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United States: 2001 Article IV Consultation—Staff Report; Staff Statement; and Public Information Notice on the Executive Board Discussion

As required under Article IV of its Articles of Agreement, the International Monetary Fund conducts periodic consultations with its member countries. In the context of the 2001 Article IV consultation with the United States, the following documents have been released and are included in this package:

- the staff report for the 2001 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **June 15, 2001,** with the officials of the United States on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on June 28, 2001.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff statement of **July 27, 2001** updating information on recent economic developments;

- the Public Information Notice (PIN), which summarizes the **views of the Executive Board as expressed during the July 27, 2001, Executive Board discussion** of the staff report that concluded the Article IV consultation.

The documents listed below have been or will be separately released

Mission Concluding Statement
Selected Issues Paper

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INTERNATIONAL MONETARY FUND

UNITED STATES OF AMERICA

Staff Report for the 2001 Article IV Consultation

Prepared by the Staff Representatives for the 2001 Consultation
with the United States

Approved by Claudio M. Loser and Leslie Lipschitz

June 28, 2001

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I. INTRODUCTION[1]

1. The staff report for the previous Article IV consultation discussions was considered by the Executive Board on July 21, 2000 (EBM/00/73).[2] Executive Directors agreed that the remarkable strength of the U.S. economy had been supported by rising real income, enhanced profitability, and rising household wealth, all of which were closely related to the surge in productivity growth beginning in the mid-1990s. However, Directors cautioned that continued domestic demand growth at a pace well in excess of the productivity-driven increase in potential output was not sustainable and needed to be slowed. In the near term, the principal priority for monetary policy was to ensure that the pace of aggregate demand growth was brought back in line with the economy's potential growth to ensure that inflation was kept in check. Directors noted that fiscal policy would also have an important role to play in restraining domestic demand growth in the near term and supported the Administration's intention to preserve a substantial share of the surpluses in prospect. From a longer-term perspective, eliminating the net public debt would be an important step toward preparing the federal government for the coming wave of unfunded liabilities associated with the aging of the population. Although Directors did not see any major vulnerabilities in the banking sector, they noted the high levels of household and corporate debt, and agreed that any substantial downturn in the economy would inevitably produce some financial pressures, and they supported pre-emptive efforts to limit potential bank balance sheet risks.

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[1] Discussions for the 2001 Article IV consultation with the United States took place in Washington, D.C. during May and June. The staff team comprised D. Goldsbrough, S. Dunaway, P. De Masi, V. Arora, M. Kaufman, R. Luzio, C. MacDonagh-Dumler (all WHD), A. McGuirk (PDR), and C. Kramer and H. Faruqee (RES). The Managing Director and First Deputy Managing Director took part in the concluding discussions with Treasury Secretary Paul O'Neill, and Federal Reserve Board Chairman Alan Greenspan. Ms. Lundsager, Alternate U.S. Executive Director, and Mr. Abbott and Mr. Baukol, Advisors to the U.S. Executive Director, attended the meetings. Comprehensive economic data are available for the United States on a timely basis. The United States has subscribed to the Fund's Special Data Dissemination Standard and has submitted metadata, which have been posted on the Fund's Data Standards Bulletin Board. In addition, the U.S. authorities have conducted self-assessments of the 12 key standards highlighted in the Financial Stability Forum's Compendium of Standards and have posted these on the U.S. Treasury website.

[2] SM/00/144, June 30, 2000, and the selected issues paper SM/00/146, July 5, 2000.

II. ECONOMIC DEVELOPMENTS AND OUTLOOK

A. Recent Economic Developments

2. ***Real GDP in 2000 grew by 5 percent—the strongest rate of growth of this long expansion—but most of these gains were concentrated in the first half, with a significant slowdown emerging later in the year (Table 1, Figure 1, and Box 1).*** During the second half of 2000, the economy grew at an annual rate of just 1½ percent and by 1¼ percent in the first quarter of 2001. A confluence of mutually reinforcing developments in the household and business sectors weighed heavily on activity during the second half of 2000 and into 2001 and caused a sudden slowdown. Higher interest rates and energy prices cut into discretionary consumer spending and squeezed corporate profit margins; slowing sales and higher costs eroded corporate earnings; equity prices tumbled—especially in the technology sector—increasing the cost of equity capital and reducing household wealth; and risk spreads on corporate debt widened, tightening financial conditions. At the same time, consumer confidence fell reflecting concerns about future economic conditions, further compounding the adverse effects of these developments (Figure 2).

3. ***Over the last several years, buoyant consumer spending underpinned the rapid pace of growth in the economy (Figure 3). Although spending in 2000 increased by 5¼ percent, similar to 1999, the largest gains were concentrated in the first quarter***. The deceleration in

Figure 1. United States: Real GDP and Domestic Demand
(Percentage change, same quarter previous year)

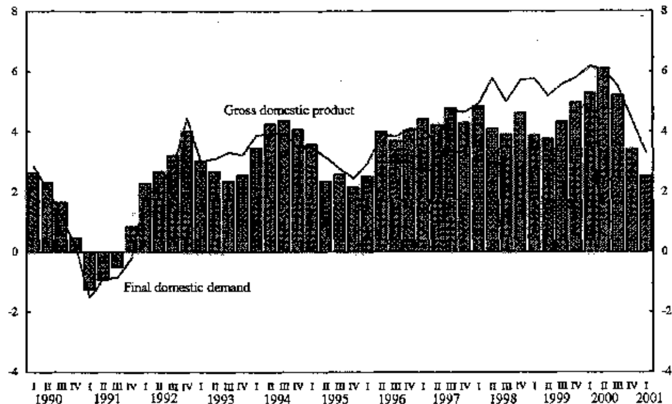


Figure 2. United States: Consumer Confidence

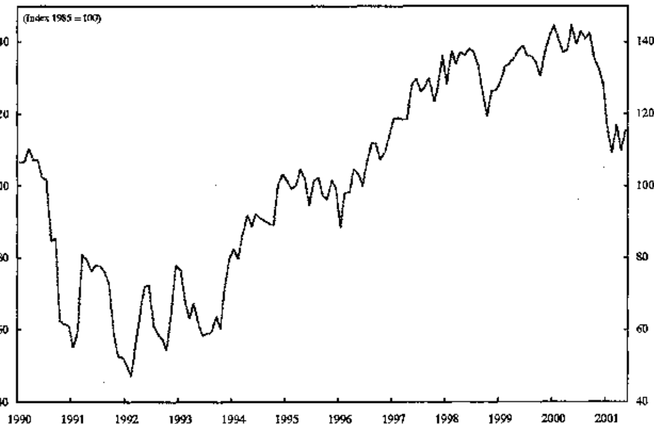
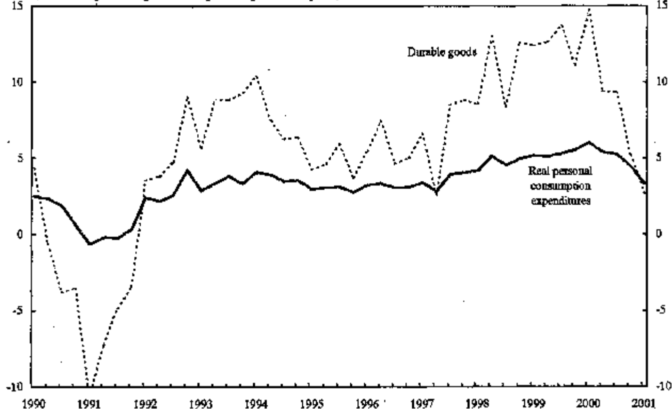


Figure 3. United States: Real Personal Consumption Expenditures
(Percentage change, same quarter previous year)



consumer spending during the second half of 2000 and in the first quarter of 2001—to an annual rate of a little more than 3 percent—reflected declines in consumer confidence, somewhat weaker growth in household real disposable income, and lower net wealth, factors which had fueled consumer spending in previous years.[3]

Box 1. Is There a Link Between the Longevity of an Expansion and the Probability of a Downturn?

The economic expansion in the United States that began in the second quarter of 1991 has persisted for 40 quarters, the longest economic expansion on record. Some observers have suggested that the longer this expansion persists, the greater the likelihood that a downturn in activity will occur. This reflects a commonly held belief that every economic expansion sows the seeds of its own destruction, as imbalances and other excesses emerge and grow over the expansion's lifespan. Hence, the longer the expansion goes on the higher is the probability that it will end and the more severe the downturn will be. While the latter expectation may be true, since the unwinding of imbalances and excesses built up during the expansion might contribute to a self-reinforcing downward spiral, the severity of the downturn ultimately tends to be highly dependent on the response of macroeconomic policies. However, the proposition that the longer an expansion persists, the greater is the probability of a downturn in activity is a statistically testable hypothesis and analyses of U.S. business cycles do not support this contention.

Post-war U.S. data show little evidence that the longer an economic expansion lasts, the higher the probability of a downturn in economic activity. Diebold and Rudebusch (1999) find that post-war U.S. expansions display no duration dependence.[1] In contrast, evidence suggests that for recessions, the probability of an upturn rises the longer the economy contracts. More recently, Leamer (2001) decomposed the U.S. business-cycle expansions since the 1950s into four distinctive phases—recovery, plateau, surge, and plateau—to estimate the probabilities of transition between phases.[2] Results suggest that output growth in each phase provides little information about the probability that the phase will end, and other indicators, such as unemployment, hours worked, and profits, are needed to identify such probabilities.

[1] F. Diebold F. and G. Rudebusch, 1999, *Business Cycles: Duration, Dynamics and Forecasting* (Princeton, N.J.: Princeton University Press).
[2] E. Leamer, 2001, "The Life Cycle of U.S. Economic Expansions," NBER Working Paper No. 8192.

[3] Over the period 1995–99, rising household stock market wealth boosted consumption on a cumulative basis by an estimated $250 to $500 billion (or roughly on average between ½ and 1¼ percent of nominal GDP on an annual basis), and the personal saving rate fell to historic lows. These estimates are based on long-run consumption responses of 3 to 7 cents for a $1 increase in wealth, with most estimates toward the lower end of this range. See M. Davis and M. Palumbo, 2001, "A Primer on the Economics and Time Series Econometrics of Wealth Effects," Board of Governors of the Federal Reserve Working Paper No. 2001-21. The staff's own work suggests that the wealth effect may be somewhat less than 3 cents for a dollar increase in wealth; see M. Cerisola and P. De Masi, 1999, "Determinants of the U.S. Personal Saving Rate," *United States: Selected Issues,* IMF Staff Country Report, No. 99/101.

4. ***In 2001, negative wealth effects associated with the stock market's decline are expected to significantly restrain consumption growth.*** From its peak in March 2000, the technology-heavy NASDAQ dropped 45 percent by year-end and a further 15 percent by end-May 2001, while the broader S&P500 composite index fell 12 and 5 percent over the same periods (Figure 4). The downturn in U.S. equities was mirrored in global markets with all major stock markets incurring significant losses (Figure 5). Although total household net worth fell in 2000 for the first time in a decade, the decline was only 2 percent; the fall in the value of equity holdings was partly offset by a rise in other financial assets as households sold stocks and realized some capital gains from the earlier rise in stock prices (Figure 6). The declines in household net worth in the United Kingdom and Japan following earlier periods of asset price increases were much larger than observed so far in the United States. During these periods, a broader range of asset prices—including real estate prices—fell in these countries, whereas in the United States, the downturn (like the rise in asset prices) has been concentrated in equities.[4]

Figure 4. United States: Stock Market Developments

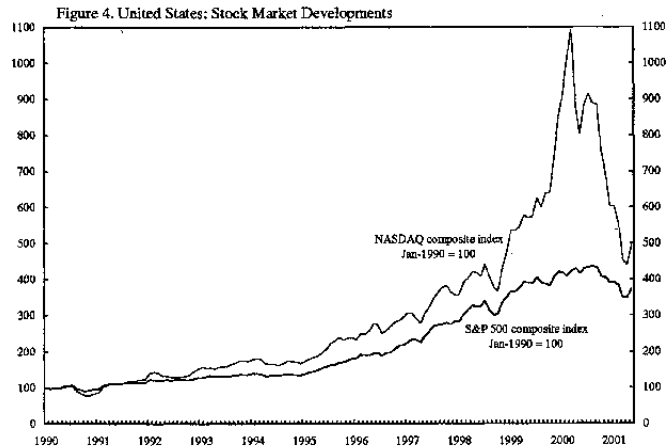


Figure 5. International Comparison: Stock Market Developments

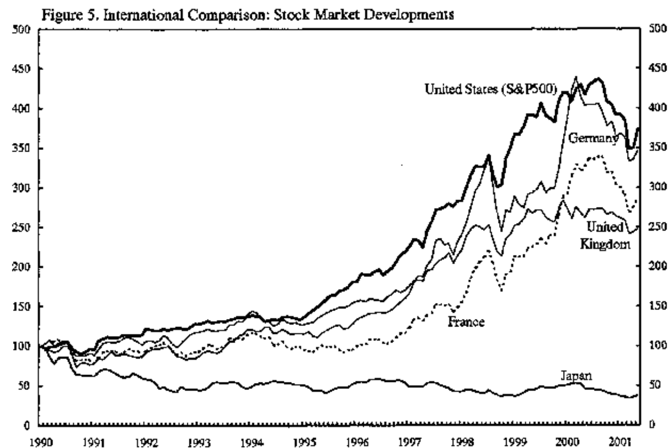
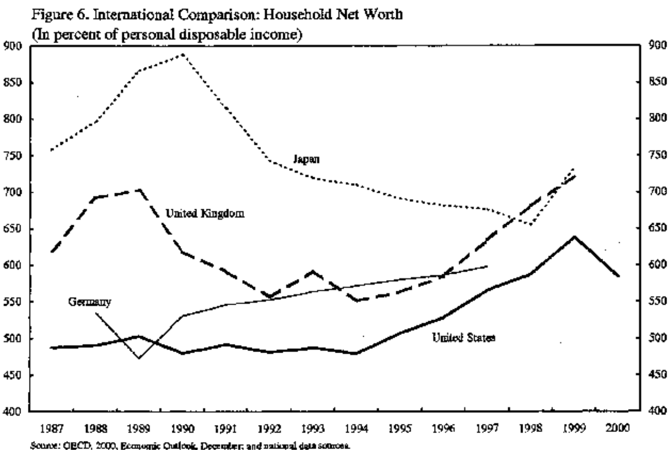


Figure 6. International Comparison: Household Net Worth
(In percent of personal disposable income)

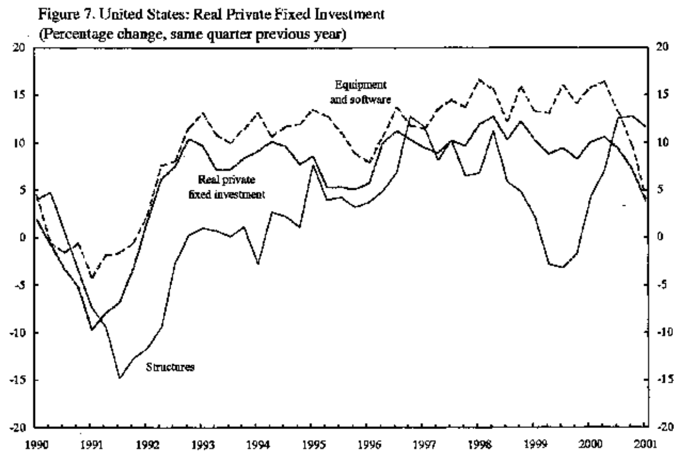


Source: OECD, 2000, Economic Outlook, December; and national data sources.

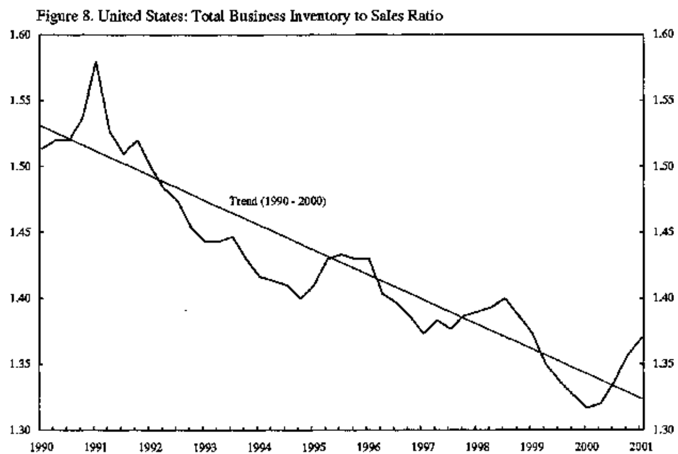
5. ***Strong growth in business fixed investment contributed over 1½ percentage points to annual growth over the last few years (Figure 7). Such investment continued strong in the first***

[4] For a detailed comparison of recent developments in the United States with the "bubble economy" period in Japan, see *United States: Staff Report for the 2000 Article IV Consultation,* IMF Staff Country Report No. 00/89.

half of 2000, with equipment and software purchases surging, but the pace of spending dropped markedly in the second half, with this weakness persisting in the first quarter of 2001. The deceleration in investment spending reflected the slowdown in economic activity, tighter financial conditions, and concerns about future profitability. Nonresidential construction, however, remained strong throughout 2000 and into 2001.



6. ***Sales slackened during 2000, and inventories rose, pushing the inventory-to-sales ratio above its long-term trend in the second half of the year (Figure 8).*** The inventory buildup developed in a broad range of manufacturing industries, but was especially pronounced in the automotive sector. Production was cut toward the latter part of the year, which sharply slowed inventory investment; adjustments in inventories reduced real GDP growth in the fourth quarter of 2000 by ½ percentage point, and by about 3 percentage points in the first quarter of 2001.



7. ***Net exports subtracted about 1 percentage point from GDP growth in 2000, reflecting the continued widening of the trade balance, but a sharp drop in imports in early 2001 dampened the impact of slowing domestic demand on real GDP growth.*** The current account deficit widened to 4½ percent of GDP in 2000, from 3½ percent in 1999, mainly reflecting a deterioration in the merchandise trade deficit (Table 2 and Figure 9). An increase in import volume growth from already high levels more than offset stronger exports driven by a strengthening of economic activity in partner countries (Table 3). With imports falling in the first quarter of 2001, the current account deficit declined to 4¼ percent of GDP.

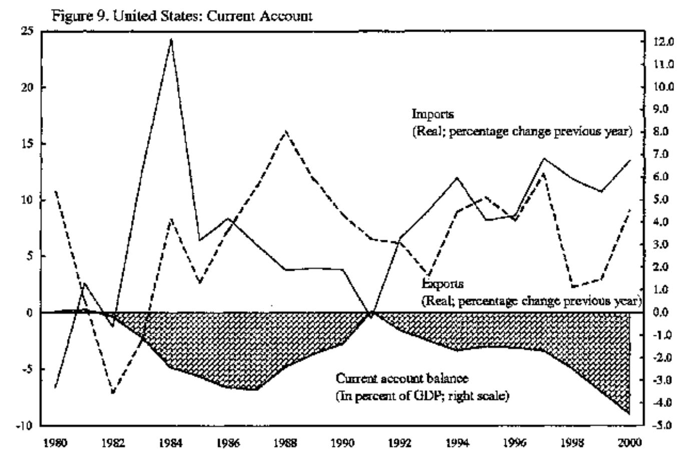
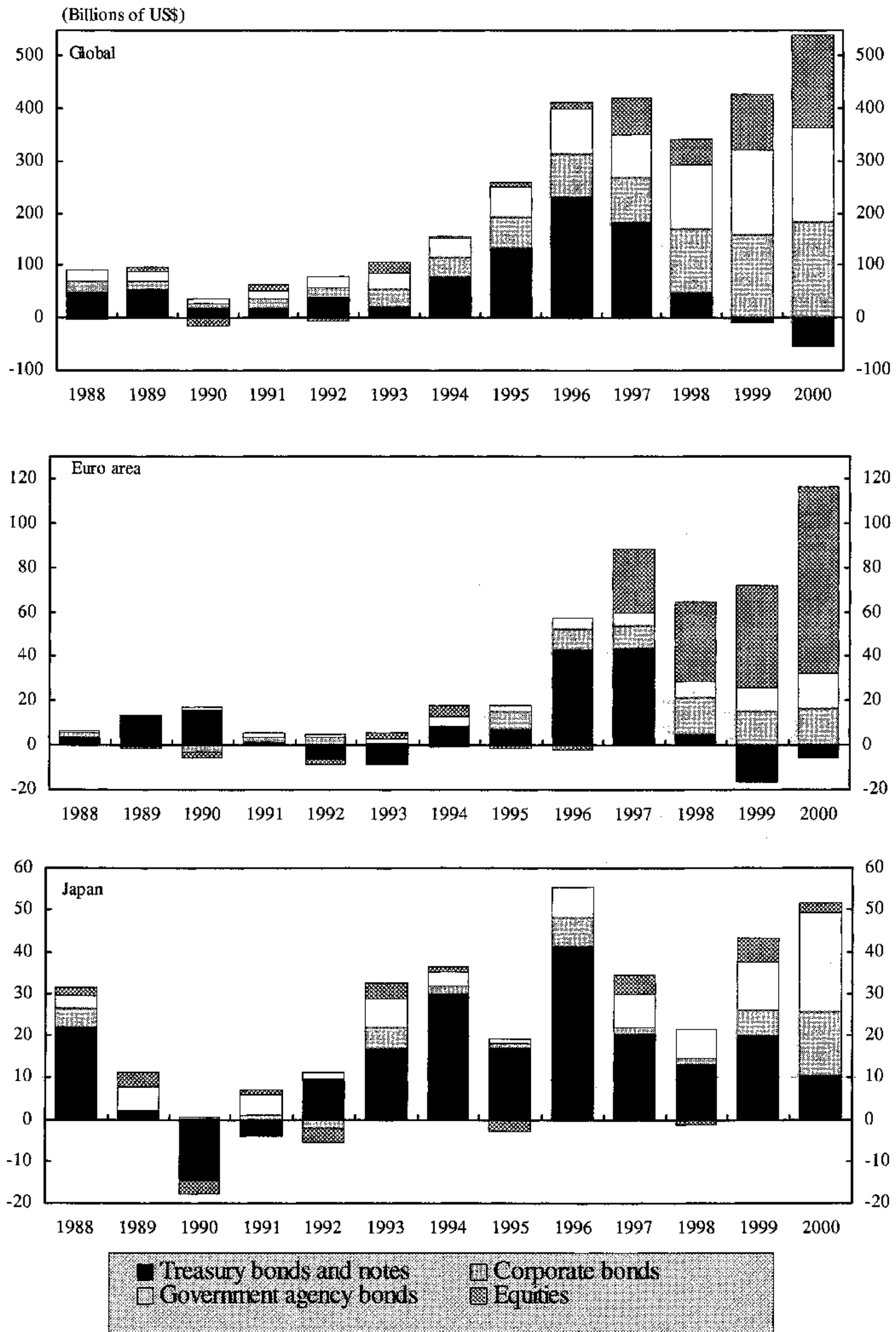
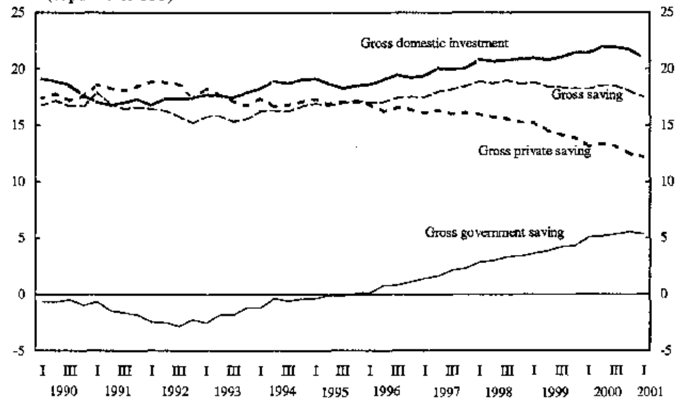


Figure 10. United States: Global Net Portfolio Inflows by Asset Class



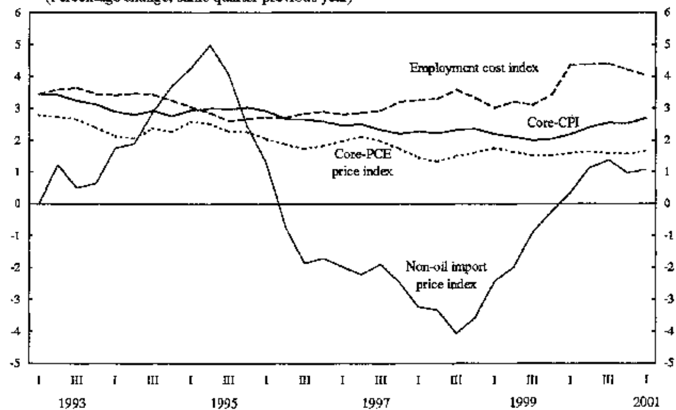
8. ***The current account deficit in 2000 absorbed an historically high 7¾ percent of the rest of the world's gross national saving, compared with an average of 2½ percent during most of the previous two decades.*** The counterpart to the widening deficit was a strong increase in net capital inflows, mainly representing net purchases of U.S. private securities in the form of bonds and equities. Flows out of U.S. Treasury securities continued, as foreigners shifted to U.S. corporate and government agency bonds. Net purchases of U.S. equities by residents of the Euro area were especially strong (Figure 10). With the continued deterioration in the current account and strong capital inflows, the net international liability position of the United States rose from 11¾ percent of GDP at end-1999 to an estimated 18½ percent of GDP at end-2000.

