{ US FISCAL CLIFF }

JEREMY WARNER

The winner of next month's presidential election has to prevent huge fiscal contraction in the US, argues Jeremy Warner

Most economic catastrophes are self-inflicted to some degree. Failure to check excesses in the boom is frequently followed by an inadequate or harmful policy response in the bust. But some are more self-inflicted than others. The US's so-called 'fiscal cliff' is one such case of it.

If US policymakers do nothing, a number of temporary tax cuts will expire and big, across-the-board federal spending reductions will kick in on 1 January 2013, resulting in a huge fiscal contraction likely to plunge the US economy back into deep recession.

All attempts at avoiding this squeeze have so far failed. American politics has proved too polarised to allow for compromise. To make matters worse, the US will again start bumping up against its self-imposed 'debt ceiling' towards the end of the year, threatening a complete shutdown of government.

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A Republican win in November's presidential election is more likely to result in happy resolution than a second term for President Obama. If only because a Republican president can expect a less hostile Congress than his Democrat opponent and is therefore more likely to be able to forge a less harmful fiscal settlement.

Even so, big uncertainties remain. Already, the economy is suffering the consequences. Lack of clarity on what's going to happen next year is causing consumers, businesses and government agencies to hold back on spending decisions.

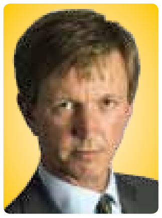
On the basis of Winston Churchill's famous observation that "Americans can always be counted on to do the right thing... after they have exhausted all other possibilities", outright catastrophe will presumably be avoided. Things may go to the wire, but some way of muddling through will surely be found.

Yet the wider question of what the US is going to do about ever more mountainous public debt is still an open book. Mitt Romney and his Republican running mate, Paul Ryan, talk the rhetoric of deficit reduction, but their plans are alarmingly short of detail and where they do get specific, apparently riddled with contradictions.

For the time being, the US can continue to borrow all it wants from international investors at astonishingly low rates. The dollar's traditional reserve currency, safe haven status, has been further enhanced by the eurozone crisis. For global money markets, there are few obvious alternatives to US treasury bonds. The upshot is that there is little in the way of market discipline to restrain US borrowing.

Even so, if long-term disaster is to be avoided, some way must eventually be found of bringing spending and revenue into line. Americans have acquired a taste for European levels of government expenditure, but have yet to come to terms with the fact that this requires a matching, European-style tax burden.

At some point, the US must confront this simple choice; does it opt for Europe's social model, or does it stay loyal to the small-state, low-tax tradition of rugged individualism? In part, that's what this election is about.



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