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Should Clinton Cut the Deficit or is there a Global Paradox of Thrift?

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1. INTRODUCTION

N this paper we examine whether now is a good time for the United States to cut its budget deficit. This is an issue which featured prominently in the recent US Presidential campaign. Our findings can be summarised in the aphorism: 'Lord save me from sin, but not yet.' They partly justify President Clinton's policies: he has, rightly in our view, said 'not yet'.

We explore this issue both theoretically and empirically, and report results for both developed and developing countries. Our work makes use of the global econometric model, GEM, and shows the way in which such a model can be used to address issues of pressing practical concern. The results for developing countries, and the work underlying them, may be of particular interest in that they make use of a new, unique modelling system which allows macroeconomic issues for less developed countries to be addressed on a *regional* basis.

a. The Problem

Concern is mounting from a number of sources about the current fiscal policy position in the United States. President Clinton has committed himself to tackling

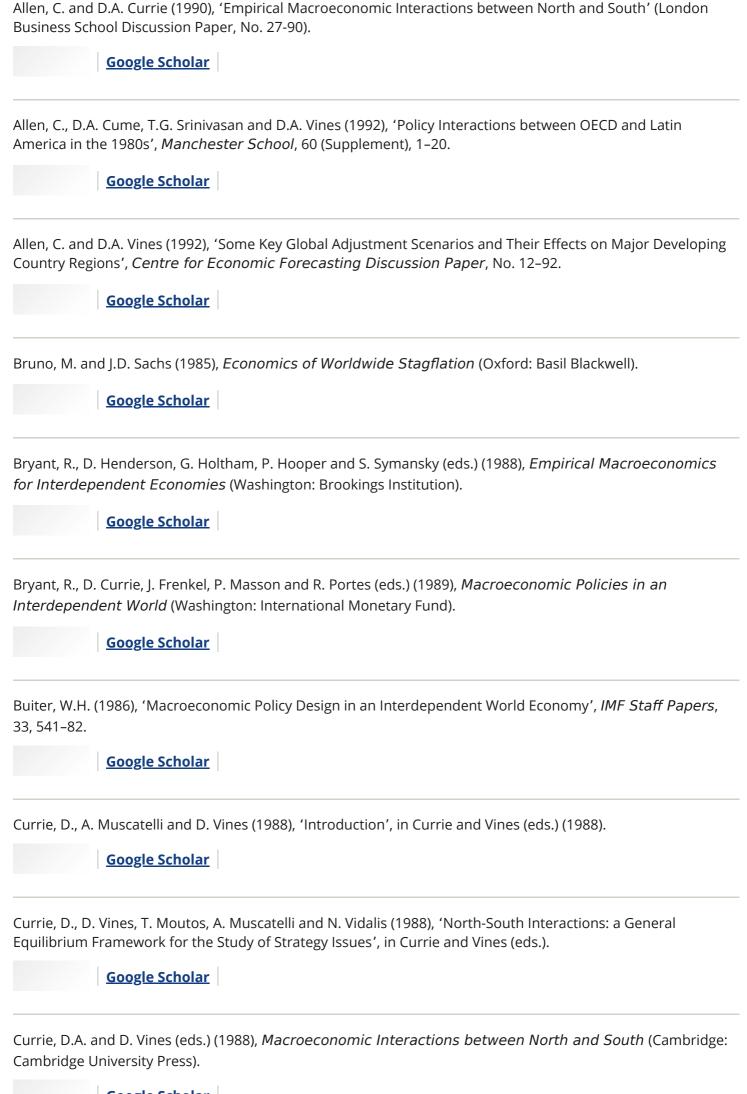
