

28. Fiscal Policy

Fiscal Policy: Any action by government which affects the size or composition of government revenue or expenditure

Key Fiscal Terms

Current Expenditure

Spending on day to day items financing the 'running of the country' i.e. public sector wages, cost of running government departments

Current Revenue

Money received by the government in taxation and other income

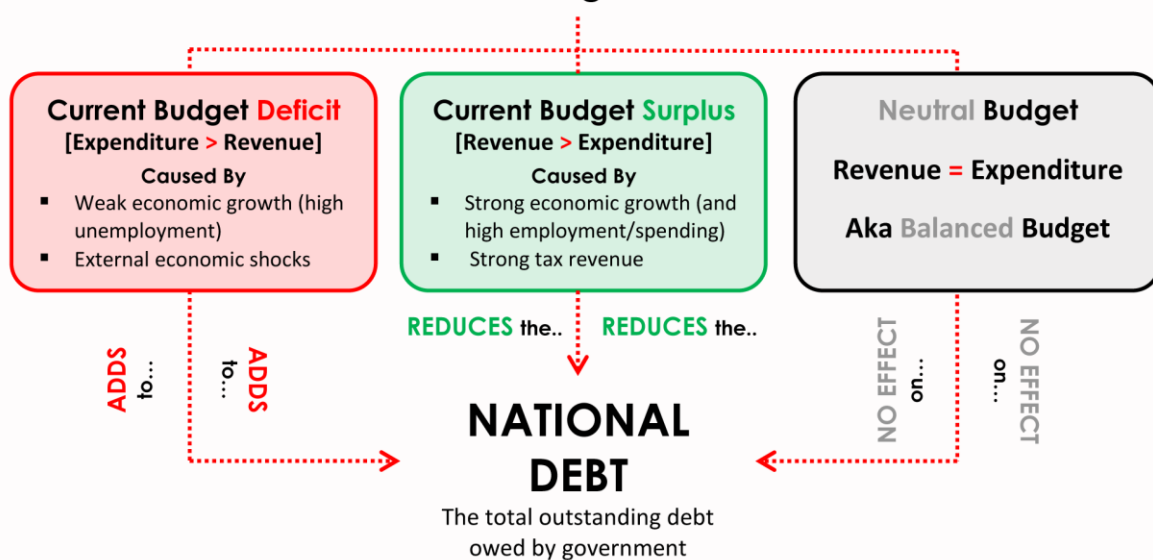
Capital Expenditure

Spending on long term projects such as large scale infrastructure

Exchequer Balance

Sum of **current** and **capital** budgets

Budgets



It's a **bad** thing as/if it...

- Pushes up **Interest rates** (In a small economy with small savings supply)
- Is spent to finance **current spending** rather than **investment** (country is living beyond its means)
- Crowds out private sector** (increases state involvement in the economy)
- Causes higher taxation** (Higher borrowing is ultimately unsustainable and will reduce aggregate demand and economic growth)
- As national debt grows, so do **interest payments**. In a downturn (as since 2007) these payments are difficult to make and the public budget gets cut, causing hardship (welfare, education, transport services)

It's a **good** thing if...

- Its spent on **infrastructure** (if money borrowed is spent on productive or social projects to provide necessary public services or increase economic output)
- Its spend on '**self liquidating uses**' (if money is medium term and will likely be repaid eventually i.e. current spending on banks)
- Its due to **natural growth** in the economy
- It leads to **borrowing at home**, instead of abroad (which can recoup tax)

Characteristics of the Good Tax System

Equity

Should be based on ability to pay

Certainty

Know your tax liability

Economy

Cost of collection must be low

Automatic Stabiliser

Should have stabilising effect on national income level

Convenience

Must be easy to collect tax

Redistribution

Taxation should enable to redistribute wealth from rich to poor

Flexible

Changeable to suit economic conditions

Not Discourage Work or Investment

Advantages

- Based on principle of **equity, certainty** and **economy**
- **Convenient** to taxpayer
- Acts as **automatic stabiliser**

Disadvantages

- As it rises, work is **discouraged** (**absenteeism** becomes a problem)
- **Tax evasion** rises
- Can discourage **investment**

Types of Taxation

DIRECT

Income Tax
Corporation Tax
Capital Gains Tax
Capital Acquisitions Tax

INDIRECT

VAT
Excise Duties
Custom Duties
Stamp Duties

Advantages

- **Cost of collection** is low (Economy)
- Easier to **extract** from the public (less sensitive)
- Doesn't **discourage work**
- Acts as **automatic stabiliser**

Disadvantages

- **Inflationary/Deflationary**
- Not **equitable**
- Hard to **predict yield** (based on assumptions of consumer spending)