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Skip to main content Fiscal space is the budgetary room allowing a government to provide resources for public purposes without impacting fiscal sustainability. Opportunities have been defined for expanding fiscal space for health and they include: economic growth reprioritizing budgets, earmarking new revenue, improved efficiency and external resources.Further evidence shows that improved public financial management in the health sector can also increase fiscal space for health. Poor budget execution contributes to reduce available space for health spending.With the view of sustaining public funding for health priorities, WHO works with Member States to enhance fiscal dialogue between health and finance authorities. In a seminal Health Policy and Planning article, Peter Heller identified five opportunities for expanding fiscal space for health: (i) raising revenue, (ii) reprioritizing expenditure, (iii) borrowing, (iv) using seigniorage and (v) mobilizing external. In 2010, the World Bank refined this concept by recognizing five pillars for fiscal space for health expansion in low- and middle-income countries (LMICs): (i) economic growth, (ii) budget prioritization, (iii) earmarking of certain revenues, (iv) improved efficiency of spending in health and (v) external resources.Empirical studies in about 40 countries since the development of the framework have shown that the macro-fiscal performance of an economy is an important consideration behind rising public funding for health. Further evidence suggests that increasing the share of a budget dedicated to health has the potential to significantly expand health sector resources where the initial allocations are low. Earmarked revenues provide relatively fewer resources overall for the sector. The fourth pillar in Tandon and Cashins approach, the efficiency component, has provided mixed evidence on the extent to which efficiency gains can be translated into more resources for the sector. Country experience indicates, however, that efficiency gains do not automatically translate into greater budget for health. Public financial management (PFM) systems must allow those gains to be kept within the health sector and repurposed towards priority health needs.Improved financial management policies and tools in the health sector can also create space in the sectors budget, particularly in publicly funded systems. Poor PFM is a constraint on fiscal discipline and a barrier to realizing the potential of fiscal space. A growing body of evidence shows the impact PFM processes have on public spending, specifically on health expenditure. The most cited examples are the late, incomplete and misaligned budget releases in many LMICs, which significantly limit the actual budget envelope available for the sector. Conversely, PFM rules that are effective, such as releasing funds in a predictable manner, and flexible, such as allowing funds to be reallocated across budget lines, are likely to increase the possibility of maximizing the existing budget envelope for health. Using examples primarily from developing countries, this section of the chapteranalyzes the range of subsidies that are available to promote healthy behavior andthe consumption of health-related goods. The first sections deal with consumersubsidies both to promote the consumption of health-producing goods and of healthcare. The second section discusses producer subsidies.Governments use consumer subsidies to encourage the use of a beneficial productby lowering the price consumers payusually in situations where theconsumers are too poor, the market prices of the good are too high, or bothsituations applyto otherwise achieve a socially optimal consumptionlevel. Examples include subsidies for staple foods, condoms, soap,insecticide-treated bednets, cooking fuels, and medicines.Ample evidence indicates that food subsidies are effective in improvingnutrition; however, appropriate targeting is often a problem (Alderman 2002). Subsidies may betargeted to specific foods, specific delivery locales or geographic areas,or specific populations. Often targeting includes all three.Food-specific subsidies, whether in the form of general subsidies, rationcards, quotas, or food stamps, increase food consumption. They will have apositive effect on health if this consumption occurs in undernourishedpopulations that require increased caloric or nutrient intake. In somecases, food subsidy programs have had unintended macroeconomic andmicroeconomic consequences (Adams2000; del Ninno and Dorosh2002; Pinstrup-Anderson1988; Siamwalla 1988).They become expensive if they are too widely available, can createincentives for black market activities, and can affect prices and volumes inagricultural and trade markets.Indonesia switched from a general rice support system to a limited subsidyduring the 1997 macroeconomic crisis. The earlier system had successfullyreduced food insecurity to low levels, but higher prices increased the costof maintaining the subsidy and led to food being smuggled out of the country(Tabor and Sawit 2001). Thegovernment targeted the new rice subsidy to the poor and issued rationcards. Within roughly a year of implementation, the subsidy was reaching anestimated 85 percent of the poor. Only about 10 percent of the subsidyappeared to be reaching nontarget population groups.India has subsidized essential consumer goods for decades, includinghealth-related goods such as food grains, edible oils, sugar, and fuels (S.Jha 1992). The governmentrationed certain goods in the belief that only the truly needy would endurewaiting in lines and purchasing the poorer quality products that wereinvolved in the subsidy schemes. This is calledself-targeting. However, Jha shows that 40 percent ofthe population purchased subsidized rice in 1990, only half of whom werepoor. The government recently modified the program to better target thesubsidy