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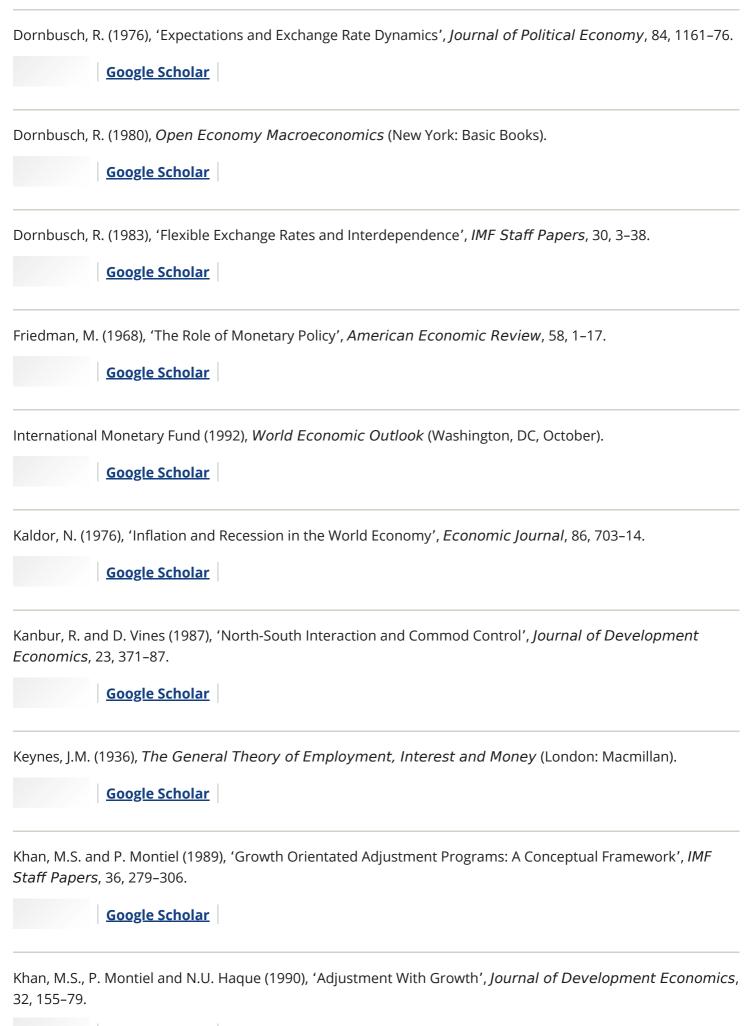
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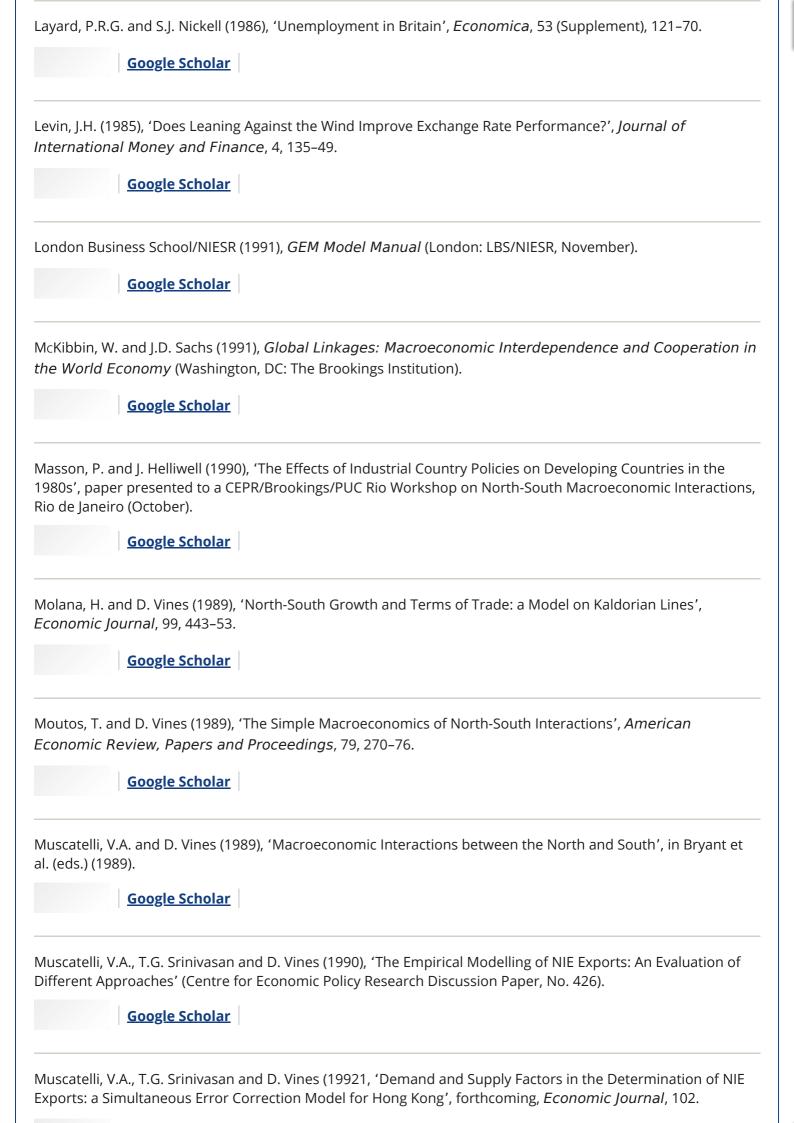
CHRIS ALLEN is from the Centre for Economic Forecasting, the London Business School. DAVID VINES is from Balliol College, Oxford, and the Australian National University. An earlier version of parts of this paper appeared in 'Some Key Global Adjustment Scenarios and their Effects on Major Developing Country Regions' which was written under contract No. F2S/038 for the United Nations. The authors are grateful to colleagues who helped to develop the models used in the work which is reported; in particular, T.G. Srinivasan now at the IECAP Division, International Economics Department, World Bank; David Currie of the London Business School; and Stan Hurn and Anton Muscatelli of Glasgow University. That development work was carried out with funding from the World Bank, from the University of Glasgow, from the United Kingdom Economic and Social Research Council under Research Grant No. R B00 23 2241, and from the United Kingdom Overseas Development Administration under Research Grant No. ESC 322/607/001. Comments on an earlier draft from two anonymous referees are gratefully acknowledged.



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