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**Statement by Mr. Padoan on the United States  
(Preliminary)  
Executive Board Meeting  
July 23, 2004**

Staff should be commended for a very informative set of papers. We also thank Ms. Jacklin for her insightful BUFF statement.

**Sustained recovery in the US economy is good news for the global economy.**

The possibly larger than expected productivity performance further encourages optimism. The key questions for surveillance are the strength and sustainability of the recovery and the relevance and impact of the associated imbalances for the US and the rest of the world.

**The sustainability of US imbalances is a systemically relevant issue.**

The sustainability of imbalances for a systemically important country such as the US is, almost by definition, something that has to be addressed in a global context. **Such sustainability depends on the interaction of three factors: policy adjustment in the US, policy adjustment in other systemically important countries, market reactions.** If policy adjustment is insufficient in the US and in other systemically important countries, correction of imbalances will take place through market reactions. The issue has been raised already in the context of WEO and WMD discussions, as well as in discussions of other areas and countries.

**Views differ on the duration of market and policy-induced financing.**

As long as policy adjustment is incomplete in the US the major source of uncertainty is the financing of the current account deficit, which closely follows the federal budget deficit. Financing will continue to be provided by markets, to the extent that investment in the US remains attractive (and sustained productivity growth bodes well in this respect), and by policy actions to the extent that other countries are willing to accumulate dollar-denominated assets. This is self-evident but also only modestly informative. **For how long and to what extent will financing postpone adjustment? To what extent will reserve accumulation in Asia, to support pegging of currencies to the US dollar, continue without putting**

**unbearable strains on the Asian economies?** Views differ in this respect with some<sup>1</sup> arguing that such a configuration (i.e. both more market and more policy-induced financing of the US deficit) could well go on for more than a decade and others<sup>2</sup> being much less confident.

Past historical experiences can be of some, but not much, help as underlying conditions change. One respected view is that while the size of the US current account deficit is larger than in the past, financial markets have become more resilient and more flexible and are therefore able to sustain larger imbalances than in the past.

**But availability of financing should not be an excuse for postponing adjustment.**

Whatever the view on the sustainability of the current imbalances it would be a source of concern if the US administration were to take the view that, **because of the contribution coming from other countries and from markets to the financing of the US current account, there is no need for adjustment.** The longer-term dynamics highlight a debt sustainability problem that needs to be addressed. We welcome, in this respect, the shift in policy emphasis towards fiscal consolidation. Successful adjustment however remains a challenging task.

**Fiscal consolidation may be more demanding than in the past.**

The selected issue paper compares the current fiscal situation with the one prevailing in the fiscal cycle of the 1980's showing that while there are important parallels, differences indicate that the **adjustment could be much more demanding during the current cycle.** Fiscal consolidation in the previous cycle was based on a sharp contraction in military spending and an "unprecedented expansion". While the second condition might still in part be holding, especially if productivity gains remain sustained, the first is hardly conceivable given current trends and security concerns.

However high military spending in the past has also contributed to growth, both in terms of short-term demand support and longer-term contribution to productivity. Could this be the case in the present cycle? Staff comments would be welcome

**Monetary policy is commendable, but not so easy to rationalize.**

Monetary policy has served the US economy extremely well. Staff analysis shows that the Fed's policy can be interpreted in terms of a "regime dependent" Taylor's rule that assigns

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<sup>1</sup> M. Dooley, D. Folkerts-Landau, P. Garber, A Map to the Revised Bretton Woods End Game: Direct Investment, Rising Real Wages and the Absorption of Excess Labor in the Periphery, Deutsche Bank, June 2004.

<sup>2</sup> B. Eichengreen, Global Imbalances and the Lessons of Bretton Woods, NBER w.p. 10497, May 2004.

different weights to inflation and growth targets according to the phase of the cycle. It is an interesting rationalization. We wonder, however, **to what extent such a rationalization incorporates the role of expectations**, the impact on which seems to have taken a central role in the actions and in the communication strategy of the Federal Reserve. Staff comments would be welcome.

### **The benefits of (what once was) the “new economy” are not over?**

Total factor productivity increases, largely related to ICT, could be sustained confirming the general purpose nature of IC technologies. The useful chapter in the selected issues paper notes that the **benefits of such technologies are enhanced by the increase in competitive pressures, brought about by deregulation, although deregulation could have also led to some overinvestment**, the effects of which have by now possibly been absorbed. The chapter also offers an interesting sectoral disaggregation of industry contributions to aggregate TFP growth. In addition to trade, electronics, and industrial machinery, FIRE<sup>3</sup> ranks fourth (while being at the next-to-last position in the previous period in the industry contribution). This indicates the potential contribution of financial markets to productivity growth. However FIRE aggregates rather different factors. Is there any way to disentangle such effects so as to better identify the specific role of the financial sector? We believe this aspect has important implications for the surveillance of financial markets. Staff comments would be welcome.

### **The role of migration. Lessons for other mature economies and implications for surveillance.**

The chapter on domestic and global perspectives of migration to the United States is highly illustrative of the contribution of migrant workers to an open, mature economy as well as their effects on the rest of the world. On the positive side we note **the significant contribution to growth by migrant workers**, and such a contribution will be all the more important as population aging and shortage of highly-skilled workers are likely to increase their pressure. Other mature regions, including the EU, could greatly benefit from similar contributions.

The chapter also documents the contribution of migrants' remittances to a large set of developing countries. Indeed the amount of **workers' remittances has now reached such considerable levels that a systematic analysis of its development and consequences should be a key topic for Fund surveillance** beyond the impact on a single, even if systemically important, country.

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<sup>3</sup> Finance, Insurance, and Real Estate.