

# Objectives and techniques of fiscal policy economics essay



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Fiscal Policy's first word Fiscal is taken from French word Fisc which means treasure of Govt. Fiscal policy concerns itself with the aggregate effect of government expenditure and taxation on income, employment and production. It refers to the instruments by which a government tries to regulate or modify the economic affairs of the economy keeping in view certain objectives. Thus, fiscal policy is a package of economic measures of government regarding its public expenditure, public revenue and public debt . Fiscal Policy is the most important part of Economic Policy . So , we can define fiscal policy as the revenue and expenditure policy of Govt. of India . It becomes the prime duty of Government to frame fiscal policy . By making this policy , Govt. collects money from his different resources and utilize it in different expenditure . Thus fiscal policy is related to development policy. Through this paper the objectives , techniques, stances and limitations of a fiscal policy are being discussed . An attempt is also been made to highlight the achievements and progress of the fiscal policy of India.

## **Introduction**

The term fiscal has been derived from the greek word fisc, meaning a basket to symbolize the public purse.. Fiscal policy thus means the policy related to the treasury of the government.

Fiscal policy is a part of general economic policy of the government which is primarily concerned with the budget receipts and expenditures of the government. All welfare projects are completed under this policy . It also suggests measures to control economic fluctuations which may become violent and create great upheavals in the socio-economic structure of the economy. It also outlines the influence of resource utilization on the level of

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aggregate demand through affecting the level of aggregate consumption and investment expenditure.

## **Definitions**

According to U. Hicks” Fiscal policy is concerned with the manner in which all the different elements of public finance , while still primarily concerned with carrying out their own duties, may collectively be geared to forward the aims of economic policy.”

According to Arthur Smithies” Fiscal policy is 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.”

## **Objectives of Fiscal Policy**

There are following objectives of fiscal policy :-

### **1. Development of Country :-**

Every country has to make fiscal policy for development of Country . With this policy , all work like govt. planning and proper use of funds for development functions is done . If govt. does not make fiscal policy , then it can happen that revenues are misused without targeted expenditure of Government.

### **2. Employment :-**

Getting the full employment is also the objective of fiscal policy . Govt. can take many actions for increasing employment. Government can fix certain

amount which can be utilized for creation of new employment opportunities for unemployed people .

### **3. Inequality :-**

In developing country like India , we can see the difference one basis of earning . 10% of people are earning more than Rs. 100000 per day and other are earning less than Rs . 100 per day . By making a good fiscal policy , govt. can reduce this difference if govt makes it as its target .

### **4. Fixation of Govt. Responsibility:-**

It is the duty of Govt. to effective use of resources and by making of fiscal policy different minister's accountability can be checked . I was seeing the Episode of Chanakya on YouTube in which I found that in old time fiscal policy was made and treasury officer and even prime minister are also responsible for any shortage of govt . fund

## **Techniques of Fiscal Policy**

### **1. Taxation Policy**

It is one of the powerful instruments of fiscal policy in the hands of public authorities which greatly affects changes in disposable income , consumption and investment. Taxation policy is relates to new amendments in direct tax and indirect tax . Every year Govt. of India passes the finance bill . In this policy govt. determines the rate of taxes . Govt. can increase or decrease these tax rates and amend previous rules of taxation . Govt.'s earning's main source is taxation . But more tax on public will adverse effect on the development of economy.

â†’ If Govt. will increase taxes , more burden will be on the public and it will reduce production and purchasing power of public .

â†’ If Govt. will decrease taxes , then public’s purchasing power will increase and it will increase the inflation.

Govt. analyzes both the situation and will make his taxation policy more progressive .

## **2. Govt. Expenditure Policy**

There are large number of public expenditure like opening of govt schools , colleges and universities , making of bridges , roads and new railway tracks . For the above projects govt has paid large amount for purchasing and paying wages and salaries , however , all these expenditures are paid after making govt. expenditure policy . Govt. can increase or decrease the amount of public expenditure by changing govt. budget . So , govt. expenditure is technique of fiscal policy by using this , govt. use his fund first on very necessary sector and other will be done after this .

