Chapter 26
Fiscal Policy

Key terms

1. Budget : the relationship between government revenue and government spending.
2. Budget deficit : government spending is higher than government revenue.
3. Budget surplus : government revenue is higher than government spending.
4. National debt : the total amount the government has borrowed over time.
5. Multiplier effect : the final impact on aggregate demand being greater than the initial change.
6. Direct taxes : taxes on income and wealth.
7. Indirect taxes : taxes on expenditure.
8. Progressive tax : one which takes the larger percentage of income or wealth of rich.
9. Proportional tax : one which takes the same percentage of income or wealth for all taxpayers.
10. Regressive tax : one which takes a larger percentage of the income or wealth of the poor.
11. Automatic stabilisers: forms of government expenditure and taxation that reduce fluctuations in economic activity without any change in policy.
12. Inflation : the rise in the price level of goods and services overtime.
13. Informal economy : that part of the economy that is not regulated, protected or taxed by the government.
14. Flat taxes : taxes with a single rate.
15. Fiscal policy : decisions on government spending and taxation to influence aggregate demand.
16. Expansionary fiscal policy : rises in government expenditure and a cut in tax to increase aggregate demand.
17. Contraction any fiscal policy : cuts in government expenditure and a rise in taxation to decrease aggregate demand

1. Government Budget

Government budget

Budget deficit

: Government spending > Government revenue

Budget Surplus

: Government spending < Government revenue

2. Categories of tax

2.1 Direct & Indirect tax

Tax

Direct tax

Eg. Income tax, Corporate tax, Capital gain tax etc.

Indirect tax

Eg. Tax on petrol, VAT

2.2 Progressive tax Proportional tax and regressive tax

- Progressive tax : Income rises, the rate of tax also increases. Eg. Income tax
- Proportional tax : Income rises, percentage paid in tax stays the same.
- Regressive tax : Income rises, the percentage paid in tax falls Eg. Tax on petrol

3. Fiscal policy

Fiscal Policy

Expansionary fiscal policy

- **Increase government spending**

: AD = C + I + G + NX increases
: Job created
: Increases national output and employment

- **Cutting a tax**

: People have more disposable income
: More ability to pay goods and services
: It can increases national output and employment

Contractionary fiscal policy

- Decrease government spending

: AD = C + I + G + NX decreases
: Job created will be lower
: Decreases national output and employment

- **Increasing a tax**

: People have less disposable income
: Less ability to pay goods and services
: It can decreases national output and employment