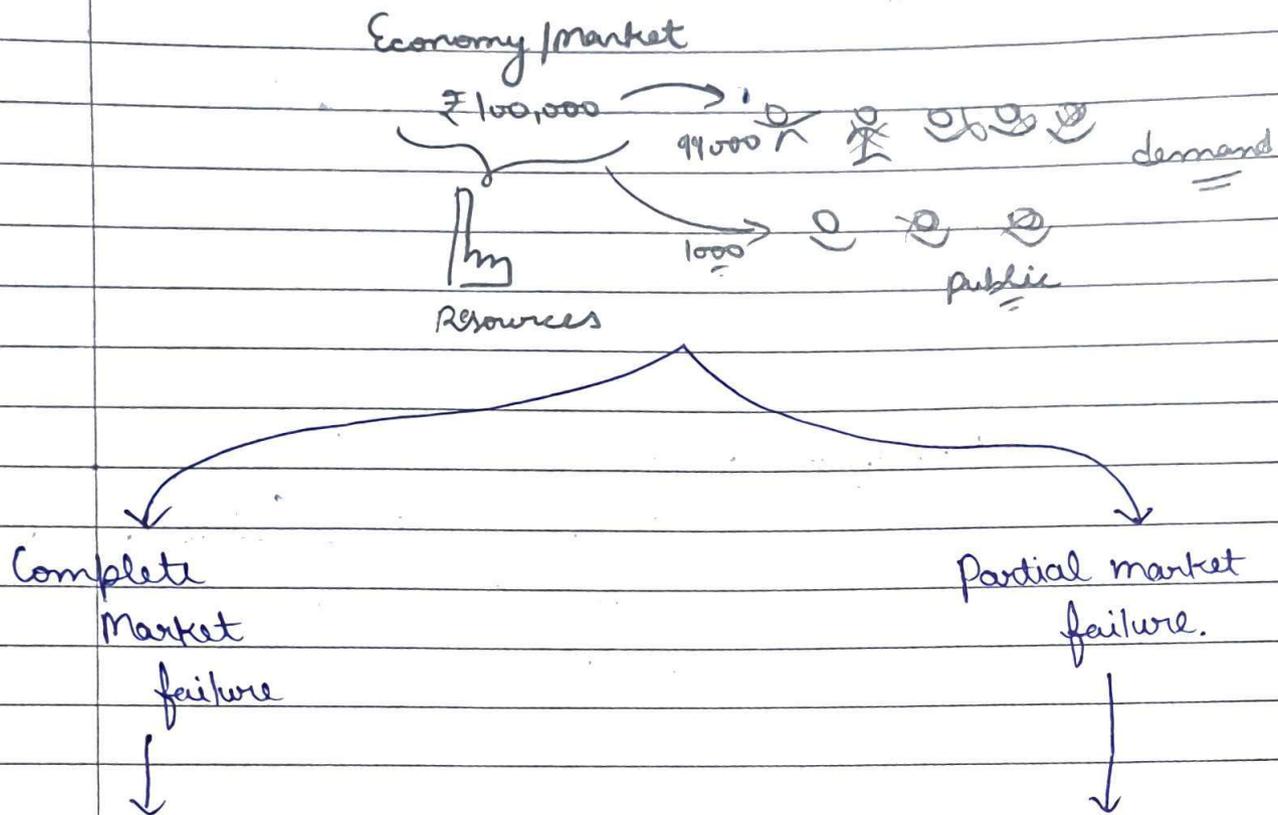
* Responsibilities.

→ Centre - Defence, Foreign affairs, foreign Trade, Exchange management, money & Banking, Communication etc.

→ State - Agriculture, Industry, Social Sector Services (Education, Health) Police Services, roads, Infrastructure.

(Unit-2 MARKET FAILURE)

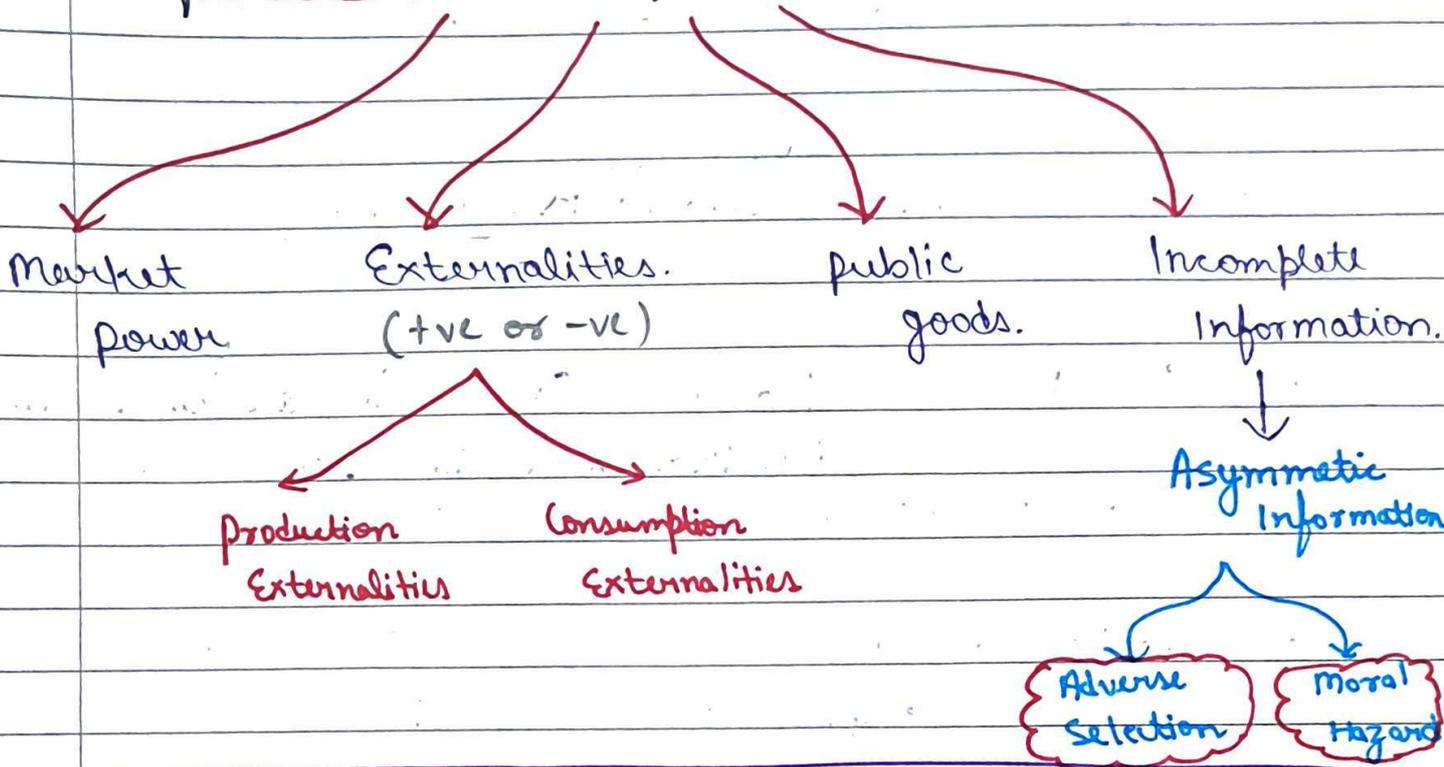
(Inefficient allocation of Resources.)



This is a case of "Missing markets" and occurs when the market does not supply products at all despite the fact that such product or service are wanted by the people. Eg. pure public goods.

failure occurs when the market does actually function, but it produces either the wrong quantity or at the wrong price. This results in loss of Economic welfare.

* Why do Markets fail??



GOVERNMENT Intervention in all these above.

I Market Power.

- Market power or monopoly power is the ability of a firm to profitably raise the market price of a good or service over its marginal cost.
- Excessive Market power causes the single producer or a small no. of producers to restrict output.

→ Thus, market fails to produce right quantity of goods & services at the right price.

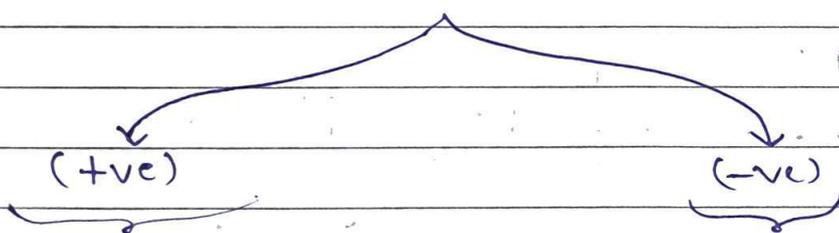
II. EXTERNALITIES

→ Externalities are **COSTS** (negative Externalities) or **benefits** (positive Externalities), which are not reflected in free market prices.

