FACULTY OF JURIDICAL SCIENCES

Lecture-24

INSTRUMENTS OF FISCAL POLICY

D.Public Works:-

Keynes General Theory highlighted public works programme as the most significant anti-depression device. There are two forms of expenditure i.e., Public Works and 'Transfer Payments. Public Works according to Prof. J.M. Clark are durable goods, primarily fixed structure, produced by the government.

They include expenditures on public works as roads, rail tracks, schools, parks, buildings, airports, post offices, hospitals, irrigation canals etc. Transfer payments are the payments such like interest on public debt, subsidy, pension, relief payment, unemployment, insurance and social security benefits etc. The expenditure on capital assets (public works) is called capital expenditure.

Keynes had strong faith in such a programme that he went to the extent of saying that even completely unproductive projects like the digging up of holes and filling them up are fully admissible.

Public works are supported as an anti-depression device on the following grounds:
(i) They absorb hitherto unemployed workers.

(ii) They increase the purchasing power of the community and thereby stimulate the demand for consumption goods.

(iii)They help to create economically and socially useful capital assets as roads, canals, power plants, buildings, irrigation, training centers and public parks etc.

(iv) They provide a strong incentive for the growth of industries which are generally hit by the state of depression.

(v) They help to maintain the moral and self respect of the work force and make use of the skill of unemployed people.

(vi) The public works do not have an offsetting effect upon private investment because these are started at a time when private investment is not forthcoming.

The above stated points are, therefore, the evidence that public works programme fully satisfies, the main criteria as laid down for public expenditure. However, this form of public expenditure is subject to certain limitations and practical difficulties. Some of these are listed as under.

1. Difficult Forecasting:
The effectiveness of public works programmes always rests upon accurate forecasting of the depression or boom. But prediction of accurate forecasting is very difficult.

2. Timing of Public Works:
Another serious problem relates to the timing of public works with the moment of cycle. Due to lack of accurate forecasting, proper timing is neither feasible nor possible. Thus this factor along undermines the significance of public works as an instrument of stabilization.

3. Delay in starting:
Public works programmes are not something which can be started immediately. Actually, it is a long term programme which requires proper planning with regard to the finance and engineering. In this way, delay is the natural cause. Dernburg and McDougal have rightly noticed, "public works are, in short, clumsy and slow moving requiring time to get ready and time to turn off."

4. Scarcity of Resources:
The undertaking of public works programme may pose a serious threat due to non-availability of resources. It is likely that scarcity of resources may further aggravate the crisis instead of giving the pace of smoothness.

5. Limited Scope of Employment:
The public works programme is not capable of assuring job to all cadres of unemployed workers. Such works are only started to absorb unskilled and semi-skilled workers and not the specialized.

6. Misallocation of Resources:
As the slump gets deepened, there is wide spread unemployment of manpower and equipment. Generally, public works are located in only few selected areas. Thus, they may prove to be inadequate to cope with the requirements. Again, immobility in factors of production may also prevent the economic utilization of available resources. As a result, they reduce the efficiency of public works programme.

7. Burden of Public Debt:
The public works programme, generally, are financed through borrowing during depression. This will saddle the country with a heavy burden of repayment of principle amount and interest therein.

8. Cost Price Maladjustments:
The public works programme may perpetuate cost price maladjustments in heavy industries where public expenditure is concentrated. During the period of boom, wages and prices in construction industries have a strong upward tendency while in recession or depression; prices move downward, wages and costs remain sticky relatively. In short, such distortion in cost price structure brings more instability in the economy.

9. Effect on Private Enterprise:
In certain areas, the construction programmes undertaken by the public agencies may complete with private investment. As a result, the later is driven out of business. In such a case, public works will prove to be self-off setting and the aggregate demand will possibly fail to increase.

10. Control over Public Works:
The success of public works mostly depends on the nature of control over them. If public works are controlled by the central authority, delay is likely to arise in selected projects.

11. Political Considerations:
Public works are often started in democratic countries in certain areas not on account of economic reasons, but the political pressures at national, state and local levels sway the government decisions. Consequently, the economic utility of such public works remains very limited.

E.Public Debt:-

Public debt is a sound fiscal weapon to fight against inflation and deflation. It brings about economic stability and full employment in an economy.

The government borrowing may assume any of the following forms mentioned as under:
(a) Borrowing from Non-Bank Public:
When the government borrows from non-bank public through sale of bonds, money may flow either out of consumption or saving or private investment or hoarding. As a result, the effect of

debt operations on national income will vary from situation to situation. If the bond selling schemes of the government are attractive, the people induce to curtail their consumption, the borrowings are likely to be non inflationary.

When the money for the purchase of bonds flows from already existing savings, the borrowing may again be non-inflationary. Has the government not been borrowing, these funds would have been used for private investment, with the result that the debt operations by the government will simply bring about a diversion of funds from one channel of spending to another with the similar quantitative effects on national income.

If the government bonds are purchased by non bank individuals and institutions by drawing upon their hoarded money, there will be net addition to the circular flow of spending. Consequently, the inflationary pressures are likely to be created. But funds from this source are not commonly available in larger quantity. Its main implication is that borrowings from non bank public are more advantageous in an inflationary period and undesirable in a depression phase. In short, the borrowing from non bank public are not of much significant magnitude whether it comes out of consumption, saving, private investment or hoarding.

(b) Borrowing from Banking System:
The government may also borrow from the banking institutions. During the period of depression, such borrowings are highly effective. In this period, banks have excessive cash reserves and the private business community is not willing to borrow from banks since they consider it unprofitable.

When unused cash lying with banks is lent out to government, it causes a net addition to the circular flow and tends to raise national income and employment. Therefore, borrowings from banking institution have desirable and favorable effect especially in the period of depression when the borrowed money is spend on public works programmes.

On the contrary, borrowing from this source dry up almost completely in times of brisk business activities i.e. boom. Actually, demand is very high during inflation period, since profit expectation is high in business. The banks, being already loaded up and having no excess cash reserves. Find it difficult to lend to the government. If it is done, it is only through reducing their loans somewhere else.

This leads to a fall in private investment. As the government spending is off-set by a reduction in private investment, there will be no net effect upon national income and employment. In nut shell, borrowing from banking institutions have desirable effect only in depression and is undesirable or with a neutral effect during inflation period.

(c) Drawing from Treasury:

The government may draw upon the cash balances held in the treasury for financing budgetary deficit. It demonstrates dishoarding resulting in a net addition in the supply of money. It is likely to be inflationary in nature. But, generally, there are small balances over and above what is required for normal day to day requirements. Thus, such borrowings from treasury do not have any significant result.

(d) Printing of Money:

Printing of money i.e. deficit financing is another method of public expenditure for mobilizing additional resources in the hands of government. As new money is printed, it results in a net addition to the circular flow. Thus, this form of public borrowing is said to be highly inflationary.