

The Impact of Fiscal Policy on Economic Growth and Optimal Fiscal Policy: A Journey through Neoclassical growth models

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Abstract

The literature on the issue of fiscal policy and economic growth and the inference on the optimal fiscal policy are vast and diverse. In this paper some prominent works based on neoclassical framework have been reviewed to obtain an overall trend and an account of the impact of various fiscal policy instruments like government expenditure and various form of taxation to finance it, on the economic growth and welfare of an economy and in this process, based on these impacts, how the optimal fiscal policies in a decentralised economy are determined. The general conclusions of the literature carried out under neoclassical framework are that the productive government expenditure is more growth enhancing than utility enhancing or consumptive lump-sum transfer. Across the study the optimal fiscal policy evolves as no capital taxation and government expenditure is to be financed by consumption tax and personal income tax.

Key words: Fiscal policy, Economic growth of open economies, Macroeconomic Analyses of Economic Development

JEL classification: E62, F43, H3, O11

1. Introduction

The disperse level of rate of growth in the world economy has been significant concern among the economist and accordingly the study of economic growth became strong in the late 1980s. The major concern became research on the determinants of growth. In this paper we would like to focus on that literature which deals with the role of fiscal policy on economic growth.

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