200

TR	300	TE	500

Deficit Budget

→ Revenue Deficit = Revenue expenditure (−) Revenue Receipts

= 150 (−) 100

= 50

→ Fiscal Deficit
(Signifies Borrowings)

= Total expenditure (−) Total Receipts (excluding Borrowings)

= 500 (−) 300

= 200 (Borrowings)

OR

= Revenue deficit (+) Capital expenditure (−) Capital receipts (excluding Borrowings)

= 50 (+) 350 (−) 200

= 200 (signifies Borrowings)

→ Primary Deficit

= Fiscal Deficit (−) Net Interest liabilities

x ——— x ——— x ——— x ——— x ——— x

CH 7
Unit 4

"Fiscal Policy"

(1) Introduction

1 Introduction

→ Budgetary policy could be broadly classified into public revenue (1) including taxation, public expenditure (2), public debt (3) and finally deficit financing (4)

सरकार का Revenue (income)

सरकार की Borrowings

Budget deficit की भरपाई

सरकार का खर्चा

→ Fiscal policy is the deliberate policy of the government under which it uses the instruments of :-

- Taxation – सरकार का Revenue
- Public expenditure – " " खर्चा
- Public borrowings – " की Borrowings

→ fiscal policy is in the nature of demand side policy

Imp → An economy which is producing at full employment level does not require government action in the form of fiscal policy

2 OBJECTIVES OF FISCAL Policy

→ Achievement & maintenance of full employment

→ Maintenance of Price stability

→ Acceleration of the rate of economic development

→ equitable distribution of income & wealth

* $GDP = C + I + G + NX$

- C – Household का खर्चा
- I – निवेश का खर्चा
- G – सरकार का खर्चा
- NX – Net Exports

Household का खर्चा | निवेश का खर्चा | सरकार का खर्चा | Net Exports (X − M)

(3) TYPES OF FISCAL POLICY

Expansionary Fiscal Policy

- It is a policy measure to close a recessionary gap. (i.e deflation) "economy में demand कम है"
- Cut all types of Tax
- Increase in Public expenditure
- While resorting to expansionary fiscal policy, the government may run into budget deficits

Contractionary Fiscal Policy

- It refers to the deliberate policy of government applied to curtail aggregate demand and consequently the level of economic activity. In other words, it is a fiscal policy to eliminate Inflationary Gap
- Increase in taxes
- Decrease in Public expenditure
- Contractionary fiscal policy should ideally lead to smaller budget deficit

(4) INSTRUMENTS OF FISCAL POLICY

I. Government Expenditure

- Current expenditures to meet day to day running of the government.
- Capital expenditures (in form of Investment)
- Transfer Payments - which do not contribute to GDP

↳ Transfer Payments - which donot contribute to GDP

↑ Expenditure :-	AD ↑	inflation ↑
↓ Expenditure :-	AD ↓	inflation ↓

II **TAXES**

- Direct Tax
- Indirect Tax

Taxes ↑	Disposable income ↓	AD ↓
Taxes ↓	Disposable income ↑	AD ↑

III **Public Debt**

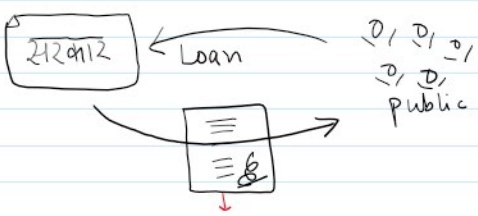
- Internal
- External

$\underbrace{\text{Internal} \quad \text{External}}$

Forms of Public debt

Market Loans

↓



Treasury bills,
Government Securities

Negotiable (✓)

Tradeable (✓)

Small Savings

↓

It represent public borrowings, which are not negotiable and are not traded
(eg National Savings Certificate, National Development Certificate etc)

Negotiable (✓)

Tradeable (✓)

National Development Certificate etc)

Public debt (↑) AD (↓)

Public debt (↓) AD (↑)

---

* Importants points relating to Fiscal Policy *

① **Budget** as Instrument of Fiscal Policy

- Balanced Budget : $\boxed{TR = TE}$ ☞ No effect on AD
  - leakages = Injections
- Surplus Budget : $\boxed{TR > TE}$ खर्चा कम है ☞ AD (↓)
  - leakages > Injections
- Deficit Budget : $\boxed{TR < TE}$ खर्चा ज्यादा है ☞ AD (↑)
  - leakages < Injections

② Fiscal Policy for **Long Run Economic Growth**

→ Fiscal policies such as those involving infrastructure spending generally have positive supply side effects

Roads ☺

24×7 electricity ☺

producers "(+)ve" ☺

→ Government provisions for public goods such as education, healthcare, nutrition etc provide momentum for long run economic growth.

momentum for long run economic growth.

→ Tax and spending policies can be effectively used to correct market failures resulting from externalities.

(3) Fiscal Policy for Reducing Inequalities of Income

- → Progressive direct tax system
- → Differential Indirect tax system

  { Luxury Goods → 28% Tax
  Necessity Goods → 0% Tax }

- → Other measures :-
  - → Poverty alleviation programmes
  - → Free or subsidized medical care, education, housing etc
  - → Various social security schemes (old age pension etc)
  - → etc etc

(4) LIMITATIONS of Fiscal Policy

(i) Different lags :-

a) Recognition lag - There is difficulty in collecting accurate & timely data.

b) Decision lag - Delays are likely to occur to make decision on the most appropriate policy.

c) Implementation lag - Even when appropriate policy measures are decided on, there are possible delays in bringing in legislation & implementing them.

d) Impact lag - It occurs when the outcomes of a policy are not visible in sometime

d) Impact lag - It occurs when the outcomes of a policy are not visible in sometime

(ii) It is practically difficult to reduce government spendings on various items.

(iii) Public works cannot be adjusted easily along with movements of trade cycle.

{ eg project → HIGHWAY long gestation period 3years }

(iv) Supply-side economists are of the opinion that certain fiscal measures will cause disincentives

{ Profit Tax (↑) investors (producer) ☹ }

(v) Increase in government borrowings will create perpetual "burden of debt" on future

5 CROWDING OUT

→ Increase in government spending during recessions will "crowd out" private spending in economy.

→ In other words when spending by government in an economy replaces private spendings, the latter is said to be crowded out.

→ As a result, the effectiveness of expansionary fiscal policy in stimulating aggregate demand will be diminished to a great extent (may possibly reduce economy's prospects of long term economic growth) economic growth)

* However during deep recessions, crowding out is less likely to happen as private investments are already minimal.

Recession
Demand ↓
prices ↓
employment ↓

Govt spending ↑↑↑↑↑

Pvt sector ↓↓↓↓↓

crowding out.

x ———— x ———— x ———— x

CH 8 — **MONEY MARKET** (8 - 10 Marks)

UNIT 1 : The Concept of Money Demand

1 INTRODUCTION

→ Money can be *anything* that can serve as :-

(i) Store of value — you can save it for future
(ii) Unit of account → common base for prices
(iii) Medium of exchange — which can be used to buy & sell goods or services

→ Money is something that holds its value over time, can be easily translated into prices, and is widely accepted. Many different things have been used as money over the years

- Cowry Shells
- Barley (Cereal Grain)
- Peppercorns
- Gold & Silver