to the poor and removed such barriers as bulk purchasing (Rao 2000).The Arab Republic of Egypt's generalized program also illustrates theproblems that beset broad food subsidy programs. The program reached itszenith in 1980, when it subsidized 20 food products and accounted for 15percent of government expenditures (Adams2000). The program has been scaled back to cover four staplefoods and now accounts for 6 percent of government expenditures.Nevertheless, about 75 percent of the population holds ration cardsentitling them to purchase the subsidized foods. The program is intended toachieve self-targeting, but the nonpoor purchase many of the subsidizedfoods. The program accounts for 44 percent of the total calorie supply ofthe poorest quintile group, but in rural areas, the rich obtain morecalories from subsidized food than the poor do.Musgrove (1993) reviews 104supplementary feeding programs in 19 countries in Latin America and theCaribbean. The review covers a range of program sizes, from those serving1,000 individuals to those supplying 28 million people; of types ofsubsidies (namely, food distribution, direct feeding, and direct payments);of levels of coverage of the targeted population, ranging from 1.9 to 100.0percent; and of extent of coverage of the poor, varying from 5.8 to 88.0percent. The per capita costs of reaching beneficiaries differed widely. Themost common reasons for program ineffectiveness were spreading resources toothinly across beneficiaries, targeting foods with minor health benefits,choosing inappropriate beneficiaries, and encountering excessive costs indistributing resources. These kinds of issues underscore the importance ofdesign considerations and country conditions in creating effective andefficient food subsidy programs.In sum, many food subsidy programs avoid the political and administrativechallenges of explicit targeting by allowing universal access to thesubsidies on the assumption that the needy will self-select into theprograms. However, Adams (2000)shows that countries with targeted food programsfor example,Chile, Jamaica, and Peruprovide much higher income transfers tothe poor than do self-targeted programs of the kind used in Egypt, Morocco,and Tunisia.Preliminary investigation indicates that subsidies on condoms can beeffective in increasing their use in both general and high-risk populations,but whether price reduction, increased access, or education leads to greateruse is not clear (Price 2001)because information campaigns about the health benefits of condoms usuallyaccompany price subsidies. Recent surges in social-marketing schemes todistribute condoms as part of the fight against HIV/AIDS, especially inAfrica, have increased condom use.2Few researchers have compared HIV infection ratesor even condomuse ratesbefore and after the introduction of a subsidy oncondoms. Cohen and others (1999)conclude that in a particular jurisdiction in Louisiana, free distributionthrough public clinics and 1,000 small businesses in areas with high levelsof HIV and other sexually transmitted diseases achieved significantly highercondom distribution than a fee-based system (77 percent use during the lastsexual encounter compared with 64 percent) and that the revenues from costrecovery were insufficient to justify imposition of the fee. The dropoff incondom use during the cost-recovery period persuaded the jurisdiction toreinstate the free distribution program.Another example suggests that promotion and information are also effective. Asocial-marketing effort in Turkey in the early 1990s offered condoms at acommercial price but included intensive advertising and other promotionalefforts. It achieved sales well beyond original expectations and gained 41percent of the market share (Yaser1993).The U.S. Centers for Disease Control and Prevention and the Pan AmericanHealth Organization designed the Safe Water System Initiative to improve thequality of drinking water for households that draw their water from sourcesoutside the home. The principle underlying the initiative is to subsidizestorage containers, disinfectant, and education on proper handling to avoidcontamination (Quick and others1999). Numerous countries have implemented similar initiatives,including Bangladesh, Bolivia, Burkina Faso, Kenya, and Zambia. Thegovernment provides containers and chemicals at subsidized prices, but thecosts are still higher than the cost of boiling water (Quick and others 2002).Another proven method for reducing the incidence of diarrhea and otherhygiene-related diseases is hand washing, with or without soap. Whether thekey factor is education or the subsidized provision of soap is unclear. Someinvestigators claim that small-scale programs that subsidize soap andeducate households about the benefits of hand washing are self-financingbecause of the consequent reduction in disease (Borghi and others 2002).Luby and others' (2001) resultsfrom Pakistan suggest that education alone may be just as effective aseducation accompanied by soap provision in reducing diarrheal disease. Bycontrast, Hoque (2003) and otherresearchers suggest that the cost of soap is a barrier to its widespread useamong extremely poor populations and that behavioral change may be difficultto achieve without a subsidy.The degree of subsidization of bednets has become a controversial issue, withsome arguing for full subsidization and others for partial subsidization.Most long-term studies indicate that consumers resist purchasing bednetseven at subsidized prices after they have had access to free bednets (Snow and others 1999).A number of researchers have undertaken studies in various locations inAfrica to assess the effect of selling bednets rather than providing themfree to vulnerable populations (Armstrong-Schellenberg and others 2001; Kolaczinski and others 2004; Snow and others 1999). The key issue is consumers'responsiveness to changes in the prices of bednets, through either subsidiesor