→ Externalities are also referred to as

- Spill Over Effect.
- Neighbourhood Effect
- Third party Effect
- Side Effect

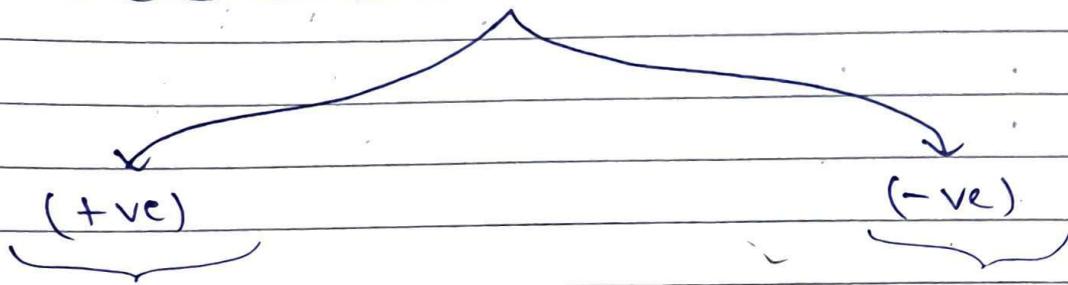
→ Production Externalities.



A firm offering trainings to its employees.

factory produces wastes or pollution.

→ Consumption Externalities.



• Consumption of service of Health Club.

• Smoking Cigarettes in public place.

• people get Immunized against Contagious diseases.

~~fy~~ • Act of undisciplined Students talking & Creating disturbance in class.

* How Externalities Cause market failure?

→ **Private Cost** - Cost of production Incurred by firms.
Ex:- Wages, Raw materials Etc.

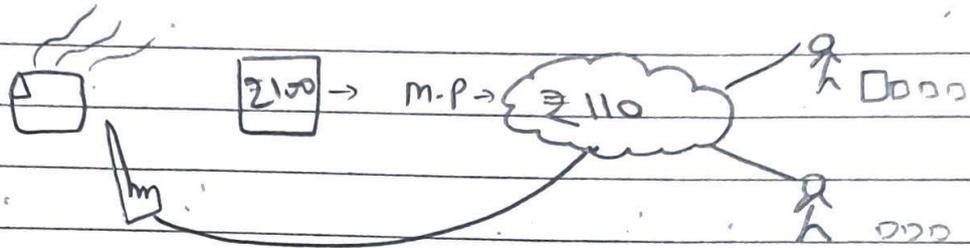
→ **Social Cost** - total Cost to the Society on the account of production.

Social Cost = private Cost + Negative Externalit

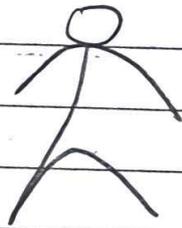
Or Social Cost = private Cost (+) ^{-ies.} External Cost.

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→ The market price determined without incorporating externalities are not ideal. Such prices send incorrect signals to the producers & consumers and cause either over production or under production.



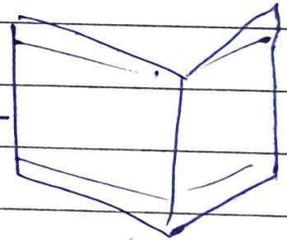
III PUBLIC GOODS / SOCIAL GOODS



Paul A. Samuelson.

1954

The Pure theory
of Public Expenditure



(first Economist to introduce
Public goods)

Private Goods

Public Goods.

- | | |
|---|--|
| ◦ No free rider problem | ◦ free rider problem is there. |
| ◦ These are Excludable | ◦ Non-Excludable |
| ◦ Consumption of private good is rivalrous. | ◦ Non-rivalrous. |
| | ◦ Indivisibility |
| | ◦ More vulnerable to externalities & other issues. |

Hello

→ Producers are not motivated to produce socially optimal amount of products if they cannot charge a positive price for them or make profits from them. Thus, there is market failure in the case of public goods.

IV Incomplete INFORMATION

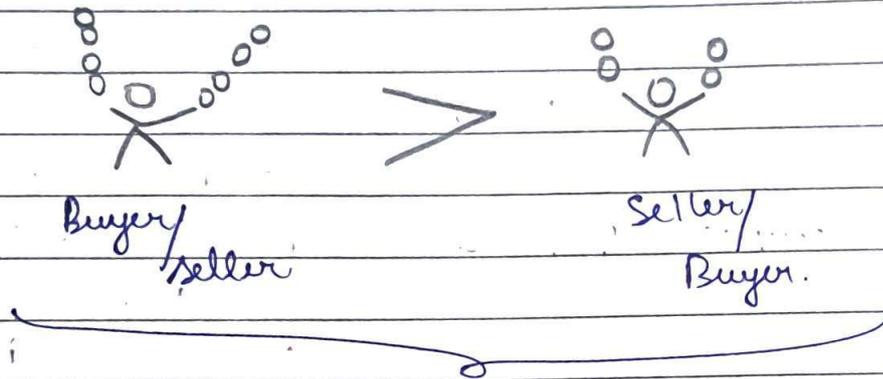
- Perfect Information implies that both buyers & sellers have complete information about anything that may influence their decision making. However, this assumption is not fully satisfied in real markets because of:-

1a) Complexity of product/service.

(b) difficulty of getting correct information.

(c) Deliberate misinformation by interested parties.

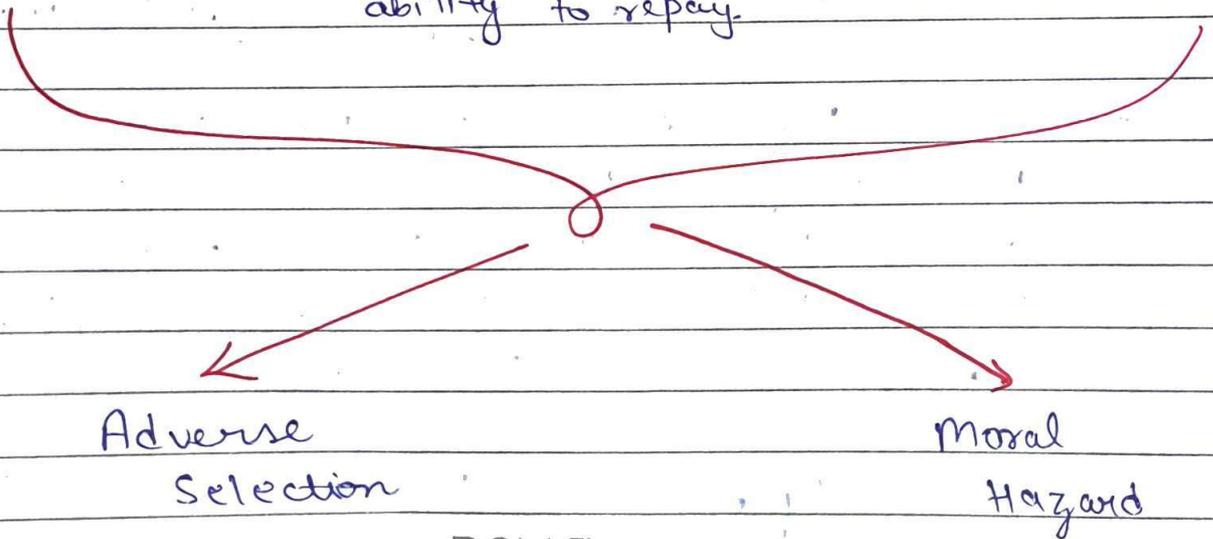
→ Asymmetric Information.



It occurs when there is an imbalance in information between the buyer & seller.

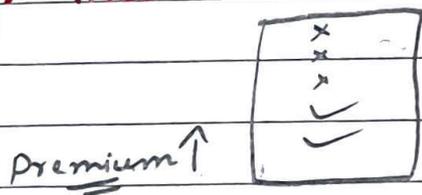
Eg:- landlords know more about their property.

:- Borrower knows more about their ability to repay.



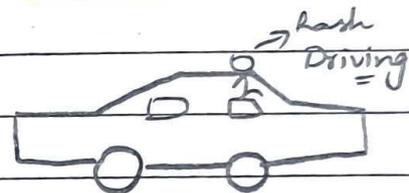
↓
The party which has more information (let say Mr. X) may take advantage of others Ignorance (let say Mr. Y) Here Mr. Y will be at loss.

