3.5 Fiscal Policy

Key Words

Fiscal policy	A policy that uses government spending and taxation to affect the economy as a whole
Government spending	The total amount of money spent by the government in a given period of time
Government revenue	The source of finance for government spending
Direct tax	A tax on income, wealth or profit eg income tax, corporation tax, inheritance tax
Indirect tax	A tax on spending often defined as a tax on goods and services
Balanced government budget	When tax revenue is equal to government spending
Budget deficit	When government spending is greater than tax revenue
Budget surplus	When tax revenue is greater than government spending
Progressive tax	A tax which takes a greater percentage of tax the higher the income

Government Revenue and Spending

Government revenue
- The source of finance for government spending

Direct Taxes

A tax on income or wealth, which is paid for by an individual directly to the government

Examples of direct taxes:
Income tax
National Insurance
Corporation tax

Indirect Taxes

A tax on spending. An indirect tax is charged on producers of goods and services and is paid by the consumer indirectly.

Examples of indirect taxes:
VAT
Excise duties
Air passenger duty
Insurance premium tax

Government Spending
– The total amount of money spent by the government in a given time period

Spending on areas such as:

Social security eg benefits, state pension, universal credit, job seeker's allowance

Health

Education

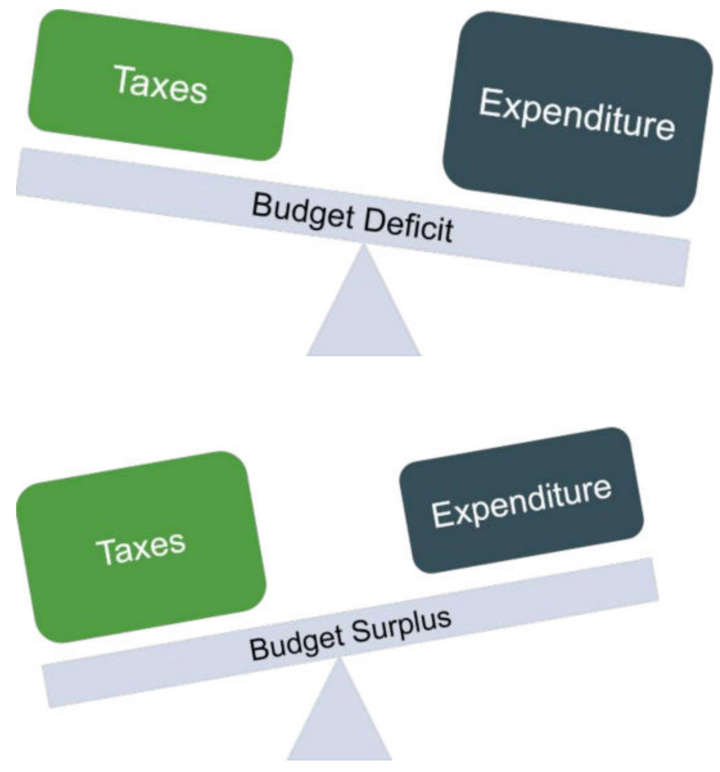
Defence

Law and order

Indirect Taxes

Arguments For Using Indirect Taxation	Arguments Against Using Indirect Taxation
Makes the person causing negative externalities pay	Many indirect taxes make the distribution of income more unequal because of their regressive effects
Changes in indirect taxes can change the pattern of demand by varying relative prices and therefore discourage consumption of demerit goods for example cigarettes	May cause job losses if demand for the product falls significantly
	A big disadvantage of increasing indirect taxes such as VAT is it could reduce spending in the economy

Government Budget



Balanced Budget

Government Expenditure = Tax Revenue

Direct Taxes

Arguments For Using Direct Taxation	Arguments Against Using Direct Taxation
Progressive	High levels of income tax will reduce incentives to work
Reduces inequalities	May lead firms to tax avoid

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