"Fiscal Policy : Meaning & Types"

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Introduction :-

Fiscal policy developed out of the great depression of 1930's, which ended the laissez-faire approach to economic management.

Till the depression of 1930's, Monetary Policy was considered as a proper and efficient instrument for the attainment of economic stability. However, during the Great Depression, the limitations of the monetary policy came to limelight and for a long period, not much reliance was placed on it to deal with inflation. Monetary policy also seemed inadequate to revive business and employment. At this stage, the significance of fiscal policy as an instrument of economic control was first emphasised in the mid-1930's by Keynes in his book "General Theory of Employment, Interest and Money." According to

Keynes, fiscal policy should be used to stabilise the level of output and employment. Through changes in its expenditure and taxes, the government attempts to increase output and income and seeks to stabilise the ups and downs in the economy. Fiscal policy creates a surplus (when total receipts exceed expenditure) or a deficit budget (when total expenditure exceeds receipts) rather than a balanced budget (when expenditure equals receipts).

Meaning of Fiscal policy:—

Fiscal policy is a policy concerning the receipts and expenditures of the government. It refers to the budgetary policy of the government. It operates through changes in government expenditure, taxation and public borrowings. Fiscal policy refers to the policy of Central Government to control the situation of money supply in the economy for stabilization and growth of the economy. In other words, Government tries to regulate or modify the economic affairs of an economy through its fiscal policy. It includes all measures

taken by the Government with respect to Public expenditure, public revenue and Public borrowing. The main instruments of fiscal policy are: i) Expenditure Policy (Public expenditure); ii) Revenue Policy (Taxation); iii) Public Borrowings (Public debt). An appropriate mix of all the instruments makes the fiscal policy sound and effective.

Various Types of Fiscal Policies:—

The main goals of fiscal policy are to achieve and maintain full employment, reach a high rate of economic growth, and to keep prices and wages stable. But fiscal policy is also used to curtail inflation, increase aggregate demand and other macro economic issues. So Fiscal Policy can be:

Contractionary Fiscal Policy:—

This involves cutting government spending or raising taxes. Thus, the tax revenue generated is more than Government spending. Also, it cuts on the aggregate

demand in the economy. So there will be economic growth leading to the reduction in inflationary pressures of the economy.

Expansionary Fiscal policy:—

This is generally the most Common method used to give a boost to the economy. Thus, it speeds up the growth rate of the economy. Also, during the recession period when the growth in national income is not enough to maintain the Current living of the population, Govt. Can spend money on projects to stimulate the economy and increase employment, or increase productivity level in the economy.

So, a tax cut and an increase in government spending would boost economic growth and decrease the unemployment rates. But this can lead to a budget deficit and the Govt. should use this with caution.

Neutral Fiscal policy:—

This policy implies a balance

between government spending and
Furthermore, it means that tax revenue
is fully used for government spending.
The overall budget outcome will have
a neutral effect on the level of economic
activities.