A Note on the Dominant Influence of Fiscal Actions

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In a recent article in this Journal, Darrat (1984) used a St. Louis-type reduced form equation to estimate the relative impacts of monetary and fiscal policy actions on economic activity in five Latin American countries. His results suggest that fiscal actions substantially dominate monetary actions for explaining changes in nominal income in these developing countries. The purpose of this note is to extend this analysis to India which is an open developing economy with a large non-monetized sector. Monetary management decisions are taken by the Reserve Bank of India which is directly controlled by the Government. The executive branch of the government also makes fiscal decisions with little or no input from the legislature.

Following Darrat, a modified St. Louis equation is estimated using annual data for the period 1955-1982. Regression results are reported in Table I, in which M, G and S represent monetary base, total government expenditures and total exports, respectively. Using the minimum final prediction error (FPE) criterion of BISSAC (1981), the optimal lag length for the variables M, G and S is calculated to be 3, 5 and 7 respectively. Coefficients of all three explanatory variables have the expected positive sign. This indicates that changes in these variables exert a positive impact on nominal income. The cumulative impact of government expenditures growth is positive and significant at the 10% level, while the cumulative impact of the growth in monetary base is positive, but not significant, even at the 10% level. This implies that, in India, government expenditures have a greater impact on nominal income than does the monetary base. This is consistent with Darrat's general conclusion regarding the Latin American countries and contrary to the findings of the St. Louis equation in the case of the USA.

The beta summed coefficients are estimated to be .473 (significant at 5% level) for government expenditures and .126 (significant at 10% level) for monetary base. This further evidence may be interpreted as that the fiscal policy variable has a greater impact on nominal income than the monetary policy variable. Finally, calculation of standard dynamic multipliers also confirm the earlier results. Due to space limitations, they are not reported here but are available upon request.

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Table I

Regression results from the Modified St. Louis Equation for India:
1955-1982

<table>
<thead>
<tr>
<th>Lag (t)</th>
<th>Constant</th>
<th>M</th>
<th>G</th>
<th>S</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>.041 (.02)</td>
<td>.110 (1.68)</td>
<td>.096 (3.08)</td>
<td>.121 (2.51)</td>
</tr>
<tr>
<td>1</td>
<td>.062 (.77)</td>
<td>.163 (3.41)</td>
<td>.086 (2.33)</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>.024 (1.42)</td>
<td>.241 (2.08)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>.048 (1.26)</td>
<td>.108 (1.32)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td></td>
<td>.201 (3.18)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td></td>
<td>.099 (1.51)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

$\Sigma_{t} = .244 (.69)

$\Sigma_{t} = .098 (3.31)

D.W. = 1.86

$\Sigma_{t} = .207 (1.86)

The numbers in parentheses are absolute values of t-statistics.

These results imply that the relative impacts of monetary and fiscal actions depend on the stage of a country's development. In the largely rural economy of India, with a limited degree of monetization, the government sector plays a dominant role. Changes in the expenditures and revenues of the government have a significant impact on various sectors of the economy and thus on national income. In contrast, changes in monetary policy influences only the small monetized segment of the national economy. Hence its influence on national income is relatively small. The empirical results support Darret's findings with respect to the dominance of fiscal policy in developing economies, although it is relevant to note that the Indian economy is different in many ways, from the Latin American economies.

REFERENCES


Against the background of a public which had grown somewhat skeptical of the efficacy of economic theory and policy, the recent reemergence of the Supply-Side School is something of an anomaly. Although this is not the first school to have been so widely discussed in the popular, business and intellectual press, it may be the first to have become popularized so early in its career. Economists, of course, have been quick to counter the resulting impression of novelty by carefully documenting its historical roots.2 Hence, we learn that many of the major names, Hume, Smith, Say, Ricardo, and both Mills, were, in fact, supply-side oriented and should be accredited in the school's genealogy. Through concentration on the major names, however, the distorted view may be promoted that the minor figures of political economy were of little importance.

One such figure, Jacob Vanderlint, is particularly worth of recognition. Vanderlint was a retired British merchant who, in 1734, published a remarkable book entitled Money Answers All Things.3 That sums up all we know about him. His book fared only slightly better in the memory of history, and never only briefly mentioned in most of the widely used histories of economic thought.

Vanderlint did not lack influential champions. Marx and Engels in the Nineteenth Century and Viner, Schumpeter and Vickers in the Twentieth were particularly supportive.4 Marx and Engels would have us believe that Hume was deeply indebted to Vanderlint, especially for his theory of the balance of trade and, in fact, may have shamelessly plagiarized his.5 Viner and Schumpeter on the other hand, were more impressed with Vanderlinit's close approximation of the price-species flow mechanism, shortly before it had been perfected by Hume.6 Vickers finally rescued Vanderlint from overemphasis of the balance of payments by discussing his more general macro-economic theory, of which the foreign sector was but a part. In vickers, we can appreciate for the first time that Vanderlinit's theory absolutely depends upon a larger stock of money, stemming from a favorable...