Eg. Insurance.



More hazard arises when there is external-ality. It is about the opportunism characterised by an informed person's taking advantage of a less informed person through an unobserved action.

Eg.



"Comprehensive Insurance Policy"

* Thus, asymmetric information leads to elimination of high quality goods from the markets. Economics agents end up either selecting sub-standard product or leaving the market altogether.

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GOVERNMENT INTERVENTION

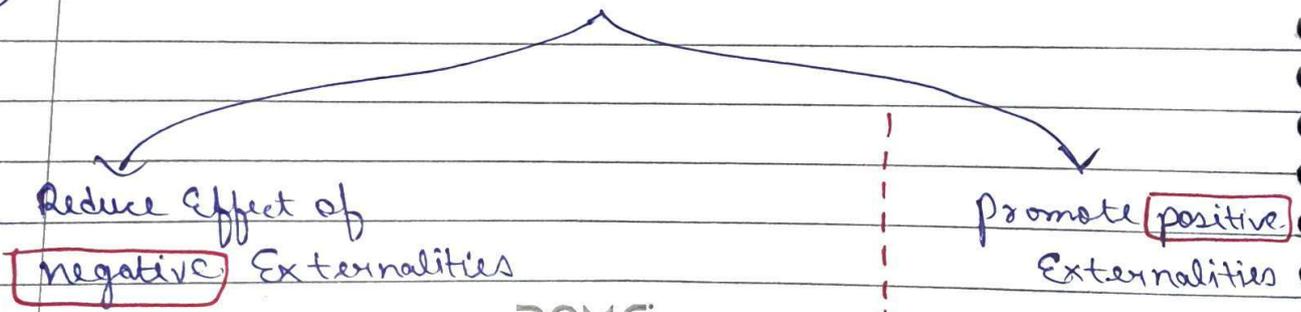
① To Minimise MARKET POWER

- Competition Act, 2002 (as amended by Competition (Amendment) Act, 2007)
- Market liberalisation.
- 'Control' on Merger & Acquisition.
- Price Capping.
- Patronage to Consumer associations.
- Reduction in Import Controls.
- Nationalisation.

Support

* However, Sometimes government give patents and copyrights & protect monopoly position of a firm 😞

② To Correct EXTERNALITIES



↓

Government Initiatives

(i) Direct Control (Command Solutions)

- fix Emission of pollutants (penalties for Exceeding limits)
- Licensing.
- Make laws.

(ii) Market Based policies.

[Environment Taxes and Cap and Trade]
i.e., setting price directly through pollution Tax or setting price indirectly through Cap and Trade.

AC Pigou } Pigouvian Taxes.

It is difficult to determine

if demand is Inelastic then these taxes may not be effective

Adverse Effect on Employment

(i) Corrective Subsidies to Producers.

↓
aimed at Increasing SUPPLY of good.

g) Subsidy on fertilisers

(ii) Corrective Subsidies to Consumers

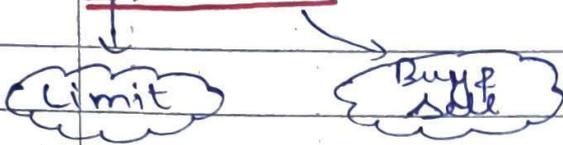
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aimed at increasing DEMAND of good.

g. Subsidies on Education

* Also govt. Engaged in:-

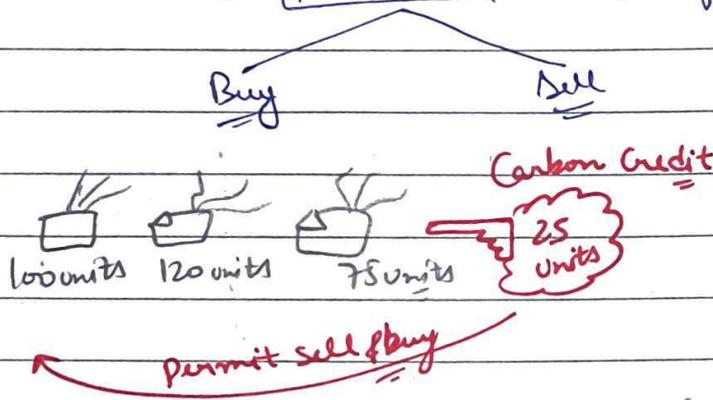
- a) Afforestation.
- b) Reforestation.
- c) protection of water bodies etc.

Cap & Trade



- Total pollution allowed to be emitted during each period.

- Concept of Permits & Concept of Carbon Credit



Ex Tradeable permits have been used since 1980s in US.

In India:-

Perform Achieve & Trade (PAT)

RPO (Renewable Purchase obligation)

REC (Renewable Energy Certificate)

Energy Conservation (Amendment)

Bill, 2022.

③ In Case of Merit goods.

- Compulsory Insurance protection
- Compulsory Immunization.

- Use of legislation (Eg. use of helmets, seat belts)
- Free Education / free medical services.

④ In Case of Demerit Goods. → Alcohol, Tobacco, drugs, cigarettes.

- Complete ban → Hidden market is still there.

- Negative advertising. (persuasion)

Surrogate advertisement

Prohibit advertisement of these goods.

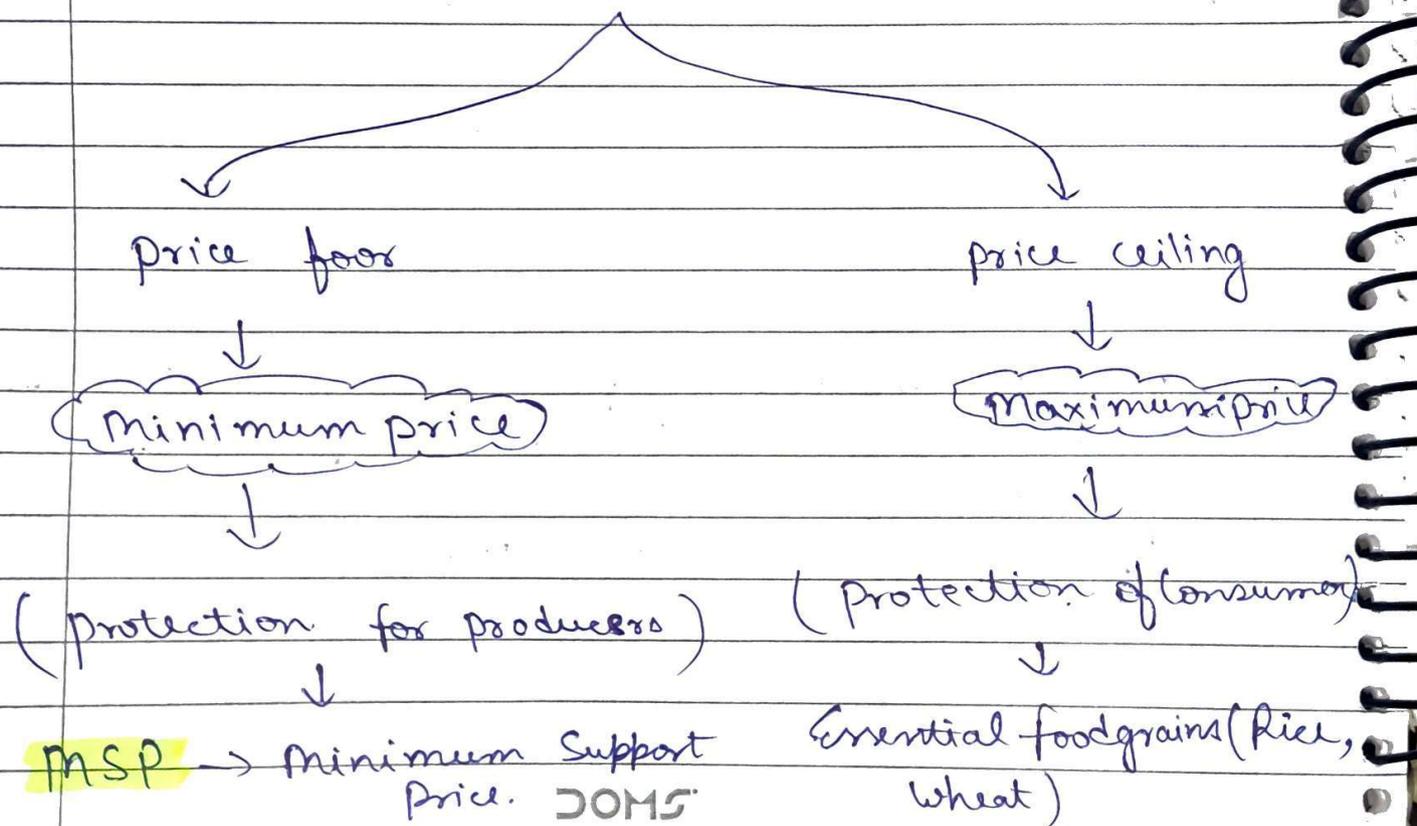
- Restriction in public areas.
- Imposing high taxes.

