FISCAL ECONOMICS Sub Code; 18ECC508

Module--V

Federal Finance

Federal finance refers to the system of assigning the source of revenue to the Central as well as State Governments for the efficient discharge of their respective functions i.e. clear-cut division is made regarding the allocation of resources of revenue between the central and state authorities.

Principles of Federal Finance

In the case of federal system of finance, the following main principles must be applied:

1. Principle of Independence.
2. Principle of Equity.
3. Principle of Uniformity.
4. Principle of Adequacy.
5. Principle of Fiscal Access.
6. Principle of Integration and dination.
7. Principle of Efficiency.
8. Principle of Administrative Economy.
9. Principle of Accountability.

1. Principle of Independence

Under the system of federal finance, a Government should be autonomous and free about the internal financial matters concerned. It means each Government should have separate sources of revenue, authority to levy taxes, to borrow money and to meet the expenditure. The Government should normally enjoy autonomy in fiscal matters.

2. Principle of Equity

From the point of view of equity, the resources should be distributed among the different states so that each state receives a fair share of revenue. The allocation of resources should be made in such a way as to give equitable treatment to the individuals and business firms in different places.

3. Principle of Uniformity

In a federal system, each state should pay equal tax payments for federal finance. But this principle cannot be followed in practice because the taxable capacity of each unit is not of the same. Since this principle of uniformity emphasis on the uniformity

of pattern of expenditure in all the states, equality of contribution imposes heavy burden on backward states.

4. Principle of Adequacy of Resources

The principle of adequacy means that the resources of each Government i.e. Central and State should be adequate to carry out its functions effectively. Here adequacy must be decided with reference to both current as well as future needs. Besides, the resources should be elastic in order to meet the growing needs and unforeseen expenditure like war, floods etc.

5. Principle of Fiscal Access

In a federal system, there should be possibility for the Central and State Governments to develop new source of revenue within their prescribed fields to meet the growing financial needs. In nutshell, the resources should grow with the increase in the responsibilities of the Government.

6. Principle of Integration and coordination

The financial system as a whole should be well integrated. There should be a perfect coordination among different layers of the financial system of the country. Then only the federal system will prosper. This should be done in such a way to promote the overall economic development of the country.

7. Principle of Efficiency

The financial system should be well organized and efficiently administered. There should be no scope for evasion and fraud. No one should be taxed more than once in a year. Double taxation should be avoided.

8. Principle of Administrative Economy

Economy is the important criterion of any federal financial system. That is, the cost of collection should be at the minimum level and the major portion of revenue should be made available for the other expenditure outlays of the Governments.

9. Principle of Accountability

In a federal set up, the Governments both Central and States enjoy financial autonomy. Thus, in such a system each Government should be accountable to its own legislature for its financial decisions i.e the Central to the Parliament and the State to the Assembly.

The Centre and State of India Financial Relations

Financial relations between the Centre and the State of India:- 1. Divisions of Powers 2. Distribution of Resources 3. Grants-in Aid 4. Loans.

1. Divisions of Powers:

The constitution lucidly lists the powers and functions of different layers of government. The seventh schedule of Indian Constitution, on the basis of the financial criteria adopted, contains three lists viz., the union list, the state list and the concurrent list.

The function of the union government include nearly 98 subjects such as defence, automatic energy, foreign affairs, Railways, National Highways, Marine Navigation, Airways, Post and Telegraph, currency and foreign exchange, foreign and interstate trade etc.

The functions of state government include about 70 items like public order, police, administrations of Justice, public health, education, agriculture, forests, fisheries etc. There are about 57 subjects in the concurrent list such as commercial and industrial monopolies, labour disputes, social security etc., where union and state governments together can operate.

2. Distribution of Resources*:*

The constitution followed the revenue allocation process in line with the provisions contained in the government of India Act of 1935. Constitution makes clear divisions of fiscal powers between the union and the state governments.

Taxes which have an interstate basis are levied by the union, where as those with a local base are levied by the states. Union government has exclusive powers to impose taxes which are not specifically mentioned in state or concurrent list.

The taxes upon which the union government has legislative jurisdiction can be conveniently classified under the following four fold divisions:

(a) Taxes which are levied collected and wholly retained by the union government. This includes customs duties, corporation tax, tax on capital value of the assets exclusive of agricultural land of individual and companies.

