Edexcel (A) Economics A-level

Theme 4: A Global Perspective

4.5 Role of the State in the Macroeconomy

4.5.3 Public sector finances

Notes

Distinction between automatic stabilisers and discretionary fiscal policy

- **Discretionary** fiscal policy is a policy which is implemented through one-off policy changes. Discretionary fiscal policy involves deliberate changes in government expenditure and taxes with the intention of influencing aggregate demand. Keynes believed that during recessions, governments should increase their spending, and finance this with more borrowing.
- **Automatic stabilisers** are policies which offset fluctuations in the economy. These include transfer payments and taxes. They are triggered without government intervention.

Distinction between a fiscal deficit and the national debt

- A government has a **fiscal (budget) deficit** when expenditure exceeds tax receipts in a financial year.

- The **national debt** is the amount of money the government has borrowed at one time through issuing securities by the Treasury.

Distinction between structural and cyclical deficits

Cyclical deficit

This is a temporary deficit, which is related to the business cycle. A deficit might occur during recessions, when governments increase spending to stimulate the economy.

Structural deficit

This is a deficit which is due to an imbalance in the revenue and expenditure of the government, so it exists at every point in the business cycle.

Factors influencing the size of fiscal deficits

- **The business cycle**

  Governments are likely to spend more during recessions. This is to try and stimulate the economy. Spending might be increased on welfare payments, since more people will be unemployed and on low incomes. Moreover, tax revenues from income tax and VAT will be lower, since people will be earning and spending less.

- **Interest payments**

  If interest rates increase on government debt, the amount the government pays in interest payments increases, so the deficit might increase.

- **Privatisation**

  An industry is privatised when the government sells the industry to the private sector. This provides them with a one-off payment, which could improve the budget deficit.

Factors influencing the size of national debts

- The national debt is the accumulation of the government deficit over time. It is the total amount the government owes.
- If the government is continuously running a deficit, the size of the debt increases.
- If the government reduces the size of their deficit, the rate of increase of the total debt is slower, but the debt is still increasing.
- It is only when the government runs a budget surplus that the size of the national debt decreases. Currently, the UK government is trying to reduce the size of the deficit and eventually run a budget surplus by 2019-2020, at which point they will start paying off the debt.

The significance of the size of fiscal deficits and national debts

- The cost of borrowing could increase, since by borrowing money, the government is increasing demand for credit in the economy.
- If confidence is lost in the government's ability to repay the debt, governments might have to raise interest rates to encourage investors to buy bonds, so that they can finance the debt.
- It could lead to higher taxes and austerity measures, especially if the debt becomes uncontrollable.
- A fiscal deficit could be inflationary if it increases AD.

- More government spending could lead to crowding out of the private sector. This leaves fewer funds in the private sector for firms to use, since the government is borrowing money, which crowds them out of the market.