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**Section: A Sem-III**

**Assignment: Principles of Macro-economics**

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**Topic: Fiscal Policy**

**Fiscal Policy**

**Definition**

Fiscal policy is the use of government spending and taxation to influence the economy. Governments typically use fiscal policy to promote strong and sustainable growth and reduce poverty.

**Example**

For example, **governments can lower taxes and raise spending to boost the economy if needed**; typically, they spend on infrastructure projects that create jobs and income and social programs. Or, if the economy is doing well, a government can reduce spending and increase taxes.

**Objectives of Fiscal Policy**

**Generally following are the objectives of a fiscal policy in a developing economy:**

**1. Full employment**

**2. Price stability**

**3. Accelerating the rate of economic development**

**4. Optimum allocation of resources**

**5. Economic stability**

**6. Encouraging investment**

**1.Full Employment**

The first and foremost objective of fiscal policy in a developing economy is to achieve and maintain full employment in an economy. In such countries, even if full employment is not achieved, the main motto is to avoid unemployment and to achieve a state of near full employment. Therefore, to reduce unemployment and under-employment, the state should spend sufficiently on social and economic overheads. These expenditures would help to create more employment opportunities and increase the productive efficiency of the economy. In this way, public expenditure and public sector investment have a special role to play in a modern state.

**2. Price Stability:**

There is a general agreement that economic growth and stability are joint objectives for underdeveloped countries. In a developing country, economic instability is manifested in the form of inflation. Therefore, in developing economies, inflation is a permanent phenomenon where there is a tendency to the rise in prices due to expanding trend of public expenditure. As a result of rise in income, aggregate demand exceeds aggregate supply. Capital goods and consumer goods fail to keep pace with rising income.

**3. To Accelerate the Rate of Economic Growth:**

Primarily, fiscal policy in a developing economy, should aim at achieving an accelerated rate of economic growth. But a high rate of economic growth cannot be achieved and maintained without stability in the economy. Therefore, fiscal measures such as taxation, public borrowing and deficit financing etc. should be used properly so that production, consumption and distribution may not adversely affect. It should promote the economy which in turn helps to raise national income and per capita income.

**4. Optimum Allocation of Resources:**

Fiscal measures like taxation and public expenditure programmes, can greatly affect the allocation of resources in various occupations and sectors. As it is true, the national income and per capita income of underdeveloped countries is very low. In order to gear the economy, the government can push the growth of social infrastructure through fiscal measures. Public expenditure, subsidies and incentives can favorably influence the allocation of resources in the desired channels.

**5. Economic Stability:**

Fiscal measures, to a larger extent, promote economic stability in the face of short-run international cyclical fluctuations. These fluctuations cause variations in terms of trade, making the most favorable to the developed and unfavorable to the developing economies. So, for the purpose of bringing economic stability, fiscal methods should incorporate built-in-flexibility in the budgetary system so that income and expenditure of the government may automatically provide compensatory effect on the rise or fall of the nation’s income. Therefore, fiscal policy plays a leading role in maintaining economic stability in the face of internal and external forces. The instability caused by external forces is corrected by a policy, popularly known as ‘tariff policy’ rather than aggregative fiscal policy.

**6. To Encourage Investment:**

Fiscal policy aims at the acceleration of the rate of investment in the public as well as in private sectors of the economy. Fiscal policy, in the first instance, should encourage investment in public sector which in turn effect to increase the volume of investment in private sector. In other words, fiscal policy should aim at rapid economic development and must encourage investment in those channels which are considered most desirable from the point of view of society.

Tools or equipment’s of Fiscal Policy

Following are tools of Fiscal Policy

Expansionary Fiscal Policy

Fiscal policy that increases aggregate demand directly through an increase in government spending is typically called expansionary or “loose.” By contrast, fiscal policy is often considered contractionary or “tight” if it reduces demand via lower spending.

Example

The two major examples of expansionary fiscal policy are tax cuts and increased government spending. Both policies are intended to increase aggregate demand while contributing to deficits or drawing down budget surpluses.

Contractionary Fiscal Policy

Contractionary fiscal policy is when the government either cuts spending or raises taxes. It gets its name from the way it contracts the economy. It reduces the amount of money available for businesses and consumers to spend.

Example

When the government uses fiscal policy to decrease the amount of money available to the populace, this is called contractionary fiscal policy. Examples of this include increasing taxes and lowering government spending.

Taxes

A tax is a compulsory financial charge, or some other type of levy imposed on a taxpayer by a governmental organization in order to fund government spending and various public expenditures, and tax. Types of taxes include **income, corporate, capital gains, property, inheritance, and sales**.

Types of Taxes

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| **Taxes** | | |
| **Direct Taxes** | **Indirect Taxes** | **Other Taxes** |
| Income Tax | Sales Tax | Property Tax |
| Wealth Tax | Goods & Services Tax (GST) | Professional Tax |
| Gift Tax | Value Added Tax (VAT) | Entertainment Tax |

Expenditure

Expenditure refers to payments made, or liabilities incurred in exchange for goods or services. Expenditure increases the value of assets or reduces a liability. The three types of expenditure are as follows

Fixed Expenditures

Fixed expenditure is that which you must spend, regardless of how many people come to the event. For items such as programmers, you still need to order these before you know the numbers who will be attending, so it is still considered as fixed expenditure.

Irregular Expenditures

Irregular expenditure is expenditure that was not incurred in the manner prescribed by legislation; in other words, somewhere in the process that led to the expenditure, the auditee did not comply with the applicable legislation.

Discretionary Expenditures

A discretionary expense is **a** non-essential expense that is incurred by an individual, household, or business.