(b) Taxes which are levied and collected by the union, but the proceeds are shared with the states. In this category comes income tax other than agricultural income and duties of excise on tobacco and other goods manufactured in India except liquors and narcotic drugs. Union excise duties also fall under this category.

(c) Taxes which are levied and collected by the union, but the entire proceed are given to the states. In this category includes succession and estate duties on properly other than agricultural land, terminal tax, tax on railway fares and freight etc.

(d) Taxes which are levied by the union but collected and appropriated by the states. This category includes stamp duties, duties of excise on medicinal and toilet preparations.

3. **Grants-in Aid***:*

Constitution clearly recognizes the facts that tax powers assigned to the states are insufficient to meet their expenditure. Articles 275, clearly specifies that states are in need of additional assistance in the form of grants-in-aid to meet the main fold expenditure of the state governments in the provision of social services and welfare activities.

The grants in aid are primarily given on the basis of needs of the state. Usually it is given to bridge the gap between revenue and expenditure of the states or to remove inter-regional disparities in resources.

4. Loans:

Both the central and state governments borrow internally to mobilize resources. Article 292 of the constitution empowers the government of India to borrow upon the security of the Consolidated Fund of India.

Problems: Financial Relations between the Centre and State

1. Mounting Vertical Imbalance*:*

Vertical imbalance emerges because of disproportionate alignment of revenue sources in relation to increasing expenditure obligations by level of government. There is a situation of growing expenditure requirements and poor yield of revenue source for states in India.

The process of assigning highly elastic revenue to the center and inelastic taxes to the states, led to a high degree of concentration in revenue collection. For example in India the centre collects 59% of total revenue whereas state and local bodies collect 41 % only. Lack of accountability and implementation of populist policies are the major cause for imbalance in state budgets.

2. Horizontal Imbalance:

Various regions and states in India differ in resources endowment, level of development and per capital income. Therefore horizontal imbalance occurs between different units of government at the same level of government in Indian federation.

The resources transfer affected through planning commission and Finance Commission has miserably failed in correcting the horizontal imbalance. As a result disparities in per-capita income are increasing.

Very often the discretionary grants provided by the centre to the states are influenced by political considerations rather than resource requirement. As a result states are not able to bridge there resource expenditure gap in fiscal operations effectively.

3. Excessive Dependence on Centre:

This situation mainly emerges owing to the existence of vertical imbalance in resources source and transfer. Very often in Indian federation the taxes which are assigned to states are generally less elastic and less productive.

More over the centre has virtual monopoly in two sources of revenue like foreign aid and deficit financing. These sources are not accessible to states. Coupled with this in as per constitutional provision, highly elastic revenue source are under the jurisdiction of the center.

4. Eroded State Autonomy:

It is usually argued that the framers of our constitution were guided by the mistaken notion of “strong centre and weak states”. The single party rule at the centre for the early decades of independence hardened this notion.

5. Overlapping of Functions:

A study report of R. Venkataraman shows that a dualism in the central assistance has developed and there has been certain overlapping of functions of finance commission and the planning commission.

6. Increasing Debt Burden of States:

Our federal financial system has developed a situation in which the states cannot survive without the central assistance. The use of loans and grants by the state has resulted in financial dependency and indiscipline on the part of the states. This also led to a situation of inevitable debt burden on the part of states.

7. Failure to Reduce Regional Imbalance

The mechanism of central resource transfer has failed to correct horizontal imbalance among states. The disparity in per-capita income has been on an increase. The major part of the central transfer of resources, owing to irrational criteria of devolution, went to richer states.

Irrespective of concrete efforts by central government, the regional economic disparity among states could not be removed and inequality of income as between individuals could not be reduced to a significant extend.

Local Finance

Meaning and Structure of Local Finance:

By local finance we mean finance of local bodies in India. There is a large variety of local bodies in India. Different states have different types of local bodies with different functions. There are municipalities, taken in the sense of municipal committees or boards, in towns in all parts of the country. Some of the large cities have municipal corporations. Further, there are important trusts and development boards in a number of big cities, but as they do not enjoy any power of taxation, they may not be considered as local bodies for one purpose. In rural areas, we have district boards and rural boards. Rural boards operate over areas smaller than a district. District boards operate in a full district. In villages, in most states, we have village panchayats which have special functions assigned to them and have their own sources of revenue. In short, we have the following main four local bodies which are functioning today in our country:

1. Village Panchayats.

2. District Boards or Zila Parishads.
3. Municipalities.
4. Municipal Corporations.

1. Village Panchayats:

• **Establishment:** A village panchayat is an institution in the village with large variety of function. The jurisdiction of a panchayat is usually confined to one revenue village. In some cases, though not very frequently, two or more small villages are grouped under one panchayat. The establishment of panchayat raj is the avowed policy of most states in India, the panchayats have to established in all villages.