Demand of these products are generally **INELASTIC**, so increase in price due to high taxes have very less effect on demand.
(Also, sellers can shift the tax on consumers)

⑤ In Case of Public Goods.

- Defense, legal system, fire protection, disease prevention etc are provided by government.
- Parks or museums financed through "Entry fees"
- Government may grant license to private firms to build good public facility.
- Government may invite Voluntary Contributions and private donations.

⑥ Price Intervention (Non Market Pricing)



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⑦ For Correcting Information failure.

- Government makes accurate **labelling** mandatory.
- Mandatory disclosures (Eg.- SEBI makes it Compulsory for Companies)
- Public dissemination. ~~-----~~
- Regulation on Advertising.

⑧ for Equitable Distribution.

- one of the most important activities of govt. is to redistribute incomes so that there is **Equity** & **fairness** in the society.

- * Progressive Taxes
- * Unemployment allowances
- * Job reservations
- * land reforms
- * Gender Sensitive budgeting etc

but Sometimes Government failure occurs when:-

- Intervention is Ineffective Causing **wastage of resources**.

o Intervention produces fresh & more serious
problem.

(Unit-3 Budget Making)

① Introduction

- Government all over the world have to perform manifold ^{functions} from protecting territories, maintaining law & order, provision of public goods and Implementation of Comprehensive plans for Economic & Social welfare of its citizens.
- A budget is a statement that presents the details of "where the money comes from and where the money goes to".



The budget also contains estimates of the government's amount for next fiscal year called budgeted estimates.

② Process of budget making

The budget is prepared by the Ministry of finance in consultation with NITI Ayog & other relevant ministries.

→ The Budget must be presented and approved by both houses of parliament before the beginning of fiscal year. (1 April - 31 March)

→ Article 112 of Constitution provides that in respect of every financial year the president shall cause to be laid before both the houses of parliament a statement of Estimated receipts and Expenditure of the govt. of India for that year, referred as Annual financial Statement.

→ The budgetary procedure are :-

(i) Preparation of Budget

(ii) Presentation & Enactment of Budget

(iii) Execution of the budget.

→ The budget process mainly consists of two activities.

a) **Administrative process.** → documentation process.

b) **Legislative process.** - legal process

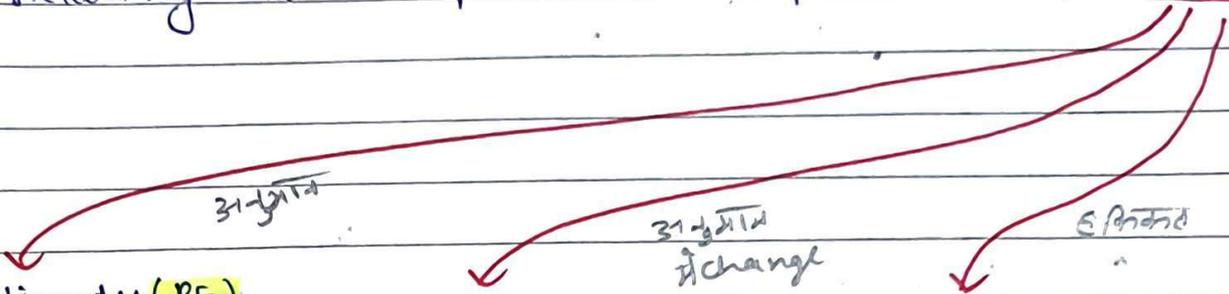
→ A Series of **pre budget consultations** are done by the Union finance minister with chief ministers of states, various stakeholders etc.

→ The Budget documents depict information relating to receipts and Expenditure for 2 years

Budget Estimates (BE) of receipts & Expenditure in respect of Current and ensuing financial year.

For the Current Year through Revised Estimates (RE)

"Actuals" of the year Preceding Current year.



→ The budget speech of finance Minister is usually in 2 parts.

→ Part A of Budget an outline of prevailing macro economic situation of the country & budget estimates for the next financial year.

→ Part B of Budget speech details the progress the government has made on various developmental measures & also the tax proposals.

//_

→ The annual financial statement shows the receipts & expenditure of govt. in **3** separate parts.

Consolidated
fund of India

Contingency
fund of India.

Public
accounts.

→ The list of budget documents presented to the Parliament, besides the finance minister's speech, is given below:

(a) Annual financial statements (AFS)

(b) Demand for Grants (DG)

(c) Finance Bill

↗ fiscal Responsibility
& Budget Management

(d) Statements mandated Under FABM Act -

→ macro economic framework statement

→ Medium-Term fiscal policy cum fiscal policy strategy statement.

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→ The Expenditure of certain categories (eg- allowances of president, Emoluments of Supreme court judges etc) are charged on "Consolidated fund of India".

* By Convention in an election year, the budget may be presented **TWICE**.

→ the Budget is discussed in two stages in Lok Sabha.

The Lok Sabha has the power to Concur or to refuse any demand or even reduce the amount of grant sought by government.

The budget is laid on the table of the Rajya Sabha soon after the finance minister has completed the speech in Lok Sabha. The Rajya Sabha, does not vote on the demands of grant and there is only general discussion.

→ After the general discussion, the government introduces Appropriation Bill.

↓
It is intended to give authority to the govt. to incur Expenditure from and out of Consolidated fund of India.

//_

Motions for reduction to various demands for grants are made in the form of **COT motions** Seeking to reduce the sum sought by the govt.

→ The **finance bill** Seeking to give effect to the government's **taxation** proposal is introduced in Lok Sabha immediately after the presentation of "General Budget". The finance bill is taken up for consideration and passing after the appropriation bill is passed.

(Finance Bill has to be passed within 75 days of its introduction)

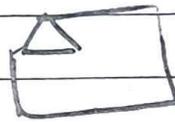
→ After the finance bill has been passed by Lok Sabha, it is transmitted to Rajya Sabha for recommendations. It has to be returned back within **14 days**. (Recommendations of Rajya Sabha may be accepted or rejected by Lok Sabha)

* On the **last day** of the days allotted for discussion on the demands for grants, the speaker puts all the "outstanding demands for grants to vote of the house". This process is **GUILLOTINE**.

* Since 2017-2018, the date of presentation of budget has been advanced to 1st february. Merger of Railway Budget with General Budget.

③ Sources of Revenue

MOF = ministry of finance.

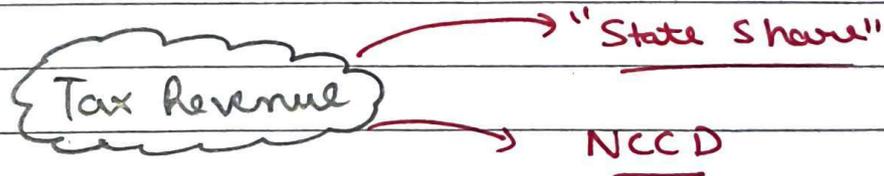


Department of Revenue
of ministry of finance

Central Board
of Direct Taxes
(CBDT)

