

## Fiscal Policy: Definition, Types & Objectives

### 1. What is Fiscal Policy?

**Fiscal Policy**, also called **Budgetary Policy**, refers to the **government's policy of taxation, public expenditure and borrowing** to influence the economy.

In simple words:

**Fiscal policy answers two basic questions:**

1. **Where should the government spend money?**
2. **From where should the government get money?**

These decisions are taken through the **Government Budget**.

### 2. Core Components of Fiscal Policy

Fiscal policy mainly works through **three instruments**:

#### (a) Public Expenditure

Government spending on:

- Defence, police
- Education and health
- Infrastructure (roads, railways, canals, airports)
- Welfare schemes and subsidies

**Example:** More spending on health during an epidemic.

#### (b) Taxation

Government raises revenue by:

- Imposing new taxes
- Changing existing tax rates
- Deciding **who to tax more and what to tax**

**Example:** Higher tax on luxury goods, lower tax on essentials.

#### (c) Public Borrowing

When tax revenue is insufficient, the government borrows from:

- Public (bonds, NSC, Kisan Vikas Patra)
- Foreign sources

Borrowing helps meet expenditure but creates future liabilities.

### 3. Types of Fiscal Policy

Fiscal policy can be classified into **three types**, based on the relationship between **government spending and taxation**.

#### 1. Neutral Fiscal Policy

**Government Spending = Tax Revenue**

- No attempt to stimulate or slow down the economy
- Budget remains balanced

Used when the economy is stable.

#### 2. Expansionary Fiscal Policy

**Government Spending > Tax Revenue**

- Government increases spending and/or reduces taxes
- Leads to budget deficit

**Used when:**

- Economy is slowing down
- Unemployment is high
- Recession-like conditions exist

**Objective:** Increase demand, production and employment.

#### 3. Contractionary Fiscal Policy

**Government Spending < Tax Revenue**

- Government reduces spending and/or increases taxes

**Used when:**

- Inflation is high
- Economy is overheating

**Objective:** Control inflation and excess demand.

#### 4. Fiscal Policy vs Monetary Policy

<b>Fiscal Policy</b>	<b>Monetary Policy</b>
Controlled by Government	Controlled by Central Bank
Deals with taxes & spending	Deals with money supply & interest rates
Political in nature	Largely independent
Affects budget & borrowing	Affects inflation & exchange rate

## 5. Objectives of Fiscal Policy

### 1. Promote Economic Growth

- Government invests in **basic and heavy industries**
- Builds infrastructure like roads, railways, power, education, health

Private sector avoids these due to huge investment needs, so government steps in.

### 2. Reduce Income and Wealth Inequality

- Higher taxes on rich
- Higher spending on poor (subsidies, welfare, employment schemes)

Ensures inclusive growth.

### 3. Generate Employment

Government creates jobs by:

- Setting up public sector enterprises
- Encouraging private sector through subsidies & tax concessions
- Promoting small-scale and cottage industries
- Launching public works (roads, bridges, canals)

### 4. Ensure Price Stability

- Controls prices of essential goods
- Maintains buffer stocks and ration shops
- Provides subsidies on LPG, electricity, transport

Protects common people from inflation.

### 5. Correct Balance of Payments (BoP) Deficit

When imports exceed exports:

- Government discourages imports through taxes
- Encourages exports via subsidies and incentives

Helps reduce foreign exchange outflow.

#### **6. Ensure Effective Administration**

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Government spends on:

- Defence
- Police
- Judiciary
- Legislature

Necessary for law, order and governance.

#### **Recall Trick**

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**Remember Fiscal Policy with “T–E–B–O–S–P”**

- **T** – Taxation
- **E** – Expenditure
- **B** – Borrowing
- **O** – Output growth
- **S** – Stability
- **P** – Poverty reduction

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