• **Functions:** The functions of panchayats range over a wide area including judicial, police, civil, economic and so on. Thus small disputes may disposed of by panchayats on the sport. In some states, roads, primary schools, village dispensaries etc. are to be managed by panchayats. In some states supply of water, both for drinking and irrigation, falls within their field of responsibility, and in some cases even productive and unproductive activities, such as, farming, marketing, storage, etc. are entrusted to them.

• **Finances:** Village panchayats in almost all the states have been given powers to levy taxes. However, they differ from state to state. Although the lists of tax powers of the panchayats are quite large, the taxes which have been widely adopted by them are :- (i) general property tax, (ii) taxes on land, (iii) profession tax, and (iv) tax on animals and vehicles. In a small number of panchayats other taxes are also levied, such as service tax, octopi, theatre tax, and pilgrim tax, tax on marriage, tax on birth and deaths, and labour tax. As a matter of fact, taxes are levied by the panchayats only with the sanction of the state government, and there are certain limits in respect of tax rates which have to be observed.

2. District Boards Or Zila Parishads:

• **Establishment:** In rural areas, district boards or Zila Parishads are established on a district level. The territorial jurisdiction of a district board is generally a revenue district. Some of the functions of the district boards are being taken up by the State and by the village panchayats. The district boards have been replaced by Zila Parishads in most of the states, the district-level body is known as the Zila Parishad

in Andhra Pradesh, Bihar, Maharashtra, Orissa, Punjab, Rajasthan, Uttar Pradesh and West Bengal, as the district panchayat in Gujarat, Zila Panchayats in Madhya Pradesh and as the District Development Council in Tamil Nadu and Karnataka.

• **Functions:** The functions of district boards and now Zila Parishads in most of the states differ from state to state. For example, In Karnataka and Tamil Nadu, the Zila Paris had is a coordinating body which exercise general supervision over the working of Panchayat Semites and advises them on implementation of Development Schemes. Besides these duties in Andhra Pradesh, the Zila Parishad has scientific executive functions in the establishment, maintenance and expansion of secondary, vocational and industrial schools. In Maharashtra, the Zila Parishad is the strongest of the panchayat raj bodies and is vested with the executive functions in various fields including Planning and Development and advising the state government.

• **Finances:** The tax powers of district boards or Zila Parishads are extremely limited. They derive a substantial part of their revenues from the government grant-in-aid. The sources of revenue of district boards, or Zila Parishads, are as follows:
i. Gran t-in-aid from the state government.
ii. Land Cesses.
iii. Total, fees etc.
iv. Income from the property and loans from the state governments.
v. State non-plan help.
vi. Grants for the central sponsored schemes relating to development work.
vii. Income from fairs and exhibitions.
viii. Property tax and other taxes which the state governments may authorise the district boards.

3. Municipalities
• **Establishment and Functions:** The municipalities are bodies or institutions which are established in urban areas for looking after local affairs, such as, sanitation, public health, local roads, lighting, water supply, cleaning of streets, maintenance of parks and gardens, maintenance of hospitals, dispensaries and veterinary hospitals, provision of drainage, provision of primary education, organising of fairs and exhibitions etc. However, all these functions are performed subject to the control of the state government.

• **Finance:** The main sources of revenue of municipalities consist of
i. taxes on property
ii. Taxes on goods, particularly octroi and terminal tax
iii. Personal taxes, taxes on profession, trades, callings and employment

iv. Taxes on vehicles and animals
v. theatre or show tax, and
vi. Grant-in-aid from state government. However, the average income of municipalities is quite low and thus they cannot perform their functions efficiently.

3. Municipal Corporations

• **Establishment and Functions:** The municipal corporation, as a distinct type of municipal organisation, is confined to only a few large cities. The municipal corporations as a class have wider functions and large powers than is usually the case with the municipalities. The pattern of municipal corporations in regard to structure and organisation is more or less the same in all the states. The municipal corporations have wide powers and enjoy greater freedom as compared to municipalities. The municipal corporations are usually entrusted with the functions, such as, water supply and drainage, lighting, roads, slum clearance, housing and town planning etc. the rapid increase in the population of cities has definitely added to the functions of municipal corporations.