Figure 11. United States: Trends in Saving and Investment
(In percent of GDP)



9. ***Gross national saving remained unchanged at about 18 percent of GDP in 2000, after rising from a low of around 15 percent in the early 1990s (Figure 11).*** The improvement in national saving over the last decade is attributable to the increase in federal government saving, which has been rising by about 1 percentage point of GDP a year since the mid-1990s, offsetting a decline in personal saving. Continuing a trend that began in the 1980s, the personal household saving rate, as measured by the national income and product accounts, fell to around zero in 2000, as it turned negative in the second half of the year. Gross domestic investment as a share of GDP has trended higher during the current expansion, reaching about 22 percent in 2000. Therefore, with government saving rising, the widening in the current account deficit reflected an increasing rate of private investment and declining personal saving.

Figure 12. United States: Indicators of Inflation
(Percentage change, same quarter previous year)



10. ***Although headline inflation picked up beginning in mid-2000 owing to higher energy prices, core inflation (excluding food and energy) remained moderate reflecting continued gains in labor productivity and a slower rise in non-oil import prices (Table 4 and Figure 12).***[5] Consumer price inflation rose to 3½ percent during the course of 2000 and

[5] During 2000, consumer prices of motor fuels rose by 14 percent and natural gas prices by 37 percent.

in early 2001. The core consumer price index increased by around 2½ percent in 2000 and slightly faster in early 2001. The core deflator for personal consumption expenditures increased by about 1¾ percent in 2000 and the first quarter of 2001.

Figure 13. United States: Employment Growth and the Unemployment Rate

11. ***With continued tight labor market conditions, labor costs increased during 2000 and early 2001.*** Employment growth decelerated sharply during the course of the year, and the unemployment rate hovered around 4 percent, but increased in early 2001 to around 4½ percent (Figure 13). After rising by just ½ percent in 1999, unit labor costs rose by 2¼ percent during 2000 owing primarily to higher wage costs, and they increased by 3½ percent in the first quarter of 2001 compared to a year earlier. Employment costs rose at an annual rate of about 4½ percent in 2000 and in the first quarter of 2001.

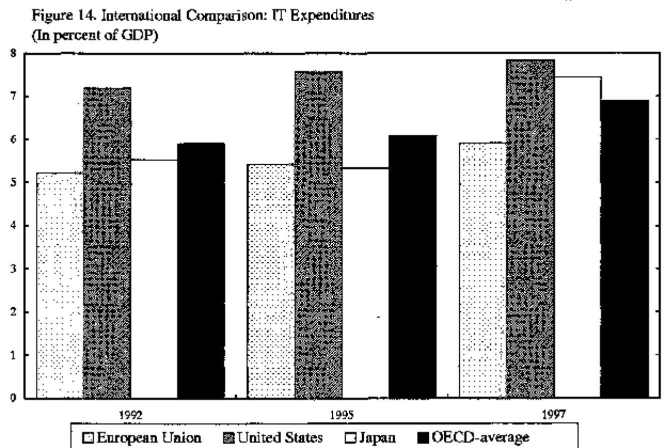


Figure 14. International Comparison: IT Expenditures
(In percent of GDP)

12. ***Labor productivity growth in the nonfarm business sector increased by 4¼ percent in 2000, but it decelerated toward year-end and contracted by nearly 1½ percent in the first quarter of 2001.*** The acceleration in labor productivity growth beginning in the mid-1990s has played a key role in holding down price pressures during the long expansion. Recent evidence suggests that the pickup in productivity growth is closely linked to strong rates of investment in computers and software and faster growth in total factor productivity in both the computer and noncomputer sectors (Box 2).[6] Despite the worldwide availability of new technologies, other industrial countries have not experienced a "U.S.-style" pickup in productivity growth, in part reflecting slower adoption and diffusion of new technology (Figure 14).[7] The deceleration in productivity

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[6] The forthcoming selected issues paper examines the connection between returns to human capital and investment in new technology. Higher returns to education reflect investment in new technology and stimulate further investment as higher returns increase the supply of skilled workers over time.

[7] C. Gust and J. Marquez, 2000, "Productivity Developments Abroad," *Federal Reserve Bulletin*, October.

Box 2. The Acceleration in Labor Productivity Growth and Prospects for Future Growth

Early studies of the acceleration in U.S. labor productivity in the second half of the 1990s found that greater efficiencies achieved in producing information technology (IT) had boosted total factor productivity (TFP)—and hence labor productivity—in these sectors, as evidenced by the plunging prices of their products.[1] These price declines and technical innovations encouraged other industries to raise their investment in IT equipment and software, contributing to capital deepening and further boosting labor productivity growth. **Together, the impact of producing and using IT accounted for an estimated 45 to 75 percent of the acceleration in labor productivity growth seen during the second half of the 1990s.** Some observers, however, were skeptical of these results, arguing that most of the acceleration reflected the fact that the U.S. economy was growing at a rate above its long-term trend. This above-trend growth in output was said to induce a "cyclical" increase in labor productivity, implying that the increase was only temporary and possibly related to overinvestment.[2]

Recent studies are consistent with the view that much of the productivity pickup is structural in nature. Using industry level data, Stiroh (2001) shows that the industries outside the IT sector that invested most aggressively in IT in the early 1990s have shown the largest gains in labor productivity growth.[3] Industries that intensively use IT and IT-producing industries account for virtually all of the acceleration in labor productivity growth, with industries insulated from the IT revolution contributing virtually nothing. Another study by the Council of Economic Advisers (2001) finds that about one quarter of the acceleration in productivity since 1995 is attributable to capital deepening, with the remaining three quarters attributable to a pickup in total factor productivity growth in both the computer and noncomputer sectors.[4] Data on labor productivity growth by industry are also examined, and support Stiroh's results that industries making intensive use of IT equipment have seen a greater pickup in productivity growth. Finance, retail, and wholesale trade have all seen strong growth in productivity largely attributable to improvements in the way that businesses are organized and how they are using technology. Nordhaus (2001) develops an alternative data set for measuring productivity growth based on the income side of the national accounts and finds that about half of the acceleration in labor productivity growth is attributable to the IT sector.[5]

Continued strong productivity growth depends critically upon further technological innovation and investment in new technology, both of which are uncertain. **Examining past trends in the factors which have promoted innovation and the outlook for producing and using technology suggest cautious optimism that underlying productivity growth will remain fairly robust at least over the medium term, although the magnitude of any short-term cyclical impact is difficult to predict.** Evidence suggests that innovation is expected to continue for some time, as there appears to be room for further improvements in microprocessor speed, storage, and data transmission capacity. IT prices are expected to decline further, providing strong incentives for firms to invest in IT equipment.[6] At the same time, a combination of features in the United States have fostered technological innovation and its adoption. These features include strong competition, which fueled demand for cost-saving technology; increased private and public spending on research and development; strong intellectual property protection; flexibility in labor and product markets, allowing firms to reorganize work processes and business practices; and access to financing especially for new firms. Many of these factors appear to be firmly embedded in the structure of the U.S. economy.

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[1] For a review see P. De Masi, 2000, "Does the Pickup in Productivity Growth Mean That There Is a New Economy?" *United States: Selected Issues*, IMF Staff Country Report No. 00/112.

[2] The use of the term "cyclical" in this context has been a source of confusion because it differs sharply from the conventional idea of a cyclical change in productivity being related to variations in the intensity with which factors of production, especially labor, are used over the course of the business cycle.

[3] K. J. Stiroh, 2001, "Information Technology and the U.S. Productivity Revival: What Do the Industry Data Say?" Federal Reserve Bank of New York, Working Paper, January 24.

[4] Council of Economic Advisers, 2001, *Economic Report of the President* (Washington, D.C.: U.S. GPO).

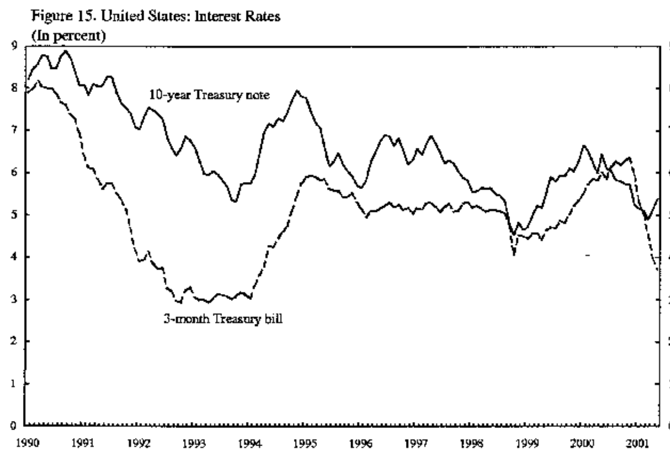
[5] W. D. Nordhaus, 2001, "Productivity Growth and the New Economy," NBER Working Paper 8096, January.

[6] D. J. Jorgenson, 2001, "Information Technology and the U.S. Economy," Presidential Address to the American Economic Association, January 6; and "The Productivity Experience of the United States: Past, Present and Future," Remarks by Vice Chairman Roger W. Ferguson, Jr., at the U.S. Embassy, The Hague, Netherlands, June 14, 2001.

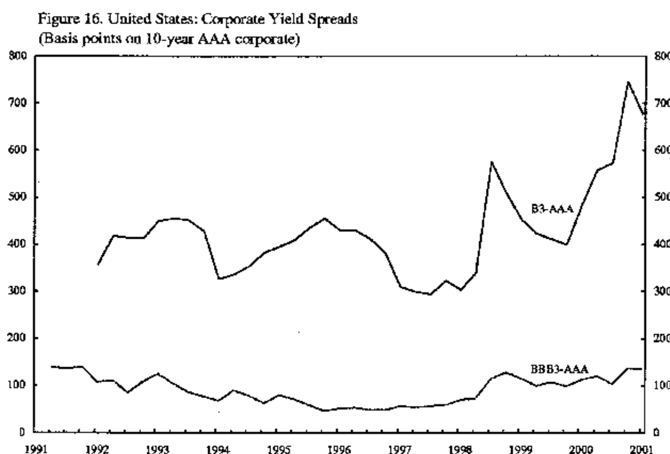
growth in late 2000 appears to be attributable primarily to normal cyclical influences, as firms appeared to "hoard" labor—at least initially—as output growth slowed.

13. ***The stance of monetary policy shifted markedly in early 2001, as the Federal Reserve responded to the changing balance of risks for inflation and output growth.*** With domestic demand growth outstripping the growth in potential output, the Federal Reserve had raised the federal funds rate by a cumulative 175 basis points to 6½ percent over the period June 1999 to May 2000. As the slowdown in activity unexpectedly intensified in late 2000, however, the Federal Reserve indicated in mid-December that weakening economic activity had become a more significant risk, and then surprised markets in early January 2001 when it lowered the federal funds rate by 50 basis points in advance of its scheduled meeting. Subsequently, in the first six months of 2001, the Federal Reserve cut rates on five more occasions—which included an intermeeting cut in April—bringing the federal funds rate down to 3¾ percent.

14. ***Interest rates on short-term Treasury securities largely mirrored the changes in monetary policy, but long-term Treasury yields declined during 2000, partly on concerns about the shrinking supply of long-term Treasury securities which imparted a scarcity premium (Figure 15).*** As a result, the Treasury yield curve for much of 2000 was inverted, but it became positively sloped in early 2001, and steepened significantly in the first five months of the year.

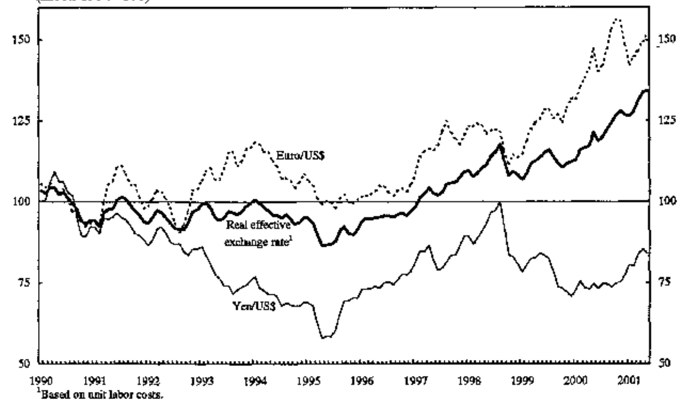


15. ***Corporate bond spreads, particularly on high-yield bonds, spiked in late 2000 and bond placements dropped as evidence of a weaker economy, combined with equity price declines and a less rosy outlook for corporate profits, prompted investors to become more cautious about credit risk.*** Spreads in the high-yield corporate bond sector relative to AAA corporate bonds jumped to about 750 basis points in late 2000, and trading virtually seized up, raising concerns that a credit crunch would ensue (Figure 16). Some spillover to investment grade bonds also occurred, where yield spreads widened but to a much lesser extent. With the Federal Reserve's easing in monetary policy in

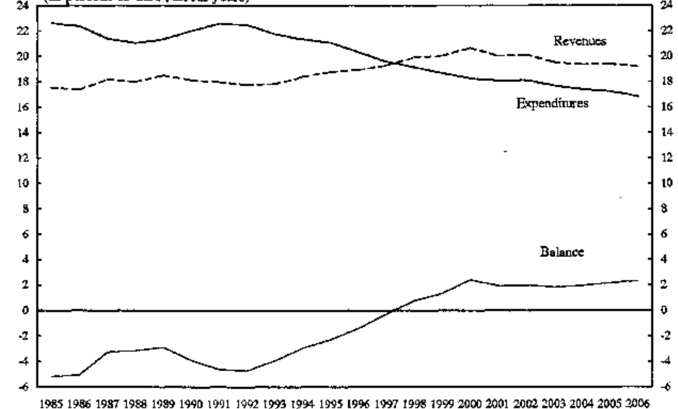


the first six months of 2001, credit spreads narrowed, but remain high relative to their levels in early 2000.

16. ***In real effective terms, the dollar appreciated by 7¾ percent in 2000, and by a further 6 percent in the first five months of 2001.*** By May 2001, it was about 55 percent higher than its low in April 1995 (Figure 17). A 5 percent depreciation of the dollar against the Japanese yen in 2000 was more than offset by a 15¾ percent appreciation againt the euro; during the first five months of 2001, the dollar appreciated against both the Japanese yen and the euro.



17. ***The unified federal budget balance recorded a surplus for the third successive year in FY 2000 (Figure 18)***. The surplus rose to 2½ percent of GDP ($236 billion), from 1¼ percent of GDP in FY 1999.[8] The Administration and the Congressional Budget Office both estimate that in FY 2001, on a current services basis, the surplus will rise to 2¾ percent of GDP (around $280 billion).[9] The steady improvement in the fiscal balance since the early 1990s reflects in part the strong growth performance of the U.S. economy, as well as fiscal legislation enacted since 1993, mainly the Omnibus Budget Reconciliation Act of 1993 (OBRA93) and the Balanced Budget Act of 1997. In FY 2000, federal debt held by the public declined to 35 percent of GDP. The state and local government budget deficit (national accounts basis) is estimated to have remained roughly unchanged in 2000 at about ½ percent of GDP and is expected to stay at that level in 2001. The turnaround in the U.S.



[8] Fiscal years start October 1. The unified federal government balance refers to the combined balances of the federal government ("on-budget") and the Social Security and Postal systems ("off-budget").

[9] During the first eight months (October–May) of FY 2001, the budget recorded a surplus of $137 billion, compared with a surplus of $121 billion in the first eight months of FY 2000.

general government financial balance over the period 1995–2000 was larger than the average for the other G7 countries (see Table 3).

B. Economic Outlook

18. ***The staff's baseline projection is that real GDP growth will slow through the first half of 2001, primarily reflecting weakness in business spending owing to a decline in corporate profitability. A lower rate of equipment and software investment, moderate consumption growth, some increase in unemployment, and relatively sluggish growth in the rest of the world will contribute to a slow revival in output growth over the course of 2001 but no outright recession.*** The modest pickup in growth in the second half of the year would be supported by the aggressive easing of monetary policy, fiscal stimulus from the recently enacted tax cuts (Box 3), and completion of the inventory adjustment process. GDP growth for the year 2001 as a whole is expected to be about 1½ percent (Table 5).[10]

Box 3. The Short-Term Economic Impact of the Tax Cuts

The recently enacted tax cut legislation provides for short-term stimulus in the form of lump sum tax rebates and reductions in tax withholding schedules effective July 1, 2001. The staff estimates that the direct effect will be to raise personal disposable income by $48 billion (½ percent of GDP) in 2001 and $76 billion (¾ percent of GDP) in 2002.

The short-term impact on aggregate demand will depend on several factors, including:

- whether the tax rebate is viewed as a down payment on future tax cuts and the extent to which it is spent rather than saved;
- the distribution of the tax rebate and withholding tax changes across income groups, with higher-income groups having greater propensities to save;
- the extent to which individuals view the current reduction in taxes as potentially leading to future tax increases (so-called Ricardian effects).

Depending on the assumptions for these factors, the short-term stimulus from the tax cut could be expected to add 1–2 percentage points (annual rate) to GDP growth in the second half of 2001 or ¼–½ percentage point to average growth for the year as a whole, and ½–¾ percentage point to growth in 2002.

Economic activity would strengthen further throughout 2002, with real GDP rising by 2½ percent for the year, and it would be faster than the staff's estimate of potential output growth of 3¼ percent in 2003–04, as the economy revives. Although in recent months there has been a pickup in wage costs, with the slow recovery in economic activity in the near term, inflationary pressures are expected to remain quiescent. The current account deficit as a

[10] The June 2001 consensus forecast (*Blue Chip Economic Indicators*) predicts U.S. GDP growth (year on year) at 1.8 percent in 2001 and at 3.1 percent in 2002.

percent of GDP is expected to narrow gradually over the medium term, as incomes are projected to grow somewhat faster in the rest of the world relative to the United States.[11]

19. ***However, the outlook for the U.S. economy is very uncertain.*** Although consumer confidence fell sharply, household spending held up reasonably well in the first quarter of 2001, with particularly strong purchases of cars and houses. It is possible that economic activity may revive more quickly in the latter part of 2001 and in 2002 than in the baseline forecast. In this case, the slowdown would largely reflect an inventory correction that runs its course during 2001, and rising business and consumer confidence would contribute to a faster pickup in growth. Accordingly, growth could be ½ percentage point higher in 2001 and 1 percentage point higher in 2002 than the baseline forecast. In such an event, the Federal Reserve would have to begin unwinding the easing in monetary policy much earlier in order to prevent the emergence of inflationary pressures.

20. ***But there is a significant risk that an additional slide in business confidence, owing in part to a more pessimistic assessment of underlying productivity growth and corporate earnings prospects, could create the conditions for a further deterioration in U.S. economic activity, with adverse consequences for the global economy.*** As a result, unemployment would rise, dampening household income and consumer spending. Productivity growth would be expected to experience a cyclical decline, and the extent to which this development would further reduce profitability and add to unemployment would depend on the flexibility of wages. Moreover, the initial downturn could be amplified by triggering adjustments in corporate and household balance sheets, which in turn would have negative effects on the financial sector, leading to a tightening of credit. Lower expected corporate earnings would also add to downward pressures on stock prices and would contribute to increase risk aversion and a further tightening of credit conditions, which would restrain consumption and investment.

