

Fiscal stimulus: a boon or a bane?

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In the face of current global crisis, many economies have injected huge amounts of fiscal stimulus in order to revive aggregate demand and thus, growth. An economic stimulus is an effort by the government to pump money into an ailing economy, whether through spending, tax cuts or interest rate reductions. A stimulus is meant to put a floor under a recession and pave the way for a return to growth.

There is a need of a well-executed policy mix of both monetary and fiscal measures to prevent the economy from further weakening and a downward debt-deflation spiral. The extraordinary policy intervention since the crisis has all but eliminated the risk of a second Great Depression, laying the foundation for recovery. It is important to answer the following questions-when and why a fiscal stimulus package? What constitutes a well executed fiscal stimulus? What are its costs?

Governments and central banks responded to financial sector difficulties by introducing substantive and innovative measures to deal with liquidity and solvency problems. Also, central banks reduced interest rates to unprecedented levels to underpin aggregate demand, and used nonconventional measures like quantitative easing and qualitative or credit easing. In spite of these efforts, credit remained tight and aggregate demand in many countries weakened rapidly. There were negative spill-overs from the weakening economies to those that had appeared more robust, and increased concern that the global economy might be moving into a period of deep and prolonged recession.

Governments around the world therefore went beyond monetary policy measures by introducing large stimulative fiscal packages (*see table 1). In this context, questions were raised about the effectiveness of temporary fiscal policy actions in lessening the depth and duration of the slowdown, and about the potential long-run negative effects on the economy of the debt accumulation and its effectiveness in boosting employment and demand.

In summary, the fiscal stimulus has not been a total failure and has definitely avoided a second Great Depression, although with potential costs. The costs include potential long run costs of fiscal deficit, high unemployment and inflation. Its failure lies in the poor design and execution by the governments. A well-executed, well-targeted, timely and temporary stimulus package along with a credible medium term fiscal framework and an accommodative monetary policy adjusted to the country specific economic conditions should act as a panacea to a global economic crisis. Maintaining sufficient fiscal space to make deposit guarantees credible is of paramount importance in all countries irrespective of the size of their debt overhangs with little room for policy manoeuvres. High

government debt displaces private investment. Now is the time for a gradual shift back toward private investment, because when consumers believe fiscal spending is not sustainable, public spending becomes less effective. Along with these, policymakers also need to focus on financial sector repair and reform, withdrawal of stimulus and rebalancing of global demand.