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EFFICIENCY OF FISCAL POLICY

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Abstract: Fiscal policy, a crucial tool in the hands of policymakers, aims to stabilize the economy by manipulating government expenditures and taxation. However, the efficiency of fiscal policy in achieving its objectives has been a subject of ongoing debate among economists. Using a combination of theoretical and empirical approaches, this research assesses the effectiveness of fiscal policy in responding to economic shocks, promoting sustainable growth, and reducing income inequality. The study also explores the role of fiscal policy in stabilizing the business cycle, managing public debt, and influencing inflation. The study concludes that fiscal policy can be an effective tool in stabilizing the economy and promoting growth, but its efficiency is highly dependent on the specific context in which it is implemented. The research contributes to the existing literature by providing insights into the optimal design and implementation of fiscal policy, highlighting the importance of careful consideration of the economic environment and the potential risks associated with fiscal policy interventions. The study's findings have significant implications for policymakers, emphasizing the need for a nuanced and evidence-based approach to fiscal policy decision-making. Conclusions, recommendations and proposal are presented in the article can be used in the implementation effective fiscal policies aimed at creating favorable institutional conditions for the implementation tax reform of the public sector..

Keywords: fiscal policy, economic growth, effectiveness, finance, money, savings, taxes, import, budget deficit, central bank, infrastructure, economy, investors.

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Introduction

Fiscal, monetary and exchange rate policies are the three standard macroeconomic policy instruments used by governments for macroeconomic stabilization and sustainable economic growth. Sustainable economic growth is the goal of the government's discretionary economic policy. Fiscal policy allows the state to influence the economy on a large scale (compared to other types of regulation) and suffers from the risk of macroeconomic deterioration when making erroneous and

ineffective decisions. From this point of view, the development of the economy in the future to a certain extent depends on the correct assessment of these risks and the effectiveness of fiscal policy[1,].

However, there are still debates about the effectiveness of each of these instruments, although their effectiveness depends on the economic situation. Finally, it is important which policy is being pursued: different instruments affect their effectiveness, development and sustainable economic growth differently[2].

Literature review

Most of the debates and discussions around fiscal policy have led to emphasizing the need for developing economies to maintain fiscal discipline. The prevailing view is that fiscal deficits should be avoided because they crowd out private investment, can lead to loss of investor confidence, and also to inflation. Standard Keynesian economics, on the other hand, confirms that fiscal policy is an effective tool for stimulating an economy experiencing an economic downturn[3]...

Methods

The effectiveness of fiscal policy in developed countries is not in doubt, while developing economies face significant obstacles to conducting fiscal policy during economic downturns (i.e. expenditures that may lead to budget deficits)[4]. A number of countries find it difficult or expensive to borrow the capital needed to finance government spending, while countries able to borrow risk sharply raising the debt burden that will be difficult to repay in the future, especially if there is some irrationality in capital investment. Countries can borrow if fiscal policy is generally effective - if not, they should avoid it because they contribute to inflationary pressures and crowd out private investment [5]. The article uses qualitative research methods (comparative analysis) of conditions a d factors for fiscal policy in the developing countries.

Results and Discussion

The analysis of the efficiency of fiscal policy in Iran's economy using the IS-MP-AS model reveals the impact of monetary and fiscal policies. The study emphasizes the application of this model to understand the dynamics of economic policies in Iran. Furthermore, exploring the effectiveness of fiscal policy in promoting economic growth across emerging markets sheds light on the importance of institutions and external debts. The study indicates that positive growth effects of fiscal policy are observed, especially when institutions are strong, leading to higher crowding-in effects of fiscal policy. Additionally, the study highlights the non-linear effects of external debt on economic growth and the varying impacts of fiscal policy based on the level of indebtedness.

Moreover, the examination of federal fiscal policy effectiveness delves into the macroeconomic implications of fiscal stimulus[8]. The paper discusses alternative perspectives on the efficacy of fiscal stimulus as a policy instrument, emphasizing the role of fiscal policy in influencing economic growth and stability. It also touches on the historical evolution of fiscal policy and its significance in addressing economic challenges, particularly during crises.

To examine the nonlinear relationship between external debt and economic growth, we estimated a growth model with external debt relative to GNI and its square as explanatory variables. Based on the results, we divided the sample into two subsamples depending on the level of external debt to GNI (see Table I). We then apply the previous procedures to the two subsamples separately to examine the effectiveness of fiscal policy under the two debt regimes.

