

U.S. approaches 'fiscal cliff,' and world watches from the sidelines

By Howard Schneider



A man looks at the stock price monitors in Sao Paulo, Brazil. Officials in Brazil and elsewhere say they are worried that economic shock waves from major changes in U.S. tax and spending policies will rock countries around the world.

BRASILIA — As Washington approaches the so-called “fiscal cliff,” officials in Brazil and elsewhere say they are worried that economic shock waves from major changes in U.S. tax and spending policies will rock countries around the world.

“It is so obvious it is a problem,” said Carlos Marcio Cozendey, head of international affairs at the Brazilian finance ministry.

If U.S. policymakers can't break their standoff over how to tame the federal deficit before the end of the year, dramatic increases in taxes and cuts in government spending will automatically start to kick in. Economists warn this could knock the world's biggest economy back into recession with spillover effects for other countries.

"The issue is frozen, and we and everybody else are hoping" it gets resolved, Cozendey said.

The potential fallout from the U.S. fiscal cliff could move it to center stage, ahead of the European debt crisis, as the most pressing risk to world economic growth. This is a reminder of the paramount role that the United States plays in the world economy.

Analyses by the International Monetary Fund, private analysts and credit-rating companies have all painted a grim picture if U.S. officials fail to resolve the current stalemate: a downturn in global trade; a sharp fall in commodity prices; a blow to confidence that could undermine investment and bank lending around the world.

"The US fiscal cliff represents the single biggest near-term threat to a global economic recovery," the Fitch Ratings service said in a recent analysis. "[T]he dramatic fiscal tightening implied by the fiscal cliff could tip the US and possibly the global economy into recession. At the very least it would be likely to halve the rate of global growth in 2013."

When Group of 20 finance ministers and central bankers meet in Mexico next week, the United States — never shy about using the bully pulpit to lecture other countries — is expected to bear the brunt of the lecturing this time. From major emerging markets to top trading partners like Canada, the message has been consistent: Just fix it.

"We want to encourage our American friends to get on the issue of the fiscal cliff as soon as possible after the U.S. election," Canadian Finance Minister James Flaherty told the Reuters wire service this week. "If the fiscal cliff were not resolved and all the measures were to come into force on the books in the United States, the U.S. would almost certainly be in recession next year" and start dragging countries like Canada along with it.

The impact is hard to measure, but analysts agree it would be dramatic — with few major nations avoiding damage.

At recent International Monetary Fund meetings in Japan, IMF managing director Christine Lagarde said she thought the fiscal cliff was already hurting world economic conditions by raising doubts about future growth.

Between the possibility of a breakup in the euro zone and a fiscal crash in the United States, "there is a level of uncertainty which is hampering decision-makers from investing, from creating jobs," she said.

The IMF has estimated that the automatic spending cuts and tax increases would knock perhaps four percentage points of growth off of a U.S. economy that is already only growing at 2 percent annually.

That means a serious blow to trade with Canada and Mexico — the countries likely to lose the most because their economies are so closely integrated with the United States. But it also means slower growth in China as U.S. imports fall, shaving perhaps as much as a full percentage point from a major Asian economy that is already slowing.

Brazil, by world standards, has a relatively small portion of its economy tied up in trade. But it relies heavily on commodity exports, and any downturn in manufacturing centers like China would likely mean Brazil earns less for its iron ore, copper and other commodities.

While Brazilian officials say they assume that Washington will find a way to avoid the automatic tax hikes and spending cuts, many in Brazil recall that their economy has suffered before from developments in the United States. The U.S. financial crisis that started in 2007 and spiked with the failure of Lehman Brothers dealt a stiff blow to Brazil's economy. And repeated efforts by the U.S. Federal Reserve to lift the U.S. economy with massive infusions of cash is blamed in Brazil for a long list of local problems as money gushed from the United States into world markets.

Now comes the prospect of the fiscal cliff. As they battle their own recent slowdown, the the last thing Brazilian officials say they want to confront is a drop in earnings from their export of commodities.

"If you have a U.S. recession, it affects the whole world," Cozendey said.

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