a reduction in taxes and tariffs. Many households do not own a bednetbecause they cannot afford it, while other reasons are lack of information,poor access to markets, and cultural preferences (Hanson and Worrall 2002; Simon and others 2002). The evidence suggests thatresponsiveness to price changes alone may be modest, but in combination withremoving some of the other barriers, demand for bednets could increasesubstantially in malaria-affected regions (Simon and others 2002).Nigeria removed tariffs and taxes on bednet insecticide in 2001, and the 18percent price drop resulted in an estimated 9 to 27 percent increase inpurchases (Simon and others 2002).Another study that reviewed a public sector subsidy for bednets combinedwith private sector marketing and distribution by means of asocial-marketing scheme concluded that the program was successful because 18percent of children slept under bednets as a result; however, the lowinsecticide retreatment rate led the authors to conclude that subsidies wereneeded on both bednets and insecticide (Armstrong-Schellenberg and others 2001).High rates of respiratory illness occur as a result of exposure to smoke andparticle emissions from biomass burning in many developing countries. Fuelsubsidy programs have been designed to promote the use of liquid petroleumgas, natural gas, or kerosene, which burn more cleanly and emit a low amountof smoke and particulates, but none has been efficacious or efficient (UNDP 2003).Liquid petroleum gas subsidies have been shown to benefit middle-andhigher-income families in urban areas rather than the poor (UNDP 2003). In attempting to targetthe poor more accurately, Cte d'Ivoire and Senegal focusedsubsidies on smaller liquid petroleum gas cylinders but found that poorconsumers still preferred charcoal (UNDP2003). Electricity subsidies in low-income countries are alsooften skewed toward the well off, who are more likely than the poor to beconnected to the electricity grid (Alderman 2002).In relation to the direct provision of health-related goods, including drugs,supplies, and services of medical personnel, governments may subsidize andregulate drug prices, make bulk purchases from manufacturers fordistribution at reduced prices, and distribute certain drugs with completeor partial subsidies to target populations. Specificinterventionsfor instance, antiretrovirals, vaccines, orreproductive health careare often more heavily subsidized or maybe targeted by population group or diseasefor example, child andmaternal health, tuberculosis, and malaria. With the exception ofantiretroviral drugs, the health benefits and low costs of these medicinalinterventions make them good targets for subsidization.In developing countries, where informal sectors tend to be large, providingsubsidized health care is an important tool for health promotion. Somecountries have chosen direct provision of health goods, whereas otherscombine the public provision of services with subsidized health insurancefor families below a certain income cutoff. Both models require identifyingthe families that are unable to afford health care and the types of servicesthat are considered public goods.One example of subsidizing the production and provision of health care is theMexican program originally called PROGRESA and now known as Oportunidades.This program is also an example of how income transfers for other goods canaffect health and how cross-subsidies can be used to strengthen theincentive effects of a fiscal policy to promote healthy behavior. Thegovernment launched the program in 1997 to provide subsidized health,nutrition, and education to poor families. By mid 2004, it was serving themajority of those living below the poverty line. Oportunidades combines acash transfer equivalent to 20 to 30 percent of families' incomes thatincludes incentives for positive behaviors in relation to health, nutrition,and schooling with subsidized basic health interventions. The program islargely financed from federal budgets.Oportunidades is successful both in terms of targeting the poorest householdsand in terms of achieving measurable gains in health, health care use,nutritional status and growth, school attendance, and school achievement.Gertler (2004), for example,finds significant and cumulative reduction in illness rates among children,lower prevalence of anemia, and an additional centimeter of growth in thefirst year of the program.The program's success is attributable to many factors, including a rigorouslongitudinal evaluation process; an integrated package of services; and thepresence of financial stimuli tied to school attendance, visits to healthclinics, and participation in health education initiatives. Furthermore, theprogram incorporates several targeting methods.Governments use producer subsidies to encourage production that improves healthby lowering manufacturers' costs in situations in which the private marketsupply is inadequate to meet social needs. Examples include medical supplies,vaccines, food additives, and medical research.Governments sometimes subsidize the fortification of staple foods through theaddition of selected micronutrients as a way of achieving broadly basednutrition improvements. Challenges involve maintaining a relationshipbetween the public sector, which initiates and funds the program, and theprivate sector, which implements the fortification. Incentives for privateproviders are often needed in the form of tax exemptions, importpreferences, subsidies for startup costs, quality control, and training.Illegal markets selling nonfortified products at a lower price often arisein response (Alderman 2002; Dorosh, del Ninno, and Sahn 1996;Rao 2000).Government support for health research consists of the provision of directsubsidies for private sector investment, the granting of tax benefits forprivate research and development (R&D) investment, the establishmentof property rights and a system to protect them, and