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BUDGET DEFICITS AND DEBT: ISSUES AND OPTIONS

Opening Remarks

Alan Greenspan

I am pleased to open this symposium on the economic consequences of budget deficits and debt. It brings together a group of fiscal and monetary experts and central bankers to exchange views on issues whose resolution will be fundamental to the stability and growth of economies throughout the world.

Concern about the harmful effects of chronic deficits and cumulative government debt has been growing both here and abroad. In the United States, policymakers have responded to this concern with a series of budget initiatives, culminating in Congress' adoption this year of a budget resolution that projects a balanced budget and the President's proposals for accomplishing the same end. European concern is evident in the firm fiscal convergence goals they have set for membership in the European Monetary Union.

Many long-term fiscal imbalances will have to be dislodged from our fiscal systems. Debt-to-GDP ratios generally have been moving upward and are projected to rise sharply after the turn of the century without budget deficit redress. Also, in assessing future risks, we must stress that today's actions and commitments are only the first step to fiscal reform that must be consolidated by future legislators. Indeed, the will and means to follow through are at least as important as the initial commitment to deficit reduction.

Finding and implementing lasting solutions to the public sectors' chronic deficit problems will be neither easy nor simple The design of programs to redress fiscal imbalances and the formation of the political consensus that will be needed to sustain fiscal reform will require an exceptional understanding of the dimensions and consequences of excessive deficits and debt, and of the options that are available for solving fiscal imbalances Developing a broader appreciation of these issues will be our agenda for the next two days

The immensity of the task before us is spelled out in this morning's paper by Michael Mussa and Paul Masson Fiscal policy in most industrial countries has produced steadily rising debt-to-GDP ratios since around 1980. Such policy outcomes cannot, in general, be sustained in the long run Nevertheless, implementation of a near-term reversal of these policies will be difficult because they are the product of deeply entrenched economic, social, political, and demographic trends Notable are increasing public acceptance of deficits and debt, and massive social spending commitments that were based on assumptions and projections that have long since gone awry In the United States, the costs of maintaining social spending commitments are certain to worsen as adverse demographics make an increasing fraction of the population dependent on the government for income support and the costs of providing health care continue to rise

It is all too easy to lose sight of the real economic damage that persistent deficits can produce Although the damage may seem small from a year-by-year perspective, the effects cumulate over time into substantial real costs Laurence Ball and Gregory Mankiw estimate, for example, that the United States federal government's 50 percent debt-to-GDP ratio has reduced gross output by as much as 6 percent This loss will, of course, mount if the debt-to-GDP ratio continues to increase An even more worrisome potential consequence of rising debt ratios would be the risk of a financial breakdown Such risks exist because there are limits to the amount of debt that foreign and domestic investors willingly accept In the hard-landing scenario discussed by Ball and Mankiw, fiscal policy pushes public debt beyond this limit, with a resulting collapse in the demand for financial assets that has dire financial and real economy consequences.

As John Taylor points out in his paper, chronic deficits can also present serious challenges to the conduct of monetary policy. With sufficiently high debt ratios, the pressure or temptation to use money growth as a source of finance for public spending can undermine the credibility of anti-inflationary monetary policies. He notes, however, that deficits and debt in the United States and most industrialized countries have not yet reached a level where this poses a serious risk. His paper also provides interesting insights into how monetary policy might adjust to a period of sustained fiscal consolidation.

Difficult and controversial issues also arise in the choice of deficit reduction strategies. Many options have been proposed, including constitutional amendments that would prohibit deficits, the adoption of better accounting and information systems, and adjustments to existing tax and spending programs. I am thus looking forward to learning more from Paul Martin at lunch today about how Canada is addressing its fiscal problems. I also expect that tomorrow's panel will provide interesting and useful insights into the merits of alternative options as they may apply in developed countries.

The developing countries provide a helpful perspective on potential solutions to the problems of chronic deficits. To be sure, their situation tends to differ from that of industrial economies because, as Mussa and Masson note in their paper, their social spending commitments have been smaller. Nonetheless, the experience of selected Latin American countries discussed in Sebastian Edwards' paper makes clear that substantial deficit reduction programs can be successfully implemented and sustained. These programs have included innovative approaches to the reform of social insurance and revenue systems, and the provision of saving incentives that we all will want to examine carefully.

Deficit reduction strategies must be sustained over an extended period of time if they are to be effective. In democratic societies this will require a lasting consensus among policymakers and the public about the sources and consequences of our deficit problems, as well as agreement about the efficacy of proposed solutions More broadly, we must recognize that chronic budget deficits are a symptom of a larger problem that must also be addressed the endeavor of governments to preempt resources from the private sector without visibly imposing taxes on their citizens When the door to chronic on-budget deficits is finally closed, pressures will quickly build to preempt resources through direct credit guarantees, government sponsored credit corporations, and other seemingly innocuous vehicles of resource transfer These pressures must be resisted There is little distinction in governments' capacity to borrow, whether funds are direct or indirect obligations The appropriate appraisal of such vehicles is not whether they involve taxpayer credit losses, which they may, but the extent to which they displace sovereign borrowing capacities

There is every reason to expect this symposium to make a significant contribution to a greater understanding of how fiscal policy is appropriately forged in the years ahead

I want to conclude by thanking the staff of the Federal Reserve Bank of Kansas City for assembling such an excellent program It promises a lively exchange of views, and I look forward to participating