• **Finances:** The taxes levied by corporations generally include (i) taxes on property, (ii) taxes on vehicles and animals, (iii) taxes on trades, calling and employment, (iv) theatre and show tax, (v) taxes on companies, (vi) taxes on goods brought into the cities for sale, (vii) taxes on advertisements, (viii) octroi and terminal tax etc. The corporations have a fair degree of freedom in respect of their choice and modification of these taxes, subject of course to the maximum and minimum rates laid down by the law.

Fiscal Policy in India

Fiscal policy in India: Fiscal policy is the guiding force that helps the government decide how much money it should spend to support the economic activity, and how much revenue it must earn from the system, to keep the wheels of the economy running smoothly.

Tools of fiscal policy

There are two key tools of the fiscal policy:

Taxation: Funds in the form of direct and indirect taxes, capital gains from investment, etc, help the government function. Taxes affect the consumer's income and changes in consumption lead to changes in real gross domestic product (GDP).

Government spending: It includes welfare programmes, government salaries, subsidies, infrastructure, etc. Government spending has the power to raise or lower real GDP, hence it is included as a fiscal policy tool.

Fiscal policy in India: Fiscal policy in India is the guiding force that helps the government decide how much money it should spend to support the economic activity, and how much revenue it must earn from the system, to keep the wheels of the economy running smoothly. In recent times, the importance of fiscal policy has been increasing to achieve economic growth swiftly, both in India and across the world. Attaining rapid economic growth is one of the key goals of fiscal policy formulated by the Government of India. Fiscal policy, along with monetary policy, plays a crucial role in managing a country's economy.

What is meant by Fiscal Policy in India? Example of Fiscal Policy in India:

Through the fiscal policy, the government of a country controls the flow of tax revenues and public expenditure to navigate the economy. If the government receives more revenue than it spends, it runs a surplus, while if it spends more than the tax and non-tax receipts, it runs a deficit. To meet additional expenditures, the government needs to borrow domestically or from overseas. Alternatively, the government may also choose to draw upon its foreign exchange reserves or print additional money.

For example, during an economic downturn, the government may decide to open up its coffers to spend more on building projects, welfare schemes, providing business incentives, etc. The aim is to help make more of productive money available to the people, free up some cash with the people so that they can spend it elsewhere, and encourage businesses to make investments. At the same time, the government may also decide to tax businesses and people a little less, thereby earning lesser revenue itself.

Main Objectives of Fiscal Policy in India

General objectives of Fiscal Policy are given below:

1. To maintain and achieve full employment.
2. To stabilize the price level.
3. To stabilize the growth rate of the economy.
4. To maintain equilibrium in the Balance of Payments.
5. To promote the economic development of underdeveloped countries.

Fiscal policy of India always has two objectives, namely improving the growth performance of the economy and ensuring social justice to the people.

The fiscal policy is designed to achieve certain objectives as follows:

1. **Development by effective Mobilization of Resources:**

   The principal objective of fiscal policy is to ensure rapid economic growth and development. This objective of economic growth and development can be achieved by Mobilization of Financial Resources. The central and state governments in India have used fiscal policy to mobilize resources.

The financial resources can be mobilized by:

a. Taxation: Through effective fiscal policies, the government aims to mobilize resources by way of direct taxes as well as indirect taxes because most important source of resource mobilization in India is taxation.
b. **Public Savings:** The resources can be mobilized through public savings by reducing government expenditure and increasing surpluses of public sector enterprises.

c. **Private Savings:** Through effective fiscal measures such as tax benefits, the government can raise resources from private sector and households. Resources can be mobilized through government borrowings by ways of treasury bills, issuance of government bonds, etc., loans from domestic and foreign parties and by deficit financing.

2. **Reduction in inequalities of Income and Wealth:**

Fiscal policy aims at achieving equity or social justice by reducing income inequalities among different sections of the society. The direct taxes such as income tax are charged more on the rich people as compared to lower income groups. Indirect taxes are also more in the case of semi-luxury and luxury items which are mostly consumed by the upper middle class and the upper class. The government invests a significant proportion of its tax revenue in the implementation of Poverty Alleviation Programmes to improve the conditions of poor people in society.