21. ***The potential implications of some of the downside risks for the United States and the rest of the world arising from a negative shock to business confidence have been explored using MULTIMOD to simulate an alternative scenario*** (Table 6). The effect on business confidence of less optimistic expectations for future earnings and underlying productivity growth are assumed to contribute to an additional decline in U.S. equity prices of 20 percent in the scenario, leading global investors to move out of dollar-denominated assets and inducing a depreciation of the dollar. Because of the decline in the U.S. stock market, equity prices in Europe and Japan are assumed to fall further, and Japan also sustains a sharp drop in consumer and business confidence. The results from this scenario indicate that the United States would experience a significant slowdown in real GDP growth in 2001–03 relative to the baseline, with real output recovering only slowly over the medium term. Among the industrial countries, Europe and Japan would experience less of a

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[11] This projection for the current account balance assumes an unchanged real exchange rate.

slowdown in growth than the United States.[12] For developing countries, there would be a modest decline in real GDP, but a more significant decline in real domestic demand. For countries with substantial trade and financial linkages with the United States, such as Canada and Mexico, the slowdown in growth is likely to be closer to that in the United States.[13] The fall in output in the industrial countries would reduce exports from developing countries, lower commodity prices, and reduce capital flows. Global monetary conditions would be eased in response to weakening activity, and this would provide some boost to the developing countries, particularly the regions which are heavily dependent on foreign borrowing, such as Latin America. However, turbulence in U.S. financial markets and an increase in risk aversion could spill over onto the emerging market countries and, through higher spreads on emerging market debt, would tighten external financing conditions and further constrain growth prospects (Box 4).

III. Policy Discussions

22. The consultation discussions focused on the following key issues:

- ***with prospects for U.S. growth highly uncertain, the principal issue is the need to assess the risks of a sharper slowdown in economic activity and what U.S. policy can do in the near term to revive growth***;

- ***whether economic activity remains sluggish for an extended period depends on the extent to which the previous booms in consumption and investment resulted in significant overinvestment and created problems in household and corporate balance sheets that might reinforce a downward movement in economic activity***;

- ***the extent to which the acceleration in labor productivity growth since the mid-1990s is sustainable, with important implications for macroeconomic policy and the outlook for economic activity;***

- ***establishing how to meet the future financing needs of Social Security and Medicare, and how they can be best matched with the authorities' other fiscal objectives for the medium term.***

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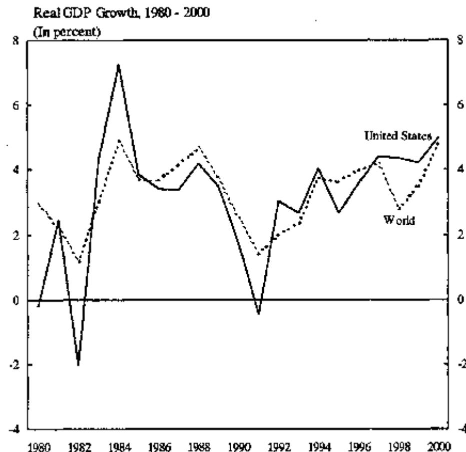
[12] The forthcoming selected issues paper examines in more detail the impact on the Euro area of weakening economic and financial conditions in the United States.

[13] Staff estimates suggest that, *ceteris paribus,* a 1 percentage point slowdown in U.S. real GDP growth results in almost a 1 percentage point slowdown in Canada's growth and a 0.6 percentage point slowdown in Mexico's growth.

Box 4. The United States in the World Economy

A U.S. economic slowdown could affect the global economy through a number of channels. The United States accounted for over one-fifth of world real GDP (PPP basis) in 2000 and for nearly a quarter of the expansion in world GDP during 1992–2000. World GDP growth in recent decades has been closely correlated with U.S. growth (see figure), with a correlation coefficient of over 0.8.

One channel through which U.S. developments affect the world economy is external trade. Trade with the United States accounts for over 15 percent of world trade and over 5 percent of world GDP (Table 1). The countries/regions most dependent on the U.S. market, in terms of shares in trade and GDP, are Canada and Mexico (by far the most closely integrated), several Asian economies, and Latin America and the Caribbean.



But the recent correlation of business cycles has been much larger than can be explained by trade linkages alone. For some countries, a more important channel may be financial linkages. For Europe, in particular, the U.S. share in trade is relatively low, but Europe accounts for nearly two-thirds (over $1½ trillion in 1999) of total foreign private holdings of U.S. stocks and bonds (Table 2). Growing mergers and acquisitions and greater cross-border trading of shares have contributed to close correlation in financial market trends. In 1999–mid-2000, the correlation between U.S. and European IT share prices was 0.85 (the U.S.-Asia correlation was 0.75); in the non-IT sector, it was 0.75 (0.35 for U.S.-Asia). The significant U.S. activity of European banks is another channel. In 2000, in France, Germany, and the United Kingdom, banks' consolidated claims on the United States accounted for 12–20 percent of their total foreign claims, equivalent to 2–4 percent of total assets.

Another channel is U.S. monetary policy, which affects the world economy both indirectly through its impact on U.S. real activity and directly through its impact on exchange rates and world financial markets. Staff analysis suggests that sovereign spreads in emerging market countries are significantly influenced by U.S. policy interest rates (as well as by U.S. market volatility), in some cases by more than one for one, and that a percentage point increase in U.S. rates could reduce developing countries' GNP by ½ percent annually relative to a baseline forecast.[1] Furthermore, a collapse in U.S. financial markets would likely be accompanied by a reduction in investors' appetite for emerging market debt, as these spreads have moved closely with U.S. high-yield spreads in recent quarters.

Table 1. World Trade with the United States, 1999 1/

	U.S. Trade/ Total Trade	U.S. Trade/ Domestic GDP
World	16	6
European Union	8	4
Canada	81	58
Japan	27	4
Developing countries	21	16
Of which:		
Africa	11	5
Asia	18	18
China	17	6
NIEs 2/	22	22
Mexico	81	49
Other Latin America, Caribbean	30	8

1/ In percent. Merchandise exports and imports, from DOTS.
2/ Hong Kong SAR, Korea, Singapore, Taiwan Province of China.

Table 2. Foreign Private Holdings of U.S. Securities, 1999

(Shares in total, in percent)

	Stocks	Corporate and Agency Bonds
Western Europe	64	63
Canada	9	2
Japan	7	11
Latin America	2	2
Other (including Asia)	18	21
Total foreign holdings ($, bill.)	1,446	1,064

Source: BEA, *Survey of Current Business,* July 2000.

[1] See V. Arora and M. Cerisola, 2000, "How Does U.S. Monetary Policy Influence Economic Conditions in Emerging Markets?" *United States: Selected Issues,* IMF Staff Country Report No. 00/112.

A. Economic Conditions and Prospects

23. ***During the discussions, the authorities and staff agreed that the economy would grow at a rate well below that of potential output during 2001.***[14] The inventory correction that began in late 2000 had restrained economic activity, particularly in the first quarter of 2001, and the exact timing of when it would end was uncertain and contingent upon whether final sales held up. In these circumstances, the authorities were of the view that inflationary pressures would remain generally well-contained, reflecting strong competition in product markets, well-anchored inflationary expectations, and a general easing in labor market tightness which should dampen future wage pressures—an assessment the staff shared. There was general agreement that, at this juncture, the outlook was unusually uncertain. The economy faced a number of downside risks and would be more vulnerable to shocks during a period of slow economic growth. Whether economic activity would remain weak for a longer period of time than projected in the staff's baseline would depend on a range of factors including: how economic and financial conditions affected consumer and business spending; whether households and businesses encountered balance sheet problems and the extent to which there were spillovers onto the financial sector with the potential to amplify the weakness in activity; and—most importantly of all—whether the recent acceleration in productivity growth was sustainable.[15]

24. ***Consumer spending was likely to be weak in the near term owing to the impact of the negative wealth effect, an erosion in consumer confidence, and the uptick in the unemployment rate.*** The authorities and the staff agreed that the degree of weakness in consumer spending would be determined by whether equity prices and consumer confidence stabilized and the extent to which unemployment rose. With a deceleration in consumer spending, the personal saving rate was expected to rise from its recent lows. The authorities did not see the current low personal saving rate as being an independent source of concern (Box 5). They noted that accurately defining and measuring saving (and disposable personal income) was difficult, especially in recent years when capital gains in financial assets had been very large. In particular, the commonly used national income and product accounts measure of the personal saving rate tended to understate the financial soundness of the

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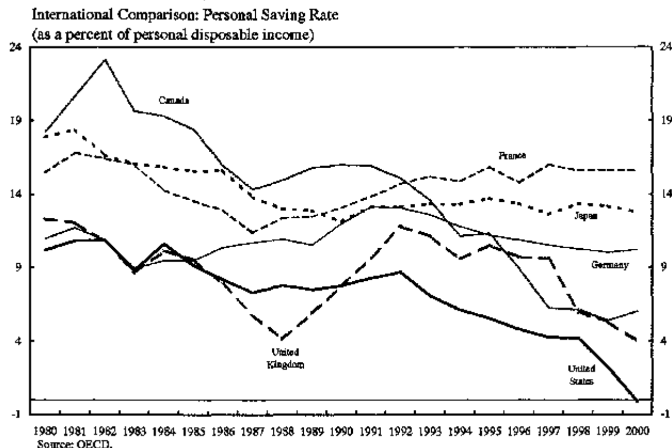
[14] The authorities' official estimate of potential output growth was in the range of 3 to 3½ percent—in line with staff estimates—but they noted that this was a conservative estimate, and that potential growth could be higher. The authorities' estimate of potential growth reflects long-term trends. Alternative estimates, especially those that attempt to gauge directly the impact of investment on the economy's productive capacity, suggest a potential growth rate of 3½–4 percent.

[15] At the time of the discussions in May, the authorities noted that their forecast used in preparing the FY 2002 Budget, which had been finalized in January, was out of date, but that they generally concurred with the Blue Chip consensus forecast for real GDP growth at that time of around 2 percent in 2001 and around 3 percent in 2002.

Box 5. Is the Low Personal Saving Rate a Problem?

Since the early 1980s, the traditional national income and product accounts (NIPA) measure of the personal saving rate in the United States has fallen from about 10 percent of disposable income to about zero in 2000. Personal saving rates have fallen in most other major industrial countries, but they remain higher than the U.S. rate (see figure). Econometric evidence suggests that the trend decline in the U.S. personal saving rate can largely be explained by a rise in household equity wealth, higher per capita Medicare transfers, higher public saving, improved household access to credit, and lower inflationary expectations.[1] In addition, the decline in the saving rate reflects some measurement factors. The NIPA measure tends to be biased downward during a period of rising capital gains, as occurred in the 1990s, because reductions in corporate contributions to defined benefit pensions of households and rising payments of capital gains taxes both lower measured personal savings. These factors are estimated to account for about 2½ percentage points of the decline in the personal saving rate since the late 1980s.

International Comparison: Personal Saving Rate
(as a percent of personal disposable income)



Source: OECD.

In principle, a low personal saving rate might be a problem because: (i) saving is "too low" to support long-term economic growth; (ii) some of the factors that have lowered saving could be quickly reversed, causing demand management problems as consumption collapses; or (iii) some groups are saving "too little," especially for retirement purpose, creating potential social problems. However, there are several considerations that make these issues less of a concern. First, the effects of rising capital gains tended to distort the allocation of national saving across sectors in the NIPA, with saving in the government and corporate sectors being boosted and personal saving being reduced. Second, over the 1990s, national saving rose, as an increase in government saving more than offset the personal saving decline. Third, many of the factors explaining the trend decline in saving are unlikely to be suddenly reversed in a manner that would cause a collapse in demand. The major exception is, however, the rise in equity wealth; a collapse in stock market prices would depress consumption and raise the personal saving rate. Fourth, once capital gains are taken into account, U.S. households, in aggregate, do not appear to be facing any looming problems of financial security, owing to lack of preparation for retirement; for example, average household wealth in relation to household income is similar to that in other G-7 countries. Nevertheless, studies based on microeconomic data suggest that some income groups are saving little and that about half of the population may not be able to preserve their level of consumption after retirement, but it is hard to know whether this reflects an explicit life-cycle choice.[2]

The most effective way for public policy to boost national saving is by raising government saving, which underscores the importance of maintaining substantial fiscal surpluses over the medium term. Fiscal policy actions intended to enhance incentives for households have generally not yielded substantial increases in personal saving. There is, however, some evidence that encouraging better coverage of employer-sponsored pension/savings plans for low-income workers can increase saving by these groups.

[1] See M. Cerisola and P. De Masi, 1999, "Determinants of the U.S. Personal Savings Rate," *United States: Selected Issues,* IMF Staff Country Report, No. 99/101.

[2] See A. Lusardi, J. Skinner, and S. Venti, 2001, "Saving Puzzles and Saving Policies in the United States," NBER Working Paper 8237.

Box 6. How Vulnerable are Household and Corporate Balance Sheets?

In the second half of the 1990s, the debt ratios of households and nonfinancial corporations increased to unprecedented levels, raising questions about how vulnerable these sectors might be to an economic downturn. In the case of households, debt service has increased in relation to disposable income, but the credit quality of households has not shown any significant deterioration. Corporate sector leverage and liquidity ratios remained sound, putting the sector generally in a good position to weather the economic slowdown, although some signs of strain have emerged in sectors such as telecommunications.

Household Sector

After little change in the early 1990s, household debt increased by about 50 percent over the period 1995–2000. Most of this increase is attributable to growth in mortgage debt, reflecting more widespread ownership of housing, and the use of home equity loans to finance other expenditures.

Household debt service relative to disposable income rose slightly in 2000 to about 14 percent, its highest level since the late 1980s. However, the credit quality of households—as measured by personal bankruptcies and delinquencies—remained solid throughout 2000 and into early 2001, reflecting low unemployment and relatively high household net worth. Personal bankruptcies declined by about 5 percent during 2000, and are well below their peak level in 1998. Delinquencies on mortgages and bank cards edged up slightly from low levels toward the end of 2000, and deteriorated modestly in early 2001.

Household net worth rose sharply over the period 1995–99, owing to strong gains in equity prices, but declined in 2000 as stock prices fell. Household holdings of corporate equities and mutual funds in 2000 declined by about one quarter to $9.6 trillion, although some of this decline was attributable to the sale of stocks and not only lower prices. Household net worth remains relatively high by historical standards, ending 2000 at 590 percent of disposable income, roughly the same as at the end of 1998.

Corporate Sector

After falling between 1990 and 1994, the debt of the nonfinancial corporate sector as a share of GDP increased by nearly 10 percentage points subsequently, reaching 47 percent at the end of 2000. This buildup has raised concerns about the corporate sector's vulnerability to an economic downturn.

However, the ratio of debt to equity has fallen through the 1990s, from an average of above 80 percent in the 1980s to below 40 percent since 1997. A much larger stock market correction, of over 50 percent from end-2000 or over 40 percent from mid-April 2001, would have to occur for the leverage ratio to rise back to its level of the 1980s.

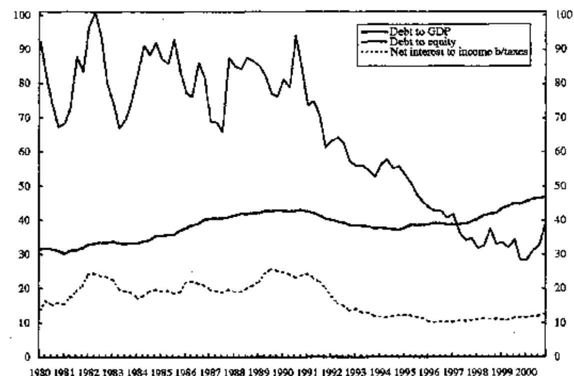
Various measures of liquidity also point to a corporate financial situation that should be able to withstand adverse shocks. The ratio of net interest expenditures to income before taxes, which averaged 20 percent in the 1980s, has fallen to about 11 percent since 1994. Since late 1999, the net interest ratio has increased moderately by about 1.5 percentage points, but it is still well below the levels exhibited in the 1980s.

Household Balance Sheet
(In percent of disposable income)

	1995	2000
Assets	600	700
Nonfinancial	198	218
Of which: real estate	155	176
Financial	402	482
Of which: equities	111	165
Liabilities	94	108
Net worth	505	593
Net worth (in bil. $)	27,391	41,418

Source: Board of Governors of the Federal Reserve, Flow of Funds Accounts, Table B.100e.

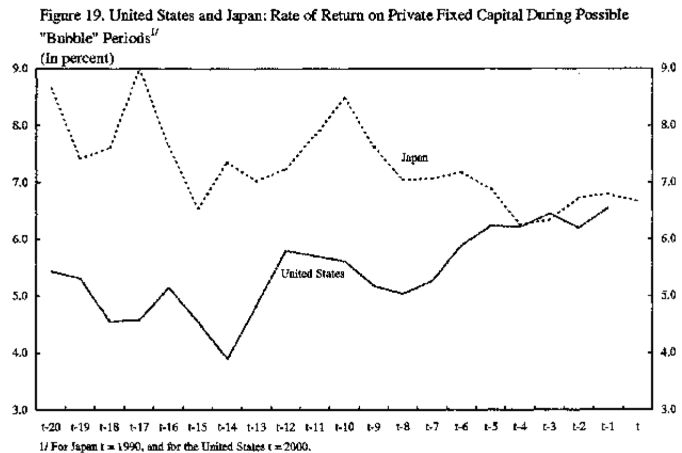
Corporate Sector Indicators



household sector. The level of household debt had increased during the long expansion, but the authorities did not view this as an independent factor that would trigger a substantial downturn in consumer spending since net wealth had risen even faster (Box 6). However, they and the staff agreed that, in the event of a prolonged downturn, defaults on household debt were likely to rise, particularly if the unemployment rate rose significantly, and amplify the weakness in economic activity.[16]

25. ***The near-term weakness expected in investment in equipment and software reflected a deceleration in spending from unsustainably high rates in recent years. The authorities and staff agreed that an economy-wide investment overhang that would result in a prolonged downturn in investment spending did not appear likely.*** Nevertheless, overinvestment had probably occurred in some sectors, most notably in telecommunications and parts of the information technology sector, which could have some lasting effects. Quantifying how much "excess" capital stock there might be is extremely difficult, particularly given the recent changes in technology and the burst of investment spending aimed at taking advantage of these innovations.[17] The staff pointed out and the authorities agreed that indirect evidence suggested that a substantial investment overhang was unlikely to exist on an economy-wide basis. For example, if there were significant overinvestment in the United States, then aggregate rates of return on capital would be low and the ratio of corporate sector fixed assets to sales would rise. In contrast to Japan during the "bubble economy" period of the late 1980s, when substantial overinvestment is believed to have occurred, the rate of return in the United States has remained at historically high levels, and the ratio of fixed assets to sales has remained unchanged since the late 1980s (Figures 19 and 20). There was general agreement that the speed of adjustment for any investment

Figure 19. United States and Japan: Rate of Return on Private Fixed Capital During Possible "Bubble" Periods 1/
(In percent)



1/ For Japan t = 1990, and for the United States t = 2000.

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[16] The forthcoming selected issues paper will examine the condition of household, corporate, and bank balance sheets and assess the implications for risks to the economic outlook.

[17] Some recent analyses of "overinvestment" have relied on comparisons of actual investment spending to trend investment spending or on cumulating errors over time in econometric equation estimates of investment. These analyses do not provide conclusive evidence about the existence of an investment overhang because the methodologies used cannot identify the extent to which above-trend levels of investment or under prediction of actual investment by investment equations may represent the effects of technological change boosting spending on plant and equipment or reflect overinvestment.

overhang that might exist in technology-related equipment would depend on the future rate of technical progress and hence prospects for productivity growth. A relatively rapid rate of innovation could significantly reduce the useful life of existing technology-related equipment, and hence more quickly eliminate any overhang. In the event of a significantly slower pace of innovation, adjustment to an overhang could be more protracted.

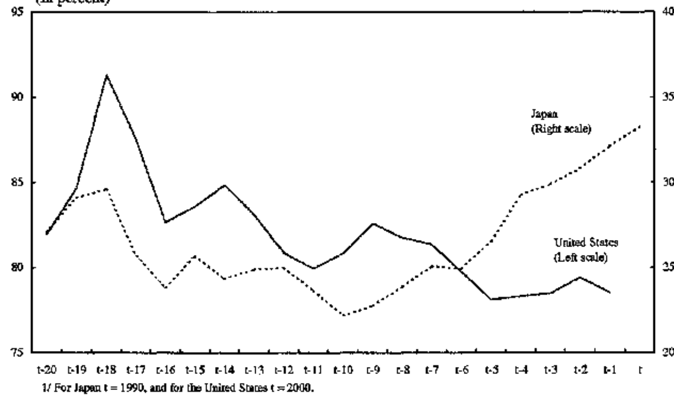

Figure 20. United States and Japan: Ratio of Fixed Private Assets to Sales During Possible "Bubble" Periods 1/
(In percent)

1/ For Japan t = 1990, and for the United States t = 2000.

26. ***Corporate debt levels have increased substantially over the long expansion. The authorities did not regard this development as a potential trigger for a major downturn in economic activity, but it could aggravate such a downturn.*** Although in recent months there had been an increase in junk bond defaults, credit spreads, and corporate bond downgrades, corporate balance sheets were viewed as being in a generally sound position (see Box 6). Some increase in financial difficulties was to be expected with a slowdown in economic activity after such a long period of rapid expansion. Nevertheless, the aggregate corporate data masked some underlying problem areas, most notably in the telecommunications sector, where firms had taken on significant amounts of debt and were expected to face some debt-servicing difficulties, given the adjustment currently taking place in this sector. In the event of a more prolonged and pronounced slowdown, debt problems in the corporate sector were likely to become more widespread, with the potential for adverse spillover effects to the financial sector that could feed into a downward spiral in economic activity.

27. ***The authorities and the staff concurred that the sustainability of the acceleration in labor productivity growth would be a key factor in determining the economy's future course.*** Improved productivity growth since the mid-1990s has been the cornerstone of the remarkable performance of the U.S. economy in recent years (Figure 21). Optimistic prospects for future profit growth had buoyed stock prices, which in turn had added to household wealth and boosted consumer spending, driving the personal saving rate down to a record low. In this environment, businesses had stepped up their pace of investment spending, particularly in information technologies, which had played an important role in further boosting productivity growth. Relatively higher returns on investment in the United States had

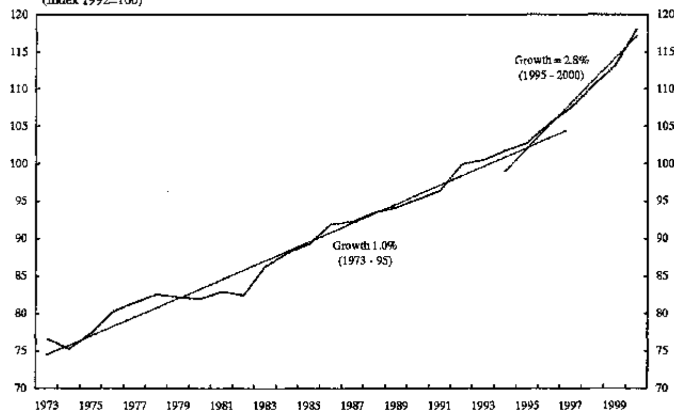

Figure 21. United States: Nonfarm Business Sector Productivity
(Index 1992=100)

attracted increasing inflows of capital pushing up the value of the dollar and, along with relatively faster economic growth in the United States, contributing to the sharp rise in the U.S. current account deficit.

