

ECO 209 Macroeconomic Theory and Policy

Case Study No. 3

Case Study No. 3 on ***The Austerity Debate*** will be discussed in class on Tuesday, June 20. The required short-readings have been posted on the course website. Read these articles and come to class ready for the discussion. The following questions will help you in your preparation:

- 1) What is understood by “government austerity”? What is the rationale behind the view that “austerity” will foster economic growth? What is the behavioural assumption underlying the “expansionary austerity” view?
- 2) Is “confidence” necessary in order for the economy to move out of a recession? How will greater “confidence” affect the behaviour of private economic agents? What does Krugman mean by the “confidence fairy”?
- 3) Why “austerity” cannot be “expansionary”? What is needed for economic private agents to regain their confidence?
- 4) Does government spending take resources away from the private sector during times of recession? That is, does government spending crowd out investment and/or consumption during a recession?
- 5) Do those who oppose austerity measures advocate greater government spending and larger deficits under all circumstances? What do you understand by being “fiscally responsible”? When should governments be worried about deficits? And about inflation?
- 6) The “expansionary austerity” view received great support from the research carried out by Rogoff-Reinhart. What was the conclusion of the Rogoff-Reinhart research? What was the impact of this research among European and Canadian policy-makers?
- 7) What were the main shortcomings of the Rogoff-Reinhart paper?
- 8) What was the impact of the implementation of austerity measures in Europe? How does the European experience compare to that of the U.S.?
- 9) What is the more recent view of the IMF regarding the implementation of austerity measures in Europe?
- 10) The periphery-countries of the Eurozone (Greece, Portugal, Spain, Italy and Ireland) have lost competitiveness over the years. What approach are these countries following to regain competitiveness? What would be an alternative approach?