On February 6, 2013, Professor Jay Rosengard, Lecturer in Public Policy and Director of Financial Sector Program at Ash Center for Democratic Governance and Innovation of Harvard Kennedy School, gave his presentation titled “Post-Election Fiscal Drama in the United States: A Real Cliffhanger” at the Canon Institute for Global Studies (CIGS). He has given his speech at the CIGS every year since 2010 and this is his fourth speech.

He initiated his presentation by looking back his speeches in the past three years, in which he discussed the slumped US economy due to the global economic crisis since 2008.

Then, he presented some figures of the current US economy and compared them to those in 2008 indicating that the US economy would have been much worse without the monetary and fiscal stimulus and that it is on the slow and painful path of recovery which he calls rehabilitation.

He explained what exactly the fiscal cliff means. The following three elements are combined: (1) an expiration of various tax cuts and benefits, (2) automatic budget cuts of $1.1 trillion over 10 years evenly split between domestic and defence programs, and (3) an increase of the government’s debt limit of $16.4 trillion. Impact of the first two elements is estimated approximately $700 billion which nearly equals to the Obama’s stimulus package. Failure to increase the debt limit happened last time resulted in the downgrade of the US credit rating. It is the legitimate concern that the US economy will go back into a recession if all these three things happens at once (he called it the “perfect storm”).

He also touched upon the need of fiscal consolidation for a long-term sustainability which combines an increase in revenue and a decrease in expenditure. He advocated that there is some room to increase people’s tax burden if compared to the level in 1980. Improvement in budget structure is also possible by reducing social security
expenditure without radical changes, such as a privatization, and by cutting in defence spending. But these are the political challenges.

He presented three scenarios in relations to the fiscal cliff: (1) do nothing, (2) a grand compromise between Obama administration and the Congressional Republicans, and (3) kick the can down the road.

The Senate and the House of Representatives temporarily reached an agreement early this year. By that, many uncertainties were eliminated on the tax issues. A tax increase was realized mainly on the wealthy. The House and the Senate also agreed to suspend the current debt ceiling until May. The issue of automatic budget cuts was also extended to March. Key remaining challenge is to formulate budget that balances the need for a long-term fiscal consolidation and a short-term economic fragility.

In sum, the US is on a path of scenario three with a glimmer of hope for a grand compromise.

In Q&A session, we discussed the issues of the market reaction to the current US political and economic situations, his evaluation on the current discussion in Japan on the monetary policy under the Abenomics, the global trend of setting inflation target or similar policies of the central banks, the new banking regulation in the US and its possible impact, the US Congressional situations especially concerning the Republicans and the Tea Party, the shale gas extraction and its possible impact, and the demographic changes and its impact on the global economy. He emphasized the need for a long-term fiscal consolidation but the difficulty to get the magnitude and timing right.