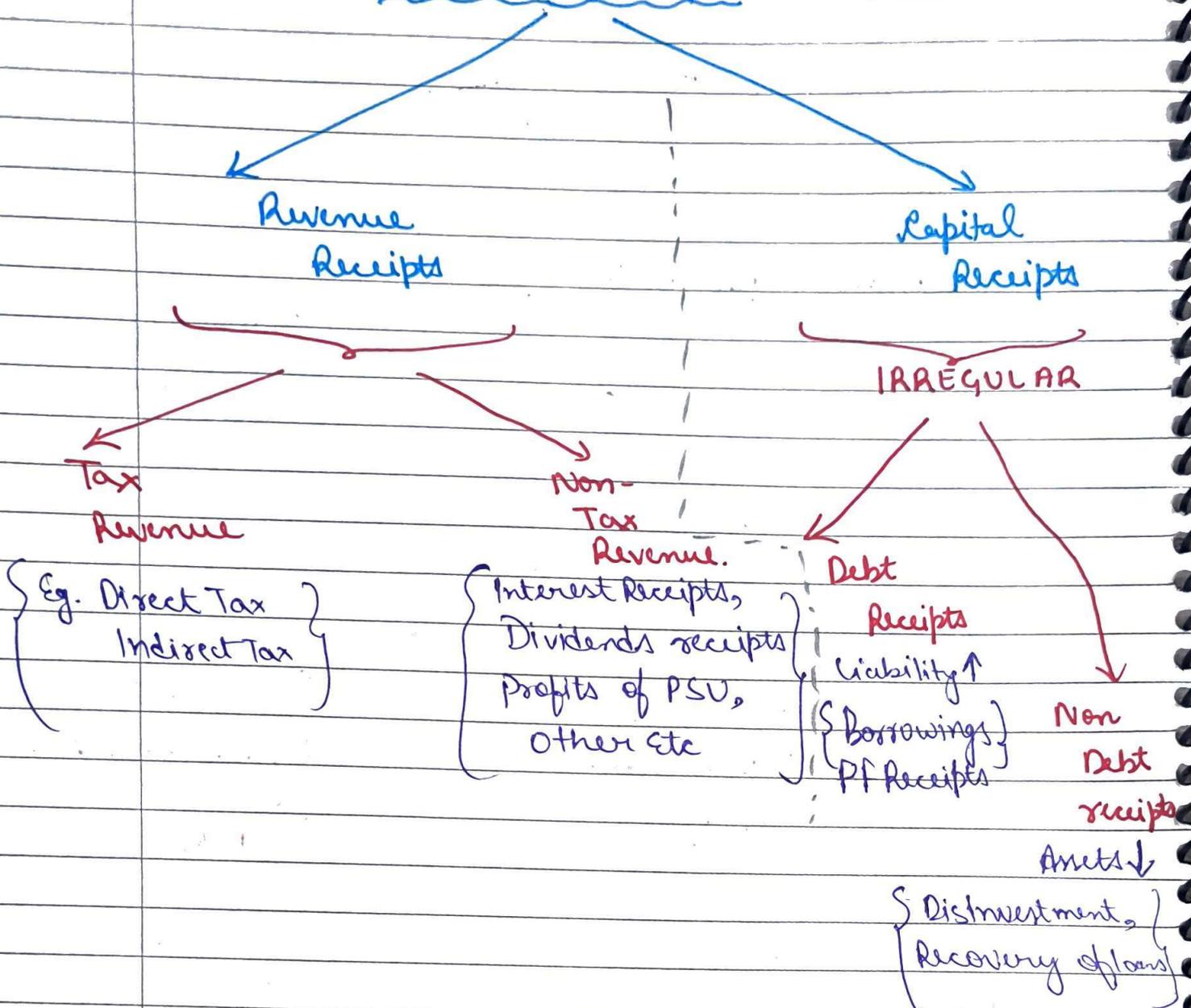
Central Board
of Indirect Taxes
& Customs.
(CBIC)

* Centre's Net Tax Revenue is the total of Tax Revenue after paying of the states share and the National Calamity Contingent duty (NCCD) transferred to National Calamity Contingency



₹21,121
(Net Tax Revenue)

Government Receipts

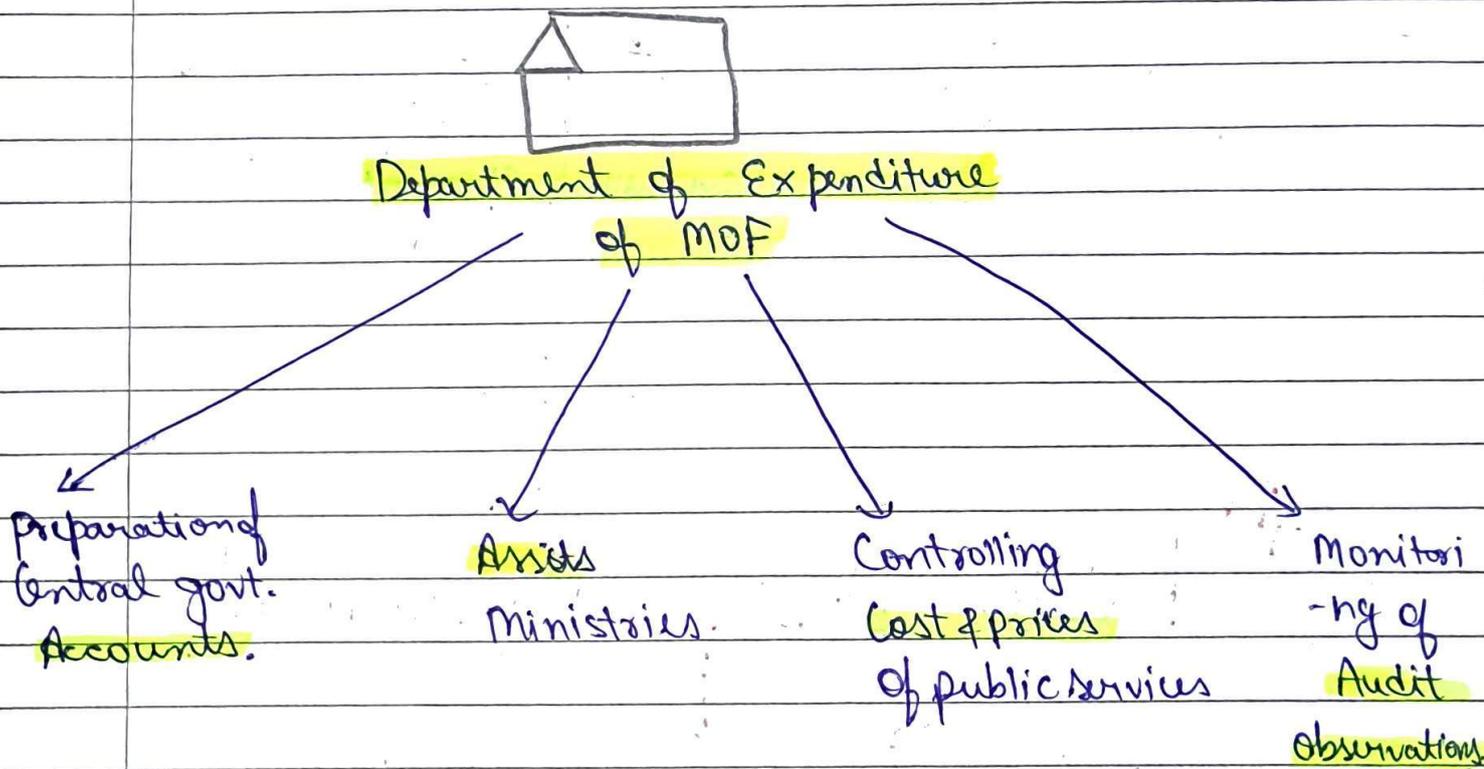


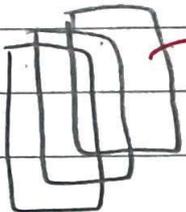
④ Public Expenditure Management

→ Public Expenditure is necessary to accelerate Economic growth & to promote Employment opportunities.

→ But Unproductive public Expenditure may lead to:-
(अप्रभुता का कारण)

- larger deficits
- high taxes
- low Economic growth
- greater debt burden.

