



What Role Does Fiscal Policy Play in Promoting Economic Growth?



But what is...?

Fiscal Policy refers to the use of government spending and taxes to achieve economic objectives.

Interest Rates are the price a borrower has to pay in order to borrow. Riskier borrowers usually pay more.

The Stability and Growth Pact (SGP) is a set of EU rules limiting national deficit and debt levels.

The European Stability Mechanism (ESM) is the permanent crisis resolution mechanism of the EU which will be operational from July 1st 2013. It will be the vehicle through which financial assistance will be provided to euro area countries in need.

The European Commission is charged with enforcing the rules set out in the SGP and reviews, but does not control, member states' budgets.

Fiscal policy is an important economic tool at the disposal of governments. During recessions, increasing public spending and cutting taxes can provide a powerful boost to the economy. Likewise, if an economy is overheating, cutting spending and raising taxes will depress output. But borrowing to fund spending can be risky. If debts and deficits get too big, they can lead to debt and financial crises.

- ① Who is responsible for conducting fiscal policy in the euro area?
- ② What role does the European Commission play in fiscal surveillance? What is the Stability and Growth Pact (SGP)? Should the SGP be reformed? If so, how?
- ③ What is the difference between government deficit and debt? Is there a level at which debts become unsustainable?
- ④ What impact did the financial crisis have on government finances in your chosen country? Did the public sector help recapitalize the banking sector? Did your country implement a fiscal stimulus or did it adopt austerity measures?
- ⑤ How does fiscal policy affect economic growth? What is counter-cyclical policy? What is a fiscal multiplier? Does it make a difference if fiscal policy is adjusted via higher (or lower) spending versus higher (or lower) taxes?
- ⑥ What would happen to a country's fiscal position if interest rates rose? What about if inflation goes up? What if GDP growth slows?
- ⑦ Why might financial markets lose faith in a country's ability to repay its debts? How do lenders react when they begin to doubt the credit worthiness of a borrower?
- ⑧ If a borrower simply cannot repay its debts, what happens? Does it matter if the borrower is a sovereign nation? What is meant by financial contagion?
- ⑨ How does being a member of a monetary union affect fiscal policy? How does the fiscal stance of your chosen country impact other euro area countries and vice-versa? Should responsibility for some areas of fiscal policy be shared in the euro area?
- ⑩ What sorts of things should the public sector spend money on? What is the impact of different types of spending, e.g. on unemployment insurance or infrastructure, on economic growth?