28. ***There was broad agreement that, provided a strong underlying level of productivity growth was sustained, the current economic slowdown would resolve itself and the large external deficit would have a chance to adjust without undue financial distress or economic dislocations in either the United States or the rest of the world.*** The staff noted that, if continued strong U.S. productivity growth were complemented by relatively faster gains in productivity in other major countries, world economic growth would be boosted, while at the same time the U.S. current account deficit could adjust as investment flows sought profitable opportunities elsewhere in the world. This was seen as the most desirable outcome. The U.S. authorities and the staff concurred that such an outcome would depend on the continued pursuit of appropriate macroeconomic policies in the United States and other major countries and on determined efforts by the latter to address structural problems.

29. ***Further gains in productivity growth were contingent upon both continued technological innovation and diffusion of technology (see Box 2).*** The authorities were optimistic about medium-term prospects in this regard and believed that underlying productivity growth was likely to remain above its long-term historical trend. They were of the view that the deterioration in productivity growth in recent quarters was heavily influenced by cyclical factors and not necessarily a good indicator of the longer-term trend.

30. ***The authorities and staff agreed, however, that if labor productivity growth were to fall back to its historic trend, recovery from the current economic slowdown would be more difficult.*** Investment spending, particularly on technology-related equipment, would remain soft, and the economy's potential rate of growth would decline, contributing to downward revisions to expected corporate earnings and declines in stock prices and household net wealth. In turn, households and corporations would have a more difficult time servicing their high levels of debt accumulated during the long expansion. The dollar also might depreciate sharply because of a significant rebalancing of domestic and international portfolios. Slower trend productivity growth would mean that current estimates of budget surpluses could prove to be too optimistic, constraining fiscal policy choices in the future. In addition, an important challenge for monetary policy would be to recognize the fall in underlying productivity growth and its implications for the growth rate of potential output and possible inflationary consequences.

B. Monetary Policy and the Exchange Rate

31. ***In response to the sharper-than-expected slowdown in economic activity, the Federal Reserve has aggressively eased monetary policy since the beginning of 2001.*** The willingness of the Federal Reserve to move so quickly and decisively on monetary policy was largely predicated on the general quiescence of inflationary pressures and the judgment that underlying productivity growth would remain strong. The Federal Reserve's responsiveness to weakening economic conditions is widely viewed as having helped to limit

the likelihood of a recession in the United States. The staff and the authorities agreed that whether further monetary easing was necessary would depend on how the economy responded to past rate cuts. Continuing signs of weakness in economic activity would suggest that additional cuts in interest rates may be necessary. However, there were limits to how far and how fast any further easing could be implemented given the considerable uncertainty about the outlook, since a forward-looking policy also needed to take into account the possibilities that the economy would respond more rapidly to the existing monetary and fiscal stimulus.

32. ***The Federal Reserve officials reiterated that the objective of monetary policy was to achieve maximum sustainable growth with low inflation. Equity prices mattered in the formulation of monetary policy only to the extent that they affected the macro economy.*** The authorities and staff agreed that monetary policy needs to respond in a forward-looking manner to weakness in economic activity, on which equity price movements could have a significant impact, while not attempting to stabilize stock prices. Since the mid-1990s, the household wealth-to-income ratio had risen sharply, so that changes in wealth had more of an impact on consumption than was previously the case. The staff raised the issue of whether the increase in household equity holdings had altered the speed and response of the economy to monetary policy actions. The authorities responded that, while it was true that equity markets tended to react quickly to changes in monetary policy and that household equity wealth had become a more important factor for consumer spending, it was uncertain whether the lag between adjustments in the federal funds rate and the response in consumption had changed. The authorities noted, however, that markets were better at anticipating monetary policy actions, and therefore may have brought forward the effects of monetary policy actions.

33. ***The authorities said that the recent FOMC decisions to cut the federal funds rate on two occasions in between regularly scheduled meetings were prompted by a rapid deterioration in economic conditions; delaying action until the next scheduled meeting was seen as imprudent.*** They emphasized that these intermeeting actions did not signal any change in the operating approach to monetary policy. In general, intermeeting policy moves were conducted infrequently because of the uncertainty and volatility they potentially could introduce into the financial markets. The FOMC retained its preference to make policy changes at its regularly scheduled meetings.

34. ***The continued decline in the stock of U.S. Treasury securities has prompted the Federal Reserve to make some adjustments in its implementation of monetary policy.***[18] Treasury securities play a key role in monetary operations, as they are the instruments in which the Federal Reserve conducts open market operations. In response to the decline in the stock of Treasury securities, the Federal Reserve has expanded the asset class for eligible

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[18] The forthcoming selected issues paper discusses the implications of the reduction in U.S. government debt for monetary policy implementation and financial markets.

collateral in its temporary operations to include some mortgage-backed securities and also expanded the eligible maturity of temporary operations. With the reduction in Treasuries, the Federal Reserve needs to diversify its portfolio and is considering using a greater number of the assets in which it is authorized to deal under the Federal Reserve Act. These include securities issued by Government Sponsored Enterprises, some municipal securities, foreign exchange, and the sovereign debt of other major countries. The Federal Reserve officials emphasized that monetary policy could cope with whatever level of government securities was generated by fiscal policy, and that there was no need for fiscal policy choices regarding the appropriate path for government debt over the medium term to be guided by the implications for monetary operations.

Figure 22. International Comparison: Real GDP Growth
(Annual percent change)

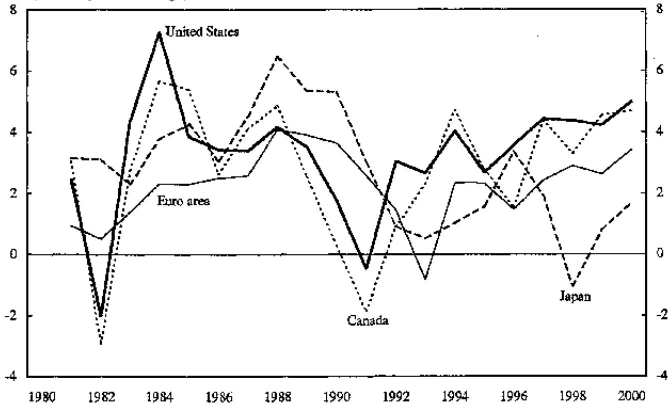
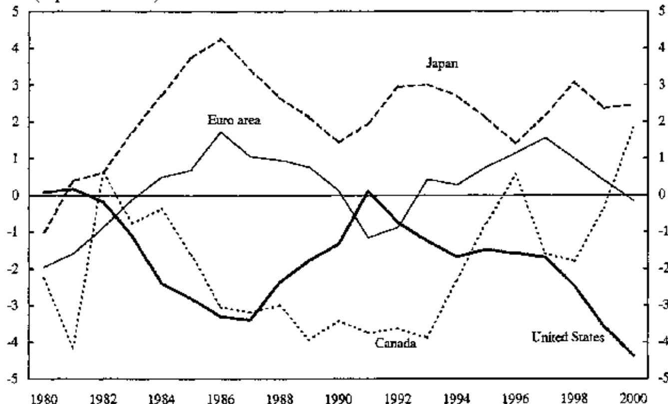


Figure 23. International Comparison: Current Account Balances
(In percent of GDP)



35. ***The size and duration of the current account deficit have raised concerns that the dollar might be at risk for a sharp and sustained depreciation, and that a rapid correction of the current account deficit, should it occur, could adversely affect the United States and other economies (Figures 22 and 23).***[19] The authorities emphasized that the good performance of the U.S. economy was the main factor contributing to the strength of the dollar. In particular, the surge in productivity growth had boosted the return to capital and attracted the capital inflows that had helped sustain the current account deficit. They stressed that, while disciplined macroeconomic policies would help to reduce the risk of a rapid adjustment in the external deficit, a particular target for the current account balance was not, and should not be, a policy objective. In general, they believed that the United States would remain in a more favorable overall economic position relative to other major countries in the near term, and this also would mitigate against the risk

[19] The forthcoming selected issues paper analyzes the sustainability of the U.S. current account in a medium- and long-term context. The latest CGER estimates suggest that the U.S. dollar is at least 20 percent stronger than its medium-term equilibrium level.

of a sharp fall in the dollar's value. Moreover, they noted that while an external sector adjustment might entail some real depreciation of the dollar, not all of the adjustment would fall on the nominal exchange rate. Indeed, the declining price of U.S. high-technology goods in recent years had helped prevent the real exchange rate from appreciating more strongly. No change had been made in the authorities' approach to exchange rate policy, which continues to view the exchange rate as an outcome of other economic developments. Exchange market intervention was strictly limited because of the difficulty in assessing whether exchange rates had moved substantially out of line with underlying economic fundamentals and the limited effectiveness of sterilized intervention.

C. Fiscal Policy

36. ***The Administration's FY 2002 Budget envisages continued sizable surpluses in the coming decade (Figure 24).*** On a current services basis (i.e., before any policy measures), the Budget envisages a unified federal budget surplus of $283 billion (2½ percent of GDP) in FY 2002 and a cumulative surplus of $5.6 trillion during the period FY 2002–11, of which $2.6 trillion represents the surplus in the Social Security program (Table 7).[20] Fiscal measures enacted to date (mainly the $1.35 trillion tax cut) and other measures proposed by the Administration, along with associated interest costs, would reduce the projected cumulative surplus during FY 2002–11 by $2.2 trillion (Table 8). The Administration proposes to use

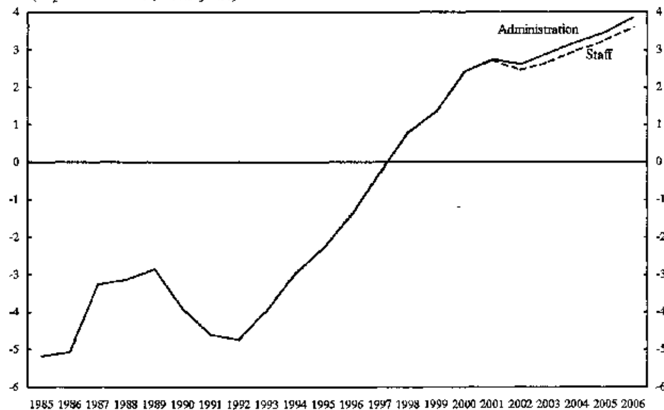


Figure 24. United States: Current Services Estimates of the Budget Balance
(In percent of GDP; fiscal years)

[20] The FY 2002 Budget uses a ten-year horizon, compared with the five-year horizon used in previous years. The macroeconomic assumptions in the Budget are not significantly different from those used by the staff, except for 2001 and 2002, when the Administration's projections for real GDP growth are higher. The staff's current services baseline is derived by adjusting the Budget's estimates for differences between the staff's and the Administration's macroeconomic assumptions, using the sensitivity factors estimated by the Administration. On this basis, the staff's estimate of the cumulative current services surplus during FY 2002–11 is $5.2 trillion. In terms of the sensitivity of the Budget to changes in macroeconomic assumptions, if real GDP growth were ½ percentage point lower each year over the next ten years, the cumulative surplus would be around $1 trillion lower. It would be about $500 billion lower if the United States were to experience a recession in 2001 roughly similar to that in 1990–91, assuming that real GDP returns to around its potential level by 2005 (which would be nearly twice as fast as after the 1990–91 recession).

the remaining prospective cumulative surplus of around $800 billion as a "reserve" for additional needs and contingencies.[21]

Federal Fiscal Position, FY 2002–11
(In trillions of dollars)

	FY 2002–11
Current-services surplus	5.6
Social Security trust fund surplus	2.6
Tax cuts	1.3
Interest expense	0.5
Other proposals	0.4
Reserve	0.8
Memorandum:	
Medicare HI Trust Fund Surplus	0.5

37. ***The Budget proposes to preserve the prospective surpluses in the Social Security trust fund for debt reduction and Social Security reform.*** Debt reduction will involve only "redeemable" federal government debt (estimated by the Administration to be about $2 trillion out of an estimated total public debt of $3 trillion at the end of FY 2001). Redeemable debt encompasses the debt due to mature over the next ten years and the publicly traded government debt that can be repurchased without unduly bidding up its price. Social Security trust fund surpluses in excess of redeemable government debt would be accumulated in the form of "excess cash balances" by the government. The Budget does not propose to preserve the surpluses in the Medicare Hospital Insurance (HI) trust fund ($525 billion), and proposes instead to use these funds to pay for the whole Medicare program (HI and Supplementary Medical Insurance (SMI)) and to modernize Medicare.

38. ***Key measures in the Administration's FY 2002 Budget proposal were retained in the recently enacted tax bill (the Economic Growth and Tax Relief Reconciliation Act of 2001) (Box 7). The cumulative tax cut, at $1.35 trillion over the next ten years, is lower than that originally proposed by the Administration.*** However, this lower cost is basically achieved through the use of some budget-accounting devices such as allowing most of the tax cuts to be rescinded at the end of 2010 (unless a future Congress votes to extend them) and letting measures to provide relief from the impact of the alternative minimum tax (AMT) expire after 2004. The new law provides for a stimulus of around $100 billion in FY 2001 and FY 2002 to be delivered in the form of lump-sum rebates and reductions in tax withholding schedules effective July 1, 2001. The staff supported the Administration's emphasis on achieving the tax cuts through rate reductions, which would improve incentives to work and invest, rather than through using the tax system to provide incentives for particular activities. However, the staff expressed concern that the budget-accounting devices used to hold down estimates of the cost of the tax cuts would increase taxpayer uncertainty about the future structure of the tax system, which could offset some of the efficiency gains from lowering marginal tax rates.

[21] A large part of the reserve may already be committed to paying for some of the Administration's spending priorities, such as higher defense expenditures and Medicare reform. The Administration has suggested that the portion of the reserve not used for new spending will instead be used mainly to reduce taxes further.

Box 7. Main Elements of the Economic Growth
and Tax Relief Reconciliation Act of 2001

The main elements of the new tax-reduction legislation are:

- A **phased reduction of marginal personal income tax rates** from 39.6, 36, 31, 28, and 15 percent currently to 35, 33, 28, 25, and 15 percent in 2006; the creation of a new 10 percent bracket for lower incomes; and a repeal during 2005–10 of the phase-out provisions for itemized deductions and personal exemptions (estimated cost, excluding interest, during FY 2001–11: $875 billion).

- An **increase in the child tax credit** from $500 at present to $1,000 in 2010 (estimated cost: $172 billion).

- A **phase-out of the estate tax** during 2002–10, with increases in exemptions and reductions in rates during 2002–09 and repeal of the tax in 2010 (estimated cost: $138 billion).

- **Marriage penalty relief,** mainly in the form of a phased increase during 2005–09 in the standard deduction for married couples filing jointly to twice that for single taxpayers and a similar increase during 2005–08 in the income threshold for the 15 percent rate bracket (estimated cost: $63 billion).

- **Alternative minimum tax (AMT) relief** through an increase in exemptions under the AMT by $2,000 for single taxpayers and $4,000 for joint taxpayers during 2001–04 (estimated cost: $14 billion).

The tax legislation contains some **budget accounting devices** in order to keep the cost of the tax cut in line with the agreed level of $1.35 trillion over the FY 2001–11 period. The legislation has a sunset provision, whereby the tax changes are effective only through the end of 2010 and, starting in 2011, the tax system reverts to the system in place before the new tax law was enacted. In addition, increases in exemptions under the AMT continue only through 2004. Without a further increase in exemptions, and with the reduction in personal income tax rates, the number of taxpayers subject to AMT would be expected to rise from around 5 million in 2004 to over 35 million in 2010.

39. ***In any event, the total cost of the tax cuts is likely to be higher than the $1.35 trillion estimate.*** Extending the tax cuts through 2011 and extending the AMT provisions would raise the cost of the package to an estimated $1.9 trillion.[22] Additional interest expenses as a result of the tax cut would amount to nearly $500 billion. Moreover, the new law does not make provision for the extension of various "temporary" tax credits (such as the research and experimentation tax credit) which have been consistently renewed in the past, adding another $200 billion to the eventual cost of the tax reductions—bringing the total cost of tax cuts potentially up to more than $2.5 trillion.

[22] Beyond 2011, the costs of the tax bill are not so large that they would threaten the Administration's objective of saving the Social Security surplus, but resources to finance other initiatives would be limited.

40. ***Pressures for additional expenditures remain a substantial risk to the medium-term budget outlook.*** The Administration's proposal that nominal discretionary spending increase in line with inflation after FY 2002 implies a constant level of real discretionary spending and a decline in real per capita terms.[23] In recent years, despite legally mandated spending caps, discretionary spending has risen on average by 6 percent annually. At the same time, the Budget proposes several initiatives to raise spending in priority areas such as public education, defense, and health care. Although in part these new initiatives could be funded out of the Budget's reserve, this reserve may be smaller than the Administration's estimates, especially if the cost of tax cuts is higher. Significant cuts in some discretionary programs may thus be required.

41. ***The staff suggested that the uncertainties associated with the cost of the tax cuts, the expenditure outlook, and the accuracy of fiscal forecasts in the out years (when the bulk of tax cuts would occur) called for implementing the tax and expenditure measures in a flexible manner over the budget horizon.*** The authorities stressed the need to focus on expenditure restraint as a means to avert potential budget shortfalls, rather than linking implementation of the tax cuts to budgetary outcomes. They were well aware of the expenditure pressures, but noted that several factors would help to restrain spending in the period ahead. The reduction in prospective surpluses arising from tax and other measures could itself be a useful disciplining device. In this regard, the authorities noted that the slackening in expenditure restraint in recent years had coincided with the emergence of substantial surpluses. The strong bipartisan consensus to preserve the Social Security surplus would also help to limit expenditures. In their view, considerable scope exists for greater efficiency in government expenditure, especially when viewed against the strong productivity gains in the private sector in recent years. They were also making efforts to encourage a more transparent and efficient budgetary process. For example, in formulating the FY 2002 Budget, the Administration has started to emphasize levels of expenditure, in addition to growth rates, to encourage a greater focus on policy tradeoffs. It has moved to interpret "one-time" appropriations more strictly, to ensure that such expenditures are actually one-time and to cut down on the practice of advancing appropriations. Finally, the Budget proposed extending the discretionary spending caps and the PAYGO requirement beyond their scheduled expiration in FY 2002. These measures had contributed significantly to the improvement in the fiscal position during the 1990s, before they started being circumvented as budgetary surpluses appeared. In the authorities view, they could be useful in providing budget discipline once again, provided there was a political commitment to respect them. The staff welcomed these initiatives as useful in preserving budget discipline, but stressed that the combination of a ten-year program of tax cuts and expenditure pressures would call for some difficult political choices. It was important that these choices not be resolved by dipping into the Social Security surpluses.

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[23] For example, if discretionary spending were maintained constant in real per capita terms, rather than constant in overall real terms, expenditures would be around $350 billion higher over ten years.

42. ***The authorities recognized that additional measures are needed to ensure the financial viability of the Social Security and Medicare programs.*** A new commission was formed in May to provide recommendations for Social Security reform later this year. The commission has been advised that its recommendations should adhere to certain guidelines, notably that: (i) payroll tax increases be avoided; (ii) the benefits of current and near-retirees not be reduced; and (iii) consideration be given to voluntary individual accounts. The Budget commits the Administration to preserving the Social Security surplus and using it for debt reduction and Social Security reform. In considering the introduction of voluntary individual accounts, the commission would have to address a number of complex issues including the problem of financing the transition to the new scheme; administrative and regulatory costs, where there are inevitable tradeoffs between the degree of choice allowed for investment options and costs; and how proceeds from these accounts would be annuitized on retirement to ensure that an adequate social safety net would be provided to the elderly.

43. ***The staff noted that, if part of the surpluses in the Social Security trust fund were used to finance reforms (such as the establishment of individual pension accounts), it would create a new gap in Social Security's finances that would need to be addressed.*** Also, the guidelines provided to the new commission seemed to suggest that significant reductions in benefits to future retirees may be required, especially if tax increases were to be avoided and individual accounts were to be established. At present, the long-term financing problems of Social Security are not large,[24] especially compared with those in several other industrial countries, and could be addressed through relatively small adjustments in the program's parameters provided they are implemented quickly. While a more detailed assessment of an approach built around the introduction of individual accounts would have to await specific proposals, such a reform alone would not provide the necessary increase in national savings to meet Social Security's long-term financial needs. The authorities indicated their preference for voluntary individual accounts—in part because they avoided direct government investment in private assets—and noted that several approaches are under consideration, although specific recommendations would not be made until the Social Security reform commission had completed its study.

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[24] The Social Security Board of Trustees defines the system as being in long-term actuarial balance if the present value of projected Social Security receipts is at least as large as the present value of projected outlays over the next 75 years. In 2001, both the employer and the employee pay a Social Security payroll tax of 6.2 percent of gross yearly wages up to a ceiling of $80,400. In the 2001 Report of the Social Security Trustees, the Social Security trust fund is estimated to face an actuarial imbalance equivalent to around 1.9 percent of taxable payroll and is projected to remain solvent until 2038. The size of unfunded liabilities as a percent of GDP in the United States, while significant—an estimated 23 percent—is lower than in other major industrial countries such as Japan (70 percent), Italy (60 percent), and France (100 percent). These estimates reflect the net present value of unfunded liabilities as a percent of GDP in 1994. See R. Kohl and P. O'Brien, 1998, "The Macro-Economics of Ageing, Pensions, and Savings: A Survey," OECD Working Paper AWP 1.1.

44. ***On Medicare, the Administration prefers to focus on the finances of the program as a whole, instead of dealing separately with each of its two components.***[25] The authorities explained that in the past an exclusive focus on the long-run financial problems of the Medicare HI program might have led to policy complacency with regard to the budget costs of the Medicare SMI program, and that it was better to focus on the program in its entirety. They also noted that the distinction between Medicare's two parts was somewhat artificial and had changed over time; for example, one measure taken in 1997 to address Medicare HI financing problems was to shift some of the fastest growing program costs from HI to SMI. While supporting the need for reform, the staff noted that the Budget effectively proposes to spend all of the $525 billion Medicare HI surplus over the next ten years to pay for the rest of the Medicare program and extend Medicare benefits by introducing a modest prescription drug benefit for low-income seniors. Saving these prospective surpluses would help pre-fund some of the looming costs associated with the aging of the baby-boom generation, and therefore, would be desirable on tax-smoothing grounds. The staff observed that it will be challenging to find a permanent long-term solution to the financing of Medicare, particularly in light of the difficulties associated with predicting health-care costs. A comprehensive solution likely would involve a number of adjustments, including to benefits, co-payments and deductibles, and contribution rates. Timely reform would avoid the need for more drastic measures at a later date.

