2.2.4 Government expenditure (G)

a) The main influences on government expenditure:
- *The trade cycle*
- *fiscal policy*

- Fiscal policy: the government's position or set of decisions on government spending and taxation
- Governments can choose to some extent how much they spend and deliberately manipulate total spending in the economy by change their own level of spending which is called discretionary fiscal policy
- National debt: the sum of all outstanding budget deficits or the total amount the government has borrowed
- Only money which directly contributes to the output of the economy is included – transfers of money such as benefits or pensions are not included
- Government spending is quite a large component of aggregate demand, so changes in government spending can have a big influence on AD
- Components of government spending:
  - Current expenditure: expenditure consumed within a year, which is vital for an economy e.g. public spending
  - Capital expenditure: investment projects
  - Welfare payments
  - Debt interest
- Factors affecting government spending:
  - Health of the economy
  - Trade cycle
  - Level of tax revenues
  - Employment levels
  - Size of the public sector
  - Priorities of the governing party
  - Size of government debt
  - Inflation
- Governments deliberately changes taxes and benefits in order to influence aggregate demand
- The government does not have to 'balance its books' in the short run so they can spend more or less than it earns in taxation
- Budget deficit: the government spends more than it earns, this is known as fiscal or budget deficit which increases the flow of income or AD
- Budget surplus: the government spends less than it earns which leads to a contraction of AD
- The government spending increases more in a recession on out-of-work benefits and taxation receipts as workers and firms earn less and the government wants to increase AD and boost economic growth
- The government automatically spends less in a boom as government spending decreases and taxation receipts rise as wages and employment rise to try to reduce AD and slow down economic growth
- An imbalance in the budget will affect the circular flow of income – a budget surplus is an overall withdrawal from the circular flow, but a budget deficit will indicate an overall injection into the circular flow

- An imbalance in the budget is fine in the short run, but in the long run governments will try to balance out any surpluses and deficits. A long term surplus means the government is harming economic growth by choosing not to spend, or by keeping taxes too high. A long term deficit is likely to mean a country has a large national debt
- Sometimes governments will balance the budget so that government spending will be equal to revenue which should have little effect on aggregate demand