BALANCED BUDGETS AND DEFICIT FINANCING

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Arguments for a Balanced Budget

- Provides an external, objective means of depoliticizing difficult fiscal decisions
- Promotes economic efficiency
- Complements a prudent monetary policy
- Increases the consistency and predictability of public expenditures

Arguments Against a Balanced Budget

- ROI/economic development justifies financing expense
- Domestic revenue is projected to increase dramatically
- Smooth out temporary downturns in the economy
- Buy political and social peace
- If future revenue overestimated, debt repayment can:
  - divert scarce resources
  - crowd out the private sector
  - penalize future generations

Middle Ground

- Distinguish between budget components
  - Recurrent vs. capital expenditures
  - Dynamic balanced budget
- Use multi-year time frame
  - Progressively phase out deficits
  - Medium term balanced budget

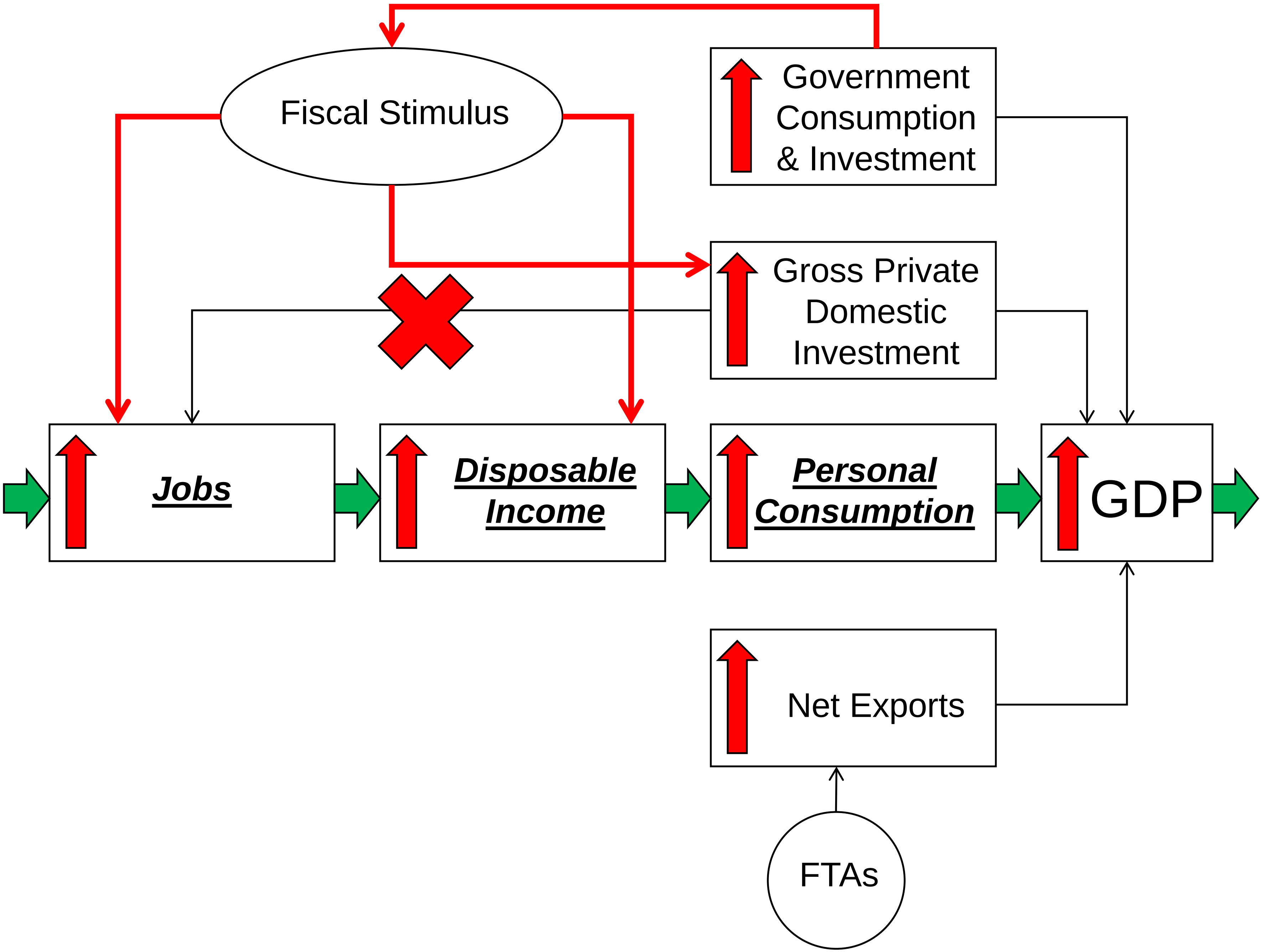
Deficit Financing

- Source of debt:
  foreign vs. domestic
- Terms of debt:
  concessional vs. commercial
- Use of debt:
  cost recovery vs. social sectors
- Non-debt sources:
  foreign grants, private sector, community contributions

Common Pitfalls

- Limited bureaucratic and economic absorptive capacity to manage borrowings →
  waste, corruption, pipeline problems

- Government implicit guarantees for private overseas debt →
  large public sector contingent liabilities


Fiscal Stimulus
Government Consumption & Investment
Gross Private Domestic Investment
Jobs
Disposable Income
Personal Consumption
GDP
Net Exports
FTAs

Does Austerity Foster Growth?

- IMF study of 173 fiscal policy changes in high income countries from 1978-2009 found that cutting budget deficit by 1% of GDP → reduction of real output ⅔ of a percent, increase in unemployment rate by ⅓ of a percent

- Exceptions ("expansionary austerity")
  - Start with strong economy, very high interest rates (Denmark 1983-86)
  - Start with overvalued currency (Ireland 1987-89 and Italy during 1990s)

What is the Current State of the U.S. Economy?

- GDP growth (2017 est.): 2.5% (1.6% in 2016)
- Unemployment Rate (12/17): 4.1% (4.7% in 2016), 17-year low, rate for blacks fell to 6.8% (lowest level since records kept as of 1972)
- Net Jobs Created (2017): +2.1 m (+2.2 m in 2016), 7th straight year of increases > 2 m
- Positive Net Jobs Created 87 consecutive months, longest expansion on record
- Hourly Pay (December 2017): +2.5% (year on year)
- 19 states increased minimum wage (eff. 1/17)
- Urban CPI thru 12/17: 2.1% (2.1% in 2016)
- Stock markets booming (although increasingly volatile)

Long-Term Concerns: Deficit and Debt

- In 2001, generated a budget surplus and gross federal debt as a share of GDP was half of its current level
- Since 2007, 3-fold increase in federal budget deficit as share of GDP (now 3.1%) and 69.9% increase in gross federal debt as a share of GDP (now 106.2%)
- Interest in the federal debt as a share of GDP will also increase (projected to reach 2.2% in 2022, or $528 b and 10.9% of total federal expenditures)
- Need for fiscal consolidation combining increased revenue and decreased expenditures
  - 2009 fed receipts 14.6% of GDP, lowest since 1950; usually 18-20% since WW II, still only 18.1% in 2017 (est.) **[16.3% in FY2019]**
  - 2009 fed outlays 24.4% of GDP, highest since 1945; increased 27.7% from 2007, still 21.2% in 2017 (est.) **[21.3% in FY2019]**

Running up the tab