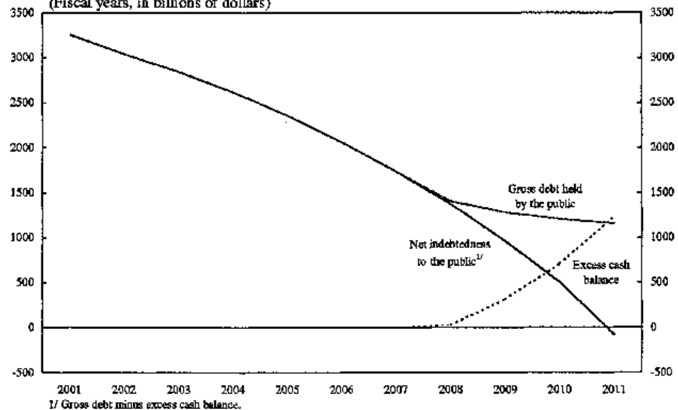
45. ***The authorities indicated that their current medium-term fiscal objective was to maintain a unified federal budget surplus that was equal to the Social Security surplus, while options for reforming Social Security and Medicare to address their longer-term finances were being studied. The staff suggested that ultimately a reasonable fiscal objective would be to provide sufficient resources to ensure the long-term financial viability of Social Security and adequate funding for Medicare and to keep the rest of the budget in balance over the economic cycle.*** Pending enactment of reforms, the staff suggested that a pragmatic goal would be to preserve the surpluses in the Social Security and Medicare HI trust funds. These trust funds were originally established as part of reform plans to partially pre-fund these largely pay-as-you-go programs in order to allow them to meet their long-term obligations without the need for sharp future increases in taxes or cuts in benefits. To achieve this purpose, the surpluses in these programs have to be saved in order to put aside real resources to meet the programs' future liabilities. The authorities noted that

[25] The Medicare system consists of two separate programs, Hospital Insurance (HI) and Supplemental Medical Insurance (SMI). The HI is funded by a payroll tax, with employer and employee each currently paying 1.45 percent of earnings (with no ceiling). Under current law, HI payments must be drawn from the flow of HI payroll tax revenues, interest payments, or redeemed HI trust fund assets. In 2001, the Medicare HI trustees estimated that the HI trust fund faced an actuarial imbalance equivalent to nearly 2 percent of taxable payroll and was solvent until 2029. SMI is fully funded by a combination of enrollee premiums and on-budget revenue, with the monthly SMI premium adjusted annually so that it covers about 25 percent of program expenditures.

the political consensus to preserve the Social Security surplus was a substantial advance compared with the situation a decade ago. However, they did not see the merit in distinguishing between the two components of the Medicare program and did not agree that the original intention in the Medicare HI trust fund was for tax smoothing purposes.

46. ***The overall budget surplus projected for the next decade is likely to exceed by a substantial margin estimates of the redeemable federal government debt (Figure 25).***[26] To save these resources to help meet future liabilities, there is no choice but to invest such excess cash balances, one way or another, in private assets. The authorities are firmly opposed to the government investing public funds in private assets, in part because such investment decisions would be susceptible to political influence, which would adversely affect economic efficiency and long-term growth prospects. They propose instead that any investment of excess cash balances be accomplished through individually controlled voluntary personal retirement accounts within the Social Security system. The staff suggested, that an alternative option may be to invest these balances through the Social Security trust fund. Such investments could be managed in a manner that would minimize the risk of political interference.[27] In addition, the administrative costs associated with investing public funds in private assets through the Social Security trust fund are likely to be substantially smaller than those of individually controlled accounts.[28]

Figure 25. United States: Outlook for Federal Government Debt, 2001-2011
(Fiscal years, in billions of dollars)



1/ Gross debt minus excess cash balance.

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[26] The Administration estimates that "non-redeemable" debt outstanding in FY 2011 would be roughly $1 trillion, representing marketable bonds that have not matured, U.S. savings bonds, and special bonds issued to state and local governments. Alternative estimates of the non-redeemable debt based on assumptions about factors such as the time path of the fiscal surpluses and the schedule of debt buybacks range between $¾ trillion and $1¼ trillion.

[27] The forthcoming selected issues paper discusses some of the international experience with governments investing in private securities.

[28] There is a tradeoff between the degree of flexibility/range of choice offered to individual investors and the costs of administering individually controlled accounts. Such accounts with a wide range of options would be the most costly, with possibly up to 30 percent of the value of the account going for administrative expenses, according to a forthcoming study by the Congressional Budget Office. A scheme involving a small number of options for investment in centrally managed index funds (similar to the present Thrift Savings Plan for federal

(continued)

D. Financial Sector Issues and Market Risks[29]

47. ***The discussion of capital markets developments and issues took place against the background of the significant repricing of risks in U.S. equity and fixed-income markets that had occurred during 2000 and the first part of 2001.*** These developments included a sharp fall in equity prices, particularly in telecommunications, media, and technology stocks, since March 2000 and a drop off in issuance and a rise in spreads in the commercial paper and high-yield securities markets toward the end of 2000. More recently, U.S. financial markets had revived following the Federal Reserve's easing in monetary policy. The staff and authorities agreed that, in retrospect, the adjustment appeared to have represented an appropriate repricing of credit after a long boom, rather than an indiscriminate withdrawal of credit of the type that characterizes a major credit crunch.

48. ***The supervisory authorities, credit rating agency reports, and private market participants all emphasized that, although deteriorating market conditions and economic performance had put downward pressure on bank earnings and credit quality, these developments did not jeopardize the safety and soundness of the U.S. banking system.*** Compared with the period prior to the previous downturn, the U.S. banking system was seen as profitable, well diversified, and strongly capitalized, and therefore, better able to weather the increased credit losses that would inevitably occcur if weak economic conditions were prolonged or the economy deteriorated further. Moreover, banks had strengthened their risk-management systems in the recent period and had responded to deteriorating credit quality by tightening lending standards, as highlighted in recent loan officer surveys. Although some U.S. banks had significant cross-border exposures, including to Japan and countries in Latin America, these exposures were viewed as small relative to overall loans and bank capital.[30] Supervisory authorities also viewed U.S. banks' exposures to the telecommunications sector as likely to generate losses but manageable, particularly because significant amounts of such exposure had been securitized. Despite this relatively sanguine assessment, it was generally expected that bank profitability would be squeezed in the event of a protracted period of slow

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government workers) would have substantially lower administrative costs. By limiting the range of investment options, the decision on investing these funds in private assets is at least partially determined by the public sector. Investment in private assets by the Social Security trust fund would be the least costly, but would leave the decision of how to allocate investments entirely with the public sector.

[29] This section was prepared jointly with the team preparing the International Capital Markets Report and draws on the team's discussions with a broad range of market participants.

[30] As a percent of total bank assets, the consolidated claims of U.S. banks on Japan and Latin America and the Caribbean in 2000 were about ½ percent and 1 percent, respectively. See BIS, 2001, *Quarterly Review*, March.

economic growth, as the quality of some loans granted during the long boom period deteriorated; however, such pressures were not expected to result in systemic problems.

49. ***Discussions with market participants during the International Capital Markets missions focused on concerns about a renewed sharp repricing in U.S. equity and fixed-income markets in the event of a prolonged economic downturn in the United States.*** In such circumstances, problems in household and corporate balance sheets and in the external imbalance could lead to a significant and potentially disorderly rebalancing of domestic and international portfolios and give rise to increased volatility and the repricing of assets in U.S. and international markets, including, possibly, a sharp decline in the value of the dollar. Spillovers and contagion to other markets could also result, including adjustments in European financial markets (which had been highly correlated with U.S. markets) and a deterioration in external financing conditions for emerging markets.

50. ***The staff noted the increased reliance of U.S. banks on off-balance-sheet financial instruments, including derivatives and securitization vehicles, to manage credit and market risks.*** Some of these newer instruments conveyed potentially significant legal and operational risks that had not yet been tested by a recession. Supervisory authorities broadly concurred, although they did not regard these market developments as necessarily involving greater systemic vulnerability. They noted that there had been a few instances recently when banks had offered purchasers of some of their previously issued securitized credits some additional protection against defaults on the loans underlying these securities, thereby effectively bringing the credit risk associated with these securitized credits back on to the banks' balance sheets. If this practice were to become more widespread during a period of stress, banks' credit exposures could significantly exceed their reported exposures. The authorities viewed credit derivatives—which were still relatively small in overall size—as having considerable potential to become useful tools for bank risk management as the market developed over time.[31] All derivatives transactions were becoming increasingly concentrated, with five of the largest banks accounting for over 90 percent of gross exposures in 2000, up from 75 percent in 1995. While this concentration made supervision easier in some ways, it increased the importance of carefully monitoring these banks' risk-management practices.

51. ***Both the U.S. authorities and market participants saw U.S. financial markets as adjusting smoothly so far to the shrinking supply of U.S. Treasury securities.***[32] Private

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[31] A credit derivative is a contract for hedging against loan default or changes in credit risk. For example, a default swap pays the holder the difference between the par value and market value of the underlying security if a default occurs.

[32] The implications of the shrinking supply of U.S. Treasury securities for U.S. and international financial markets are discussed in G. Schinasi, C. Kramer, and T. Smith, 2001, *Financial Implications of the Shrinking Supply of U.S. Treasury Securities,* IMF Working Paper No. WP/01/61.

market participants were increasingly relying on substitutes, like swaps and agency securities, in place of Treasury securities as benchmarks and hedging vehicles. Looking ahead, the authorities were confident that private markets could continue to find substitutes for Treasury securities in their various roles. However, they noted some concern with the perception in the markets that securities issued by the government-sponsored enterprises were free of credit risk. The staff agreed that the well-developed private U.S. markets included a number of possible substitutes for Treasury securities, but added that it was unknown how the use of private securities as safe-haven assets might affect market dynamics during periods of turmoil.

52. ***The authorities viewed the new framework for financial supervision in the context of the Gramm-Leach-Bliley Act (GLB) as functioning well.*** The GLB Act had authorized the creation of financial holding companies (FHCs) that could engage in a broad array of financial activities ranging from commercial banking to merchant banking to securities underwriting to insurance.[33] The Act also gave national banks the authority to engage in certain other financial services through financial subsidiaries of the banks. In addition, it gave the Federal Reserve supervisory powers over FHCs, while limiting its authority over FHCs' affiliates that are supervised by other banking agencies and functional (e.g., insurance or securities) regulators. Under GLB, the Federal Reserve was expected to rely to the extent possible on examinations and reports prepared by the functional regulators. The staff noted a concern that material prepared by the functional regulators may not contain sufficient information for timely identification of potential problems developing within a FHC. The authorities emphasized that efforts were underway to increase coordination and communication both between the Federal Reserve and functional supervisors and among the functional supervisors, including within the framework for supervision of large complex banking organizations that was adopted in 1999. In addition, functional regulators increasingly took a more risk-focused approach that would better complement macro-prudential supervision. They also noted that spreads on subordinated debt issued by banks provided useful information on the market's assessment of particular institutions; although there was no intention to make the issuing of subordinated debt mandatory, in practice virtually all larger banks already had such debt outstanding.

E. Trade Policy and Other Issues

53. ***Trade policy discussions focused on the Administration's objectives, prospects for the launch of a global trade round, recent market access initiatives for developing countries, and the risks of protectionist pressures.*** The U.S. authorities indicated that the Administration plans to pursue a comprehensive agenda of trade liberalization that encompassed WTO-sponsored trade talks, a Free Trade Area of the Americas (FTAA), and

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[33] For a detailed discussion of the GLB Act, see P. De Masi, 2000, "U.S. Financial Sector Reform: The Gramm-Leach-Bliley Act," *United States: Selected Issues*, IMF Staff Country Report No. 00/112.

bilateral free trade agreements. Congressional approval of new Trade Promotion Authority is a key objective in this regard since, without it, countries are likely to be reluctant to negotiate with the United States.

54. ***The staff asked about the prospects for launching a global trade round this year and whether the pursuit of the FTAA and other trade agreements would detract from efforts to strengthen the multilateral trade system.*** The authorities emphasized that the Administration was strongly committed to launching a multilateral round, although it was too early to gauge whether there would be sufficient progress on an agenda by the time of the next WTO Ministerial meeting in November at Doha, Qatar. Either in or out of a new round, the Ministerial should focus on continued liberalization, including advancing the good progress being made under the built-in agenda of negotiations in agriculture and services. Recalling the experience with the Uruguay Round and NAFTA in the early 1990s, the authorities expressed the view that multiple trade negotiations can proceed together, and there can be a "healthy competition" and complementarities among negotiations.

55. ***The Administration had a strong desire to see increased trade with the least-developed countries as part of encouraging sustainable development and reinforcing commitments to economic, social, and political liberalization.*** In the recent past, the United States had passed the Caribbean Basin Enhancement Initiative (CBI+) and the African Growth and Opportunity Act (AGOA), and had added 1,800 items to the Generalized System of Preferences (GSP). By linking trade preferences to progress on political, social, and economic reforms, these initiatives aimed to support reform efforts in the least-developed countries. While welcoming the improved market access these initiatives provided, the staff noted that they excluded many products and included conditions that neither supported reform nor provided secure market access, thereby potentially limiting benefits.[34] The U.S. authorities acknowledged that the initiatives fell short of full free trade and were more cumbersome than the approaches adopted by some other countries, but they noted that the preferential arrangements were designed to promote social objectives as well as trade.

56. ***The staff noted that the economic slowdown may give rise to protectionist pressures; in particular, past economic slowdowns have been associated with rising numbers of antidumping (AD) and countervailing duty (CVD) cases.*** The staff asked whether any changes were contemplated in trade remedy laws to help ensure that they did not impede competition and economic efficiency. The authorities said that they had not observed an overall intensification of protectionist pressures, although there were some high-profile cases, such as steel.[35] They stressed that the U.S. trade laws, including the provision for

[34] With regard to CBI+, of the 24 eligible countries, only 12 have qualified. Under AGOA, 35 countries are eligible for expanded GSP treatment, but only 5 qualify for additional AGOA benefits that increase market access for textile products.

[35] Subsequent to the consultation discussions, the Administration initiated a safeguard trade investigation on behalf of the steel industry.

antidumping cases, were an important element in maintaining the political commitment to a liberal trade regime.

57. ***With regard to agricultural policy, the staff raised concerns about the large "emergency" assistance that had been provided to U.S. farmers over the past four fiscal years and that had adversely affected other countries.*** Although U.S. subsidies and protection to agricultural producers were substantially lower than in Europe and Japan, subsidies have increased considerably in recent years.[36] The objective of the 1996 Federal Agricultural Improvement and Reform (FAIR) Act was to move government assistance to the farm sector away from price support and toward income support, but recent emergency spending measures—to alleviate the financial strains on farmers arising from depressed commodity prices—represent a substantial deviation from this goal.[37] The impact of this spending was to exacerbate commodity price weakness by introducing incentives to produce crops already in oversupply, and thereby adversely affect producers in other countries. While the authorities acknowledged that some of the assistance to agriculture distorted incentives, they noted that much of the recent emergency spending was for income support, which is less distortionary than traditional price supports. In addition, some changes in crop production were due to the elimination of past programs that discriminated against certain crops (soybeans in particular). The authorities pointed out that a re-examination of agricultural assistance policies was underway in the context of a new farm bill to be considered this year. There were substantial pressures to lock in place current levels of support and to extend assistance to other crops not previously covered. The staff encouraged the authorities to resist efforts to broaden the scope of agricultural assistance programs and to return to the goals of the 1996 FAIR Act, which would substantially reduce the level of support. The persistence of high levels of assistance to counteract the impact of market forces was expensive and inefficient because it distorted the relative price of agricultural crops and impeded sectoral adjustment. It also adversely affected other countries that had a comparative advantage in these crops, including some developing countries.

58. ***Official development assistance (ODA) has remained at low levels as a percent of GNP, and the Administration's FY 2002 Budget does not envisage an increase.*** Such assistance in FY 2001 is estimated to be $8.3 billion, or 0.1 percent of GNP, the same level as in recent years. On an OECD Development Assistance Committee (DAC) basis, ODA was

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[36] The forthcoming selected issues paper will discuss recent U.S. agricultural policy, including its international implications. Between 1997 and 1999, U.S. agricultural subsidies as a percent of production increased from about 15 percent to about 30 percent; in the European Union subsidies increased from about 46 percent to 60 percent and in Japan from 60 percent to 68 percent.

[37] Between fiscal years 1998–2001, the U.S. Congress passed four emergency bills, totaling $23.1 billion, to primarily provide income support to producers of major field crops, which include wheat, oilseeds, corn, and rice.

$9.6 billion in 2000, the lowest among the major industrial countries in terms of GNP (Table 9). Staff welcomed measures in the Administration's FY 2002 Budget to provide funds that, along with carryover funds from 2001, would fully fund the U.S. commitment to help finance the HIPC initiative but urged the Administration to make further efforts to raise foreign assistance. The Administration officials cited a very tight budgetary environment in terms of international affairs, but noted that, in addition to honoring its HIPC commitments, the United States continued to reduce non-concessional debt in the Paris Club on Naples terms for eligible countries.

IV. STAFF APPRAISAL

59. ***Sound fiscal and monetary policies over the past decade have provided a strong foundation for the longest U.S. economic expansion on record.*** Determined policy efforts led to a dramatic improvement in the federal fiscal balance since 1992, resulting in large and growing fiscal surpluses in the last three years. The sure-handed implementation of monetary policy allowed the economy to expand strongly, and unemployment fell to levels not seen in more than three decades, without igniting inflationary pressures. With concerns rising that the strong pace of growth in 1999 and early 2000 might push output past even what appeared to be the economy's rapidly expanding productive capacity, the Federal Reserve moved during this period to tighten monetary policy to guard against overheating of the economy and the emergence of inflationary pressures. Signs of slower growth did not appear until mid-2000, but then the economy slowed much more rapidly than expected.

60. ***The sharp slowdown in economic growth reflected a number of mutually reinforcing developments that weighed heavily on economic activity in the second half of 2000 and into early 2001.*** Higher interest rates, rising energy prices, falling stock prices, and wider credit spreads contributed to reducing investment and dampening consumer spending. Lagging sales and a buildup in inventories triggered sharp cutbacks in production in some sectors of the economy and clouded corporate earnings and employment prospects, creating considerable uncertainty regarding the future course and strength of economic activity. At this juncture, whether economic activity recovers soon or remains sluggish for a protracted period depends on how consumer and business confidence evolve and influence consumption and investment decisions; whether households and businesses encounter balance-sheet problems that spill over on to the banking system; and whether the stronger productivity growth of recent years is sustained. The recent slowdown in a number of major economic partners is likely to have some dampening effect on U.S. growth.

61. ***In these circumstances, the staff believes that the principal policy priority for the United States in the near term is to revive economic growth.*** While the new tax reduction act will provide some stimulus to domestic demand, monetary policy should be the primary instrument for stimulating economic activity. The Federal Reserve's substantial easing of monetary policy since early 2001 has been appropriate. Whether further easing will be needed will depend on the economy's response to past interest rate cuts. If economic and financial indicators remain weak, additional cuts in interest rates may be necessary. Provided that underlying productivity growth continues at a reasonable pace, inflationary pressures are

expected to remain generally well contained owing to an easing in labor market tightness and strong competition in product markets, thereby providing room for a forward-looking monetary policy to support the economy in the event of persistent weakness.

62. ***In recent years, the stronger pace of U.S. growth relative to major trading partners and the real effective appreciation of the dollar—largely driven by capital inflows seeking a higher relative rate of return from investments in the United States—contributed to a large widening in the U.S. external current account deficit. The size of that deficit—now 4½ percent of GDP—is not sustainable in the longer term, and has raised concerns that the dollar might be at risk for a sharp depreciation. Nevertheless, with the right policies in the United States and other major countries, adjustment in the current account should occur in an orderly manner.*** In the period ahead, as world demand growth is rebalanced and the cyclical positions of the United States and other major countries converge, demand for U.S. net exports should increase and U.S. net capital inflows should moderate, leading to a gradual depreciation in the dollar and a narrowing in the U.S. current account deficit. Disciplined macroeconomic policies in the United States—including the continuation of fiscal surpluses which will contribute to maintaining national saving—will facilitate, although not guarantee, an orderly adjustment. Further reforms in Europe and Japan that enhance the prospects for profitable domestic investment in these areas would also help to ensure that the adjustment of external balances takes place in a manner conducive to strong global growth.

63. ***Although evidence suggests a reasonably favorable outlook for underlying productivity growth—reflecting continued gains in technological innovation and in the adoption and diffusion of technology—less optimistic productivity prospects could trigger a downward revision in expected earnings growth and lead to a significant rebalancing of domestic and international portfolios.*** This might involve a sharp adjustment in the value of the dollar. In that event, monetary policy should remain focused on ensuring sustained low-inflation economic growth. The main challenge for predicting inflation in these circumstances would be to determine whether underlying productivity growth had actually slowed down.

64. ***Given the current weakness in economic activity, some short-term fiscal stimulus along the lines of the recently enacted tax cut will help to insure against a sharper slowdown. More generally, fiscal policy should remain focused on medium-term issues, with tax policy driven mainly by structural considerations.*** The staff welcomes the emphasis that has been placed on cutting all marginal personal income tax rates—rather than using the tax system to provide incentives for particular activities—and on simplifying the structure of the tax system by removing the phaseout provisions for personal exemptions and itemized deductions. These efforts are likely to yield better incentives to work and invest, to improve transparency, and to lower compliance costs. However, the scheduled expirations of some of the tax cuts, which were used as budget accounting devices to keep the estimated cost of the package within agreed limits, will increase uncertainty and complicate tax planning; it also means that parts of the tax package will need to be revisited.

65. ***In the end, the total cost of the tax cuts is likely to be significantly higher than current estimates suggest, unless offsetting actions are taken.*** The tax reductions that expire in 2010 and the relief from the impact of the alternative minimum tax that lapses in 2004 can be expected to be extended beyond these expiration dates, adding significantly to the cost of tax reductions. Moreover, various "temporary" tax credits are likely to be renewed, as they have been in the past, entailing further budgetary costs.