## **3. Deficit Financing Policy**

If Govt.’s expenditures are more than his revenue , then govt. should have to collect this amount . This amount is deficit and it can be fulfilled by issuing new currency by central bank of country . But , it will reduce the purchasing power of currency . More new currency will increase inflation and after inflation value of currency will decrease . So, deficit financing is very serious issue in the front of govt. Govt. should use it , if there is no other source of govt. earning .

## 4. Public Debt Policy

If Govt. thinks that deficit financing is not sufficient for fulfilling the public expenditure or if govt. does not resort to deficit financing, then govt. can take loan from world bank, or take loan from public by the way of issuing govt. securities and bonds. But it will also increase the cost of debt in the form of interest which govt. has to pay on the amount of loan. So, govt. has to necessarily make solid budget for this and after taking into consideration the amount which is taken as debt. This policy can also use as the technique of fiscal policy for increase the treasure of govt. Internal sources of debt include market loans, compensation bonds, 15 year's annuity certificates, small private savings through various saving schemes. External sources includes in borrowing from the external market, from international institutions such as the World bank, IMF IDA etc and the governments of other countries.

## 5. Budget

. Fiscal policy operates through the budget. Thus it is also called budgetary policy. The term budget is derived from a French word "Bougette" which means a leather bag or a wallet used to carry financial papers. The budget of a nation is a useful instrument to assess the fluctuations in an economy. Different budgetary principles have been formulated by the economists, prominently known as the annual budget, cyclical balanced budget and fully managed compensatory budget.

## **Fiscal Consolidation**

- With recovery taking root, there is a need to review public spending, mobilise resources and gear them towards building the productivity of the economy.
- Fiscal policy shaped with reference to the recommendations of the Thirteenth Finance Commission, which has recommended a calibrated exit strategy from the expansionary fiscal stance of last two years.
- It would be for the first time that the Government would target an explicit reduction in its domestic public debt-GDP ratio.

## **Stances of fiscal policy**

The three possible stances of fiscal policy are neutral, expansionary and contractionary. The simplest definitions of these stances are as follows:

A neutral stance of fiscal policy implies a balanced economy. This results in a large tax revenue. Government spending is fully funded by tax revenue and overall the budget outcome has a neutral effect on the level of economic activity.

An expansionary stance of fiscal policy involves government spending exceeding tax revenue.

A contractionary fiscal policy occurs when government spending is lower than tax revenue.

However, these definitions can be misleading because, even with no changes in spending or tax laws at all, cyclical fluctuations of the economy cause

cyclical fluctuations of tax revenues and of some types of government spending, altering the deficit situation; these are not considered to be policy changes. “. Thus, for example, a government budget that is balanced over the course of the business cycle is considered to represent a neutral fiscal policy stance.

## **Methods of funding**

Governments spend money on a wide variety of things, from the military and police to services like education and healthcare, as well as transfer payments such as welfare benefits. This expenditure can be funded in a number of different ways:

Taxation

Seigniorage, the benefit from printing money

Borrowing money from the population or from abroad

Consumption of fiscal reserves.

Sale of fixed assets (e. g., land).

All of these except taxation are forms of deficit financing.

## **Some facts about fiscal policy**

-Government revenues and expenditures don't need to balance every year but over one business cycle

-Functional finance is the principle that government budgets should be geared to the yearly needs of the economy

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- Defenders of functional finance are those who believe fiscal policy is a powerful stabilization tool.
- The choice of fiscal policy guideline depends on the government's belief in fiscal policy as an effective tool for stabilizing the economy .
- In 1970s and 1980s Canada believed in functional finance but recently has made unsuccessful attempts to move toward cyclically balanced budgets.
- Government deficits were highest during recessions during the early 1980s and early 1990s
- Tax revenues fell with slumping incomes during that time as a result of the automatic stabilizers
- Discretionary expansionary policy also contributed since federal government increased purchases of goods and services to counteract the effects of sagging outputs and incomes.
- 1990s downturn caused a concern over increased public debt and lowered confidence in discretionary fiscal policies to counteract a recession.

## **Achievements of fiscal policy in India**

The fiscal policy has played an important role in the following fields.

### **Mobilization of resources**

To finance the development need of India , the government has extensively used the fiscal policy. The policy of public borrowing and deficit financing has enable the government to raise huge amounts of resources for development.