The data collected from 2002 to 2014 for 20 emerging countries shows that these economies experienced robust economic growth, as evidenced by the high average growth rates of GDP and GDP per capita. Investment growth was also strong, in line with the target of foreign direct investment (FDI) flows. However, the institutional framework in these countries had significant room for improvement, with average levels around zero on a scale of -2.5 to +2.5 in the World Governance Indicators report. This suggests that government effectiveness, regulatory quality, and control of corruption were suboptimal. Additionally, governments in emerging market economies were generally in an expansionary phase, as indicated by positive general government consumption growth rates, although this varied across countries due to high standard deviations..

Variables	Obs.	Mean	SD	Min.	Max.
Full sample (20 emerging markets)					
Gdpg	260	4.898	3.177	−10.894	14.195
Gdppc	260	8.316	0.865	6.285	9.409
Capg	260	7.078	11.856	−41.000	48.406
Popg	259	1.055	0.797	−1.911	2.254
Credit	260	3.661	0.657	2.152	4.955
Patent	257	8.363	1.664	5.455	13.741
Trade	260	4.070	0.521	3.096	5.349
Fdi	260	3.112	3.114	−0.254	30.995
Debt	260	36.591	21.776	8.251	163.582
Govexg	260	4.818	4.794	−9.453	48.324
Goveff	260	−0.063	0.424	−0.870	1.250
Regu	260	−0.062	0.488	−1.100	0.840
Concor	260	−0.414	0.380	−1.490	0.580
8 emerging markets with the average external debt level under the 40% GNI including: Bangladesh, Brazil, China, Colombia, Egypt, India, Mexico, and South Africa					
Gdpg	104	5.090	3.033	−4.700	14.195
Gdppc	104	8.191	0.936	6.285	9.376
Capg	104	7.520	7.101	−13.330	31.741
Popg	104	1.301	0.405	0.479	2.254
Credit	104	3.750	0.581	2.564	4.955
Patent	103	9.015	2.016	5.666	13.741
Trade	104	3.787	0.304	3.096	4.289
Fdi	104	2.547	1.671	−0.205	9.344
Debt	104	22.466	8.172	8.251	47.676
Govexg	104	4.760	3.135	−1.190	13.880
Goveff	104	−0.090	0.385	−0.870	0.680
Regu	104	−0.097	0.469	−1.100	0.780
Concor	104	−0.393	0.395	−1.490	0.580
12 emerging markets with the average external debt level above the 40% GNI including: Argentina, Bulgaria, Indonesia, Malaysia, Pakistan, Peru, Philippines, Romania, Russia, Thailand, Turkey, and Vietnam					
Gdpg	156	4.770	3.272	−10.894	9.452
Gdppc	156	8.399	0.806	6.754	9.409
Capg	156	6.783	14.183	−41.000	48.406
Popg	155	0.889	0.941	−1.911	2.121
Credit	156	3.602	0.700	2.152	4.799
Patent	154	7.927	1.202	5.455	10.713
Trade	156	4.259	0.549	3.358	5.349
Fdi	156	3.489	3.741	−0.254	30.995
Debt	156	46.007	22.911	20.493	163.582
Govexg	156	4.858	5.645	−9.453	48.324
Goveff	156	−0.044	0.449	−0.810	1.250
Regu	156	−0.038	0.500	−1.080	0.840
Concor	156	−0.428	0.370	−1.130	0.480

Reference: The effectiveness of fiscal policy: contributions from institutions and external debts , Nguyen Phuc Canh ,University of Economics Ho Chi Minh City, Ho Chi Minh City, Vietnam, 2 May 2018

In Keynesian analyses, government spending (or tax cuts) leads to an increase in GDP growth rates, which is the result of multiplying the initial spending. Most of the money paid out by the government is money put back into circulation and the more recapitalized money, the higher the multiplier[4]. If the savings rate is low, as is often the case in less developed developing countries, the share of consumption funds will be high, the multiplier will be very large, and government spending will be particularly effective. On the contrary, in East Asia, where savings rates were very high, multipliers were somewhat smaller.