66. ***Potential expenditure slippages are also a risk to the medium-term budget outlook.*** With budget surpluses in the last three fiscal years, discretionary spending has risen more rapidly than the mandated spending limits. The staff welcomes the Administration's efforts to keep discretionary spending in check and its proposal to extend the use of the PAYGO requirement and discretionary spending caps (with an appropriate adjustment in their levels) beyond their expiration in FY 2002. Strong prospective spending pressures will test this resolve. The Administration, itself, has indicated a few priority areas for increasing expenditures, suggesting that this additional spending will be funded out of the "reserve" in the FY 2002 Budget or by implementing offsetting spending cuts in nonpriority items. The Budget reserve, however, may be smaller than anticipated (particularly if the cost of the tax cuts is higher than envisaged), and a substantial portion of the reserve is likely to be required to pay for the Administration's education initiatives and its plans for defense. While there is scope for cuts in other discretionary spending, limiting total discretionary spending to the modest increases planned is likely to prove to be very difficult.

67. ***In view of the uncertainties in the final cost of tax cuts, in the ability to hold down increases in discretionary spending, and in the accuracy of fiscal forecasts in the out years (when the cost of the tax cuts would be greatest), the staff takes the view that both spending increases and multi-year tax cuts need to be implemented flexibly with an eye toward ensuring that sufficient resources will be available to finance these measures over the budget horizon.*** To firmly lock in place both tax reductions and new expenditure initiatives would substantially increase the risk that the budget position could deteriorate sharply in the longer term, with the possibility that the Administration's objective of preserving the Social Security surplus might not be achieved.

68. ***The Budget recognizes the need for additional measures to put the Medicare and Social Security programs on a sound long-term financial footing.*** With respect to Medicare, the Administration has chosen to focus on the finances of the program as a whole, instead of separately dealing with its two components—Hospital Insurance and Supplementary Medical Insurance. The Budget proposes effectively to spend all of the $525 billion surplus which will accrue to the Medicare HI trust fund over the next ten years in part to pay for the costs of the whole Medicare program and to expand Medicare benefits by introducing a modest prescription drug benefit for low-income seniors, pending consideration of a comprehensive Medicare reform. At the same time, the Budget commits the Administration to preserving the Social Security surplus and using it for debt reduction and Social Security reform. However, it acknowledges the need for further actions to adequately meet the program's future obligations, and a new commission has been formed to study Social Security reform.

69. ***In the staff's view, a reasonable fiscal target over the medium term would be to set aside sufficient resources to put Social Security and the whole Medicare program on a financially viable basis over the longer term and keep the rest of the budget in balance over the economic cycle.*** Priority needs to be given to solving the financing problems of Social Security and Medicare, and at present there are sufficient resources available to solve these problems. In the period immediately ahead, preserving the surpluses in the Social Security and Medicare HI trust funds and balancing the rest of the budget would make a meaningful down payment toward this fiscal target. The trust funds for Social Security and Medicare HI were established originally as part of reform plans to partially pre-fund these largely pay-as-you-go programs to allow them to meet their long-term obligations without the need for sharp future increases in tax rates or cuts in benefits. To achieve this purpose, the surpluses in these trust funds have actually to be saved in order to put aside real resources to meet the programs' future liabilities. While the Administration does not find it useful to distinguish between the HI and the SMI components of Medicare, the staff views some pre-funding of the entire program—which saving the Medicare HI surplus would accomplish pending the enactment of a comprehensive Medicare reform—as advantageous for tax-smoothing purposes. For Social Security, its long-term financing problems are not large, especially in comparison with those faced by many other industrial countries, and could be solved by making some moderate adjustments now to the program's parameters.

70. ***Finding a permanent long-term solution for the financing of Medicare will present a significant challenge given the difficulties associated with predicting the program's costs.*** Periodic adjustments to the program are likely to be needed, and a mechanism for making such adjustments on a regular basis should be established. A comprehensive solution to Medicare's financial problems is likely to involve a menu of choices that would include changing benefits, raising co-payments and deductibles, and increasing contribution rates. Timely adoption of a comprehensive reform package to improve the program's longer-term financial viability would avoid the need for more drastic measures if such reforms were unduly delayed.

71. ***Prospects for a significant pay down in U.S. government debt have improved dramatically from only a few years ago. In the period ahead, saving by the federal government will result in overall budget surpluses that are likely to exceed the government's redeemable marketable debt. If this money is to be saved, which it should be to deal with future liabilities, there is no choice but to invest such excess cash balances in private assets.*** The challenge will be to ensure that such investments are managed in a manner that will minimize any risk that there would be undue political interference in investment decisions and adverse effects on economic efficiency and long-term growth prospects. This could be accomplished by establishing individually controlled voluntary personal retirement accounts within the Social Security system, as the Administration suggests, or by investing these balances through the Social Security trust fund. There are important tradeoffs to be considered in adopting either of these approaches, but regardless of the means chosen, the staff believes that the ultimate objective has to be to ensure that sufficient resources are set aside to meet the future needs of Social Security and Medicare.

72. ***Although U.S. banks experienced some moderate deterioration in commercial loan quality in 2000 and early 2001, the overall condition of the banking sector remains healthy.*** The deterioration in loan quality reflected higher interest rates through mid-2000, slowing corporate profit growth, and weakness in certain sectors (particularly telecommunications). The slowdown in economic growth during 2001 is likely to result in some further deterioration in credit quality that will have a negative impact on bank profitability. However, current profit and capitalization levels are relatively high, putting banks in a strong position to weather the impact of these effects.

73. ***In late 1999, passage of the Gramm-Leach-Bliley Act introduced a comprehensive overhaul of the outdated laws regulating the financial sector in the United States.*** The Act repealed the restrictions on affiliation between banks, securities firms, insurance companies, and other financial service providers. It designated the Federal Reserve as the supervisor for the newly created financial holding companies, but limited its authority over the operating units of these companies that are regulated by other banking agencies and the nonbank functional regulators. Since the passage of the GLB Act, progress has been achieved in making this new supervisory framework operational, as the regulatory agencies have worked to enhance interagency cooperation and information sharing. These efforts are especially important in view of the wide distribution of responsibilities among different agencies. In particular, the continued emphasis on refining the program for the supervision of large complex banking organizations, with the focus on evaluating and reviewing internal systems and controls for risk management, is welcome.

74. ***The United States should continue to be a major force for further liberalization of trade on a multilateral basis, and efforts to initiate a new round of multilateral trade negotiations should remain the key priority.*** At the same time, the staff notes recent progress with free trade initiatives on a regional and bilateral basis and recognizes the beneficial effects that such negotiations may yield for global trade liberalization. The staff also welcomes the renewed efforts by the Administration to obtain Trade Promotion Authority because of the important role it could play in securing commitments from other countries to conclude trade liberalization agreements. Improvements in market access provided in the African Growth and Opportunity Act and the Caribbean Basin Enhanced Initiative are useful steps in enhancing growth prospects for countries in these regions, and the staff encourages the authorities to take additional needed steps to provide duty- and quota-free access to the U.S. market for all least-developed countries.

75. ***The slowdown in U.S. economic activity and the continued strength in the dollar may give rise to increased demands for import protection, as suggested by the recent initiation of a safeguard investigation of the steel industry.*** Such protectionist pressures need to be strongly resisted. To enhance market competition with substantial benefits to the economy overall, the staff believes that a change in the administration of antidumping and countervailing duty procedures is needed. Such import protection should be provided only in those cases where foreign producers are found to be engaged in anticompetitive behavior.

76. ***While U.S. agricultural policy involves lower levels of overall support than in many OECD countries, supplemental actions taken in recent years to alleviate financial difficulties faced by U.S. farmers in the context of declining world commodity prices have created perverse incentives in the U.S. farm sector and have had an adverse impact on producers in other countries.*** Reforms implemented in 1996 under the Federal Agricultural Improvement and Reform Act sought to move government assistance to the sector away from price supports and toward income support. The recent practice of providing supplemental assistance appears to have impeded and prolonged adjustment in the farm sector. In formulating the new farm act this year, the staff recommends that the authorities return to the original goals of the FAIR Act and significantly reduce income support payments and resist pressures to extend support to a wider range of crops. Also, steps need to be taken to eliminate, or at least to substantially scale back, the crop loan program, which continues to distort production decisions.

77. ***ODA in recent years has remained at historically low levels of around 0.1 percent of GNP, compared to an average of 0.2 percent during the 1980s and early 1990s, and the FY 2002 Budget does not envisage an increase.*** The staff encourages the authorities to make further efforts to raise foreign assistance. At the same time, the staff welcomes the support for the enhanced HIPC initiative, with U.S. commitments to the HIPC trust fund and bilateral debt-reduction initiatives likely to be in place in FY 2002.

78. The quality, coverage, periodicity, and timeliness of U.S. economic data are considered to be excellent both in the context of the Article IV consultation and for purposes of ongoing surveillance. The United States has subscribed to the Special Data Dissemination Standard and its metadata are posted on the Dissemination Standard Bulletin Board.

79. It is recommended that the next Article IV consultation takes place within the standard 12-month cycle.

Table 1. United States: Historical Economic Indicators

(Annual change in percent, unless otherwise noted)

	Averages								
	1960s	1970s	1980s	1995	1996	1997	1998	1999	2000
Economic activity and prices									
Real GDP	4.4	3.3	3.0	2.7	3.6	4.4	4.4	4.2	5.0
Real net exports 1/	0.0	0.2	-0.1	0.1	-0.2	-0.3	-1.2	-1.0	-0.9
Real final domestic demand	4.4	3.1	3.0	3.0	3.7	4.3	5.4	5.6	5.5
Private final consumption	4.4	3.5	3.2	3.0	3.2	3.6	4.7	5.3	5.3
Nonresidential fixed investment	7.2	5.4	3.3	9.8	10.0	12.2	13.0	10.1	12.6
Labor force	1.7	2.7	1.7	1.0	1.2	1.8	1.0	1.2	1.1
Employment (in percent)	1.9	2.4	1.7	1.5	1.5	2.3	1.5	1.5	1.3
Unemployment rate	4.8	6.2	7.3	5.6	5.4	5.0	4.5	4.2	4.0
Labor productivity 2/	2.8	1.9	1.4	0.9	2.5	2.0	2.7	2.6	4.3
Total factor productivity 2/	1.9	1.1	0.3	0.5	1.4	1.0	1.4	0.6	...
Capital stock 3/	3.6	3.6	2.7	2.4	2.8	3.0	3.3	3.5	...
GDP deflator	2.4	6.6	4.8	2.2	1.9	1.9	1.3	1.5	2.0
Consumer price index	2.3	7.1	5.6	2.8	2.9	2.3	1.5	2.2	3.4
Unit labor cost 2/	2.1	6.3	4.3	1.2	0.5	0.9	2.5	1.8	0.7
Nominal effective exchange rate 4/	0.5	-2.4	0.2	-6.0	5.2	8.1	4.9	-2.5	4.0
Real effective exchange rate 4/	...	...	...	-6.4	6.0	8.9	6.8	0.9	7.8
Three-month Treasury bill rate (percent) 5/	4.0	6.3	8.8	5.5	5.0	5.1	4.8	4.6	5.8
Ten-year Treasury note rate (percent) 5/	4.7	7.5	10.6	6.6	6.4	6.4	5.3	5.6	6.0
	(In percent of GDP or NNP)								
Balance of payments									
Current account	0.5	0.0	-1.7	-1.5	-1.5	-1.7	-2.5	-3.5	-4.5
Merchandise trade balance	0.6	-0.5	-2.2	-2.4	-2.4	-2.4	-2.8	-3.7	-4.5
Invisibles, net	-0.1	0.5	0.5	0.9	0.9	0.7	0.3	0.2	0.1
Fiscal indicators									
Unified federal balance (fiscal year)	-0.8	-2.1	-3.9	-2.2	-1.4	-0.3	0.8	1.3	2.4
Structural balance (fiscal year) 6/	...	...	...	-1.5	-0.7	0.2	1.1	1.4	2.4
Central government fiscal balance (NIPA) 7/	-0.1	-1.7	-3.8	-2.6	-1.8	-0.6	0.6	1.3	...
General government fiscal balance (NIPA) 7/	-1.2	-2.4	-4.4	-3.3	-2.4	-1.3	0.0	0.7	...
Savings and investment 8/									
Gross national saving	21.0	19.7	18.5	17.0	17.3	18.1	18.8	18.5	18.3
General government	4.0	1.3	-0.8	-0.1	0.8	1.9	3.2	4.0	5.3
Of which: Federal government	2.2	-0.5	-2.2	-1.5	-0.7	0.4	1.6	2.3	3.5
Private	17.1	18.4	19.2	17.1	16.5	16.2	15.7	14.4	13.0
Personal	5.7	6.8	6.7	4.1	3.5	3.0	3.0	1.6	-0.1
Business	11.4	11.6	12.6	13.0	13.0	13.1	12.6	12.9	13.1
Gross domestic investment	20.7	20.4	20.5	18.7	19.1	19.9	20.8	21.1	21.8
Private	15.5	16.7	16.9	15.5	15.9	16.7	17.6	17.7	18.4
Public	5.2	3.7	3.6	3.2	3.2	3.2	3.2	3.3	3.4
Of which: Federal government	2.4	1.3	1.6	1.1	1.1	1.0	1.0	1.1	1.1
Net foreign investment	0.6	0.2	-1.5	-1.3	-1.4	-1.5	-2.3	-3.4	-4.3
Net national saving	15.0	12.4	9.3	7.9	8.3	9.2	9.9	9.3	9.0
Net private investment	8.8	9.0	7.5	6.1	6.7	7.6	8.6	8.5	9.1
In real terms									
Gross domestic investment	17.1	16.6	17.3	18.3	19.1	20.3	21.6	22.2	...
Private	12.4	13.6	14.1	15.1	15.9	17.1	18.4	18.8	19.7
Public	4.7	3.0	3.1	3.2	3.2	3.2	3.2	3.4	...

Sources: U.S. Department of Commerce, Bureau of Economic Analysis; and Board of Governors of the Federal Reserve System.

1/ Contribution to GDP growth.
2/ Private nonfarm business sector.
3/ Business sector; in chained 1996 dollars.
4/ Monthly average on a unit labor cost basis (1990=100).
5/ Yearly average.
6/ As a percent of potential GDP.
7/ Overall balance.
8/ Gross national saving does not equal gross domestic investment and net foreign investment because of capital grants and statistical discrepancy. Net national saving and net private investment are expressed in percent of NNP.

Table 2. United States: Balance of Payments

(In billions of dollars)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Current account	4	-49	-83	-118	-110	-121	-140	-217	-324	-445
Percent of GDP	0.1	-0.8	-1.2	-1.7	-1.5	-1.5	-1.7	-2.5	-3.5	-4.5
Goods and services	-31	-36	-69	-97	-96	-102	-108	-167	-262	-376
Merchandise trade	-77	-97	-132	-166	-174	-191	-198	-247	-345	-452
Exports	414	440	457	503	575	612	678	670	685	772
Imports	-491	-537	-589	-669	-749	-803	-876	-917	-1,030	-1,224
Services	46	60	64	69	78	89	90	80	84	76
Receipts	164	177	186	201	219	240	257	262	273	293
Payment	-118	-116	-122	-132	-141	-151	-166	-182	-189	-217
Investment income	24	23	24	17	21	21	9	-6	-14	-15
Receipts	149	132	134	165	212	226	261	259	285	353
Payment	-125	-109	-110	-149	-191	-205	-252	-265	-299	-368
Unilateral transfers	11	-35	-38	-38	-34	-40	-41	-44	-49	-54
Government transfers	29	-16	-17	-15	-11	-15	-12	-13	-14	-17
Private transfers	-18	-19	-21	-23	-23	-25	-28	-31	-35	-37
Capital account transactions, net	-4	1	0	0	0	1	0	1	-3	1
Financial account	46	96	81	130	113	172	272	145	377	443
Private capital	20	54	11	85	14	40	254	172	322	407
Direct investment	-15	-28	-33	-34	-41	-5	1	36	146	135
Outflows	-38	-48	-84	-80	-99	-92	-105	-143	-155	-152
Inflows	23	20	51	46	58	87	106	178	301	288
Securities	24	31	-23	54	86	153	250	147	215	309
Outflows	-46	-49	-146	-60	-123	-150	-119	-136	-131	-125
Inflows	69	81	123	115	208	303	369	283	346	434
Net U.S. bank flows	3	37	56	100	-45	-75	8	4	-22	-51
Nonbank capital	8	13	11	-35	14	-33	-5	-15	-17	13
U.S. official reserves	6	4	-1	5	-10	7	-1	-7	9	0
Foreign official assets	17	40	72	40	110	127	19	-20	44	38
Other items	3	-2	0	0	-1	-1	0	0	3	-1
Statistical discrepancy	-46	-48	1	-11	-4	-52	-132	72	-49	1

Source: U.S. Department of Commerce, Bureau of Economic Analysis.

Table 3. United States: Indicators of Economic Performance

	1994	1995	1996	1997	1998	1999	2000	Projection 2001	2002
(Annual percent change)									
Real GDP									
United States	4.0	2.7	3.6	4.4	4.4	4.2	5.0	1.5	2.5
Japan	1.0	1.6	3.3	1.9	-1.1	0.8	1.5	1.0	1.8
Germany	2.3	1.7	0.8	1.4	2.1	1.6	3.0	2.2	2.6
Canada	4.7	2.8	1.5	4.4	3.3	4.5	4.7	2.3	2.4
France, Italy, and United Kingdom 1/	2.8	2.5	1.6	2.5	2.6	2.4	3.0	2.7	2.9
G-7 countries	3.1	2.3	2.7	3.3	2.8	3.0	3.8	1.9	2.8
Real domestic demand									
United States	4.4	2.5	3.7	4.7	5.5	5.2	5.7	1.8	2.9
Japan	1.3	2.1	3.8	1.0	-1.4	0.9	1.1	1.3	1.6
Germany	2.3	1.7	0.3	0.6	2.4	2.4	2.0	2.0	2.5
Canada	3.2	1.7	1.4	6.2	2.2	4.2	5.5	2.6	2.7
France, Italy, and United Kingdom 1/	2.3	1.9	1.5	2.4	3.9	3.3	3.2	3.0	2.8
G-7 countries	3.1	2.2	2.8	3.2	3.5	3.7	4.0	2.3	2.8
GDP deflator									
United States	2.1	2.2	1.9	1.9	1.3	1.5	2.0	2.3	2.1
Japan	0.1	-0.4	-0.6	0.3	-0.1	-1.4	-1.6	-1.1	-0.5
Germany	2.5	2.0	1.0	0.8	1.1	0.9	-0.4	1.3	1.4
Canada	1.1	2.3	1.7	1.0	-0.6	1.6	3.6	2.1	1.9
France, Italy, and United Kingdom 1/	2.3	3.1	3.3	2.2	2.1	1.4	1.5	1.6	1.5
G-7 countries	1.8	1.9	1.7	1.5	1.1	0.9	1.2	1.4	1.6
(As percent of GDP)									
General government financial balance									
United States	-3.8	-3.3	-2.4	-1.3	0.0	0.7	1.9	1.5	1.3
Japan	-2.2	-3.5	-4.2	-3.2	-4.5	-7.0	-8.3	-6.7	-5.8
Germany	-2.4	-3.3	-3.4	-2.7	-2.1	-1.4	1.5	-2.0	-1.5
Canada	-6.7	-5.4	-2.8	0.2	0.2	2.2	3.4	2.7	2.5
France, Italy, and United Kingdom 1/	-7.2	-6.2	-5.1	-2.4	-1.7	-0.7	0.7	-0.3	-0.4
G-7 countries	-4.2	-4.1	-3.4	-1.9	-1.3	-1.0	-0.1	-0.4	-0.6
Gross savings									
United States	16.4	17.0	17.3	18.1	18.8	18.5	18.3	17.5	17.0
Japan	30.7	30.2	30.6	30.9	29.9	28.6	28.8	29.3	29.5
Germany	22.0	21.8	21.3	21.4	21.6	21.3	21.2	21.5	21.9
Canada	15.4	17.6	18.1	19.0	21.4	22.8	22.3	20.7	20.2
France, Italy, and United Kingdom 1/	18.2	19.2	18.9	19.6	19.4	19.1	19.3	19.2	19.3
G-7 countries	19.9	20.4	20.5	21.1	21.2	20.7	20.6	20.7	20.2
Fixed private investment (In nominal terms)									
United States	14.7	15.0	15.5	16.0	16.8	17.3	17.8	17.4	17.4
Japan	19.8	19.4	19.9	20.5	19.4	18.5	18.7	18.9	19.1
Germany	20.5	20.2	19.6	19.5	19.5	19.5	19.6	19.3	19.3
Canada	15.5	14.5	14.9	17.0	17.3	17.4	17.1	16.7	16.9
France, Italy, and United Kingdom 1/	15.0	15.3	15.5	15.4	15.9	16.4	16.7	16.9	17.1
G-7 countries	16.3	16.4	16.7	17.1	17.3	17.5	17.9	17.9	18.0
Fixed private investment (In real terms)									
United States	14.2	14.7	15.5	16.3	17.4	18.3	19.0	18.9	19.2
Japan	19.7	19.4	20.0	20.8	20.0	19.2	19.4	19.9	20.4
Germany	20.3	20.2	19.9	19.9	20.2	20.5	20.4	20.3	20.4
Canada	15.1	14.4	15.3	17.3	17.4	18.2	19.2	19.5	19.9
France, Italy, and United Kingdom 1/	14.9	15.3	15.6	15.9	16.6	17.2	17.5	17.7	17.8
G-7 countries	16.1	16.2	16.8	17.4	18.0	18.4	18.9	19.2	19.5
Current account balance									
United States	-1.7	-1.5	-1.5	-1.7	-2.5	-3.5	-4.5	-4.2	-4.1
Japan	2.7	2.1	1.4	2.2	3.1	2.4	2.5	2.6	2.7
Germany	-1.1	-0.8	-0.3	-0.1	-0.2	-0.9	-1.4	-1.0	-0.8
Canada	-2.3	-0.8	0.6	-1.6	-1.8	-0.4	1.8	1.3	0.8
France, Italy, and United Kingdom 1/	0.5	0.8	1.5	2.1	1.4	0.7	0.1	0.0	0.0
G-7 countries	-3.1	-1.0	0.7	-2.1	-2.6	-0.6	2.6	1.8	1.3

Sources: World Economic Outlook; and staff estimates.

1/ Composites for the country groups are averages of individual countries weighted by the average value of their respective GDPs converted using PPP weights over the preceding three years.

