Fiscal Consolidation in America: the Policy Options
Comments to Altshuler & Bosworth

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What is A&B’s goal?

Two-fold goal:

• to evaluate the options for fiscal consolidation in future years

• to place those options “within the context of a continuing tradeoff between the objective of an improved fiscal balance and desires to restore the economy to high levels of employment
What do A&B discuss?

- Economic outlook and the challenges that it raises for fiscal and monetary policy
  - trade-off between budget reduction and support to growth
- Lessons from the international experience with fiscal consolidation programmes
- Baseline projection for the US budget outlook
- Options for fiscal consolidation over the medium-term
  - expenditure reduction
  - revenue increases
What do A&B conclude?

• Policy options are limited:
  – monetary policy → limited impact
  – Fiscal policy → political constraints both domestically and internationally (problems with coordination/cooperation)

• Current budget policies will fast increase the public debt as a share of GDP

• Action to bring back the federal budget into balance will require large structural changes in both expenditures and revenues

• The US need to consider a broader range of new revenue sources
This is a ‘three-papers’ paper

A few suggestions:

• Focus on economic outlook and challenges for policies within the context of global rebalancing, or
• Focus on fiscal consolidation and tax reform in the US and discuss lessons from other countries - i.e. Sweden and Canada, or
• Draw scenarios based on fiscal consolidation and tax reform, and assess the impact on growth
Alternative paths to recovery
Pre-crisis and post-crisis growth trends for the US and the euro area

Figure 2: pre-crisis and post-crisis growth trend for the US and the euro area

Source: IMF data and estimates by Chatham House International Economics
Can the US afford to go ‘solo’?

• The US is the only major country with a further fiscal stimulus
  – Less need to please the “bond vigilantes”: USD as the key reserve currency and ‘safe haven’
  – But the tools used may not be the most appropriate and risk fuelling international tension
  – And potential loss of impact through imports

• A&B suggest that any additional stimulus measures need to be temporary and integrated with a coherent long-term plan of fiscal consolidation
There are three lessons from the international experience

- Credible and transparent rules
- Need for an enforcement mechanism
- Flexibility and robustness in the response to unforeseen shocks
The budget outlook (short term)

Federal Revenues and Expenditures, 1970-2020 (% of GDP)
The budget outlook (long term)

Projected Federal Program Outlays, 1970-2050 (% of GDP)
The US needs to look at new revenues sources

- Higher revenues within the current framework of the individual and corporate income tax
- VAT tax
- Tax on carbon emissions
- Tax reform programme based on the three previous points
Is revenue increasing feasible?

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<thead>
<tr>
<th>Policy</th>
<th>Measures</th>
<th>Goal</th>
<th>Feasibility</th>
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<tbody>
<tr>
<td>Increase revenues the existing ind and corp income tax</td>
<td>Ind. in. tax rates</td>
<td>little impact</td>
<td>difficult</td>
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<tr>
<td></td>
<td>Corp income tax</td>
<td>little impact</td>
<td>difficult</td>
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<td></td>
<td>Tax expenditure reform</td>
<td>good</td>
<td>difficult</td>
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<tr>
<td>Adopt VAT</td>
<td>VAT</td>
<td>complicated design</td>
<td>difficult</td>
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<tr>
<td>Adopt green tax</td>
<td>Tax on carb emission</td>
<td>Revenues do not go against goal</td>
<td>difficult</td>
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<tr>
<td></td>
<td>Raise tax on gas</td>
<td>good</td>
<td>difficult</td>
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Thank you

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