It should be noted that in the simplest macroeconomic model, where savings (S) are only a "leak" (leaks) of aggregate demand (i.e. additional income of an individual or household that is not spent), the multiplier is 1/S, where S is the savings rate. Moreover, all leaks should include not only private savings, but also taxes and imports[5].

When businesses and households are limited in credit and cash (as is often the case in a developing economy), the multiplier can even be higher: if the same households and businesses had more money, they would spend it. For example, if the government provides for an increase in unemployment benefits, it is likely that the unemployed will spend all or almost all of the benefit. Some of the money they spend will go to individuals (landowners, store owners, etc.), not all of whom will spend it. But most importantly, in developing countries the multiplier can be very high.

Discussion

It is important to differentiate the impact of deficits when the economy is in recession and when the economy is at full employment; the latter is the case when the budget deficit is likely to have the opposite effect. The effect of crowding out private investment and inflationary arguments are convincing because the budget framework is tightly constrained. When the economy is on the rise, an increase in government revenues should be achieved by reducing consumption or reducing investments wherever possible in the economy. But cuts are inevitable when the economy is below full employment. The size of the budget can increase so that government spending can rise without reducing private investment or in the case of tax cuts, consumption can rise without reductions in private investment. And finally, the crowding out argument blindly assumes that the central bank cannot take action to compensate (reimburse) for lower interest rates. However, the central bank can do this by increasing the money supply. As for government borrowing, the debt will be monetized (financed by money emission) and the banking system will allow to increase the money supply (and credit) significantly up to the established inflation limit.[7] Even when the interest rate approaches zero and there are restrictions on the prerogative of the monetary authorities to further lower the interest rate (Keynesian type of liquidity trap), central banks will be able to at least tie higher interest rates to the results of exiting budget deficits[6]. In a small open economy, another reason why interest rates cannot rise is that capital inflows into the country prevent interest rates from rising. Finally, the private sector can have a reverse effect - increasing the effectiveness of fiscal policy. For example, higher government spending can stimulate the economy and significantly improve the economic situation, which creates an opportunity for greater investment. Similarly, an increase in government investment complements private investment (for example, infrastructure spending) can increase private sector incomes and stimulate private investment throughout the economy. The positive impact of China's government spending during the East Asian crisis of the 90s - 2000s confirms this position[12]. Part of the reasons for China's success was that current expenditures based on established strategic plans are mainly aimed at improving

infrastructure. Improved infrastructure increases the profitability of private investment. This, in turn, increases investment in production, which has been in particular the basis for China's long-term economic growth.

India's experience in stabilizing and regulating post the external debt crisis in the early 1990s differs in some ways[12]. However, it also represents the complementarity between public and private investments, suggesting more integration than displacement. Another reason why some economists argue for maintaining a restrained fiscal policy is the need to uphold investor confidence. Government spending leading to a decrease in private investments due to perceived deficit and loss of trust in the economy is a concern. Only decisive government actions against deficits can restore trust, boost investments, and expedite economic recovery.

Repeal of most existing tax benefits. This makes it possible to ensure equal competitive conditions, limit corruption in the tax sphere, increase the transparency of the taxation mechanism, simplify the work of calculating taxes for enterprises, and facilitate control over the fulfillment of tax obligations; taking measures to ensure the stability of the tax system by legislatively limiting the practice of making new decisions and introducing frequent changes to legal documents and organization[13;14]

Conclusion

Nevertheless, the general practice indicates that in most cases, reducing government expenditures leads to a decline in GDP growth rates in both developing and developed countries. Cutting government spending in East Asia in the 1990s had a negative effect, contrary to predictions by the standard Keynesian model. The impact of strict fiscal policies on investor confidence largely depends on the type of investors the government aims to attract. Short-term investors and creditors are often more concerned about the size of the fiscal deficit. For them, the government's ability to repay its debt quickly by increasing savings and reducing the fiscal deficit is crucial.

Long-term investors view the deficit as one of many variables. Policies leading to sustainable long-term growth naturally instill more confidence in the economy and attract more investments. If a country borrows to finance capital investments in profit-generating sectors, leading to growth that surpasses interest costs, growth indicators will rise. Investors recognize the growing strength of the national economy, showing more trust in it. This contributes to enhancing the efficiency of fiscal policy in the country. Additionally, coordination of fiscal, credit-monetary, exchange rate policies, along with capital flow regulation and other economic tools, is essential..

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