the promotion ofprivate goods by other means (OECD2003). Despite the strong evidence from developed countries thatthe private sector will underinvest in R&D and that tax incentivesincrease R&D investment, developing countries should be cautious inapplying those results to their own situations. Empirical investigationstend to conclude that producer subsidies for R&D in developingcountries are not effective (Shah1995; Zee, Stotsky, and Ley2002). Many conditions need to be in place to realize high socialreturns and to minimize rent seeking and profiteering, including a strongprivate sector research effort that is stimulated by the public investment,the presence of appropriate targeting, a transparent and fair set of publiclaws and institutions to grant and monitor the tax benefits, and the abilityto forgo alternative public investments. Share copy and redistribute the material in any medium or format for any purpose, even commercially. Adapt remix, transform, and build upon the material for any purpose, even commercially. The licensor cannot revoke these freedoms as long as you follow the license terms. Attribution You must give appropriate credit , provide a link to the license, and indicate if changes were made . 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[cited 22 Aug 2016].Page 2FR0.03**0.04***(0.01)(0.01)ER0.04**0.05***(0.01)(0.01)BBR0.04**0.05***(0.01)(0.01)BBR (detailed levels)National0.02(0.02)Supranational0.06***(0.02)Both0.08***(0.02) Country FE YYYYYYY Year FE YYYYYYY N 717717717717609609609adj. R20.9970.9970.9970.9970.9970.9970.997 Skip to main content The Fiscal Policies for Health (TAX) unit provides strategic leadership, capacity building and specialized technical assistance in the field of fiscal measures for health, particularly on excise taxation on tobacco, alcohol and sugar-sweetened beverage products. In addition, the TAX unit leads WHOs work on the development of tools, normative evidence, and market surveillance to provide best practice guidance for countries on how to use fiscal measures to improve health, reduce healthcare costs and generate a revenue stream for development.Building on its strong expertise and track record advising Member States on tobacco taxation, the TAX team in the Health Promotion Department serves as the overall coordinator on health taxes work within WHO, building on lessons learned from tobacco taxation work. The unit works across a wide range of countries, including high tobacco burden countries like China, India and Indonesia, as well as other countries such as across Africa where the tobacco epidemic presents a clear and present public health risk. This report provides an assessment of taxes applied to alcoholic beverages at the global level. It qualitatively compares their design and provides estimates... This report provides a global assessment of taxes applied to sugar-sweetened beverages (SSBs). It describes and qualitatively compares their design and... WHO has been publishing standardized data on tobacco taxes and prices on a biennial basis since 2008. This database forms part of the WHO report on the global tobacco epidemic and has become an invaluable tool to researchers, policy makers and advocates to track and compare country, regional and global progress on the implementation of tobacco taxes, and to identify needs for tobacco tax reforms. As WHO scales up technical assistance on alcohol and sugar-sweetened beverage (SSB) taxes, buoyed by the significant interest in this area by Member States, data collected for the first time on alcohol and SSBs provide a panorama of current taxes applied on identified alcoholic and non-alcoholic beverages and disseminates standardized indicators of tax design and tax level. This work aims to help understand the global implementation of taxes on alcoholic and non-alcoholic beverages, measure their level and identify areas of improvement. Skip to main content Public Health The Task Force on Fiscal Policy for Health convened in 2018 to address the growing global burden of noncommunicable diseases (NCDs). Co-chaired by Mike Bloomberg, Prime Minister of Barbados Mia Amor Mottley and renowned economist Larry Summers, and composed of fiscal policy, development, and health leaders from around the world, the Task Force works to draw attention to the role of fiscal policies to address the growing burden of NCDs worldwide.NCDs are the leading cause of death in the world, killing more than 40 million people each year. Seventy-seven percent of NCD deaths occur in low- and middle-income countries, imposing a strain on health care systems, contributing to poverty, and obstructing development. Tobacco use, obesity, and alcohol consumption are three leading risk factors for the development of NCDs.In 2019, the Task Force released an inaugural report concluding that health taxes were a highly effective but greatly underutilized policy tool to improve health outcomes, save lives and raise domestic resources. The report concluded that if countries increased their excise taxes to raise prices on tobacco, alcohol, and sugary beverages by 50 percent, over 50 million premature deaths could be averted worldwide over the next 50 years while raising over US $20 trillion of additional revenues.Since the initial report, the world is experiencing a protracted health and fiscal crisis as a result of the COVID pandemic. Despite the potential for health taxes to address both the health and fiscal crisis, little progress has been made.In response, the Task Force released a new report in 2024 highlighting the lack of progress and urgent need to raise health taxes to immediately ease fiscal pressures, reduce the burden of NCDs on struggling healthcare systems and most importantly save lives. Top photo: The bus displays a mass media campaign Bloomberg Philanthropies partners developed in Mexico to raise public support for front-of-package warning labels to help people make healthy choices. Photo