Chapter 4
A Discussion on Fiscal Policies Implemented in EU During and After the Great Recession

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ABSTRACT

Along with the global financial crisis that took place in 2008, the ineffectiveness of other policies used for exiting from the crisis has brought back the feasibility of fiscal policy as an alternative. It is accepted that the only way to overcome the severe shrinking of the total demand during the 2008 global financial crisis is expansionary fiscal policy applied globally. However, differences in the subjective conditions of the EU member countries in particular have not made it possible to implement an expansionary fiscal policy for all of the member countries. More developed EU countries have begun to carry out from expansionary fiscal policies, while the less developed ones have begun to conduct contractionary fiscal policies. With the awareness that the financial stability is a public good, the obstacles, challenges on the global fiscal policy implementation by the EU member states are discussed by examining fiscal policies performed during and after the 2008 global financial crisis.

INTRODUCTION

The development of financialization along with globalization has opened the way for contagious effects of financial fragility to disperse throughout the world easily. Income has been transformed from the real sector to the financial sector and consequently the importance of financial system relative to real sector has escalated in the near past. Nevertheless, the financial system has reached an unprecedented level

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notably after the end of the 1990s and has become vulnerable to risks and fragilities that have arisen from speculative activities in the system. Owing to the nature of the capitalist system, bubbles have become inavoidable in the financial system, and eventually they have triggered bursts and turmoils in the economic system. For instance, 2008 global financial crisis (GFC) came to exist by the bubble in the US subprime mortgage market and the hazardous effects of the crisis quickly spread out to the rest of the world owing to strong financial connectedness of the countries. Similar to the rest of the world, contagious effects of the financial crisis dispersed into European Union (EU) area and EU member states have begun to perform monetary and fiscal policies in order to overcome negative effects of the crisis. Likewise, EU states have launched expansionary monetary policies along with expansionary/discreatonary, fiscal policies for exiting the global financial crisis. In the meantime, the need for carrying out coordinated and consistent policy actions has gained importance within the EU area.

EU governments have begun to benefit from fiscal policy actions since monetary policy tools were insufficient to restore financial stability from financial turmoil rapidly. However; the financialization and development level of the governments ("periphery"/"core") directly designated the type of the fiscal policy action. Primarely; more developed EU states have begun to carry out expansionary fiscal policies; while the less developed ones have begun to conduct contractionary fiscal policies on the basis of their subjective conditions.

Nonetheless, there is no fiscal authority in the EU area that has power over EU member states in contrast to European Monetary Union (EMU) that has power of sustaining common monetary policy. This impediment induced seperation of fiscal policies due to subjective conditions of the governments and made difficult to maintain contemporaneous fiscal policies within the Euro area. Hereby, each member state performs its own fiscal policy during calm and turmoil financial periods and benefits from either expansionary or contractionary fiscal policies in exiting financial turmoils.

This chapter investigates the fiscal policy actions overtaken by "core"/ "peripheral" EU member states during global financial crisis (GFC) and European Sovereign debt crisis (Eurozone crisis). In addition, challenges, impediments in exiting from financial turmoils using fiscal policy actions (expansionary/ contractionary) by governments are discussed.

The remainder of this chapter is as follows: In Section 2; Keynesian view of fiscal policy in terms of expansionary/contractionary fiscal policy actions are discussed. Section 3 reviews the studies that describe the anatomy of financial crises. It presents well-known events during the global financial crisis and policy actions applied by the US government and discusses reasons behind the "great recession". Section 4 views the fiscal developments of periphery/core EU states during the GFC and European Sovereign debt crisis (Eurozone crisis). Finally, Section 5 discusses and gives the concluding remarks.

KEYNES AND THE FISCAL POLICY

The crisis of 1929 represents an important disintegration in terms of the theory of public finance. Fiscal policy approaches differ before and after the 1929 crisis in the public finance literature. Prior to 1929 crisis classical fiscal approach ("fiscal conservatism") was dominant, while modern fiscal approach (interventionist) became dominant during post 1929 crisis era.

During pre-1929 crisis period, it was widely believed that there would not be any problems in the economy as long as the each supply create its own demand. The 1929 crisis emerged as an important event that shows that this notion is not valid. In that period, it was seen that every supply did not create