



Fiscal responsibility and monetary policy

Fiscal Policy

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Fiscal policy can always mean two things. The real, you know, discretion or your intention of programmes that, say in the situation of recession, do more construction works or have more public employment, employ a few more teachers and so on. And that I think came only really into its own in the 60's, in the mid 60's, the first bigger worldwide recession or OECD recession we should say. While there's also a fiscal policy that works at a much more subtle level. And that is inbuilt into our budgets where what we call the automatic stabilisers, in other words fiscal policy that works through the tax transfer mechanism such that all the items that vary in a way that make the budget balance very counter cyclically with the economy. In other words the deficit goes up in a recession so as to stabilise aggregate demand. And the deficit goes down in a boom in order to rein in some of that demand that drives prices and would create difficulties for inflation. And that stabilises about this automatic stabilisers. Today about 30, if you take the US to 50% of the fluctuation that you have cyclically caused. So it is quite important and probably more important than anything that governments can at short notice and in time produce for normal cyclical fluctuation. Simply because you don't have the diagnosis problem. You don't have the problem that you need to come up with a package that passes Parliament. And where your civil servants first have to find these ready-made ways of spending money basically.

So the automatic stabilisers that what most people don't notice, the most important ones are unemployment benefits that obviously more are paid in a recession because more people get unemployed. But more importantly Income Taxes that go up when everybody has employment, works overtime and so on and goes down in a recession in that sense. Some people may actually fall into different classes of the tax structure, tax rates. And so that leads more to the economy in a recession. And this is a very important smoothing device that a modern government budget represents.