credit: Alianza por la Salud Alimentaria As countries face tightening fiscal constraints and sharp reductions in health aid, the global health community is confronting a hard truth: a critical piece of the financing that supported decades of progress is rapidly eroding. At a side event during the 78th World Health Assembly, the Alliance for Health Policy and Systems Research co-sponsored by the governments of Ethiopia, Japan, Norway and the Philippines brought together health leaders and researchers to explore not only the consequences of this shift, but also what can be done about it.The discussion focused on charting a path forward: how countries can respond, what role domestic financing and global cooperation should play, and how research and evidence can support tough decisions in real time.From sudden cuts to system shocks: the crisis in real termsWhat has been quite shocking is the speed and scale of the cutbacks, said Helen Clark, Chair of the Alliance Board, as she opened the meeting. We were beginning to talk about a post-aid era but you dont expect it to be dropped on you within six months. The adjustment costs are very, very difficult.For Ethiopia, the consequences were immediate. The initial blow was to implementing partners, said Dr Muluken Argaw Haile of the Ministry of Health, noting that large portions of technical assistance and commodity procurement were disrupted. He noted that in 2019, about one third of the total health budget was supported by foreign aid. The government is now reprioritizing essential interventions and negotiating increased allocations with the Ministry of Finance, but gaps remain. Even that will not be enough, he added.In the Philippines, the announcement that long-time development partners were stepping back created both funding and coordination gaps. We couldnt believe our ears, said Dr Albert Domingo. Suddenly youre not sure who is still funding what and who youre supposed to talk to. Yet the crisis also prompted a closer look at domestic fiscal space. Weve always had the resources, he said. We are not a rich country, but our utilization rates have hovered around 60 to 70% of the approved health budget. Thats largely due to a sixfold increase in the budget since 2013, much of it driven by health taxes.Domestic financing and the promise and politics of health taxesWith traditional aid in retreat, many countries are turning to domestic resource mobilization. Building on a conversation convened earlier in the week by the Alliance and partners, health taxes became a focal point not just as a way to raise revenue, but to protect population health.Taxing tobacco reduces demand and gives the revenue a boost its time to dust off the evidence, urged Helen Clark.Dr Domingo agreed: Taxes protect the vulnerable women and children are the most price sensitive. If you raise prices on tobacco and sugary drinks, theyre the first to stop buying.But several participants noted the political complexity. Daniel Thornton, Director of Coordinated Resource Mobilization at WHO, asked from the audience about their political feasibility noting that South Africa had recently backed away from increasing value-added tax due to political pushback. Japans Dr Satoshi Ezoe concurred, recalling that the introduction of a national consumption tax nearly 30 years ago caused major political upheaval.Coordinating smarter, more equitable global supportDr Cathrine Lofthus, Secretary-General at Norways Ministry of Health and Care Services, emphasized the need for more coherent and efficient global health funding. The Lusaka Agenda captures the consensus of a truly global process, she said, highlighting its call for stronger primary health care, catalytic support for domestic financing and reduced fragmentation.While the Agenda predates the current cuts, she noted, it was already clear that we needed to use resources in a more efficient way and support country ownership. Norway is investing in tools to support priority-setting, health information systems, and common metrics including partnerships with countries like Ethiopia to strengthen institutional capacity.Clark also called for a broader rethink of how the global community finances collective action. One of the big issues will be whether there can be a new approach to funding for global common goods in the health area, she said, citing ongoing debates around pandemic preparedness and global public investment. Global public goods have to be financed whether its climate, whether its pandemics and we need effective instruments for that, which we dont really have at the present time.Research and real-time evidence: the role of learning in a crisisSpeakers across the panel underscored the importance of evidence-informed decision-making and of research that is timely, specific and grounded in context.We dont need frameworks we need to know how many Filipino lives will be saved by every peso added to alcohol tax said Domingo, adding and we need it in two months. For Ethiopia, building research institutions is only part of the solution. We need the capacity for these prioritization exercises to be done frequently, not just as a one-time project, said Dr Haile.As panel moderator Zubin Shroff of the Alliance noted, many of the challenges being faced from fragmented systems to hard funding choices cut across income levels. That only strengthens the case for learning and collaboration between countries.Japan is now launching a new UHC Knowledge Hub in Tokyo to help share policy solutions. We want to learn from each other how to mobilize additional resources for health not just rely on traditional aid, said Ezoe.A new kind of solidarityAs the event closed, Alliance Executive Director Dr Kumanan Rasanathan reflected on the stakes. Weve talked a lot about taxes today. But were also talking about changes and cuts that are leading to deaths as we speak.His message was clear: the response cannot wait. Countries are