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Fiscal Policy and its Role in the Economy

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Introduction:

Fiscal policy deals with the taxation and expenditure decisions of the government. Monetary policy deals with the supply of money in the economy and the rate of interest. These are the main policy approaches used by economic managers to steer the broad aspects of the economy. In most modern economies, the government deals with fiscal policy while the central bank is responsible for monetary policy. Fiscal policy is composed of several parts. These include, tax policy, expenditure policy, investment or disinvestment strategies and debt or surplus management. The most significant aspects of the economy are addressed through fiscal policy measures, which range from budgeting to taxation. The three components of fiscal policy in India are as follows. Public Debt, Government Expenditures, and Government Revenues. The Ministry of Finance establishes the fiscal policy with support from NITI Ayog. Fiscal policy also feeds into economic trends and influences monetary policy. When the government receives more than it spends, it has a surplus. If the government spends more than it receives it runs a deficit. To meet the additional expenditures, it needs to borrow from domestic or foreign sources, draw upon its foreign exchange reserves or print an equivalent amount of money

Types of Fiscal Policy

1. Expansionary Fiscal Policy

These entail the choices made by the governments to increase their financial contributions to the national economy. Thus, it produces a large number of goods and services. Additionally, it expands employment prospects, increasing both individual and governmental profits as a result of all the growth.

2. Contractionary Fiscal Policy

The second kind of fiscal policy is this one. When there is an economic boom, this is employed. Rapid economic expansion can occasionally be risky, though. The government is attempting to halt the current economic boom in this instance. This controls inflation and economic growth.

3. Neutral Fiscal Policy

When the country's economy is in balance, this fiscal policy is employed. With economic highs and lows, it suggests things are moving well. It covers government expenditures that are paid for through taxes levied against citizens, businesses, or sectors of the economy. and won't have any impact on the nation's economic situation.

Main objectives of Fiscal Policy in India:

- **Economic growth:** Fiscal policy helps maintain the economy's growth rate so that certain economic goals can be achieved.
- **Price stability:** It controls the price level of the country so that when inflation is too high, prices can be regulated.
- **Full employment:** It aims to achieve full employment, or near full employment, as a tool to recover from low economic activity.

Fiscal Policy Components

Government Receipts

Government Expenditures

Public Accounts of India

1. Government Receipts- These government receipts take into account the government's income, which has been achieved through the collection of taxes, interest, and the revenue produced by investments, cess, and other forms of revenue the nation has generated. This represents the total funding received by the government from all sources. There are two types of government receipts. Income Receipts Any government payment that neither increases liabilities nor decreases assets is referred to as a revenue receipt. Revenues from taxes and other sources can also be separated from this. The interests and dividends earned on government investments, as well as cess and some other receipts, constitute non-tax revenues. Direct tax and indirect tax make up the two categories of tax revenues.

1. **Capital Receipts-**All government payments that increase liabilities or decrease assets are considered capital receipts. These funds are used by the governments to run smoothly. Another kind of capital receipt is the existence of an incoming cash flow. It is known as a debt receipt if the government borrows money since the money must be repaid to the government from whom it was borrowed. Non-debt receipts are those payments that do not require repayment. Non-debt receipts make up around 75% of all budgets. Loans

taken by the general public, some foreign governments, and the Reserve Bank of India make up the majority of capital receipts.

2. **Revenue Receipts-**Non-debt receipts are those payments that do not require repayment. Non-debt receipts make up around 75% of all budgets. Loans taken by the general people, some foreign governments, and the Reserve Bank of India make up the majority of capital receipts (RBI)
3. **Government Expenditure**

- **Revenue expenditures-**They are one-time costs that are incurred now or usually within a year. Revenue expenditures are essentially the same as operating expenses since they cover the charges necessary to cover the government's continuing operational costs (OPEX). regular costs for upkeep and repairs on state-owned property. Unlike most capital expenditures, which are one-time costs, they are ongoing expenses. An illustration would be paying for electricity, rent, employee salaries, and government-owned property taxes.
- **Capital Expenditure-**Investments made by the government in capital to run or grow its operations and bring in more money. Purchasing long-term assets, such as equipment, and purchasing fixed assets, which are tangible assets. Therefore, compared to revenue expenditures, capital expenditures are frequently for bigger sums. An illustration would be the acquisition of manufacturing equipment, commercial purchases, other government expenditures like furniture, infrastructure investment, etc.

4. **Public Accounts of India (Public Debt) -** When the government is only acting as a banker in a transaction, the Public Account of India records the flows for those transactions. According to Article 266(2) of the Constitution, this fund was established. It takes into consideration flows for transactions in which the government only serves as a banker. Examples include minor savings, provident funds, etc. This money doesn't belong to the government; instead, they must be returned to their original owners at some point. Consequently, the Parliament is not required to authorize spending from the public account.