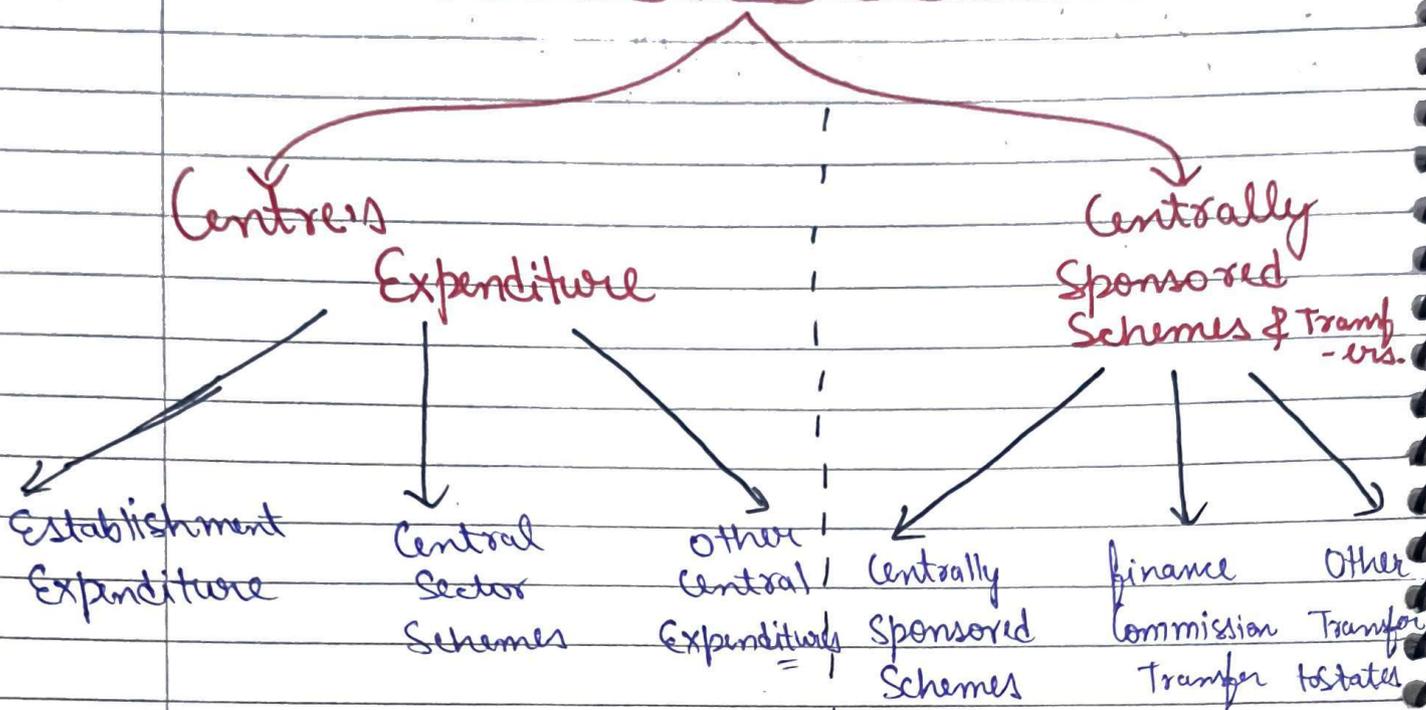


*  → Expenditure Profile → After approval of finance minister, Circulated to the ministries.

Budget documents

*

Central Government Expenditure



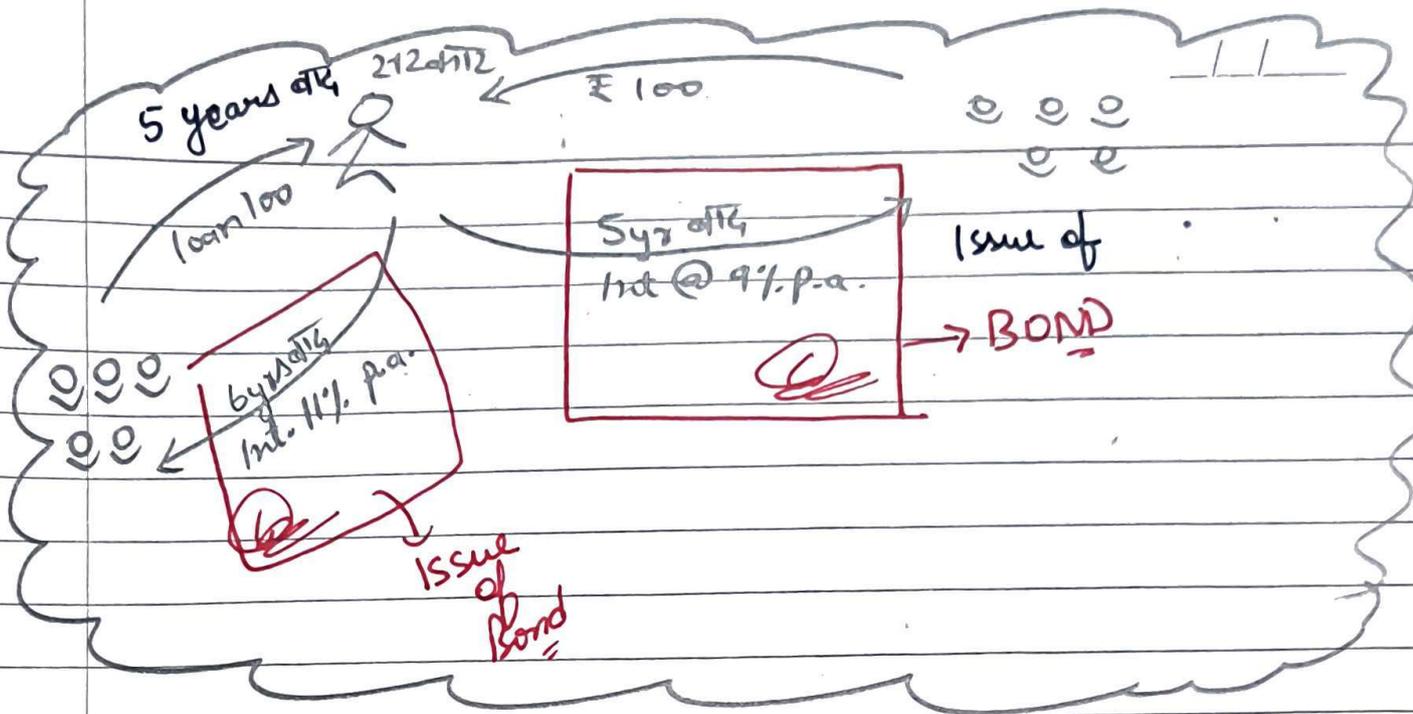
⑤ Public Debt Management

Sovereign Debt

21/2/24
(KING)

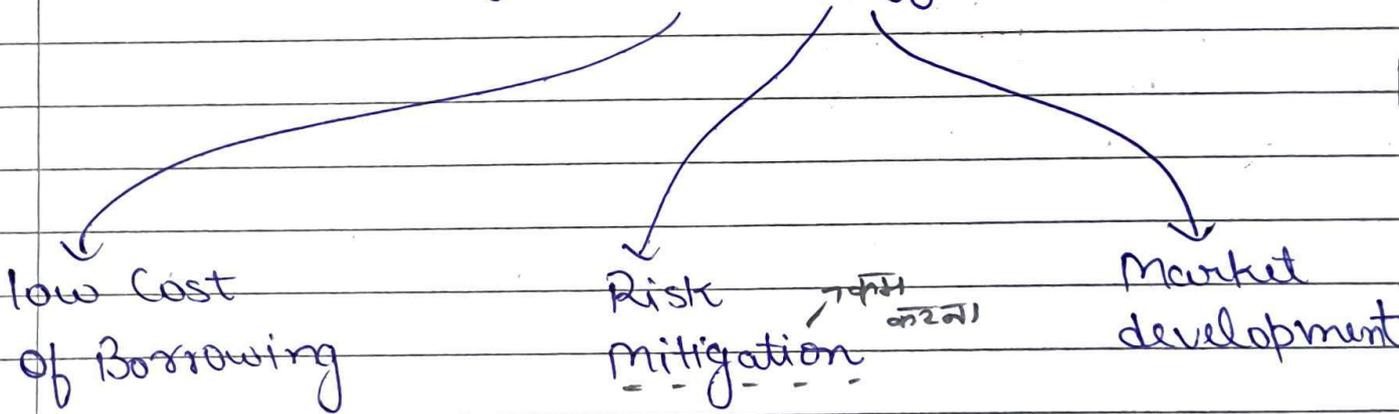
Government borrowings from Internal & External Sources

Government keeps on refinancing the debt by issuing bonds.

