Economics and Public Finance
Tutorial P11

- Topics:
  - Budget constraint, and Public Debt Sustainability
  - Fiscal policy in the context of EMU
  - The Stability and Growth Pact
  - The Stability and Growth Programme
  - The excessive deficit procedure.

Readings

- "The reform of economic governance in the euro area – essential elements". ECB Monthly Bulletin, March 2011, pp. 99-119.
- Glossary of Public Finance terms.

Multiple Choice Question - 1

Say which of the statements is false. Government debt:

a) Changes from year to year.

b) Is a stock variable.

c) One way of using private resources to finance public deficits.

d) Is given by the difference between effective revenue and effective expenditure.

Multiple Choice Question - 2

The issuance of government debt in a given year equals:

a) The net borrowing requirements.
b) The gross borrowing requirements.
c) The budget deficit.
d) The redemption (amortization) of government debt.

Multiple Choice Question - 3

The government budget constraint of a country that cannot issue money and does not sell financial assets to finance the budget deficit, obeys the following condition:

a) The change in the debt ratio is equal to the total budget balance.

b) The change in the debt ratio is equal to the symmetric of the total budget balance.

c) The change in the debt ratio is equal to the primary budget balance.

d) The change in the debt ratio is equal to the symmetric of the primary budget balance.

Multiple Choice Question - 4

Which statement is false regarding the Stability and Growth Programme:

a) Sets medium-term objectives for a fiscal situation close to balance.

b) Defines an adjustment path for the medium-term objectives.

c) Forecasts the economic developments.

d) Sets limits to the budget deficit, 3% of GDP, and to the debt ratio, 60%, of the general government.

Multiple Choice Question - 5

The debt ratio in a given country is 140% of GDP in t. Given the adjustment speed of the debt ratio in the context of the Fiscal Stability Treaty, which should be the debt ratio in t+3:

a) 110%.
b) 128%.
c) 120%.
d) 98%.

Topics for discussion - 1

In the context of the government budget constraint, explain of which variables, and in what sense, depends the sustainability of government debt.

Topics for discussion - 2

a) In the context of the Stability and Growth Pact, revised in 2005, mention succinctly its main underlying budgetary principles.

b) Mention also which were the main changes approved in 2011 in terms of coordination and monitoring of Fiscal Policies in the EMU.

Exercise - 1

Consider the government budget constraint: $\Delta b=d-nb$ (b – debt ratio; d – budget deficit, % of GDP; n – nominal growth rate of GDP). Countries A and B have the same nominal growth rate of 5%, and stabilize their debt ratios respectively at 160% and 100%.

a) Compute the resulting budget deficit ratio for each country, and comment in the context of the SGP.

b) What options are theoretically available for these countries to reduce the debt ratio?

Exercise - 2

Consider the following data for GDP, government debt, and the budget deficit in a given country.

a) If the budget balance where to be kept at the same level as in 2010, and the same were also true for nominal growth, would public finances be sustainable? Justify.

b) Assuming that in the next decades the nominal growth rate will be 2,5% and that the implicit nominal interest rate for government debt will be on average 3,75%, compute the total and the primary budget balance consistent with a convergence of the debt ratio to 60%.

Exercise - 2

Million euros	2010	2011
Net borrowing requirements	-14911.6	-8046.3
Government debt	159469.1	168756.6
GDP	172546.3	173476.5
Net borrowing requirements (% of GDP)	-8.6	-4.6
Government debt (% of GDP)	92.4	97.3
GDP nominal growth rate	2.33	0.54