1. Does it matter if a government is in debt?

*Answers may include:*

Government deficit occurs when its revenue is less than its expenditure over a given period such as a year. Government debt is the total amount it owes; it is a stock concept. The deficit each year adds to the stock of debt. The debt will incur interest charges. Repaying these each year uses up funds that could have been used for investment elsewhere. At the same time the debt has occurred because of spending which may have been invested into the economy. The significance of the debt depends on:

- The scale of the debt relative to the income earned by the country and government
- The scale of the interest costs
- The perceived ability of the government to pay these costs; the higher the perceived risk of non-payment the higher the interest rates will be adding to the burden of the government
- What the money has been spent on e.g. is it on consumption or capital goods?

2. To what extent is a budget deficit a good indicator of an expansionist government fiscal policy?

*Answers may include:*

A government budget deficit occurs when its revenue is less than its expenditure over a given period such as a year. Government spending on final goods and services is autonomous of national income. Net tax revenue is directly linked to national income; as income increases tax revenue (on spending, incomes and profits) will automatically increase and spending on unemployment benefits will automatically fall as there will be less people without a job. This means that the government’s budget position automatically improves as the economy grows. Similarly as an economy shrinks tax revenues fall and benefit spending increase; this means a government’s budget position automatically worsens as the economy shrinks. A budget deficit may therefore simply be the result of a fall in national income. It may not be due to discretionary changes but due to automatic changes in the economy. Having said this, discretionary (deliberate) changes may increase the deficit further- an increase in government spending on investment projects or a decrease in income or corporation tax rates would lead to a bigger deficit for any level of income.

When analyzing the deficit position it is important therefore to distinguish between automatic and discretionary changes.
3. Is fiscal policy a better way of controlling the economy than monetary policy?

*Answers may include:*
Fiscal policy involves changes in government spending and taxation and benefit rates to influence the economy. Monetary policy involves changes in the money supply and interest rates to influence the economy. Government spending and tax changes can be targeted very specifically e.g. spending can be on specific project, tax incentives/disincentives can be offered for certain types of behavior e.g. diesel usage. However:
It can take a long time to agree on a spending project and for the effects to work through the economy
Tax changes may not lead to the desired effect- a cut in taxes may lead to more savings rather than more spending

Monetary policy also has problems; a cut in interest rates may not lead to the desired increased in borrowing and spending. Attempts to limit lending by banks may not be effective if banks find a way around any regulations.

Both policies have difficulties and it is usually a question of emphasis rather than one or the other.