

Box B

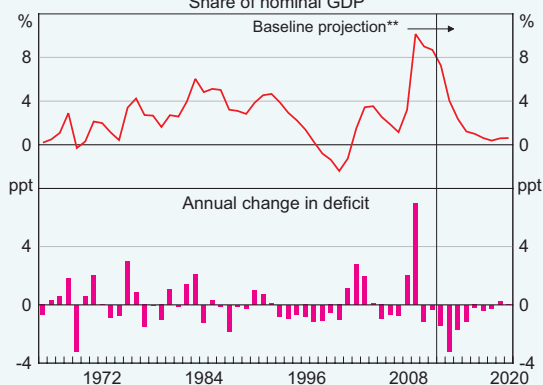
Fiscal Consolidation in the United States

Under current legislation in the United States, significant fiscal consolidation is set to occur in January 2013. This sharp tightening, which has come to be known as the 'fiscal cliff', would be the result of tax rate increases and spending cuts. These measures would reduce the federal budget deficit by more than 4 percentage points of GDP in the 2013 calendar year or by 3¼ percentage points in the 2013 fiscal year according to Congressional Budget Office estimates. If it proceeds in this way, it would be the largest reduction in the federal budget deficit in a single fiscal year since 1969 (Graph B1). It is estimated that such rapid fiscal consolidation would result in annual average growth in the United States 3–4 percentage points lower than otherwise in 2013, with output contracting in the first half of the year.

such as various individual income tax provisions enacted in 2001 and 2003 (usually referred to as the 'Bush-era tax cuts') and subsequently extended. Others were part of fiscal stimulus measures enacted in 2009 and 2010 to support economic growth. These include the reduction in the employees' payroll tax rate by 2 percentage points and the extension of unemployment benefits to those who have been out of work for more than 26 weeks (and up to 99 weeks). The individual income tax provisions (the majority of which are the Bush-era tax cuts) make up the largest component of the fiscal cliff, while the extended unemployment benefits and payroll tax cuts are a smaller part (Graph B2).

A small share of the fiscal cliff is accounted for by automatic spending cuts from the *Budget Control Act 2011*. These cuts were originally legislated as a default mechanism to reduce the deficit if, by November 2011, a special Congressional committee (the Joint Select Committee on Deficit Reduction) could not agree on measures that would reduce the

Graph B1
United States – Federal Budget Deficit*
 Share of nominal GDP

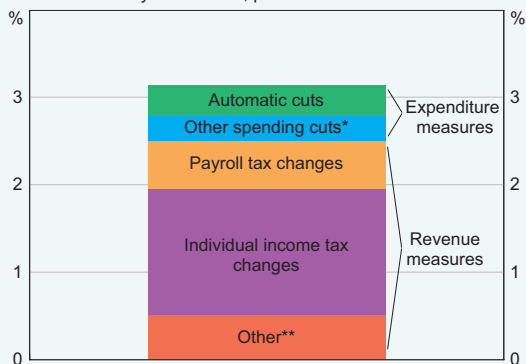


* Data are for fiscal years which end on 30 September
 ** Based on legislation at July 2012
 Sources: Congressional Budget Office; Office of Management and Budget

Components of the Consolidation

The fiscal cliff largely reflects the expiry of a number of budget measures that were initially legislated to be temporary. Some have been in place for many years,

Graph B2
United States – Fiscal Consolidation
 Fiscal year 2012/13, per cent of nominal GDP



* Includes unemployment insurance and Medicare payments to physicians
 ** Mostly changes in revenues and includes an economic feedback effect
 Source: Congressional Budget Office

deficit by at least US\$1.2 trillion over the following decade. Because the Committee was unable to produce legislation within the deadline, cuts in spending, evenly split between defence and non-defence items, are now automatically set to occur in each fiscal year over the next decade, starting in January 2013.

Timing of Key Events

Given the significant economic contraction implied by the fiscal cliff, most forecasters assume that it will not proceed to its full extent. However, to avoid the

full impact of consolidation on economic growth, new legislation would need to be enacted before major revenue measures are due to expire at the end of December and major reductions in outlays are scheduled to occur in early January (Table B1). This will require agreement across the major political parties, something that has been difficult to achieve to date. If new legislation is not passed by the end of December, the new Congress could enact retroactive legislation sometime after it first sits in January to minimise the economic impact of the fiscal cliff. ✎

Table B1: Timeline of Key Legislative and Political Events

Year	Date	Event
2012	6 November	Federal elections for: <ul style="list-style-type: none"> – President and Vice-President – All seats in the House of Representatives – One-third of the seats in the Senate The existing Congress returns for a final session of government before the new Congress is sworn in
	31 December	Expiry of various individual income tax measures Expiry of the temporary reduction in payroll tax
2013	2 January	End of extended (emergency) unemployment benefits Automatic spending cuts from the <i>Budget Control Act 2011</i> take effect
	3 January	New Congress sworn in
	21 January	Inauguration ceremony for elected President

Sources: Congressional Budget Office; Department of Labor; Joint Congressional Committee on Inaugural Ceremonies