3. **Price Stability and Control of** Inflation:

One of the main objectives of fiscal policy is to control inflation and stabilize price. Therefore, the government always aims to control the inflation by reducing fiscal deficits, introducing tax savings schemes, productive use of financial resources, etc.

4. **Employment Generation:**

The government is making every possible effort to increase employment in the country through effective fiscal measures. Investment in infrastructure has resulted in direct and indirect employment. Lower taxes and duties on small-scale industrial (SSI) units encourage more investment and consequently generate more employment. Various rural employment programs have been undertaken by the Government of India to solve problems in rural areas. Similarly, self-employment scheme is taken to provide employment to technically qualified persons in the urban areas.

5. **Balanced Regional Development:**

There are various projects like building up dams on rivers, electricity, schools, roads, industrial projects etc run by the government to mitigate the regional imbalances in the country. This is done with the help of public expenditure.

6. **Reducing the Deficit in the Balance of Payment:**

Sometime government gives export incentives to the exporters to boost up the export from the country. In the same way import curbing measures are also adopted to check import. Hence the combine impact of these measures is improvement in the balance of payment of the country.

7. Increases National Income:

It's the strength of the fiscal policy that is brings out the desired results in the economy. When the government want to increase the income of the country then it increases the direct and indirect taxes rates in the country. There are some other measures like: reduction in tax rate so that more peoples get motivated to deposit actual tax.

8. Development of Infrastructure:

when the government of the concerned country spends money on the projects like railways, schools, dams, electricity, roads etc to increase the welfare of the citizens, it improves the infrastructure of the country. A improved infrastructure is the key to further speed up the economic growth of the country.

9. Foreign Exchange Earnings:

When the central government of the country gives incentives like, exemption in custom duty, concession in excise duty while producing things in the domestic markets, it motivates the foreign investors to increase the investment in the domestic country.

What is the difference between fiscal policy and monetary policy

The government uses both monetary and fiscal policy to meet the county's economic objectives. The central bank of a country mainly administers monetary policy. In India, the Monetary Policy is under the Reserve Bank of India or RBI. Monetary policy majorly deals with money, currency, and interest rates. On the other hand, under the fiscal policy, the government deals with taxation and spending by the Centre.

Importance of Fiscal Policy in India:

- In a country like India, fiscal policy plays a key role in elevating the rate of capital formation both in the public and private sectors.
- Through taxation, the fiscal policy helps mobilize considerable amount of resources for financing its numerous projects.
- Fiscal policy also helps in providing stimulus to elevate the savings rate.

- The fiscal policy gives adequate incentives to the private sector to expand its activities.
- Fiscal policy aims to minimize the imbalance in the dispersal of income and wealth.

- **Difference between monetary policy and fiscal policy**

- Monetary Policy is mainly changing interest rates, as an example, if central banks like US Federal Reserve feel that the inflation is increasing and the economy is growing at a very fast rate, they will increase interest rates to reduce demand in the economy. Fiscal Policy, on the other hand, is the ability of the government to control demands by expenditure and taxes, for instance, if there is an increase in fiscal deficit, it requires a government to borrow more.
- Monetary Policy is with context to the interest rates. Fiscal Policy is related to the revenue and capital expenditure of the government.
- Monetary Policy is also a credit policy where interest rate changes and monetary measures are communicated through central banks; Fiscal policy provides the number of incentives to increase disposable income.
- Fiscal policies are of two types expansionary and contractionary, the former is where the government reduces taxes and increase public spending while the latter is to increase taxes and reduce public expenditure.

- Similarly, if the money supply is increased along with decreasing the interest rates is known as expansionary monetary policy, while a decrease in money supply and rise in interest rates the policy is regarded as contractionary monetary policy.
- Monetary Policy is not given as much preference. Fiscal Policy is given much more preference by countries during recessions.

Which is more effective monetary or fiscal policy

In recent decades, monetary policy has become more popular because:

- Monetary policy is set by the Central Bank, and therefore reduces political influence (e.g. politicians may cut interest rates in the desire to have a booming economy before a general election)
- Fiscal policy can have more supply side effects on the wider economy. E.g. to reduce inflation – higher tax and lower spending would not be popular, and the government may be reluctant to pursue this. Also, lower spending could lead to reduced public services, and the higher income tax could create disincentives to work.
- Monetarists argue expansionary fiscal policy (larger budget deficit) is likely to cause crowding out – higher government spending reduces private sector expenditure, and higher government borrowing pushes up interest rates. (However, this analysis is disputed)
- Expansionary fiscal policy (e.g. more government spending) may lead to special interest groups pushing for spending which isn't really helpful and then proves difficult to reduce when the recession is over.
- Monetary policy is quicker to implement. Interest rates can be set every month. A decision to increase government spending may take time to decide where to spend the money.

