Fiscal Policy

[UPSC Notes]

What is Fiscal Policy in India?

Through the fiscal policy, the government controls the revenue generated by the country and the expenses needed to be fulfilled. The goal of Fiscal Policy is to increase government income while also increasing government spending. The government finance or policy known as Fiscal Policy is used to produce income and increase spending.

- Suppose the government receives more revenue than the total expenses. In that case, the government is in surplus condition.
- If it has more expenses than the total revenue collected, it is in the deficit condition.

So, to complete these expenses, the nation needs to borrow financial help from either domestically (which includes such private partners of the government) or needs to get help from other countries. Or the other option the country can stand upon is to print money in the nation by exchanging the foreign reserves.
These are the guidelines that can be given to the fiscal policy. Government can make use of this to help the economic condition be maintained in the country.

Latest News on Fiscal Policy

In pursuit of the Long-term infrastructure created for economic revival, the Union Budget 2021 has emphasized the Development of Financial Institutions (DFIs). It also proposed establishing a Dispute Resolution Committee (DRC).

The DRC will be responsible for helping taxpayers by providing quick relief in tax disputes.

Who formulates Fiscal Policy in India?

Fiscal policy in India is formulated by the Ministry of Finance in India. This policy was implemented in the year 2003.

Nowadays, the importance of fiscal policy is increased, and economic stability is the main base through which the country's development is mainly considered. India's main and crucial fiscal policy role is achieving fast and rapid economic growth. Along with fiscal policy, monetary policy plays an essential role in managing the country's economy.

Objectives of the Fiscal Policy

During a recession, for example, the government may opt to spend more on infrastructure projects, social welfare programs, and corporate incentives. The goal is to assist in making more productive money accessible to individuals, freeing up some income for consumers to spend elsewhere, and encouraging companies to invest. The following are some significant objectives of Fiscal Policy.

Price Stability: The total control of prices over all items or things is mainly governed by this policy. It controls the prices when the country faces economic crises and maintains the prices of things during the inflation period; thus, it controls the prices of things in the country.

- The government promotes price stability by controlling the supply of necessary commodities and services. As a result, it spends money on rationing and fair-priced stores with an adequate supply of food grains. It also subsidizes cooking gas, water, electricity, and other essential services like transportation, keeping their costs low enough for ordinary people to pay.

Complete Employment: If any country needs to improve its economic condition, the primary consideration should be employment. Since India has the largest youth population, resulting in a greater probability of development. The young generation is more capable of doing thin than the older people. Thus, if our country could provide complete or near to complete employment, it would boost our economic stats to the next level. All the employment-related decisions are made under the Fiscal policy.

The government expands employment possibilities in a variety of ways.

- One, when it establishes public sector firms, it creates jobs.
- Two, it gives incentives and other benefits to the private sector, such as tax holidays, reduced tax rates, and so on, to boost output and employment.
- It also encourages individuals to start small-scale, cottage, and rural enterprises to create jobs. This is accomplished by giving them tax breaks, incentives, subsidies, and low-interest loans, among other things.

Economic Growth: The fiscal policy has specific schemes that can increase the country's growth rate and help it fulfill its needs. The government encourages economic growth by establishing fundamental and heavy industries such as steel, chemicals, fertilizers, and industrial machinery, among other things. It also constructs infrastructures that promote economic growth, such as highways, bridges, trains, education and health facilities, water and energy supply, telecommunications, and so on.

Instruments of Fiscal Policy

The objectives mentioned above are met in the following ways
Public Expenditure
Taxation
Public Borrowing which includes price control, wages, and production

All the objectives are explained in detail below.

1. **Control over consumption**

This is the way through which the saving of the country is increased. Thus, it can be used to have things in the future and increase the country's current economic condition.

2. **By increasing the rate of investment**

This can be the best option to increase the economic condition in the present and future. As people invest, money is not wasted on unwanted things; it is invested into the proper things, increasing its value daily. Thus, the future economic condition of the country will be much better.

3. **Infrastructure development**

When some country is said to be a developed or a developing country, the major factor determining the country's development is the country's infrastructure. Thus, infrastructure development is more important if we need to increase the economic condition.

4. **Maximum taxes on Overseas products and Luxury Products**

Some products imported directly from the other countries into India have approx. 100% taxes involved in it. Due to this, the revenue generated by the country has maximum benefit. It will also make people buy self-made products, which will increase the development of industries in the country. Other significant aspects are huge taxation on the luxury products, if some things are overcharged due to their quality and other factors, the most important factor due to which the cost of the product is increased is the huge tax which the government has applied. As this huge tax is applied to luxury items, the revenue generated through these products will be maximum, directly affecting the country's economic condition.