Increasing tax GDP ratio is a good indication of the increasing mobilization of resources. The tax GDP ratio was only 6.7 percent in 1950-51 but it has reached to 17.3% in 2006-07.

### **Increase in savings**

The fiscal policy has been successful in raising the rate of savings in the household sector, corporate sector and public sector. To encourage savings, prize based schemes to encourage savings, expansion of the network of savings bank, post office schemes.

### **Increase in capital formation**

Capital formation involves three stages-incentive to save, mobilization of savings and investment of savings. The fiscal policy has tried to influence all the three stages. A well spread network of postal banks, savings bank, commercial banks, financial institutions and money market is there to collect people's savings. The government has also been successful in using the savings of the public of the public sector for development.

### **Incentives to investment**

The government has exclusively used it to influence the government decisions of the private sector. Various tax concessions, tax rebates, subsidies and fiscal incentives are given to investors. Cottage and small scale industries have survived due to the support of the fiscal policy. The government is mobilizing increased amounts of resources through public borrowings and deficit financing to push up the level of investment in infrastructure, social sectors, exploration and development of natural resources.

## **Reduction in Income and wealth Inequalities**

To create equitable conditions in the society , a progressive tax system has been adopted in the realm of direct taxes. The rate of taxes on income goes on increasing with the increase in income . Direct and indirect taxes are used to mop up more resources from the richer sections of the society. Luxuries are heavily taxed. The government has also launched several poverty eradication programmes to directly benefit the poor people. The poor sections of the society are provided with subsidized grains and other essential items of consumption.

## **Reduction in inter regional variations**

The states like Bihar, U. P. , Rajasthan , Madhya Pradesh, Orissa etc. are given preference while transferring resources from the center to the states . Both statutory and non statutory channels of resource transfer are being used for the purpose. The government of India also gives discretionary grants to economically poor states. In addition to this special incentives, subsidies and concessions are given for locating industrial units in backward regions.

## **Limitations of Fiscal Policy**

### 1. Inadequate resource mobilization

The fiscal policy has achieved a mixed success in mobilization of resources. The defective tax system , limited base of direct taxes , exemption of agriculture from direct taxation , evasion of taxes , inefficient and corrupt tax collection machinery are some of the causes of poor tax collection in the

country. Another cause of poor resource mobilization is the low share of non-tax revenue in the total revenue receipts.

2. Inflation of India is increasing rapidly after issuing new notes for payment of govt. of expenses and in this inflation, prices of necessary goods are increasing very fastly. Living of poor people has become difficult due to this . So , these signs show the failure of Indian fiscal policy.

3. Govt. fiscal policy has failed to reduce the black money . Even large amount of past minister is in the form of black money which is deposited in Swiss Bank.

4. After taking loan from world bank under the fiscal policy's debt technique , govt. has to follow the rules and regulations framed by world bank and IMF . These rules are more harmful for developing small domestic business of India. These organizations are inter related with WTO and they intend to stop Indian domestic Industry.

5. After expending large amount for generating new employment under fiscal policy , rate of unemployment is increasing fastly and big lines on govt. employment exchange can be seen generally in working days . Database of employment exchanges are full from educated unemployed candidates .

6. Fiscal policy and inflation

The direct taxes are the main instruments of the fiscal policy. The rise in the rates of direct taxes result in the reduction of the disposable income of the people . The indirect taxes contribute more than four-fifths of the tax

revenue . Taxes on commodities, sales taxes , excise duties, customs etc .  
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add to the prices of commodities . Increase in the rates of sales taxes and excise duties immediately cause a rise in the price level.

## **Conclusion**

Thus, the fiscal policy encompasses two separate but related decisions; public expenditures and the level and structure of taxes. It occupies the central place for maintaining full employment without inflationary forces in the economy. With its various instruments it influences the economic stability of an economy. The fiscal policy of the Indian government has been very successful in several fields such as mobilization of resources for economic development, increasing rate of savings and capital formation, developing cottage and small scale industries , reducing the incidence of poverty etc. Despite a few drawbacks of this policy, India has truly achieved a considerable level of fiscal maturity.