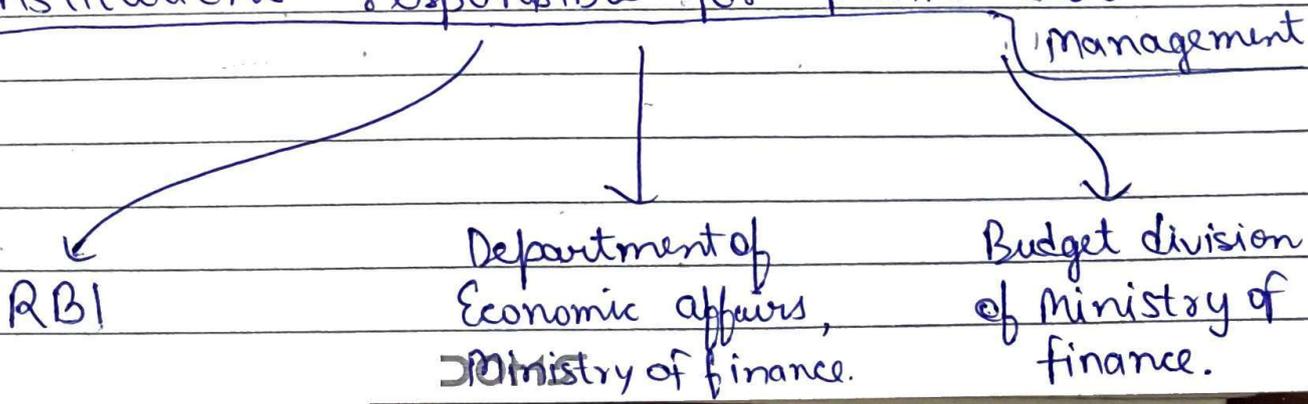


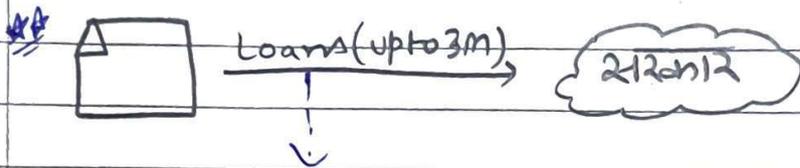
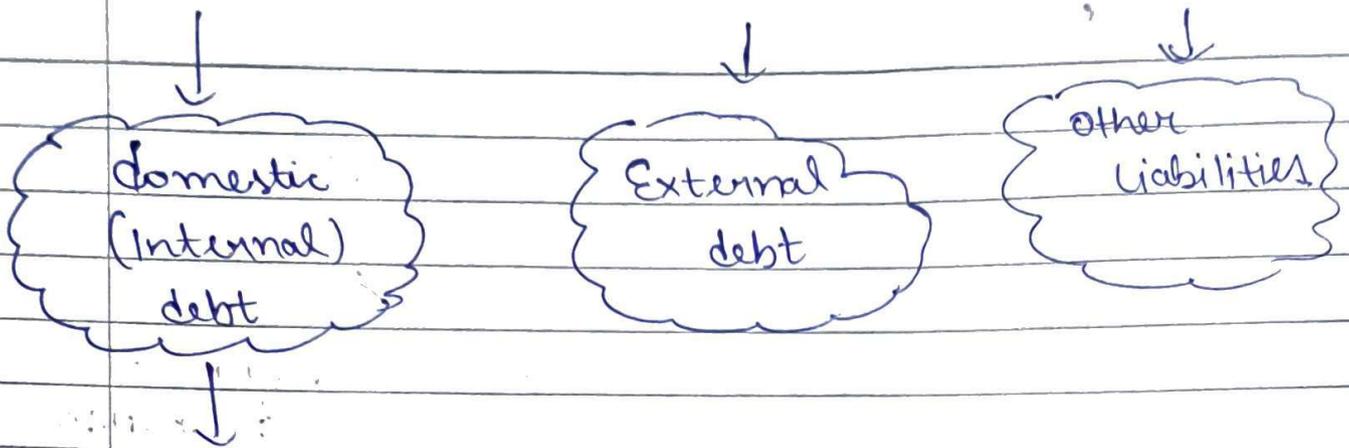
→ Debt Sustainability is an Important Indicator of overall macro Economic health of Country.

→ Debt Management Strategy (Pillars)



→ Institutions responsible for public debt





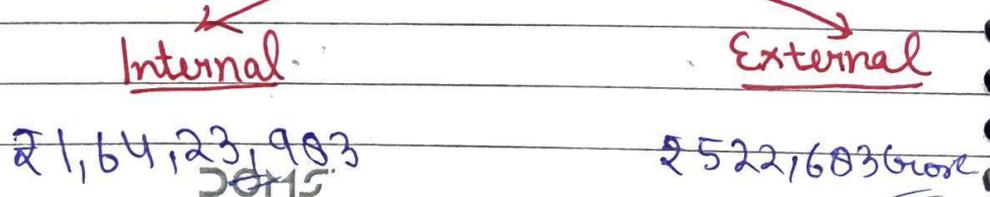
Ways & Means Advances (WMA)

- * FRBM was passed in 2003 to promote legislative framework for reduction of deficit

Fiscal Responsibility & Budget Management

- * Public debt Management Cell (PDMC) was created in 2016 under Department of Economic Affairs.

* Public Debt - ₹1,69,46,666 Crore
(31 March 2024)



₹1,64,23,903
2015

₹522,603 Crore

* RBI is developing **G-Sec market** to broaden investor participation.
(Retail Direct Scheme)

Government Securities.

⑥

BUDGET CONCEPT

Balanced Budget

Surplus Budget

Deficit Budget



* Total Expenditure = Capital Expenditure (+) Revenue Expenditure.

* Total Receipts = Capital Receipts (+) Revenue Receipts

Capital Expenditure:- $\uparrow A$ or $\downarrow L$ Roads Construction, Repayment of loan.

Revenue Expenditure:- Subsidies given, Salary given, Int. pay-ments

Capital Receipts:- $\uparrow L$ or $\downarrow A$ Borrowings, Disinvestment

Revenue Receipts:- Tax Revenue, Non Tax Revenue.

⑦ Budget Deficit

200 = Total Expenditure (-) Total Receipts

Fiscal Deficit

200

RA = 100

RE = 150

CR = 200

CE = 350

\rightarrow +200

TR 300

TE 500

Deficit Budget

\rightarrow Revenue Deficit = Revenue Expenditure (-) Revenue Receipts

$$= 150 - 100$$

$$= 50$$

//_

→ fiscal deficit = Total Expenditure (-) Total Receipts
(Signifies Borrowings) (Excluding Borrowings)

$$= 500 (-) 300$$
$$= \underline{200} \text{ (Borrowings)}$$

or

= Revenue deficit + Capital Expenditure - Capital Receipts
(Excluding Borrowings)

$$= 50 + 350 - 200$$
$$= \underline{200} \text{ (Borrowings)}$$

→ Primary Deficit

= fiscal deficit (-) Net Interest liabilities

(Unit-4 "fiscal policy")

① Introduction.

→ Budgetary policy could be broadly classified into Public Revenue^① including Taxations, Public Expenditure^②, Public debt^③ and deficit financing^④.

Govt की खर्च

Govt. की Borrowings.

Budget deficit की
माप

→ fiscal policy is the deliberate policy of the government under which it uses the instruments of:-

- Taxation.
- Public Expenditure.
- Public Borrowings.

→ fiscal policy is in the nature of demand side policy.

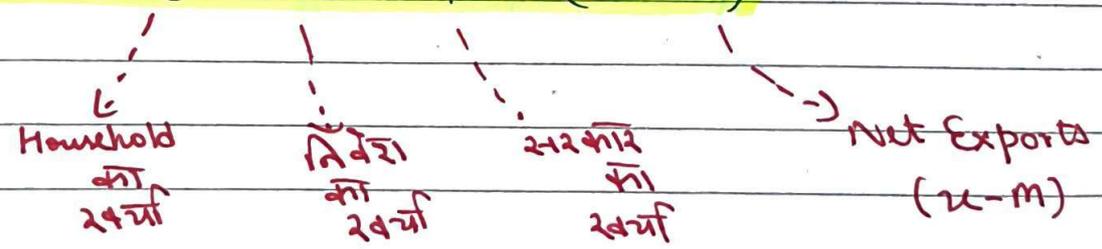
Imp. →

An Economy which is producing at full Employment level does not require govt. action in the form of fiscal policy.

② OBJECTIVES of fiscal Policy.

- Achievement & maintenance of full Employment.
- Maintenance of price stability
- Acceleration of the rate of Economic development.
- Equitable distribution of Income & wealth.

* $GDP = C + I + G + (X - M)$



③ TYPES of fiscal Policy

Expansionary fiscal policy.

• It is a policy measure to
close a recessionary gap
(i.e., deflation).

or
Economy of
demand $< C >$

• Cut all types of Tax

• Increase in Public Expenditure.

• while resorting to Expansionary fiscal policy, the govt. may run into budget deficits.

Contractionary fiscal policy.

• It refers to the deliberate policy of govt. applied to curtail aggregate demand & consequently the level of economic activity. In other words, it is a fiscal policy to eliminate inflationary gap.

• Increase in Taxes

• Decrease in Public Expenditure.

