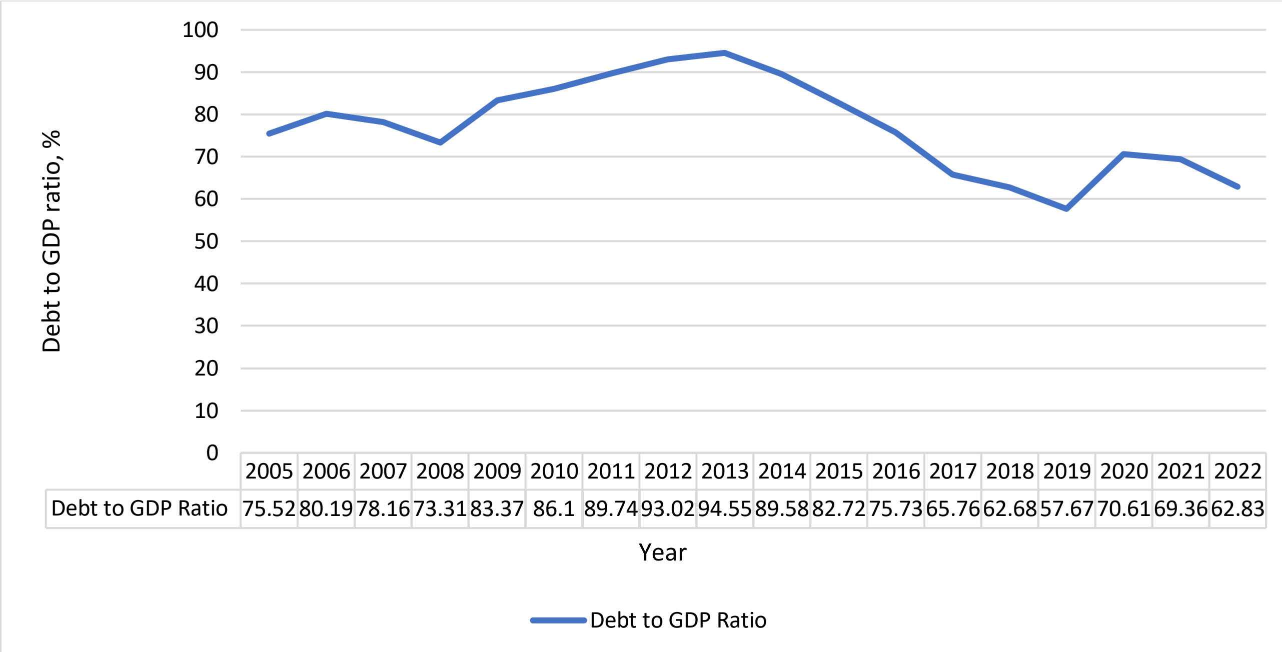
**Budget Alert 3.7 Managing the Economy with Fiscal Policy Part 4**

**By Laurel Theresa Bain**

The ultimate role of government is to improve the welfare of the population. In doing so, the Government, through the use of fiscal policy, provides public goods and services; contributes to the achievement of growth; stabilizes the economy to avoid sharp declines in the Gross Domestic Product (GDP) and facilitates the fair distribution of national income.

The stabilization function and the fair distribution of incomes could be very challenging during depressions. Governments increase expenditure, financed by borrowing, to halt the decline in national income and employment. The combination of higher debt and declining GDP results in elevated debt to GDP ratios as manifested during the financial and economic crisis and the Covid-19 Pandemic.

There is therefore a correlation between the increased debt and the contraction in economic activity, and this was manifested in Grenada. During the high growth period of 2005 to 2007, the Debt to GDP ratio of the Central Government averaged 78 percent, but this ratio increased during the financial and economic crisis and its aftermath of 2009 to 2011 to an average of 86 percent. In the high growth period of 2014 to 2018, combined with debt restructuring, the Central Government debt to GDP ratio was lowered to an average of 75 percent and was on a declining trend to reach 58 percent in 2019. See **Chart 1: Central Government Debt as a Percentage of GDP (2005-2022).**




| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Debt to GDP Ratio | 75.52 | 80.19 | 78.16 | 73.31 | 83.37 | 86.1 | 89.74 | 93.02 | 94.55 | 89.58 | 82.72 | 75.73 | 65.76 | 62.68 | 57.67 | 70.61 | 69.36 | 62.83 |

Source: Eastern Caribbean Central Bank website, June 2023.

This stabilization function of government and its correlation with the public debt was vividly demonstrated during the Covid-19 Pandemic when economic activity was contracting. The Covid-19 Stimulus packages were rolled-out in Grenada and many countries to halt the decline in GDP and reduce the fluctuation in income of individuals and businesses. The period also coincided with higher debt to support the stabilization of the economy.

With the sharp contraction in economic activity and increased borrowing, the Central Government debt to GDP ratio rose to 71 percent in 2020. These stabilisation policies are generally temporary measures which may not be necessary during the growth period. This function could be compared to an individual who is hemorrhaging after an accident. The main focus will be on stopping the hemorrhage while paying attention to the need to address the critical condition. This is the stabilisation role of Government.

The stabilisation function is also linked with the need to ensure that national income is fairly distributed among the population, referred to as the income distribution function of the government, that is, addressing pockets of poverty and unemployment. Through its fiscal policy of taxation and expenditure, the government seeks to redistribute incomes. Therefore, the structure of the tax system and policies on taxation are applied to ensure that the system is not too burdensome to the low-income earners. Expenditure should be well targeted to assist the low- and no-income segments of the population. The social safety net programmes are the common policies applied to redistribute incomes. These programmes must be well targeted, or they could reinforce income inequalities. However, fiscal policy, by itself, is not adequate to address extreme income inequality and chronic unemployment. Eliminating extreme poverty and chronic unemployment should be an integral part of the development strategy.

Economic growth and development are the ultimate goals of fiscal policy which are manifested by improvements in the standard of living of the population. Economic growth focuses on increasing output as measured by the Gross Domestic Product. Economic development, however, is the capacity of the economy to achieve sustainable growth, through a competitive, dynamic, and flexible economy. It is argued that the structure of the economy inhibits economic development and hence, the need to rebalance or transform the economy.

The Government contributes to the development and transformation of the economy through its capital spending and the industries it supports by its taxation policies. However, the achievement of development and transformation of the economy requires coordinated policies and programmes by the public and private sectors. Ultimately, a combination of fiscal, monetary, and structural policies is needed for the development and transformation of the economy.

Knowledge is power and experience is the greatest teacher.

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