**FISCAL POLICY**

The most important instrument of government intervention in the

economy today is that of fiscal or budgetary policy. Fiscal policy refers

to the taxation, expenditure and borrowing by the government. The

economists now hold the government intervention through fiscal policy

is essential in the matter of overcoming recession or inflation as well as

of promoting and accelerating economic growth.

**Meaning and Definitions**

The fiscal policy is concerned with the raising of government

revenue and incurring of government expenditure. The government

frames a policy called budgetary policy or fiscal policy. So, the fiscal

policy is concerned with government expenditure and government

revenue. Fiscal policy has to decide on the size and pattern of flow of

expenditure from the government to the economy and from the economy

back to the government.

According to **J.M. Culbertson**, “By fiscal policy we refer to

government actions affecting its receipts and expenditures which we

ordinarily takes as measured by the government’s net receipts, its

surplus or deficit.” The Government may offset undesirable variations in

private consumption and investment by anti-cyclical variations of public

expenditures and taxes.

**Arthur smithies** defines fiscal policy as “a policy under which

the government uses its expenditure and revenue programmes to produce

desirable effects and avoid undesirable effects on the national income,

production and employment.” Though the ultimate aim of fiscal policy

is the long run stabilisation of the economy, yet it can only be achieved

by moderating short run economic fluctuations.

During a recession or depression fiscal policy should help in

increasing demand. For this purpose, the government can increase its

expenditure and spend more on public works. This will provide

employment to more people. The government can also increase its

expenditure on subsidies to producers of consumer goods so as to

increase consumption spending. Similarly, the government can lower its

tax rates so as to stimulate consumption and investment. Thus, a budget

deficit during a depression helps greatly in removing unemployment. On

the other hand, during periods of inflation, there is too much of demand

and hence the government should reduce its own expenditure and curb

private spending by increasing taxes. Thus, in periods of inflation we

should have surplus budgets. Therefore, there is no inherent superiority

in a balanced or a surplus budget. It all depends on the prevailing

economic situation.

**Objectives of Fiscal Policy**

The importance of fiscal policy is high in underdeveloped

countries. The state has to play active and important role. In a democratic

society direct methods are not approved. So, the government has to

depend on indirect methods of regulations. In this way, fiscal policy is a

powerful weapon in the hands of government by means of which it can

achieve the objectives of development. The principle objectives of fiscal

policy are given below :

**1. Development by Effective Mobilisation 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 Mobilisation of Financial Resources..

The financial resources can be mobilised by :

A. **Taxation** : Through effective fiscal policies, the government aims

to mobilise resources by way of direct taxes as well as indirect

taxes because most important source of resource mobilisation is

taxation.

B. **Public Savings** : The resources can be mobilised 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 mobilised through government

borrowings by ways of treasury bills, issue of government bonds, etc.,

loans from domestic and foreign parties and by deficit financing.

**2. Efficient Allocation of Financial Resources**

The central and state governments have tried to make efficient

allocation of financial resources. These resources are allocated for

development activities which includes expenditure on railways,

infrastructure, etc. While non-development activities includes expenditure

on defence, interest payments, subsidies, etc.

But generally the fiscal policy should ensure that the resources are

allocated for generation of goods and services which are socially

desirable. Therefore, India's fiscal policy is designed in such a manner

so as to encourage production of desirable goods and discourage those

goods which are socially undesirable.

**3. 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.

**4. Price Stability and Control of Inflation**

One of the main objective 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.

**5. Employment Generation**

The government is making every possible effort to increase

employment in the country through effective fiscal measure. 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 generates more employment.

**6. Balanced Regional Development**

Another main objective of the fiscal policy is to bring about a

balanced regional development. There are various incentives from the

government for setting up projects in backward areas such as cash

subsidy, concession in taxes and duties in the form of tax holidays,

finance at concessional interest rates, etc.

**7. Reducing the Deficit in the Balance of Payment**

Fiscal policy attempts to encourage more exports by way of fiscal

measures like exemption of income tax on export earnings, exemption of

central excise duties and customs, exemption of sales tax and octroi, etc.

The foreign exchange is also conserved by providing fiscal benefits

to import substitute industries, imposing customs duties on imports, etc.

The foreign exchange earned by way of exports and saved by way

of import substitutes helps to solve balance of payments problem. In this

way adverse balance of payment can be corrected either by imposing

duties on imports or by giving subsidies to export.

**8. Capital Formation**

The objective of fiscal policy is to increase the rate of capital

formation so as to accelerate the rate of economic growth. An

underdeveloped country is trapped in vicious circle of poverty mainly

on account of capital deficiency. In order to increase the rate of capital

formation, the fiscal policy must be efficiently designed to encourage

savings and discourage and reduce spending.

**9. Increasing National Income**

The fiscal policy aims to increase the national income of a

country. This is because fiscal policy facilitates the capital formation.

This results in economic growth, which in turn increases the GDP, per

capita income and national income of the country.

**10. Development of Infrastructure**

Government has placed emphasis on the infrastructure development

for the purpose of achieving economic growth. The fiscal policy measure

such as taxation generates revenue to the government. A part of the

government's revenue is invested in the infrastructure development. Due

to this, all sectors of the economy get a boost

FISCAL POLICY TOOLS

A government has two tools at its disposal under the fiscal policy – taxation and public spending.

Taxation includes taxes on income, property, sales, and investments. On the one hand, more taxes means more income for the government, but it also results in less income in the hand of the people.

Public spending includes subsidies, transfer payments, like salaries to a govt. employee, welfare programs, and public works projects. Those who get the funds have more money to spend.

TYPES OF FISCAL POLICY

There are two types of fiscal policy – expansionary and contractionary fiscal policy.

EXPANSIONARY FISCAL POLICY

A government uses this type of policy to stimulate economic growth by increasing spending or lowering taxes or both. The objective of this policy is to ensure more money in the hands of the citizens so that they spend more. More spending, in turn, leads to more income and more job creation as well.

There have been debates over which is more effective – tax cuts or spending. Some say that spending in the form of public projects ensures that the money reaches the consumers. Those in favor of the tax argue that tax cuts allow businesses to hire more staff. Though there is no consensus on which of the two is better, the government uses a combination of both the tools to boost economic growth.

CONTRACTIONARY FISCAL POLICY

A government rarely uses this policy as it aims to slow economic growth. You must be thinking why any government will want to do that, the answer is to curtail inflation. Too much inflation has the potential to damage the economy in the long-term. So, the government has to step in to control inflation.

Here also, the government has the same tools at its disposal – spending and tax cuts. But, they are used differently – taxes are raised while the spending is reduced. One can easily imagine how unpopular such measures will be among the voters.

NEUTRAL FISCAL POLICY

It is usually undertaken when an economy is in equilibrium . Government spending is fully funded by tax revenue and overall the budget outcome has a neutral effect on the level of economic activity.