Components of Fiscal policy

The components of the fiscal policy can be divided into three: -

1. Government Receipts
2. Government Expenditures
3. Public Accounts of India

Government Receipts

The government's income, which has been done by the collection of the taxes, interests, and the revenue generated by the investments, cess, and other forms of revenue the country has generated, have been considered in these Government Receipts. This is the government's total money from all the different sources. Government Receipts are categorized into two categories.

Revenue Receipts

A revenue receipt is defined as any government receipt that neither creates liabilities nor reduces assets. This can also be further divided into tax and non-Tax revenues. Non-tax revenues are the interests and the dividend which have been generated on the government investments, cess, and some other receipts. The tax revenues are divided into two sets; direct and indirect tax.

Capital Receipts

Capital receipts are all government receipts that create liabilities or reduce assets. The governments use this money to function properly. Having incoming cash flow is another type of capital receipt. If the government borrows the money, it is called a debt receipt because it needs

to be paid back by the government from which they have received the money. Some payments are not needed to pay back, so these are termed non-debt receipts. Almost 75 percent of the total budget are non–debt receipts. The main part of the capital receipts is formed by the loans taken by the general public, some foreign governments, and the Reserve Bank of India (RBI).

Government Expenditures

Government Expenditures have been further divided into two

- **Revenue Expenditures**

These are the short-term expenditures that have a period of about one year. This includes the expenses which are related to the current operational costs. And are much similar to operating expenses (OPEX). This also consists of the repair and maintenance costs which help the assets in the working period for a longer period. And also make use of the complete life of the assets. Examples of this are the salaries and utilities and rents etc.

- **Capital Expenditure**

These are the investments made by the governments in the capital and into the business to have an extended revenue. These are the long-term assets that the governments have invested in. These are used for buying fixed assets which can include the things like equipment. Thus, capital expenditure generates higher revenue as compared with revenue expenditure. These are examples of purchasing factory equipment for business and government spending on infrastructure.

Fiscal Policy & Public Account of India

These are also called public debt. The Public Account of India acts as a mediator, or we can call a bank for the transactions. These funds were created underside Article 266 (2) of the Indian Constitution. An example of this is providing funds and some small savings. But these funds are not owned by the government.

All of the government's income and outlays are credited to and deducted from the following:

- Consolidated Fund of India
- Contingency Fund of India
- Public Account of India

Types of Fiscal Policy

The types of Fiscal Policy in India are described below

1. **Expansionary Fiscal Policy**

These involve the decisions made by the governments to invest more money in the economy itself. Thus, it creates more services and many products. And also increases the job opportunities; thus, due to all increases, it also increases the profit of the people as well as the government.

2. **Contractionary Fiscal Policy**

This is the second type of fiscal policy. This is used when the condition of an economic boom arises. However, sometimes the high growth of the economy can also be dangerous. In this case, the government tries to slow back the condition of the economic boom. This helps in the control of the economic growth as well as it has control over inflation.

3. Neutral Fiscal Policy

This fiscal policy is used when the country's economic condition is in equilibrium. It means going well, with lows and highs in the economy. It includes the government's spending, funded by tax revenue collected from the people, companies, or industries. And will not be having any influence on the country's economic conditions.

Fiscal Policy vs Monetary Policy

The government employs fiscal and monetary policy to fulfil the county's economic goals.

A country's central bank is in charge of monetary policy. The Reserve Bank of India is responsible for India's monetary policy. Money, currencies, and interest rates are all part of monetary policy. The government handles the Centre's taxing and expenditure.

Fiscal Policy is vital in raising the rate of economic growth in India's public and private sectors. Fiscal Policy, through taxes, aids in the mobilization of significant resources for the funding of its myriad programmes. It also contributes to increasing the savings rate by providing the private sector with sufficient incentives to grow its operations. In addition, fiscal Policy aims to reduce inequity in the distribution of wealth and income.

Fiscal Consolidation vs Fiscal Federalism

Fiscal Consolidation: It is a process that encompasses the measures taken for the improvement of fiscal deficit. The government tries to improve the revenue receipts and set a better configuration in public expenditure with the help of Fiscal Consolidation.
The FRBM Act was introduced aiming for fiscal consolidation.
Fiscal Federalism: It indicates the distribution of resources or taxes between the state and central government. The 7th schedule of the constitution incorporates the distribution of taxes between central and state governments. Union List, Concurrent List, and the State List are three records that share the tax distribution between states and the center.