



What Is Fiscal Space?

Fiscal space is a term that has gained considerable importance in policy circles, especially when discussing the long-term health of a country's finances. In simple terms, fiscal space is the financial wiggle room that a government has to respond to emergencies and pursue new policy initiatives without compromising economic stability.

Imagine fiscal space as how much a nation can spend before hitting its credit limit. Just as individuals have a maximum amount of money they can borrow based on their income and expenses, a country has a limit to how much it can borrow before it starts to affect the country's economic health and credit rating. Going beyond this limit can lead to increased borrowing costs, reduced confidence among investors, and, in the worst-case scenario, a debt crisis.

Calculating fiscal space is not straightforward. It involves an assessment of current and projected public debt, economic growth rates, interest rates, and the government's existing financial commitments. Economists have developed frameworks for evaluating fiscal space, typically focusing on the ratio of public debt to Gross Domestic Product (GDP), that are used by the IMF, OECD, and other institutions.

For the U.S., which benefits from issuing debt in the world's primary reserve currency, the dollar, there's more flexibility. U.S. Treasuries are considered among the safest investments globally, which typically allows for more fiscal space. However, that space is not infinite.

Consider this: the federal debt of the U.S. has climbed to levels not seen since the aftermath of World War II, largely due to responses to financial crises and, most recently, the COVID-19 pandemic. Such borrowing can be justified as necessary to stimulate the economy during downturns and fund essential public services. However, persistent deficits and an increasing debt pile raise concerns about how much fiscal space the U.S. truly has left.

An erosion of fiscal space means the government might have to choose between raising taxes, cutting spending, or borrowing more at higher interest rates, which can slow economic growth. Furthermore, it could limit the government's ability to respond to future crises, such as natural disasters, economic downturns, or pandemics.

To preserve America's fiscal space, **Congress might need to look at reforms that ensure spending growth does not outpace revenue growth indefinitely**. A recent EPIC analysis finds that preserving fiscal space over the next two decades will require \$2.4 trillion in deficit reduction over the next 10 years, as well as policy reforms designed to spur economic growth.

In essence, **preserving fiscal space is about keeping the country's financial options open** for the future. It's about ensuring that we have the capacity to borrow for the right reasons and at reasonable costs, maintaining the trust of investors in U.S. financial solvency, and safeguarding the economic prosperity for generations to come.