Instruments of Fiscal Policy:

The tools of fiscal policy are taxes, expenditure, public debt and a nation's budget. They consist of changes in government revenues or rates of the tax structure so as to encourage or restrict private expenditures on consumption and investment.

Public expenditures include normal government expenditures, capital expenditures on public works, relief expenditures, and 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.

During inflation, fiscal policy aims at controlling excessive aggregate spending, while during depression it aims at making up the deficiency in effective demand for raising the economy from the depths of depression.

Limitations of Fiscal Policy

1. **Policy Lags:**

During the recent times, there is not much argument about the desirability or otherwise of a discretionary fiscal policy. The burning question in this context is related with the timing of the fiscal measures. Unless the variations in taxes and public expenditure are neatly timed, the desired counter-cyclical effects can not be realized.

(a) Recognition Lag:
This is the interval between the time when action is needed and when it is recognized that action is needed. This lag may exist when a change in the economy and a report concerning the change do not coincide. Such a lag has a duration of 3 months. It can be reduced if the forecasting is satisfactory.

(b) Administrative Lag:
This is the interval between the time when need of an action is recognized and the time when the action is actually taken. This is perhaps the most difficult lag to deal with. Even when the need of action has been recognized, the sanction from

legislature and executive must take some time and that may involve about 1 to 15 months of time.

(c) Operational Lag:

The time interval between when action is taken and when it has its impact on income and employment is known as the operational or the outside lag.

2. Forecasting:

Another most serious limitation of fiscal policy is the practical difficulty of observing the coming events of economic instability.

3. Correct Size and Nature of Fiscal Policy:

The most important necessity on which the success of fiscal policy will depend is the ability of public authority to frame the correct size and nature of fiscal policy on the one hand and to foresee the correct timing of its application on the other.

4. Fiscal Selectivity:

When monetary policy is general in nature and impersonal in impact, the fiscal policy, in contrast, is selective. The former permits the market mechanism to operate smoothly.

5. Inadequacy of Fiscal Measures:

In anti-depression fiscal policy, the expansion of public spending and reduction on taxes are always important elements. The question arises naturally, whether a specific variation in public spending or taxes will bear the desired results or not

6. Adverse Effect on Redistribution of Income:

It is felt that fiscal policy measures redistribute income, the actual effect will be uncertain. If income is redistributed in favour of the low-income classes whose marginal propensity to consume is high, the effect will be increase in total demand.

7. Self-offsetting Effect:

The compensatory fiscal policies of the government may discourage private investment, since the private entrepreneurs have to face a competition from public enterprises in securing labour, raw materials and finances.

8. Reduction in National Income:

Balanced budget multiplier as a fiscal weapon can be gainfully applied during depression is conditioned by the fact of marginal propensity to spend of the recipients of public expenditure being larger than or, at least, equal to that of the taxpayers.

9. Solution for Unemployment:

The purpose of fiscal policy will be defeated if the policy cannot maintain a rising supply level of work effort. The money national income will rise with increase in productive efficiency and increased supply of work effort..

10. Adverse Effect on debt Management:

The use of fiscal instruments during unemployment and depression is often associated with the subsequent problem of debt management. Because deficit budgeting is the normal fiscal cure, public debt is made for financing it.

11. Adverse Psychological Reaction:

Large deficit programs financed by borrowings bring about adverse psychological reactions.

12. Hardships in underdeveloped countries:

The creation of additional income through compensatory fiscal measures is not easily possible in underdeveloped countries as in advanced economies. This is mainly because a stagnating agricultural sector dominates the largest part of their economy where marginal propensity to consume is so high that most of the additional income is consumed and the marketable surplus is the least.

13. Administrative Problems in Democratic Countries:

In a democracy fiscal policy measures must be a time-consuming process. Legislative actions, administrative tasks and the executive process are often delayed and the original estimates of revenue earnings and government expenditures often become irrelevant.