Role of fiscal policy development of India:

1. **To Mobilize Resources:** The foremost aim of fiscal policy in underdeveloped countries is to mobilize resources in the private and public sectors. Generally, the national income and per capita income is very low due to low rate of savings. Therefore, the governments of such countries through forced savings pushes the rate of investment and capital formation which in turn accelerates the rate of economic development.
2. **To Accelerate the Rate of Growth**: Fiscal policy helps to accelerate the rate of economic growth by raising the rate of investment in public as well as private sectors. Therefore, various tools of fiscal policy as taxation, public borrowing, deficit financing and surpluses of public enterprises should be used in a combined manner so that they may not adversely affect the consumption, production and distribution of wealth.
3. **To Encourage Socially Optimal Investment:** In underdeveloped countries, the fiscal policy encourages investment into those productive channels which are considered socially and economically desirable. This means optimal investment which promotes economic development and avoids wasteful and unproductive investment.
4. **Inducement to Investment and Capital Formation:** Fiscal policy plays a crucial role in underdeveloped countries by making investments in strategic industries and services of a public utility on one side and induces investment in the private sector by giving assistance to new industries and introducing modern techniques of production. Thus, investment in social and economic overheads is helpful in increasing the social marginal productivity and thereby raising the marginal productivity of private investment and capital formation. Here, the optimum pattern of investment can also go a long way to yield fruitful results for economic development.
5. **To Provide more Employment Opportunities:** Since in less developed countries, the population grows at a very fast rate, the aim of fiscal policy in such countries is to make high doses of expenditures which are helpful to raise employment opportunities. Generally, underdeveloped economies suffer from unemployment.

6. **Promotion of Economic Stability:** Still another role played by fiscal policy in developing countries is of maintaining reasonable internal and external economic stability. Generally, a developing country is prone to the efforts of international cyclical fluctuations. Such countries mainly export primary products and import manufactured and capital goods. However, in order to minimize the effects of international cyclical fluctuations, fiscal policy should be viewed from a longer perspective. It must aim at the diversification of all sectors of the economy. For bringing balanced growth and reducing the effects of cyclical fluctuations, a contra-cyclical fiscal policy of deficit budgeting in depression and surplus budgeting in inflation is the most suitable measure.
7. **To Check Inflationary Tendencies:** Inflationary tendencies are one of the main problems of developing countries as these countries make heavy doses of investment for their development activities. Thus, there is always an imbalance between the demand for and the supply of real resources. With the additional injection of purchasing power, the demand rises and supply remains inelastic on account of its structural rigidities, market imperfections and other bottlenecks which in turn lead to inflationary pressures on the economy. Aggregate demand as a result of a rise in the income of the people exceeds the aggregate supply. Capital goods and consumption goods fail to keep pace with the rising income.
8. **National Income and Proper Distribution**: The importance of increasing national income and removing inequalities of income and wealth can hardly be exaggerated. According to Prof. Raja J. Chelliah, a mere increase in per capita income does not necessarily lead to an increase in the welfare of all sections of the people unless an equitable distribution is usually taken to mean a reduction in the existing inequalities of income and wealth.
9. **Reallocation of Resources:** Allocation of resources is not proper in underdeveloped countries. Much of the resources in the private sector are directed to the production of those goods which meet the need of richer sections of society and yield a higher profit. It is very important that the fiscal tools are employed in such a way as to divert resources from less useful production to more useful channels. This can be done by various tax incentive measures and government subsidy programmes.

10. **Balanced Growth:** Most underdeveloped countries suffer acutely from a regional imbalance in the matter of economic development. The private sector in these countries normally concentrates its production on those luxury goods which are consumed mostly by richer sections who live in the urban areas. Hence, backward areas will not be developed unless government interferes in the decision-making relating to industrial location. By providing financial incentives to the private sector and by setting up industries in the public sector in these geographical areas, the government can achieve balanced development of the country.

Investment and Capital Formation: Fiscal policy encourages investment in planned industries and services of service on one hand, and persuades investment in the private sector by assisting innovative enterprises and presenting cutting-edge production methods on the other. Investment in social and economic costs helps increase social marginal efficiency, which in turn increases the marginal productivity of private capital investment and capital development. Here, choosing the right investment strategy can also go a long way towards producing positive outcomes for economic growth. Economic growth is a potentially very dynamic process that incorporates alterations in population number and quality, as well as in preferences, knowledge, and social institutions. If social marginal productivity in socially acceptable enterprises is low, taking into account all relevant criteria, economic

Conclusion: Using the tools of policy, such as public spending, taxes, borrowing, and deficit financing, fiscal policy that promotes economic development, price stability, social justice, etc., is achieved, according to this article. India's economic strategy has several shortcomings, but there is also a pressing need to develop a rationalised and growth-oriented one. Economic policy's success depends on prompt action and efficient management of those actions during execution. The success of the economic policy depends upon taking timely measures and effective administration throughout the implementation.

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