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July 15, 2021

Statement by Mr. Bhalla and Mr. Natarajan on United States
(Preliminary)
Executive Board Meeting
July 19, 2021

1. We thank the staff for the detailed report and Ms. Shortino and Mr. Sturm for the comprehensive Buff. We commend the US authorities for their sustained effort in healthcare and the successful roll out of the vaccination program which has resulted in significant fall in new COVID-19 cases and test positivity rate. Improvement in the pandemic situation, coupled with exceptional fiscal support measures has provided a tremendous boost to the economic recovery with potential positive spillovers to the global economy. While the crisis has revealed the resilience of the country's institutions under extraordinary stress, it has also provided important lessons of the systemic shortcomings in their functioning. As the pandemic effects recede, the authorities need to manage the key transitions – demographic, digitalization, and climate change. Like the staff, we believe the inherent innovativeness and flexibility of the country's system will help to address these transitions.

2. After the pandemic-induced contraction in 2020, the economy is on a sound path of recovery and is expected to achieve about 7 percent growth in 2021. Witnessing a healthy growth in the first quarter, the economy is expected to grow stronger as vaccination rates rise and normal activities resume. Share of services in consumption has fallen but is expected to revive with normalization of in-person services.

3. The exceptional fiscal support measures have helped to improve health care coverage and support to households, vulnerable, unemployed, small businesses, and the corporate sector. The American Rescue Plan has provided support measures to the tune of US $ 1850 billion to accelerate vaccination and expand healthcare coverage, support to schools and colleges, food, housing, unemployment benefits and transfers. The proposed American Families Plan focuses on investment in infrastructure, human

capital, and support to vulnerable households. In a similar vein, American Families Plan proposes tax credits for childcare, nutrition, universal pre-school, and grants to college students. We welcome these efforts and the multi-year investment in infrastructure which will help to improve productivity and increase labor force participation. We agree with the authorities that these gains are "institutional" and encourage better targeting of policies to strengthen their impact.

4. The cost of the fiscal measures is expected to be partially funded by raising taxes on high-income households and corporates. Proposals for increase in corporate taxes include increase in statutory corporate tax rate, minimum tax on book income profits, and minimum tax on offshore profits of US multinationals. On the personal tax front, proposals include an increase in the top income tax rate, taxing qualified dividends, taxing capital gains at top personal income tax rate and eliminating certain benefits in capital gains. We note that the staff has suggested raising tax revenues by increasing the reliance on indirect taxes. *Could the staff comment on the merit of this suggestion as indirect taxes are considered regressive with adverse impact, particularly on the poor?*
5. On the monetary policy front, we commend the policy framework of the Federal Reserve which is intended to be accommodative for a longer period. The flexible average inflation targeting framework provides scope for temporary overshooting when the inflation approaches 2 percent and could be effective in returning the economy to full employment. We agree that the benefits of the approach include accommodation over a longer horizon in response to adverse shocks and placing more weight on inflation expectations. Inflation is expected to increase to above two percent by end-2022 and in case of steeper rise in inflation, the authorities have committed to act promptly. The size of the fiscal and monetary measures also weighs heavily on managing the transition wherein the monetary policy will continue to provide required support while preparing for the eventual withdrawal of monetary accommodation. The adverse fallout of this on the financial conditions, market pricing and spillover on the global capital flows needs careful consideration and deft management.

6. The treasury and money markets were subject to enormous stress due to shifting of assets, liquidation of reserve assets by foreign official institutions and drawing down of credit lines by non-financial corporates at the time of onset of the pandemic. The banking system has remained resilient given its sound capital distribution, profitability, and credit quality. Though the prospects of widespread corporate

failures have diminished, risk due to hedge fund leverages, exposure of nonbank financial institutions and credit risks in the commercial real estate sector have increased. *Could the staff comment on the measures taken or envisaged to mitigate the risks arising from rise in hedge fund leverage?*

7. In the external sector, the current account deficit is expected to rise driven by a sizable increase in the fiscal deficit. We agree with the staff that there is a need to address the longstanding global trade and investment distortions in areas such as tariffs, service trade, farm subsidies and industrial subsidies by engaging with the concerned stakeholders. We take note of the administration's focus on ensuring a fair international trading system based on inclusivity, sustainability and rules-based international order and recognize the commitment in executing the domestic priorities consistent with the existing international obligations.

8. In managing the multiple transitions facing the country, we strongly welcome the authorities' commitment to use the current opportunity for 'building back better'. The pandemic has created lasting shifts in consumer preference along with transitions due to climate change, demographic changes, and digitalization. We appreciate the focus of the authorities in addressing the old economy's structural weaknesses, inequalities, and long-standing disparities in social and economic outcomes. In this regard, we believe that the innovativeness and flexibility of the US system will facilitate this transition towards a greener, more productive, and more equitable economy and society.

9. We wish the people and the authorities of the U.S success in their endeavors.