Fiscal Sustainability as an Extension of Budget Credibility

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Fiscal Sustainability

- A sustainable fiscal policy is one where government spending and revenue policies do not cause debt to rise continuously relative to the size of the economy.
- In other words, the ratio of debt held by the public to gross domestic product (GDP) is ultimately stable or declining over the long term.
- A scenario in which debt grows faster than the economy over the long term is unsustainable.
Debt Accumulation: U.S. Example

• For most of U.S. history, federal debt held by the public as a share of GDP has increased during wartime and recessions and decreased during peacetime and economic expansions.

• However, this pattern has changed during more recent times.
  • Debt held by the public as a share of GDP grew during three of the four most recent economic expansions.
  • The U.S. federal government has run a deficit (i.e., spending is greater than revenue) and added to its debt in every fiscal year since 2002.
Unsustainable Debt Levels Increase Risk of a Fiscal Crisis

- A fiscal crisis is a situation in which investors lose confidence in the government’s ability to manage the budget, and interest rates increase abruptly.
- In such a situation, policymakers might feel the need to adopt more drastic spending cuts and/or tax increases than would be required had action been taken earlier.
- These larger and more abrupt changes also would be more painful and more difficult for people to absorb.
- Even if there is no fiscal crisis, rising debt, relative to the economy, could still have negative effects, such as higher borrowing costs and lower economic growth.
Using External Audits to Enhance Budget Credibility/Sustainability

- Draw attention to budget credibility/sustainability issues among policymakers (e.g., legislative representatives/politicians) and the public.
- Leverage NGOs that focus on budget credibility/sustainability issues, as well as the media, to amplify work.
- Make recommendations to address budget credibility/sustainability challenges.
- Example of potential outcome: U.S. fiscal commission proposals.