

Fiscal policy essay sample

[Economics](#)



**ASSIGN
BUSTER**

The purpose of the assignment is to enhance learners' understanding of how fiscal policy can be used to achieve economic goals.

REQUIREMENT

Discuss and evaluate how fiscal policy tools can assist in improving economic growth, employment and mitigate inflation.

Answer

Fiscal policy is a policy concerned with Government Revenues and Government Expenditures. The tools are government expenditures (G), taxes (T), both direct and indirect, deficit financing, i. e., government borrowing and printing of new notes, subsidies, and transfer payments like unemployment allowances, stipends and scholarships. These tools can improve the economic growth, employment and mitigate inflation. Economic growth can be improved by price stability, influencing the consumption pattern, economic development and removal of deficit in balance of payments. Price stability, inflation and deflation are the big vices which the capitalist world has to face. During the inflation, there are economic sufferings for the fixed income groups.

Moreover, the inflation creates so many long-run social and economic problems. If government expenditures are reduced and taxes are increased – all they will reduce NI many a time through multiplier effect. Thus, when excess demand is controlled – the inflation will be controlled. On the other hand, during deflation, if government expenditures are increased and taxes are reduced – then, NI will go up through multiplier effect and economic

depression will come to an end. But in most of the poor countries, government expenditures are rigid downward. Moreover the government expenditures and imposition of taxes are influenced by political decisions. The curtailment of government expenditures and raising of the taxes will obstruct economic activities – producers will be disappointed and foreign private investment is discouraged.

Influencing the Consumption Pattern, in capitalist economies, governments normally do not interfere in the consumption matters of people. However, for collective betterment, it can do so. That is, if, government wants to reduce the consumption of some particular product, it can be done by imposing tax on that commodity. For example, if government wants to reduce the consumption of petrol, tax will be imposed on petrol. If government wants to raise the consumption of any commodity, government can give subsidy on its production and consumption. As, government wants to increase the consumption of corn oil, subsidies can be given to the producers of the corn oil. Moreover, imports can be checked by imposing higher duties on the luxurious imports.

Economic development, it is a process whereby the real national and per capita income of the country increases over a long period of time. The developing countries are over-ambitious of attainment of economic development. But they have shortage of financial resources. In this connection, easy fiscal policy, consequent upon reduction in taxes, increase in government expenditures and granting of subsidies to the producers can be adopted. This will provide incentives to the producers to increase investment. Once the process of increased investment starts, through <https://assignbuster.com/fiscal-policy-essay-sample/>

multiplier effect NI will increase many a time. The persistent increase in NI means economic development. But it must be remembered that the process of development cannot merely be started with easy fiscal policy.

To attain economic development, there is need of natural resources, technology, human skill and management. Moreover, economic development may result in inflation and unequal income distribution. Removal of Deficit in Balance of Payments (BOP), if a country's foreign payments exceed its foreign receipts then the country faces a deficit in BOP. This situation shatters the economic life of the country. Accordingly, need is to remove it. In this connection, if government pursues a strict fiscal policy – desirable results can be obtained. This strict fiscal policy means reduction in government expenditures and increase in taxes – which will reduce NI through multiplier. Hence, there will be deflationary tendencies in the economy -prices will fall and exports will increase. On the other hand, due to deflation, a country's income falls. It will reduce imports of the country. Ultimately, BOP position is improved. But a strict fiscal policy will have negative effect on country's investment, production and employment.

Employment can be improved by raising the level of employment and redistribution of income. Raise the level of employment, the developing countries, due to population growth, shortage of resources, etc. are clutched into the hands of unemployment and underemployment. To remove this situation, fiscal policy helps us. If government expenditures, on the basis of deficit financing, are increased and taxes are lowered, through multiplier effect NI will increase many a time. The multiple expansions in NI will have an impact on the level of employment. In this way, the easy fiscal policy will

<https://assignbuster.com/fiscal-policy-essay-sample/>

have the effect of raising employment. But, according to Phillips – there exists a positive relationship between employment and inflation. In other words, if we . want to raise the level of employment, inflation will have to be restored.

Redistribution of income, in UDCs low per capita income is accompanied by great inequalities in income distribution. Thus, there is need of redistribution of income. In this connection, progressive system of taxation is advocated. This system will affect the increased incomes of the rich people. On the other hand, the flow of expenditures to the poor is increased. They be provided with free housing, medical and educational facilities. The redistribution in income is justified on the following grounds. 1. Even distribution of income will mean a larger market for products produced by the local industry. 2. Redistribution will check the higher marginal propensity to import. 3. The flow of expenditures towards the poor will increase their productivity and incentives. Hence, such increase in productivity (income) should be considered as investment, rather consumption which would lead to accelerate the rate of growth... 4. But the policy of imposing greater taxes on rich and exempting the poor from taxes may not be adopted in developing countries, where the feudal and rich dominate the parliament. Moreover, giving subsidies to the poor on basic amenities of life is out of question in poor countries.

Mitigate inflation can be improved by progressive system of taxation, unemployment allowances and other welfare contributions and agricultural price support policies. Progressive of taxation, in capitalist economies the progressive system of taxation is in operation. During inflation when incomes

<https://assignbuster.com/fiscal-policy-essay-sample/>

of people are rising, the tax rate also increases. Accordingly, the major part of incomes will be taken away by the government. In this way, the inflation will be checked. On the other hand, during deflation when incomes of the people are decreasing, the tax rate also decreases. In this way, the Disposable income of the people will not decrease.

Accordingly; deflation will be controlled. Unemployment allowances and other Welfare Contributions, during inflation when incomes of the people are rising, the firms and government make heavy deductions from the wages and salaries of their workers and employees. In this way, inflation will be checked; hence propensity to consume will decrease. While in depression such deductions are decreased. Hence, consumption will increase and deflation will be checked. Agricultural Price Support Policies, during depression, when prices of agricultural goods are falling, government purchases them at a reasonable price. In this way, farmers are compensated and' depression does not intensify itself. While during inflation, government sells agricultural goods at low prices from its reserves. Accordingly, inflation will be controlled.