Table 4. United States: Inflation 1/
(Percentage change, December-over-December)

	CPI	Core CPI	PCE Price Index 3/	Core PCE Price Index 3/	PPI	Core PPI	Average Hourly Earnings	Employment Cost Index 2/ Total	Employment Cost Index 2/ Wages and Salaries	Unit Labor Costs
1994	2.6	2.7	2.2	2.2	1.8	1.6	2.6	3.2	2.7	1.1
1995	2.6	3.0	2.1	2.3	2.1	2.6	3.0	2.6	2.9	1.5
1996	3.3	2.7	2.4	1.8	2.8	0.6	3.7	3.0	3.4	0.9
1997	1.7	2.2	1.4	1.7	-1.2	0.0	4.2	3.4	3.9	1.1
1998	1.6	2.5	1.2	1.7	-0.1	2.5	3.8	3.3	3.9	2.4
1999	2.7	1.9	2.0	1.4	3.0	0.8	3.5	3.5	3.5	0.6
2000	3.4	2.5	2.3	1.6	3.6	1.3	4.3	4.4	3.9	2.3
2001 4/	3.6	2.6	2.2	1.7	3.7	1.6	4.3	4.2	3.9	3.4

Sources: U.S. Department of Labor, Bureau of Labor Statistics; and U.S. Department of Commerce, Bureau of Economic Analysis.

1/ Core inflation rates exclude changes in food and energy prices.
2/ Fourth quarter over fourth quarter.
3/ Chained-type price index for personal consumption expenditures.
4/ April 2001/April 2000 for PCE; May 2001/May 2000 for CPI, PPI, and Average Hourly Earnings; 2001Q1/2000Q1 for Employment Cost Index, and Unit Labor Cost.

Table 5. United States: Economic Outlook

(In percent changes from previous year, unless otherwise indicated)

	1997	1998	1999	2000	Staff Projection 2001	2002	2003	2004	2005	2006
NIPA in constant prices										
Real GDP	4.4	4.4	4.2	5.0	1.5	2.5	3.7	3.5	3.2	3.2
Net exports 1/	-0.4	-1.2	-1.0	-0.8	0.0	-0.4	-0.3	-0.2	-0.1	-0.1
Total domestic demand	4.7	5.5	5.2	5.7	1.8	2.9	3.9	3.6	3.3	3.2
Final domestic demand	4.3	5.4	5.6	5.6	2.5	2.8	3.8	3.7	3.3	3.2
Private final consumption	3.6	4.7	5.3	5.3	2.8	2.4	3.2	3.2	2.7	2.6
Public consumption expenditure	1.8	1.5	2.1	2.0	2.8	2.8	1.8	2.7	2.9	2.9
Gross fixed domestic investment	8.8	10.7	9.1	8.8	1.3	3.9	6.8	5.6	5.0	5.4
Private	9.6	11.8	9.2	9.3	0.9	4.0	7.7	6.2	5.4	5.8
Public	5.0	4.9	8.9	6.1	3.6	2.8	1.8	2.6	2.8	2.7
Change in business inventories 1/	0.5	0.2	-0.4	0.1	-1.0	-0.1	0.0	0.0	0.0	0.0
Real GNP	3.5	4.3	4.2	5.0	1.5	2.5	3.7	3.5	3.2	3.2
Employment and inflation										
Unemployment rate	5.0	4.5	4.2	4.0	4.4	5.0	4.6	4.5	4.5	4.5
CPI	2.3	1.5	2.2	3.4	3.0	2.2	2.5	2.5	2.5	2.5
GDP deflator	1.9	1.3	1.5	2.0	2.3	2.1	2.2	2.3	2.3	2.3
Financial indicators										
Unified federal balance 2/	-22	69	124	236	197	172	194	211	237	253
(as a share of GDP)	-0.3	0.8	1.3	2.4	1.9	1.6	1.7	1.7	1.8	1.9
Central government fiscal balance (NIPA)	-48	51	119	247	211	199	220	241	266	284
(as a share of GDP)	-0.6	0.6	1.3	2.5	2.0	1.8	1.9	2.0	2.1	2.1
General government fiscal balance (NIPA)	-106	0	65	189	152	136	154	171	191	205
(as a share of GDP)	-1.3	0.0	0.7	1.9	1.5	1.3	1.3	1.4	1.5	1.5
Three-month Treasury bill rate	5.1	4.9	4.8	6.0	3.7	3.2	4.3	4.7	5.5	5.5
Ten-year Treasury bond rates	6.4	5.3	5.6	6.0	4.7	4.1	5.0	5.4	6.3	6.3
Balance of payments										
Current account balance	-140	-217	-324	-445	-432	-441	-474	-505	-522	-533
(as a share of GDP)	-1.7	-2.5	-3.5	-4.5	-4.2	-4.1	-4.1	-4.2	-4.1	-3.9
Merchandise trade balance	-198	-247	-345	-452	-456	-471	-487	-495	-495	-493
(as a share of GDP)	-2.4	-2.8	-3.7	-4.5	-4.4	-4.4	-4.2	-4.1	-3.9	-3.6
Export volume (NIPA)	12.3	2.3	2.9	9.0	2.6	6.1	7.6	8.2	8.2	8.1
Import volume (NIPA)	13.7	11.9	10.7	13.5	2.2	7.1	8.0	7.5	7.1	7.0
Invisibles, net	58	29	21	8	24	30	13	-10	-26	-40
(as a share of GDP)	0.7	0.3	0.2	0.1	0.2	0.3	0.1	-0.1	-0.2	-0.3
Saving and investment (as a share of GDP)										
Gross national saving	18.1	18.8	18.5	18.4	17.5	17.0	17.4	18.0	18.5	19.2
General government	1.9	3.2	4.0	5.4	4.9	4.6	4.7	4.7	4.8	4.8
Private	16.2	15.7	14.4	13.0	12.5	12.4	12.8	13.3	13.7	14.4
Personal	3.0	3.0	1.6	-0.1	-0.4	-0.2	0.1	0.5	0.9	1.4
Business	13.1	12.6	12.9	13.1	13.0	12.6	12.7	12.8	12.8	13.0
Gross domestic investment	19.9	20.8	21.1	21.8	20.4	20.2	20.6	20.7	20.9	21.1
Addenda:										
GDP in current prices	6.5	5.7	5.8	7.1	3.9	4.6	6.0	5.9	5.6	5.6
GNP in current prices	5.5	6.3	5.8	7.1	3.9	4.6	6.0	5.9	5.6	5.6

Source: Staff estimates.

1/ Contribution to GDP growth.
2/ Fiscal year. Based on the Administration's FY 2002 budget proposal, adjusted for staff's macroeconomic assumptions.

Table 6. United States: Alternative Scenario to Illustrate Potential Downside Risks
(Percent deviation from baseline levels, unless otherwise noted)

	2001	2002	2003	2004	2005
World					
Real GDP	-1.1	-1.2	-0.8	-0.3	0.0
United States					
Real GDP	-1.5	-1.6	-1.2	-0.6	-0.4
Real domestic demand	-2.6	-2.9	-2.5	-1.7	-1.4
Net private saving (percent of GDP)	0.4	0.4	0.4	0.4	0.6
Current account (billions of U.S. dollars)	1.8	64.6	101.1	132.3	145.4
CPI inflation	1.0	-0.4	-1.0	-1.2	-1.1
Short-term interest rate	-2.9	-3.1	-3.0	-2.3	-1.6
Real effective exchange rate	-13.1	-13.3	-12.5	-10.8	-9.4
Euro rate					
Real GDP	-1.1	-1.2	-0.9	-0.2	0.3
Real domestic demand	0.0	0.2	0.6	1.2	1.6
Net private saving (percent of GDP)	-0.1	-1.1	-1.3	-1.6	-1.5
Current account (billions of U.S. dollars)	-16.6	-42.0	-57.3	-72.9	-87.1
CPI inflation	-1.1	-0.9	-0.5	-0.2	-0.1
Short-term interest rate	-2.8	-2.9	-2.9	-2.7	-2.7
Real effective exchange rate	7.6	8.3	8.0	6.8	5.5
Japan					
Real GDP	-1.2	-1.2	-0.7	0.0	0.4
Real domestic demand	-0.9	-0.8	-0.2	0.3	0.7
Net private saving (percent of GDP)	-0.3	-0.9	-1.2	-1.4	-1.4
Current account (billions of U.S. dollars)	3.1	-23.0	-36.4	-48.5	-48.6
CPI inflation	-0.2	-0.4	-0.4	-0.4	-0.4
Short-term interest rate	-0.1	-0.3	-0.6	-0.8	-0.5
Real effective exchange rate	4.7	6.4	6.2	4.5	3.4
Developing countries					
Real GDP	-0.5	-0.5	-0.4	-0.3	-0.2
Real domestic demand	-0.8	-0.8	-0.6	-0.4	-0.3
Memoranda: baseline real GDP growth					
World	3.4	4.1	4.3	4.4	4.6
United States	1.5	2.5	3.7	3.5	3.2
Canada	2.3	2.4	3.2	2.9	2.7
Euro area	2.5	2.9	2.6	2.2	2.2
Japan	1.0	1.8	2.4	2.5	2.6
Developing countries	5.1	5.7	6.0	6.1	6.4

Source: Based on IMF, *World Economic Outlook*, May 2001.

Table 7. United States: Fiscal Indicators

(For fiscal years, in percent of GDP except where noted otherwise)

	2000	2001	2002	2003	2004	2005	2006	2002-11 1/
FY 2002 budget current-services baseline								
Administration								
Outlays	18.3	18.0	17.9	17.4	17.0	16.8	16.3	22,345
Debt service	2.3	2.0	1.7	1.5	1.2	1.0	0.7	710
Other	16.0	16.0	16.2	15.9	15.8	15.8	15.6	21,635
Revenue	20.7	20.7	20.5	20.3	20.2	20.3	20.2	27,981
Unified balance	2.4	2.8	2.6	2.9	3.2	3.5	3.9	5,637
Primary balance	4.7	4.8	4.3	4.4	4.5	4.4	4.6	6,347
Unified balance excluding social security	0.9	1.2	1.0	1.2	1.5	1.6	2.0	3,038
Net debt held by public 2/	34.8	30.8	26.7	22.5	18.3	14.0	9.6	
Staff								
Outlays		18.0	18.0	17.5	17.1	16.9	16.5	22,581
Debt service		1.9	1.6	1.3	1.1	1.0	0.8	785
Other		16.1	16.5	16.2	16.0	16.0	15.7	21,796
Revenue		20.8	20.5	20.2	20.1	20.2	20.1	27,795
Unified balance		2.7	2.5	2.7	3.0	3.2	3.6	5,214
Primary balance		4.7	4.0	4.0	4.1	4.2	4.4	5,998
Unified balance excluding social security		1.2	0.8	1.0	1.2	1.4	1.7	2,614
Net debt held by public 2/		31.0	27.2	23.2	19.1	14.9	10.7	
FY 2002 budget with proposed measures								
Administration								
Outlays		18.1	18.1	17.7	17.4	17.2	16.9	23,241
Debt service		2.0	1.8	1.6	1.4	1.2	1.0	1,198
Other		16.1	16.4	16.1	16.0	16.0	15.9	22,041
Revenue	-	20.0	20.1	19.5	19.4	19.4	19.2	26,707
Unified balance		2.0	2.0	1.8	2.0	2.2	2.3	3,467
Primary balance		4.0	3.8	3.4	3.4	3.4	3.3	4,665
Unified balance excluding social security 3/		0.4	0.4	0.2	0.2	0.3	0.4	875
Net debt held by public 2/		31.6	28.0	24.9	21.8	18.6	15.4	
Staff								
Outlays		18.1	18.3	17.8	17.5	17.3	17.0	23,477
Debt service		2.0	1.6	1.4	1.3	1.2	1.1	1,298
Other		16.2	16.6	16.4	16.2	16.2	15.9	22,179
Reserve 3/		0.0	0.2	-0.1	0.0	0.1	0.2	444
Revenue		20.0	20.1	19.4	19.2	19.3	19.1	26,521
Unified balance		1.9	1.6	1.7	1.8	1.9	1.9	2,600
Primary balance		3.9	3.2	3.1	3.0	3.0	3.0	3,898
Unified balance excluding social security		0.4	0.0	0.0	0.0	0.0	0.0	0
Net debt held by public 2/		31.8	28.9	25.7	22.7	19.7	16.9	
Memorandum items:								
Medicare HI trust fund surplus	0.3	0.3	0.3	0.3	0.4	0.4	0.4	525
Structural unified balance (staff) 4/	2.1	1.8	1.7	1.8	1.8	1.9	1.9	
Administration economic projections (calendar years, in percent)								
Real GDP growth	5.0	2.4	3.3	3.2	3.2	3.1	3.1	3.2 5/
CPI inflation rate	3.4	2.7	2.6	2.6	2.5	2.5	2.5	2.5 5/
Three-month Treasury bill rate	6.0	5.3	5.6	5.6	5.6	5.3	5.0	5.2 5/

Sources: Budget of the United States Government, FY2002; U.S. Congress, Joint Committee on Taxation, 2001, *Estimated Budget Effects of the Conference Agreement for H.R. 1836 [1]* May 26; and staff calculations.

1/ Cumulative, in billions of dollars.
2/ Gross debt held by the public minus excess Government cash balances, which build up after 2007.
3/ Includes the reserve (the Additional Needs and Contingency Reserve) that the Administration proposes to set aside over ten years for unexpected contingencies and future priorities, including defense and Medicare.
4/ As a percent of potential GDP, based on FY 2002 Budget under staff's economic assumptions.
5/ Average during 2002-11.

Table 8. United States: Fiscal Proposals

(In billions of dollars)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2002-06	2002-11
Tax package 1/	-74	-38	-91	-108	-107	-135	-152	-160	-168	-187	-130	-479	-1,275
Reduce individual income tax rates, and create a new 10 percent bracket	-40	-55	-61	-69	-73	-93	-103	-109	-114	-118	-39	-351	-835
Increase child tax credit	-1	-9	-10	-11	-13	-18	-19	-19	-21	-25	-26	-61	-171
Phase out estate tax	0	0	-7	-6	-8	-5	-10	-12	-13	-24	-54	-25	-138
Other tax cuts	-33	26	-12	-22	-14	-19	-20	-19	-20	-20	-11	-42	-131
Outlays 2/	-10	-27	-32	-43	-55	-68	-95	-114	-132	-153	-177	-225	-896
Debt service	-2	-6	-10	-18	-26	-36	-48	-62	-77	-95	-112	-96	-490
Other	-8	-21	-21	-25	-29	-32	-48	-52	-54	-59	-65	-129	-406
Impact of total proposals	-84	-65	-123	-151	-162	-203	-247	-274	-299	-340	-307	-703	-2,171
In percent of FY GDP	-0.8	-0.6	-1.1	-1.3	-1.3	-1.5	-1.8	-1.9	-1.9	-2.1	-1.8	-1.2	-1.5

Sources: Budget of the United States Government FY 2002; U.S. Congress, Joint Committee on Taxation, 2001, *Estimated Budget Effects of the Conference Agreement for H.R. 1836 [1]* May 26; and staff calculations.

1/ Based on the Economic Growth and Tax Relief Reconciliation Act of 2001.
2/ Based on the conference resolution approved by Congress.

Table 9. Net Official Development Assistance Flows, 1999-00

	1999		2000	
	In millions of U.S. dollars	In percent of GNP 1/	In millions of U.S. dollars	In percent of GNP 1/
Australia	982	0.26	995	0.27
Austria	527	0.26	461	0.25
Belgium	760	0.30	812	0.36
Canada	1,699	0.28	1,722	0.25
Denmark	1,733	1.01	1,664	1.06
Finland	416	0.33	371	0.31
France	5,637	0.39	4,221	0.33
Germany	5,515	0.26	5,034	0.27
Greece	194	0.15	216	0.19
Ireland	245	0.31	239	0.30
Italy	1,806	0.15	1,368	0.13
Japan	15,323	0.35	13,062	0.27
Luxembourg	119	0.66	116	0.70
Netherlands	3,134	0.79	3,075	0.82
New Zealand	134	0.27	116	0.26
Norway	1,370	0.91	1,264	0.80
Portugal	276	0.26	261	0.26
Spain	1,363	0.23	1,321	0.24
Sweden	1,630	0.70	1,813	0.81
Switzerland	984	0.35	888	0.34
United Kingdom	3,450	0.24	4,458	0.31
United States	9,145	0.10	9,581	0.10
Total	**56,378**	**0.24**	**53,058**	**0.22**

Source: Development Assistance Committee (DAC) of the Organisation of Economic Co-operation and Development.

1/ DAC members are progressively introducing a new system of national accounts, which is leading to slight upward revisions in measured GNP and corresponding declines in measured ODA/GNP ratios.

Table 10. United States: Indicators of External and Financial Vulnerability

(In percent of GDP, unless otherwise indicated)

	1995	1996	1997	1998	1999	2000
External indicators						
Exports (annual percentage change)	12.9	7.3	9.7	-0.2	2.6	11.3
Imports (annual percentage change)	11.3	7.1	9.3	5.4	10.9	18.2
Terms of trade (annual percentage change)	0.5	-0.4	1.1	3.0	-2.1	-4.6
Current account balance	-1.5	-1.5	-1.7	-2.5	-3.5	-4.5
Capital and financial account balance	0.2	0.2	0.3	0.2	0.4	0.4
Of which: Inward portfolio investment (debt securities, etc.)	2.6	3.7	4.1	3.0	3.5	4.3
Inward foreign direct investment	0.8	1.1	1.3	2.0	3.2	2.9
Other investment liabilities (net)	0.4	0.2	1.8	0.5	0.6	0.9
Official reserves (in billions of dollars)	85.8	75.1	70.0	81.8	71.5	67.7
Broad money (M3) to reserves ratio	78.2	90.8	110.3	126.7	145.5	170.0
Central bank foreign liabilities (in billions of dollars)	0.4	0.2	0.5	0.2	0.1	0.3
Official reserves in months of imports	1.2	0.9	0.8	0.9	0.7	0.6
Net international investment position (in billions of dollars) 1/	-514.6	-596.6	-970.5	-1,111.8	-1,099.8	-1,842.7
Of which: General government debt (in billions of dollars) 2/	856.3	1,113.0	1,276.8	1,350.0	1,289.6	...
External debt to exports ratio	0.6	0.7	1.0	1.2	1.1	...
External interest payments to exports (in percent) 3/	19.4	19.4	21.6	23.7	24.5	27.4
Nominal effective exchange rate (percent change)	-1.0	5.1	8.1	7.8	-1.3	3.4
Financial market indicators						
General government gross debt	72.9	72.8	70.3	66.6	63.2	57.3
Three-month Treasury bill yield (percent)	5.5	5.0	5.1	4.8	4.6	5.8
Three-month Treasury bill yield (percent, real)	2.69	2.1	2.8	3.3	2.4	2.4
Change in stock market index (S&P500 percent, year average)	17.7	23.9	30.1	24.2	22.3	7.6
Banking sector risk indicators						
Total loans to assets	60.4	61.4	59.2	59.5	60.1	61.1
Total loans to deposits	86.0	87.9	86.8	88.0	91.1	91.4
Share of nonperforming loans in total loans (percent)	2.5	2.4	2.3	2.2	2.1	2.2
Loans to the rest of the world (billions of dollars)	34.6	43.7	52.1	58.9	59.4	70.7
Share of loans in total bank credit (percent)	72.2	74.3	73.7	73.7	73.3	74.6
Return on equity (percent)	14.6	14.4	14.8	14.0	15.3	14.1
Risk-based capital ratio	12.7	12.5	12.2	12.2	12.2	12.1

Sources: Board of Governors of the Federal Reserve System; and U.S. Department of Commerce, Bureau of Economic Analysis.

1/ Current cost valuation.

2/ Foreign official assets (U.S. Government securities plus Treasury securities).

3/ External interest payments: income payments on foreign-owned assets (other private payments plus U.S. Government payments).

United States: Fund Relations
(As of May 31, 2001)

I. **Membership Status**: Joined 12/27/45; Article VIII

II. **General Resources Account:**	**SDR Million**	**Percent Quota**
Quota	37,149.30	100.0
Fund holdings of currency	25,759.13	69.3
Reserve position in Fund	11,387.91	30.7
Financial Transaction Plan transfers (net)	0.00	

III. **SDR Department:**	**SDR Million**	**Percent Allocation**
Net cumulative allocation	4,899.53	100.0
Holdings	8,356.17	170.6

IV. **Outstanding Purchases and Loans**: None

V. **Financial Arrangements**: None

VI. **Projected Obligations to Fund**: None

VII. **Payments Restrictions**: The United States has notified the Fund under Decision No. 144 of restrictions on payments and transfers for current international transactions to Libya, Iraq, North Korea, Cuba, and Iran. The United States restricts the sale of arms and petroleum to UNITA and to the territory of Angola and has prohibitions against transactions with terrorists and international narcotics traffickers. The United States notified the Fund under Decision No. 144 on August 2, 1995 of the imposition of further restrictions on current transactions with Iran (EBS/95/107).

VIII. **Statistical Issues**: The quality, coverage, periodicity, and timeliness of U.S. economic data are considered to be excellent both in the context of the Article IV consultation and for purposes of ongoing surveillance (see Attachment for a summary). The United States has subscribed to the Special Data Dissemination Standard (SDDS) and its metadata are posted on the Dissemination Standard Bulletin Board (DSBB).

United States of America: Core Statistical Indicators

as of May 31, 2001

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	External Debt/Debt Service
Date of latest observation	Same day	May 25	May 23	May 23	May 23	Same day	April 2001	March 2001	2000Q4	April 2001	2001Q1	1999
Date released	Same day	May 29	May 25	May 25	May 25	Same day	May 16	May 18	March 15	May 18	May 25	July 2000
Frequency of data	daily	weekly	weekly	weekly	weekly	daily	monthly	monthly	quarterly	monthly	quarterly	annual
Frequency of reporting	daily	weekly	weekly	weekly	weekly	daily	monthly	monthly	quarterly	monthly	monthly	annual
Source of data	Federal Reserve	Treasury	Federal Reserve	Federal Reserve	Federal Reserve	Federal Reserve	Dept. of Labor	Dept. of Commerce	Dept. of Commerce	Treasury	Dept. of Commerce	Dept. of Commerce
Mode of reporting 1/	electronic	electronic	electronic	electronic	electronic	electronic	electronic	electronic	electronic	electronic	electronic	electronic
Confidentiality	none	none	none	none	none	none	none	none	none	none	none	none
Frequency of Publication	daily	monthly	weekly	weekly	weekly	daily	monthly	monthly	quarterly	monthly	monthly	annual

1/ Most data are available from statistical releases and from private electronic databases.

Statement by the IMF Staff Representative
July 27, 2001

1. Since the staff report (SM/01/196) was issued, recently released economic indicators paint a mixed picture, although some of the forward-looking indicators suggest a moderate improvement; Chairman Greenspan presented the biannual report to the Congress on the economic situation and monetary policy; Office of Management and Budget (OMB) Director, Mitchell Daniels, outlined possible revisions to the fiscal surplus projections for FY 2001; and the President's Commission on Social Security Reform issued its preliminary report. The thrust of the staff appraisal is unchanged by these developments.