already taking action reviewing budgets, reprioritizing services, exploring new sources of funding. The task now is to support that work: with research, with smarter financing, and with genuine solidarity. STAY CURRENT WITH OUR LATEST DATA & INSIGHTS Sign Up Use of government revenue collection and expenditure to influence a country's economyPublic financePoliciesAgriculturalEconomicEnergyIndustrialInvestmentSocialTradeFiscalMonetaryPolicy mixFiscal policyBudgetpolicyDebtinternalDeficit/ surplusFinance ministryFiscal unionRevenueSpendingdeficitTaxMonetary policyBank reservesrequirementsDiscount windowGold reservesInterest rateMonetary authoritycentral bankcurrency boardMonetary baseMonetary (currency) unionMoney supplyTrade policyBalance of tradeFree tradeGains from tradeNon-tariff barrierProtectionismTariffTrade blocTrade creationTrade diversionTrade/ commerce ministryRevenueSpendingNon-tax revenueTax revenueDiscretionary spendingMandatory spendingOptimumBalanced budgetEconomic growthFiscal illusionPrice stabilityReformFiscal adjustmentMonetary reform PortalvtePart of a series onMacroeconomicsBasic conceptsAggregate demandAggregate supplyBusiness cycleCAGRDeflationDemand shockDisinflationEffective demandExpectationsAdaptiveRationalFinancial crisisGrowthInflationDemand-pullCost-pushInterest rateInvestmentLiquidity trapMeasures of national income and outputGDPGNINNIMicrofoundationsMoneyEndogenousMoney creationDemand for moneyLiquidity preferenceMoney supplyNational accountsSNANominal rigidityPrice levelRecessionShrinkflationStagflationSupply shockSavingUnemploymentPoliciesFiscalMonetaryCommercialCentral bankUniversal basic incomeModelsISLMADASKeynesian crossMultiplierAcceleratorPhillips curveArrowDebreuHarrodDomarSolowSwanRamseyCassKoopmansOverlapping generationsGeneral equilibriumDSGEEndogenous growthMatching theoryMundellFlemingOvershootingNAIRURelated fieldsEconometricsEconomic statisticsMonetary economicsDevelopment economicsEvolutionary economicsInternational economicsSchoolsMainstreamKeynesianNeo-NewMonetarismNew classicalReal business-cycle theoryStockholmNew neoclassical synthesisSaltwater and freshwaterHeterodoxAustrianChartalismModern monetary theoryEcologicalPost-KeynesianCircuitismDisequilibriumMarxianMarket monetarismSupply-sidePeopleFranois QuesnayAdam SmithThomas Robert MalthusKarl MarxLon WalrasKnut WicksellIrving FisherWesley Clair MitchellJohn Maynard KeynesAlvin HansenMicha KaleckiGunnar MyrdalSimon KuznetsJoan RobinsonFriedrich HayekJohn HicksRichard StoneHyman MinskyMilton FriedmanPaul SamuelsonLawrence KleinEdmund PhelpsRobert Lucas Jr.Edward C. PrescottPeter DiamondWilliam NordhausJoseph StiglitzThomas J. SargentPaul KrugmanN. Gregory MankiwSee alsoMacroeconomic modelPublications in macroeconomicsEconomicsEconomicsAppliedMicroeconomicsPolitical economyMathematical economics Money portal Business portalvteIn economics and political science, fiscal policy is the use of government revenue collection (taxes or tax cuts) and expenditure to influence a country's economy. The use of government revenue expenditures to influence macroeconomic variables developed in reaction to the Great Depression of the 1930s, when the previous laissez-faire approach to economic management became unworkable. Fiscal policy is based on the theories of the British economist John Maynard Keynes, whose Keynesian economics theorised that government changes in the levels of taxation and government spending influence aggregate demand and the level of economic activity. Fiscal and monetary policy are the key strategies used by a country's government and central bank to advance its economic objectives. The combination of these policies enables these authorities to target inflation and to increase employment. In modern economies, inflation is conventionally considered "healthy" in the range of 2%3%. Additionally, it is designed to try to keep GDP growth at 2%3% and the unemployment rate near the natural unemployment rate of 4%5%.[1] This implies that fiscal policy is used to stabilise the economy over the course of the business cycle.[2]Changes in the level and composition of taxation and government spending can affect macroeconomic variables, including:aggregate demand and the level of economic activitysaving and investmentincome distributionallocation of resources.Fiscal policy can be distinguished from monetary policy, in that fiscal policy deals with taxation and government spending and is often administered by a government department; while monetary policy deals with the money supply, interest rates and is often administered by a country's central bank. Both fiscal and monetary policies influence a country's economic performance.Main article: Monetary/fiscal debateSince the 1970s, it became clear that monetary policy performance has some benefits over fiscal policy due to the fact that it reduces political influence, as it is set by the central bank (to have an expanding economy before the general election, politicians might cut the interest rates). Additionally, fiscal policy can potentially have more supply-side effects on the economy: to reduce inflation, the measures of increasing taxes and lowering spending would not be preferred, so the government might be reluctant to use these. Monetary policy is generally quicker to implement as interest rates can be set every month, while the decision to increase government spending might take time to figure out which area the money should be spent on.[3]The recession of the 2000s decade shows that monetary policy also has certain limitations. A liquidity trap occurs when interest rate cuts are insufficient as a demand booster as banks do not want to lend and the consumers are reluctant to increase spending due to negative expectations for the economy. Government spending is responsible for creating the demand in the economy and can provide a kick-start to get the economy out of the recession. When a deep recession takes place, it is not sufficient to rely just on monetary policy to restore the economic equilibrium.