A2 Business Studies

Fiscal Policy

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Fiscal policy involves the use of government spending, taxation and borrowing to affect the level and growth of aggregate demand, output and jobs

Why raise tax?

- Raise revenue - to finance government spending
- Managing aggregate demand - to help meet the government's macroeconomic objectives
- Changing the distribution of income and wealth
- Market failure and environmental targets – taxes may help correct market failures

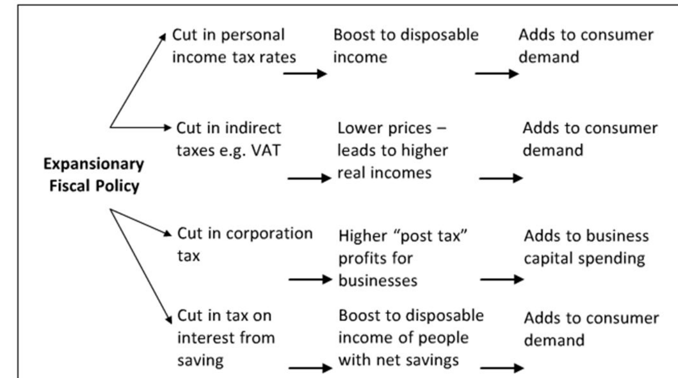
Direct Tax

- Direct taxation
  - Levied on income, wealth and profit
- Direct taxes include
  - Income Tax
  - National Insurance Contributions
  - Corporation Tax
  - Capital Gains Tax

Indirect Tax

- Indirect taxes are levied on spending by consumers on goods and services
- Examples
  - VAT (15% - 17.5%)
  - Excise duties on fuel and alcohol, car tax, betting tax and the TV licence
- Who pays?
  - The burden of an indirect tax might be passed onto the consumer by the producer
  - Depends on the price elasticity of demand and supply for the product

Promoting Growth



Taxation Effects on Firms

- Income tax – affects consumer spending, demand and ultimately profit. Not ALL firms will be affected
- VAT – makes goods more expensive, so affects consumer spending. SOME products exempt (newspapers, childrens' clothes etc.)
- Excise duty – mainly effects price inelastic products (petrol, alcohol, cigarettes) – consumer may have less disposable income which affects other firms
- Corporation tax – affects profit, expansion, risk-taking

Spending Effects on Firms

- Generally, spending increases total spending in the economy – most markets grow
- Any firm involved in an area of government spending (construction, education etc.) are directly affected
- Multiplier effects – spending on one sector may create jobs in others (e.g. health care – construction – drug manufacturers)