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Economic Prospects after the US Election

One of the key reasons why Bill Clinton was successfully re-elected, by a clear majority, as President on 5th November is that the economy has performed well during the past four years: the business upswing has sustained its strength well, and evident progress has been made in consolidating the federal budget, which had been the most prominent election issue back in 1992. The USA's main partners in the world economy have also largely benefited from its positive economic performance. As US economic activity picked up strongly, this had stimulating effects on the world economy; in addition, major agreements encouraging trade liberalization were concluded, and the improving budgetary position along with monetary stabilization affected capital markets favourably. What will the outcome of the election mean for the USA's partners around the world? Will we continue to see positive effects emanating from the USA for the world's goods and capital markets?

During the last four years US imports have increased by about 13% p.a., outpacing the growth of overall world imports and slightly accelerating until recently. A growing portion of the world's exports has thus been destined for the USA, the picture for exports from member countries of the European Union being even somewhat brighter than the general trend. Overall, even though US exports have also risen strongly, the country's trade balance has worsened. Against this background, the Clinton administration has often had to withstand calls for a protectionist trade policy, and it did so when signing the NAFTA agreements it inherited from the Bush administration. Although these trade agreements at first glance appear to foster regionalism, they should ultimately be beneficial to all trading nations around the world. Recently, however, trade liberalization has tended to take a back seat, presumably due in no small measure to the rough-and-tumble of the election campaign. The administration's demands for an aggressive opening of foreign markets and "fair trade" have given another fillip to protectionist thinking, and the USA's commitment to multilateral mechanisms for resolving trade conflicts has appeared doubtful at times. In addition, when a number of important new agreements have to be negotiated in the coming months, such as the expansion of NAFTA to cover Chile, progress could also be retarded by the administration's dependence on the renewal of the Fast Track Authority by a Congress where the Republicans hold the majority.

One helpful development for this discussion is likely to be that the trade deficit, which is often cited in the political debate as evidence of the need for protectionist trade measures, should begin to decline again. On the one hand, the pace of export growth should pick up as the economies of major trading partners have embarked upon a course of stronger expansion. On the other hand, there are now clear signs that the US expansion is slowing to a rate corresponding to the growth of production potential. The consequence for the USA's trading partners is that US imports will probably no longer grow quite as strongly as they have been doing of late. However, given the maturity of the business cycle, and in particular the relatively high rates of capacity utilization already reached, the slackening pace of growth is a very welcome development not only for the USA, since it means that over-heating – and as a consequence enforced stabilization efforts by a decidedly restrictive monetary policy – will largely have been avoided.

Just as important from an international point of view has been the conduct of US fiscal policy over the past four years. Faced with a steady increase in the federal budget deficit, President Clinton aimed at attaining sustained deficit reduction and eliminating the fundamental weaknesses in fiscal policy, i.e. at decisive cuts in the public sector's claim on the economy's resources, with its associated detrimental effects both domestically and internationally. There has been some considerable success in making a move towards fiscal consolidation, promoted by the long upswing. The budget deficit for the 1995/96 fiscal year was again lower than the previous year's, making it the fourth consecutive year of deficit reduction. In absolute terms, at \$107 billion, this was the lowest deficit since 1981, while as a proportion of gross domestic product, at 1.7%, it was the lowest since 1974. The level of fiscal credibility thus gained and the positive effects this development had on the capital markets were important contributory factors towards the fact that the economic upswing in the USA has been as long-lasting, as robust and as free of destabilizing tension as it has. Nor have the benefits of budgetary consolidation and monetary stabilization been confined to the US economy alone. Firstly, it is fair to assume that this policy has also had positive effects on international capital markets, and secondly, the sustained US upswing itself, which was made possible by this policy, has had stimulating effects on the world economy.

Nevertheless, important challenges for American fiscal policy still lie ahead. Deficit reduction has been a relatively easy matter during the buoyant phase of the economic and fiscal cycles. A large portion of the consolidation results from a particularly strong revenue flow and a reduced need for government expenditure. Once growth slows to the more modest pace now expected, the built-in stabilizers will no longer relieve the fiscal burden. Indeed, unless additional savings measures are implemented the deficit is set to rise again. The most urgent and also the most difficult problem which has to be tackled is that of curbing federal entitlement programmes: only if these claims on the state can be held in check will the state not absorb an increasing part of the economy's resources. As elsewhere, demographic trends in the USA will confront the government with the challenge of how to adapt the welfare system to the requirements of an ageing society. The opportunity presented by the economic upswing to make the toughest decisions on the reforms of the social security system and of Medicare, which faces particularly soaring costs, has to a large part been missed. However, if the share of current spending cannot be drastically curtailed to allow greater emphasis on government investment, it will be impossible to sustain the achievements made so far in easing the burden on government finances. The decisions taken in this arena are not only crucially significant for the domestic economy, but in the longer term carry important repercussions for the rest of the world too.

These longer-term risks aside, the overall prospect of the USA's playing a positive role in the global economy over the next four years is very favourable. Firstly, there are plenty of signs that fiscal policy will not abandon its current path of consolidation. Apart from the fact that the US government has presumably now realized that deficit reduction can have more to offer than pain alone, but can bear fruit in a political sense, the balance of power between Congress and the Administration suggests that gradual deficit reduction will remain the key guiding principle. If the crucial steps for reform are taken, the USA could not only function as a role model for other countries with similar problems, but will continue to act as a driving force for the global economy. Secondly, even as the expansion slows down the USA will continue to have a substantial demand for goods and services from abroad, while at the same time the slower pace of import growth should take some wind out of the sails of protectionist tendencies. That should allow enough scope in the trade policy arena for the USA to renew its involvement as a major player in the multilateral trade negotiation process.

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