[3]Each side of these two policies has its differences, therefore, combining aspects of both policies to deal with economic problems has become a solution that is now used by the US. These policies have limited effects; however, fiscal policy seems to have a greater effect over the long-run period, while monetary policy tends to have a short-run success.[4]In 2000, a survey of 298 members of the American Economic Association (AEA) found that while 84 percent generally agreed with the statement "Fiscal policy has a significant stimulative impact on a less than fully employed economy", 71 percent also generally agreed with the statement "Management of the business cycle should be left to the Federal Reserve; activist fiscal policy should be avoided."[5] In 2011, a follow-up survey of 568 AEA members found that the previous consensus about the latter proposition had dissolved and was by then roughly evenly disputed.[6]See also: Procyclical and countercyclical variables Economic policy makingDepending on the state of the economy, fiscal policy may reach for different objectives: its focus can be to restrict economic growth by mediating inflation or, in turn, increase economic growth by decreasing taxes, encouraging spending on different projects that act as stimuli to economic growth and enabling borrowing and spending.The three stances of fiscal policy are the following: Neutral fiscal policy is usually undertaken when an economy is in neither a recession nor an expansion. The amount of government deficit spending (the excess not financed by tax revenue) is roughly the same as it has been on average over time, so no changes to it are occurring that would have an effect on the level of economic activity.Expansionary fiscal policy is used by the government when trying to balance the contraction phase in the business cycle. It involves government spending exceeding tax revenue by more than it has tended to, and is usually undertaken during recessions. Examples of expansionary fiscal policy measures include increased government spending on public works (e.g., building schools) and providing the residents of the economy with tax cuts to increase their purchasing power (in order to fix a decrease in the demand).Contractionary fiscal policy, on the other hand, is a measure to increase tax rates and decrease government spending. It occurs when government deficit spending is lower than usual. This has the potential to slow economic growth if inflation, which was caused by a significant increase in aggregate demand and the supply of money, is excessive. By reducing the economy's amount of aggregate income, the available amount for consumers to spend is also reduced. So, contractionary fiscal policy measures are employed when unsustainable growth takes place, leading to inflation, high prices of investment, recession and unemployment above the "healthy" level of 3%4%.However, these definitions can be misleading because, even with no changes in spending or tax laws at all, cyclic fluctuations of the economy cause cyclic fluctuations of tax revenues and of some types of government spending, altering the deficit situation; these are not considered to be policy changes. Therefore, for purposes of the above definitions, "government spending" and "tax revenue" are normally replaced by "cyclically adjusted government spending" and "cyclically adjusted tax revenue". Thus, for example, a government budget that is balanced over the course of the business cycle is considered to represent a neutral and effective fiscal policy stance.Governments spend money on a wide variety of things, from the military and police to services such as education and health care, as well as transfer payments such as welfare benefits. This expenditure can be funded in a number of different ways:TaxationSeigniorage, the benefit from printing moneyBorrowing money from the population or from abroadDipping into fiscal reservesSale of fixed assets (e.g., land)Selling equity to the populationA fiscal deficit is often funded by issuing bonds such as Treasury bills or and gilt-edged securities but can also be funded by issuing equity. Bonds pay interest, either for a fixed period or indefinitely that is funded by taxpayers as a whole. Equity offers returns on investment (interest) that can only be realized in discharging a future tax liability by an individual taxpayer. If available government revenue is insufficient to support the interest payments on bonds, a nation may default on its debts, usually to foreign creditors. Public debt or borrowing refers to the government borrowing from the public. It is impossible for a government to "default" on its equity since the total returns available to all investors (taxpayers) are limited at any point by the total current year tax liability of all investors.A fiscal surplus is often saved for future use, and may be invested in either local currency or any financial instrument that may be traded later once resources are needed and the additional debt is not needed.The concept of a fiscal straitjacket is a general economic principle that suggests strict constraints on government spending and public sector borrowing, to limit or regulate the budget deficit over a time period. Most US states have balanced budget rules that prevent them from running a deficit. The United States federal government technically has a legal cap on the total amount of money it can borrow, but it is not a meaningful constraint because the cap can be raised as easily as spending can be authorized, and the cap is almost always raised before the debt gets that high.This article needs additional citations for verification. Please help improve this article by adding citations to reliable sources. Unsourced material may be challenged and removed.Find sources:"Fiscal policy"news newspapers books scholar JSTOR (July 