• Contractionary fiscal policy should ideally lead to smaller budget deficit.

④ INSTRUMENTS of fiscal Policy.

(i) Government Expenditure

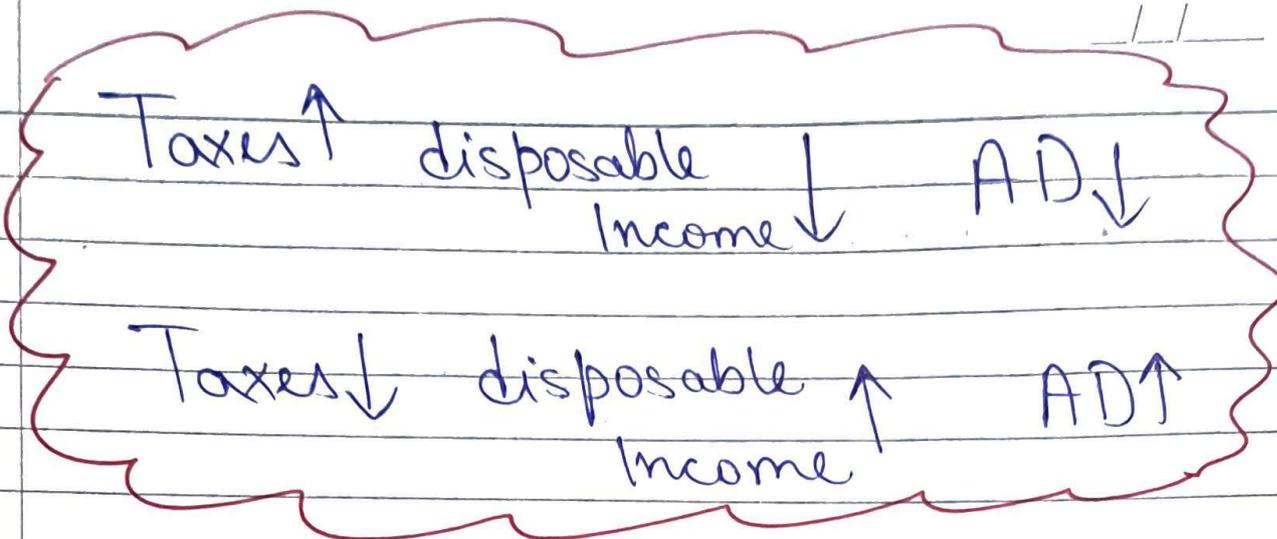
- Current Expenditure to meet day to day running of the govt.
- Capital Expenditures (in form of Investment)
- Transfer Payments. - which do not contribute to GDP.

↑ Expenditure = AD ↑ Inflation ↑

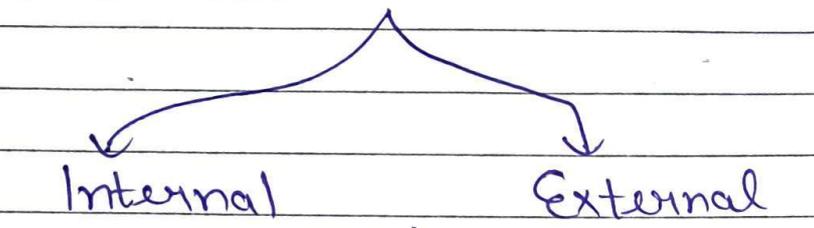
↓ Expenditure = AD ↓ Inflation ↓

(ii) Taxes

- Direct Taxes
- Indirect Taxes



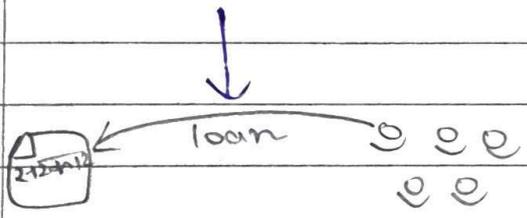
(iii) Public debt



Forms of Public debt

Market loans

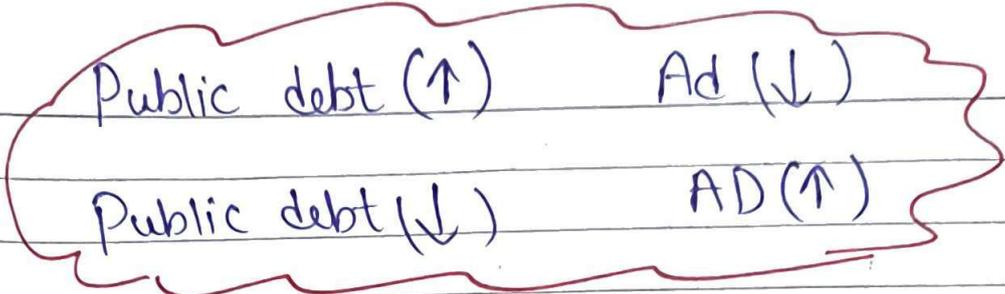
Small Savings.



It represents public borrowings, which are not negotiable and are not traded.

(Eg. National Savings Certificate, National Development Certificate Etc.)

Negotiable & Tradable { Treasury Bills, Govt. Securities } COMS



* Important points relating to fiscal policy *

① Budget as Instrument of fiscal Policy.

- Balanced Budget :- $TR = TE$ No effect on AD
 Leakages = Injections
- Surplus Budget :- $TR > TE$ ²⁰²¹ AD (↓)
 Leakages > Injections
- Deficit Budget :- $TR < TE$ ²⁰²¹ AD (↑)
 Leakages < Injections

② fiscal policy for long-run Economic growth.

→ fiscal policies such as those involving Infrastructures spending generally have positive supply side effects.

Producers :-

//_

→ Govt. provisions for **public goods** such as Education, healthcare, nutrition etc provide momentum for long-run economic growth.

→ Tax and Spending policies can be effectively used to correct market failures resulting from externalities.

③ fiscal policy for Reducing Inequalities of Income.

→ **Progressive** Direct Tax System

→ **Differential** Indirect Tax System

{
Luxury Goods → 28% Tax
Necessity Goods → 0% Tax
}

→ other measures :-

- poverty alleviation programmes
- free or subsidized medical use, Education, housing etc.
- Various Social Security schemes
DOMS (old age pension etc)

④ LIMITATIONS of fiscal policy.

(i) Different Lags :-

a) Recognition lag:- There is difficulty in collecting accurate & timely data.

b) Decision lag:- Delays are likely to occur to make decision on the most appropriate policy.

c) Implementation lag:- Even when appropriate policy measures are decided on, there are possible delays in bringing in legislation & implementing.

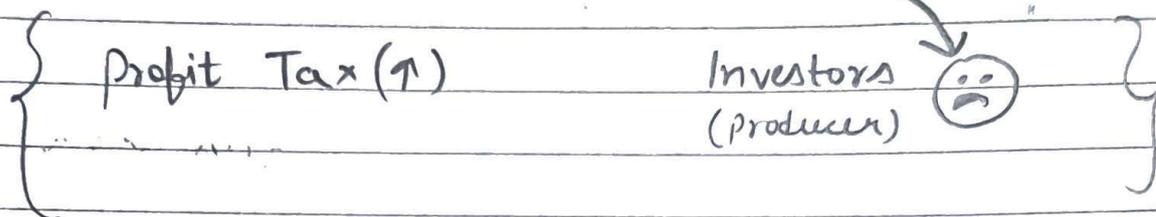
d) Impact lag:- It occurs when the outcome of a policy are not visible in sometime.

(ii) It is practically difficult to reduce govt. Spendings on various items.

(iii) Public works cannot be adjusted easily along with movements of trade cycle.

{ Eg. project → HIGHWAY } Long gestation period.

(iv) Supply side Economists are of the opinion that certain fiscal measures will cause disincentives.



(v) Increase in govt. borrowings will create perpetual "burden of debt" on future.

⑤ CROWDING OUT

→ Increase in government spendings during recessions will "Crowd out" private spending in Economy.

→ In other words, when spending by govt. in an Economy replaces private spendings, the latter is said to be crowded out.

→ As a result, the Effectiveness of Expansionary fiscal policy in stimulating aggregate demand will be diminished to a great extent (may possibly reduce Economy's prospects of long term Economic growth)

//_

* However during deep recessions, crowding out is less likely to happen as private investments are already minimal.

Recession

Demand ↓
prices ↓
Employment ↓

Govt Spending ↑↑

Pvt. sector ↓ ↓ ↓

↓
Crowding out