Recent economic developments

2. While industrial production and employment continued to decline in June, and global growth prospects weakened further in recent weeks, data released on a variety of indicators point toward improving prospects for U.S. economic activity in coming months. Industrial production fell by 0.7 percent in June, led by a further large decline in manufacturing activity, especially production of business equipment, reflecting the slump in capital investment. Employment in June declined by 171,000 workers, following declines of 251,000 and 425,00 in April and May, respectively; the unemployment rate, however, remained largely unchanged since March at 4.5 percent. In contrast, suggesting stronger future growth, the index of leading indicators rose in June for the third consecutive month and consumer confidence increased for the second month in a row. The National Association of Purchasing Managers' (NAPM) index of business activity in the manufacturing sector increased in June to 44.7 from 42.1 in May. While an index number less than 50 indicates declining activity in the sector, the index's recent behavior suggests that the rate of decline in manufacturing has diminished substantially, primarily owing to improving new orders. Other data indicate that orders for durable goods increased in May, with a significant increase in orders for semiconductors. The NAPM index for nonmanufacturing rose from 46.6 in May to 52.1 in June, indicating that activity was increasing in this sector. Activity in the housing sector remained strong, with new housing starts rising to nearly 1.7 million units (annual rate) in June, a 6¼ percent increase over the level of starts in June 2000. The international trade deficit on goods and services narrowed sharply in May to $28.3 billion, reflecting a 2.4 percent decline in imports and a 0.9 percent rise in exports. According to First Call, current expectations are for corporate earnings to decline by 9 percent in the third quarter, before increasing by 2½ percent in the fourth quarter, and strengthening to 12 percent in 2002 and to 18 percent through 2006. Since the end of June, stock prices moved lower with the S&P 500 index down by about 4 percent, and the NASDAQ decreasing by 9 percent.

Chairman Greenspan's testimony

3. In his Congressional testimony on the Federal Reserve's Semiannual Report on Monetary Policy on July 18, Chairman Greenspan explained that the Federal Reserve's

aggressive easing in monetary policy since the beginning of 2001 was aimed at supporting demand and helping to lay the groundwork for the economy to achieve maximum sustainable growth over the longer term. The rapid and sizable easing in monetary policy was possible because of quiescent inflation pressures reflecting well anchored inflation expectations and a general lack of pricing power in product markets. Mr. Greenspan noted that, given the difficulties associated with accurately forecasting economic developments, the policy making process at times might require substantial swings in the federal funds rate to help stabilize economic activity, as for example, when recurring waves of consumer and business optimism and pessimism were affecting the economy. With regard to the behavior of asset prices and monetary policy, Mr. Greenspan said that the only realistic monetary policy response to a speculative bubble was to lean against the economic pressures that may accompany a rise in asset prices, bubble or not, and address forcefully the consequences of a sharp deflation of asset prices should they occur. Mr. Greenspan acknowledged the difficulty that monetary policy makers have in anticipating and acting on asset price bubbles, and he noted that expectations about future economic developments inevitably play a crucial role in policy formulation.

4. Mr. Greenspan indicated that the risks to the outlook remain tilted toward weakness in the economy. In his view, the period of below trend economic growth was not yet over, and a risk remained that economic weakness could turn out to be greater than expected and require a further easing in monetary policy. He said that the front-loaded easing in monetary policy this year coupled with the tax cuts underway should be increasingly stimulating economic activity as the year progresses. Mr. Greenspan noted that at present with energy prices headed lower and lessening labor market tightness, which should dampen wage increases, overall price pressures are likely to remain well contained in the period ahead.

5. While underscoring the downside risk to the Federal Reserve Board's current forecast, Mr. Greenspan anticipated a slight strengthening in real activity in the second half of 2001, with real GDP growth over the four quarters of 2001 likely to be in the range of 1¼ to 2 percent, and reaching 3 to 3¼ percent in 2002 (staff estimates of real GDP growth lie toward the lower end of these ranges). He expected that the easing of pressures in product and labor markets would result in personal consumption expenditure price inflation of 2 to 2½ percent over the four quarters of this year and 1¾ to 2½ percent next year.

Budget outlook

6. In recent congressional testimony, OMB Director Daniels said that the unified federal budget surplus for FY 2001 was likely to be lower than previously thought, largely owing to a more negative than expected impact of the economic slowdown on tax revenues, particularly tax payments by corporations. He estimated that the surplus for FY 2001 would be in the range of $160 to $190 billion, with the surplus possibly coming in at the bottom of that range. Previously, the Administration had projected a surplus of around $197 billion, roughly in line with staff estimates. A complete set of revised fiscal projections will be available in the mid-session review of the budget, which is expected to be released in early August.

Social Security Commission

7. The Social Security Commission appointed by the President in May 2001 released an interim report last week. The report highlights the weaknesses of the existing Social Security system and the criteria by which any reform proposals would be evaluated. The report argues that the existing Social Security system provides inadequate incentives for raising personal (and national) saving rates and provides relatively low rates of return to the most economically vulnerable population groups. The report suggests that the introduction of voluntary personal retirement accounts would help address both of these problems, although no details are provided. The Commission at the outset was advised that its recommendations should adhere to certain guidelines, notably that: the Social Security surplus is dedicated to Social Security only; payroll tax increases are avoided; the benefits of current and near retirees are not reduced; and voluntary individual accounts are included. The report contains criteria against which reform proposals should be judged which are consistent with these guidelines and include: ensuring equity of lifetime Social Security taxes and benefits, both between and within generations; encouraging personal and national saving; moving the Social Security system toward a fiscally sustainable course that can withstand unforeseen economic and demographic changes; and analyzing all necessary sources of tax revenue and benefits (including from the traditional system and from personal accounts). The Commission expects that a final report will be issued later this year, and will include specific recommendations to reform and revitalize the Social Security System.

INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 01/87
FOR IMMEDIATE RELEASE
August 14, 2001

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes 2001 Article IV Consultation with the United States

On July 27, 2001, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the United States.[1]

Background

Real GDP in 2000 grew by 4 percent—the fourth consecutive year of strong growth—but most of these gains were concentrated in the first half of the year, as growth slowed to an annual rate of around 1½ percent during the second half of 2000 and 1 percent in the first half of 2001.The slowdown in U.S. economic activity was more sudden than expected. Higher interest rates, rising energy prices, falling stock prices, and wider credit spreads contributed to reducing investment and dampening consumer spending. Lagging sales and a buildup in inventories triggered sharp cutbacks in production in some sectors of the economy and clouded corporate earnings and employment prospects, creating considerable uncertainty regarding the future course and strength of economic activity. Labor market conditions continued to be tight during 2000, with the unemployment rate hovering around 4 percent, but the situation eased in early 2001, and employment began to fall and the unemployment rate rose to 4½ percent by July 2001. Core inflation remained generally well contained; core consumer prices rose at around 2½ percent in 2000 and 3 percent in the first half of 2001, while the core deflator for personal consumption expenditures increased by about 2 percent in 2000 and 1¾ percent in the first half of 2001

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. This PIN summarizes the views of the Executive Board as expressed during the July 27 2001 Executive Board discussion based on the staff report.

The stance of monetary policy shifted in early 2001, as the Federal Open Market Committee (FOMC) responded to the changing balance of risks for inflation and output growth. With domestic demand growth outstripping the growth in potential output, the FOMC had raised the federal funds rate by a cumulative 175 basis points to 6½ percent over the period June 1999 to May 2000. As the slowdown in activity unexpectedly intensified in late 2000, however, the FOMC indicated in mid-December that weakening economic activity had become a more significant risk, and then surprised markets in early January 2001 when it lowered the federal funds rate by 50 basis points in advance of its scheduled meeting. Subsequently, in the first six months of 2001, the Federal Reserve cut rates on five more occasions—which included an intermeeting cut in April—bringing the federal funds rate down to 3¾ percent.

The unified federal budget balance recorded a surplus for the third consecutive year in FY 2000, with the surplus rising to 2½ percent of GDP, from 1¼ percent of GDP in FY 1999. The steady improvement in the fiscal balance since the early 1990s reflects in part the strong growth performance of the U.S. economy, as well as fiscal legislation enacted since 1993, mainly the Omnibus Budget Reconciliation Act of 1993 and the Balanced Budget Act of 1997. In FY 2000, federal debt held by the public declined to 35 percent of GDP.

In real effective terms, the dollar appreciated by 5 percent in 2000 and by a further 4½ percent in the first five months of 2001. A 5 percent depreciation of the dollar against the yen in 2000 was more than offset by a 15¾ percent appreciation against the euro. During the first seven months of 2001, the dollar appreciated by 11 percent against the yen and by 4¼ percent against the euro. In real effective terms, the dollar in May 2001 was 40 percent higher than its low in April–July 1995. The external current account deficit widened to about 4½ percent of GDP in 2000, from 3½ percent in 1999, largely owing to a widening in the merchandise trade deficit, as an increase in import volume growth from already high levels more than offset a substantial increase in export volume growth driven by a strengthening of economic activity in partner countries.

Executive Board Assessment

Executive Directors commended the U.S. authorities for implementing sound fiscal and monetary policies over the past decade which provided a strong foundation for the longest U.S. economic expansion on record. Economic activity slowed, however, more sharply than expected in late 2000 and in the first half of 2001, reflecting the effects of rising energy prices, falling stock prices, a drop in business and consumer confidence, higher interest rates, and squeezed profit margins. The ensuing slowdown in the rest of the world has further dampened economic activity in the United States. Directors expressed concern that, in light of the importance of the U.S. economy to the rest of the world, any prolonged weakness in the United States was likely to be felt elsewhere, and especially in those economies that are highly dependent on the United States for exports.

Directors agreed that at the present juncture, the uncertainty surrounding the economic outlook was higher than usual. Whether economic activity picks up in the second half of 2001 or

remains sluggish for an extended period depends on a number of interrelated factors, including how consumer and business confidence evolve and affect spending, and whether the rapid rate of underlying productivity growth seen in the second half of the 1990s is sustained.

In these circumstances, Directors welcomed the flexible policy stance that the authorities have been pursuing in recent months. They considered that the principal policy priority is to revive near-term growth and welcomed recent actions on the monetary and fiscal fronts as appropriate and timely. They commended the Federal Reserve's aggressive easing of monetary policy since the beginning of 2001. Most Directors expected that inflationary pressures would remain generally quiescent, and therefore should provide the room for monetary policy to support economic activity in the event of persistent weakness. However, a few Directors warned that the authorities should remain vigilant in monitoring inflation prospects. Whether further easing will be needed will depend on the economy's response to past interest rate cuts, with additional cuts needed if economic and financial indicators remain weak.

Directors observed that judgments about whether domestic and external financial imbalances in the U.S. economy would be resolved in an orderly manner depended importantly on prospects for underlying productivity growth. These prospects would play a crucial role in determining whether the favorable economic performance of the late 1990s could be resumed and inflation pressures remain contained. The deterioration in the external current account balance to a large extent had been driven by the surge in U.S. productivity growth during the second half of the 1990s which had boosted the relative return on capital and attracted substantial capital inflows to the United States. Although evidence suggests a reasonably favorable outlook for underlying productivity growth—reflecting continued gains in technological innovation and in the adoption and diffusion of technology—Directors cautioned that less optimistic productivity prospects could trigger a less favorable outcome and pose a significant challenge for U.S. policy.

Directors indicated that the size of the U.S. external current account deficit did not appear sustainable in the longer term and that it raised concerns that the dollar might be at risk for a sharp depreciation, particularly if productivity performance proved disappointing. A sudden correction in the current account deficit was seen as possibly having adverse effects on the United States and the rest of the world economy. Directors stressed that disciplined macroeconomic policies—including continued fiscal surpluses—would help to facilitate an orderly adjustment in the dollar and the current account deficit. At the same time, they observed that further reforms in other major countries, that would enhance prospects for profitable domestic investment, would also help to ensure that the adjustment of global external imbalances takes place in a manner conducive to strong growth in the world economy.

Directors expressed concern about the decline in personal saving and rise in household and corporate debt levels in recent years. They cautioned that if productivity growth turned out to be far weaker than the growth rates experienced since the mid-1990s, the economic slowdown could be prolonged, adversely affecting household and business balance sheets. At the same time, given that the rise in equity wealth in recent years had contributed to the decline in household saving, Directors noted that a further decline in equity prices could depress

consumption and raise the personal saving rate in the short term, pushing the economy into a more pronounced decline. Although in these circumstances supportive monetary policy could cushion the negative impact, a sizable adjustment in household and corporate balance sheets would need to take place to reduce debt levels.

With the current weakness in economic activity, Directors viewed the recently enacted tax cut, which will help to insure against a sharper economic slowdown, as appropriate and timely. However, they emphasized that, more generally, fiscal policy should remain focused on the medium term, with decisions about tax policy reflecting structural considerations. They agreed that the reduction in marginal personal tax rates would create better incentives to work and invest, to improve transparency, and to lower compliance costs.

Directors cautioned that the total cost of the tax cut was likely to be higher than current estimates suggest unless offsetting actions are taken, largely owing to the likelihood that tax measures would not expire as scheduled. They saw expenditure slippages as a significant risk, particularly in light of the tendency in recent years for discretionary spending to rise faster than mandated spending limits. Given the uncertainties about the final costs of the tax cut, the ability to contain discretionary spending, and the accuracy of fiscal forecasts, Directors recommended that spending increases and multi-year tax cuts should be implemented flexibly so as to ensure that there will be sufficient resources over the medium term to finance these measures.

Over the longer term, Directors considered that a reasonable fiscal target would be to set aside sufficient resources to put Social Security and Medicare on a financially sound footing and keep the rest of the budget in balance over the economic cycle. They urged that at this point priority be given to strengthening the financial outlook for Social Security and Medicare, particularly because at present there are sufficient resources available to address these problems. Preserving the surpluses in the Social Security and Medicare Hospital Insurance trust funds and balancing the rest of the budget would constitute a meaningful first step in achieving this fiscal target. Directors noted that additional reform efforts would be needed for both Social Security and Medicare and would best be implemented sooner, rather than later, to avoid the need for more drastic measures if reforms were unduly delayed.

Determined fiscal policy efforts over the last decade have dramatically improved prospects for paying down the U.S. government debt, and overall budget surpluses in the period ahead are expected to exceed the government's redeemable debt. After that, one possible approach to manage the build up of assets would be to establish individually controlled voluntary personal retirement accounts within the Social Security system, while another approach would be to invest these balances through the Social Security trust fund. Regardless of the means chosen, Directors underscored the need to set aside sufficient resources to finance the future liabilities of Social Security and Medicare.

Directors observed that the overall condition of the U.S. banking sector remains healthy, although banks had seen some deterioration in loan quality in 2000 and the first half of 2001. In this connection, they cautioned against the risks associated with the use of off-balance sheet

instruments. Directors expected that the slowdown in economic activity will likely result in some further deterioration in credit quality and bank profitability. However, currently high profit and capitalization levels are expected to cushion the impact of these negative developments, allowing banks to weather the economic slowdown without undue difficulties.

Directors considered that, in light of the importance of the United States as a global capital market and recent legislation in the financial area, it would be useful if the United States participated in a Financial Sector Assessment Program. Directors called on the staff to report on U.S. policies with respect to anti-money laundering in future Article IV consultations and in a separate report to the Board some time soon.

Directors urged the United States to continue to push for further liberalization of international trade on a multilateral basis and that efforts to initiate a new round of multilateral trade negotiations should remain a key priority. Although the African Growth and Opportunity Act and the Caribbean Basin Enhanced Initiative improved market access for developing countries in these regions, they encouraged the authorities to take additional steps to improve duty- and quota-free access to the U.S. market for these countries and to provide such access for all countries, particularly the least-developed countries.

Directors cautioned that the recent continued strength of the U.S. dollar and the slowdown in U.S. economic activity could give rise to a greater frequency of calls for trade protection, noting in particular the recent safeguard action initiated on behalf of the steel industry. They urged that the authorities resist such pressures for protection. In addition, to promote market competition and limit the use of antidumping (AD) and countervailing duty (CVD) actions, Directors suggested that the authorities change the manner in which AD/CVD procedures are administered so that such protection is provided only in those cases where foreign producers are found to be engaged in anticompetitive behavior.

Although Directors acknowledged that U.S. agricultural support is lower than in many other OECD countries, they noted that in recent years supplemental assistance to U.S. farmers has created distortions in the farm sector, which may have contributed to reducing world prices for major grains and oil seeds, adversely affecting producers in other countries. Directors urged the authorities to resist pressures to continue such supplemental agricultural assistance and to return to the goals of the Federal Agriculture Improvement and Reform (FAIR) Act implemented in 1996, which was designed to move government assistance to the farm sector away from price supports and toward income supports.

Directors expressed concern about the continued low level of U.S. official development assistance as a ratio of GNP, and urged that the authorities increase their commitment to foreign assistance to bring it in line with the U.N. target of 0.7 percent. However, Directors welcomed U.S. support for the enhanced HIPC Initiative.

Directors noted that the quality, coverage, periodicity, and timeliness of U.S. economic data are considered to be excellent, both in the context of the Article IV consultation and for purposes of ongoing surveillance.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. The Staff Report for the 2001 Article IV Consultation with the U.S. is also available.

Table 1. United States: Historical Economic Indicators

(Annual change in percent, unless otherwise noted)

	Averages								
	1960s	1970s	1980s	1995	1996	1997	1998	1999	2000
Economic activity and prices									
Real GDP	4.4	3.3	3.0	2.7	3.6	4.4	4.3	4.1	4.1
Real net exports 1/	0.0	0.2	-0.1	0.1	-0.2	-0.3	-1.2	-1.0	-0.8
Real final domestic demand	4.4	3.1	3.0	3.0	3.7	4.3	5.3	5.2	4.9
Private final consumption	4.4	3.5	3.2	3.0	3.2	3.6	4.8	5.0	4.8
Nonresidential fixed investment	7.2	5.4	3.3	9.8	10.0	12.2	12.5	8.2	9.9
Labor force	1.7	2.7	1.7	1.0	1.2	1.8	1.0	1.2	1.1
Employment (in percent)	1.9	2.4	1.7	1.5	1.5	2.3	1.5	1.5	1.3
Unemployment rate	4.8	6.2	7.3	5.6	5.4	5.0	4.5	4.2	4.0
Labor productivity 2/	2.8	1.9	1.4	0.9	2.5	2.0	2.6	2.3	3.0
Total factor productivity 2/	1.9	1.1	0.3	0.5	1.4	1.0	1.4	0.6	...
Capital stock 3/	3.6	3.6	2.7	2.4	2.8	3.0	3.3	3.5	...
GDP deflator	2.4	6.6	4.8	2.2	1.9	1.9	1.2	1.4	2.3
Consumer price index	2.3	7.1	5.6	2.8	2.9	2.3	1.5	2.2	3.4
Unit labor cost 2/	2.1	6.3	4.3	1.2	0.5	0.9	2.7	2.0	3.1
Nominal effective exchange rate 4/	...	...	8.5	-1.0	5.1	8.1	7.8	-1.3	3.4
Real effective exchange rate 4/	...	...	...	-3.3	4.3	7.4	7.1	-0.6	4.9
Three-month Treasury bill rate (percent) 5/	4.0	6.3	8.8	5.5	5.0	5.1	4.8	4.6	5.8
Ten-year Treasury note rate (percent) 5/	4.7	7.5	10.6	6.6	6.4	6.4	5.3	5.6	6.0
	(In percent of GDP or NNP)								
Balance of payments									
Current account	0.5	0.0	-1.7	-1.5	-1.5	-1.7	-2.5	-3.5	-4.5
Merchandise trade balance	0.6	-0.5	-2.2	-2.4	-2.4	-2.4	-2.8	-3.7	-4.6
Invisibles, net	-0.1	0.5	0.5	0.9	0.9	0.7	0.3	0.2	0.1
Fiscal indicators									
Unified federal balance (fiscal year)	-0.8	-2.1	-3.9	-2.2	-1.4	-0.3	0.8	1.3	2.4
Structural balance (fiscal year) 6/	...	...	...	-1.5	-0.7	0.2	1.1	1.4	2.4
Central government fiscal balance (NIPA) 7/	-0.1	-1.7	-3.8	-2.6	-1.8	-0.6	0.5	1.3	2.2
General government fiscal balance (NIPA) 7/	-1.2	-2.4	-4.4	-3.3	-2.4	-1.3	-0.1	0.6	1.5
Savings and investment 8/									
Gross national saving	21.0	19.7	18.5	17.0	17.3	18.1	18.8	18.4	18.1
General government	4.0	1.3	-0.8	-0.1	0.8	1.9	3.1	3.9	4.7
Of which: Federal government	2.2	-0.5	-2.2	-1.5	-0.7	0.4	1.5	2.3	3.2
Private	17.1	18.4	19.2	17.1	16.5	16.2	15.7	14.5	13.4
Personal	5.7	6.8	6.7	4.1	3.5	3.0	3.4	1.7	0.7
Business	11.4	11.6	12.6	13.0	13.0	13.1	12.2	12.8	12.7
Gross domestic investment	20.7	20.4	20.5	18.7	19.1	19.9	20.7	20.9	21.1
Private	15.5	16.7	16.9	15.5	15.9	16.7	17.5	17.7	17.9
Public	5.2	3.7	3.6	3.2	3.2	3.2	3.2	3.3	3.2
Of which: Federal government	2.4	1.3	1.6	1.1	1.1	1.0	1.0	1.0	1.0
Net foreign investment	0.6	0.2	-1.5	-1.3	-1.4	-1.5	-2.3	-3.3	-4.4
Net national saving	15.0	12.4	9.3	7.9	8.3	9.2	9.9	9.3	8.8
Net private investment	8.8	9.0	7.5	6.1	6.7	7.6	8.5	8.4	8.6

In real terms									
Gross domestic investment	17.1	16.6	17.3	18.3	19.1	20.3	21.5	22.1	22.5
Private	12.4	13.6	14.1	15.1	15.9	17.1	18.3	18.7	19.2
Public	4.7	3.0	3.1	3.2	3.2	3.2	3.2	3.4	3.3

Sources: U.S. Department of Commerce, Bureau of Economic Analysis; and Board of Governors of the Federal Reserve System.

1/ Contribution to GDP growth.
2/ Private nonfarm business sector.
3/ Business sector; in chained 1996 dollars.
4/ Monthly average on a consumer price index basis (1990=100).
5/ Yearly average.
6/ As a percent of potential GDP.
7/ Overall balance.
8/ Gross national saving does not equal gross domestic investment and net foreign investment because of capital grants and statistical discrepancy. Net national saving and net private investment are expressed in percent of NNP.