2024) (Learn how and when to remove this message)See also: Gross fixed capital formation Economic analysisGovernments use fiscal policy to influence the level of aggregate demand in the economy, so that certain economic goals can be achieved:[7]Price stability;Full employment;Economic growth.The Keynesian view of economics suggests that increasing government spending and decreasing the rate of taxes are the best ways to have an influence on aggregate demand, stimulate it, while decreasing spending and increasing taxes after the economic expansion has already taken place. Additionally, Keynesians argue that expansionary fiscal policy should be used in times of recession or low economic activity as an essential tool for building the framework for strong economic growth and working towards full employment. In theory, the resulting deficits would be paid for by an expanded economy during the expansion that would follow; this was the reasoning behind the New Deal.The IS curve shifts to the right, increasing real interest rates (r) and expansion in the "real" economy (real GDP, or Y).The IS-LM model is another way of understanding the effects of fiscal expansion. As the government increases spending, there will be a shift in the IS curve up and to the right. In the short run, this increases the real interest rate, which then reduces private investment and increases aggregate demand, placing upward pressure on supply. To meet the short-run increase in aggregate demand, firms increase full-employment output. The increase in short-run price levels reduces the money supply, which shifts the LM curve back, and thus, returning the general equilibrium to the original full employment (FE) level. Therefore, the IS-LM model shows that there will be an overall increase in the price level and real interest rates in the long run due to fiscal expansion.[8]Governments can use a budget surplus to do two things: to slow the pace of strong economic growth;to stabilise prices when inflation is too high.Keynesian theory posits that removing spending from the economy will reduce levels of aggregate demand and contract the economy, thus stabilizing prices.But economists still debate the effectiveness of fiscal stimulus. The argument mostly centers on crowding out: whether government borrowing leads to higher interest rates that may offset the stimulative impact of spending. When the government runs a budget deficit, funds will need to come from public borrowing (the issue of government bonds), overseas borrowing, or monetizing the debt. When governments fund a deficit with the issuing of government bonds, interest rates can increase across the market, because government borrowing creates higher demand for credit in the financial markets. This decreases aggregate demand for goods and services, either partially or entirely offsetting the direct expansionary impact of the deficit spending, thus diminishing or eliminating the achievement of the objective of a fiscal stimulus. Neoclassical economists generally emphasize crowding out while Keynesians argue that fiscal policy can still be effective, especially in a liquidity trap where, they argue, crowding out is minimal.[9]In the classical view, expansionary fiscal policy also decreases net exports, which has a mitigating effect on national output and income. When government borrowing increases interest rates it attracts foreign capital from foreign investors. This is because, all other things being equal, the bonds issued from a country executing expansionary fiscal policy now offer a higher rate of return. In other words, companies wanting to finance projects must compete with their government for capital so they offer higher rates of return. To purchase bonds originating from a certain country, foreign investors must obtain that country's currency. Therefore, when foreign capital flows into the country undergoing fiscal expansion, demand for that country's currency increases. The increased demand, in turn, causes the currency to appreciate, reducing the cost of imports and making exports from that country more expensive to foreigners. Consequently, exports decrease and imports increase, reducing demand from net exports.Some economists oppose the discretionary use of fiscal stimulus because of the inside lag (the time lag involved in implementing it), which is almost inevitably long because of the substantial legislative effort involved. Further, the outside lag between the time of implementation and the time that most of the effects of the stimulus are felt could mean that the stimulus hits an already-recovering economy and overheats the ensuing h rather than stimulating the economy when it needs it.Some economists are concerned about potential inflationary effects driven by increased demand engendered by a fiscal stimulus. In theory, fiscal stimulus does not cause inflation when it uses resources that would have otherwise been idle. For instance, if a fiscal stimulus employs a worker who otherwise would have been unemployed, there is no inflationary effect; however, if the stimulus employs a worker who otherwise would have had a job, the stimulus is increasing labor demand while labor supply remains fixed, leading to wage inflation and therefore price inflation.EconometricsFiscal Observatory of Latin America and the CaribbeanFiscal policy of the United StatesFiscal unionFunctional financeInteraction between monetary and fiscal policiesMonetary policyNational fiscal policy response to the late 2000s recessionPolicy mixTax policy^ Kramer, Leslie. "What Is Fiscal Policy?". Investopedia. Dotdash. Retrieved April 26, 2019.^ O'Sullivan, Arthur; Sheffrin, Steven M. (2003). Economics: Principles in Action. Upper Saddle River, New Jersey: Pearson Prentice Hall. p.387. ISBN978-0-13-063085-8.^ a b Pettinger, Tejvan. "Difference between monetary and fiscal policy". Economics.Help.org. Economics.Help.org. 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