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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 18/60-2

10:50 a.m., June 29, 2018

**2. United States—2018 Article IV Consultation**

Documents: SM/18/159 and Correction 1; and Supplement 1

Staff: Chalk, WHD; Kaufman, SPR

Length: 1 hour, 44 minutes

## Executive Board Attendance

C. Lagarde, Chairman

| Executive Directors | Alternate Executive Directors |
|---|---|
| M. Mkwezalamba (AE) | |
| D. Sembene (AF) | |
| A. Armas (AG) | |
| H. Jang (AP) | |
| A. Tombini (BR) | |
| Z. Jin (CC) | |
| C. Hurtado (CE) | |
| N. Horsman (CO) | |
| | C. Just (EC) |
| H. de Villeroché (FF) | |
| S. Meyer (GR) | |
| | M. Roy (IN), Temporary |
| A. Leipold (IT) | |
| | Y. Saito (JA) |
| | M. Daïri (MD) |
| H. Beblawi (MI) | |
| A. De Lannoy (NE) | |
| T. Ostros (NO) | |
| A. Mozhin (RU) | |
| H. Alogeel (SA) | |
| J. Agung (ST) | |
| | P. Inderbinen (SZ) |
| S. Riach (UK) | |
| M. Claver-Carone (US) | |

J. Lin, Secretary
O. Vongthieres, Summing Up Officer
V. Sola, Board Operations Officer
M. McKenzie, Verbatim Reporting Officer

**Also Present**
Communications Department: R. Elnagar, A. Ranck. Legal Department: K. Kwak, N. Rendak. Monetary and Capital Markets Department: M. Savastano. Research Department: S. Hannan. Strategy, Policy, and Review Department: R. Green, M. Kaufman, E. Lundback, B. McDonald, N. Sheridan, M. Takebe, E. Van Heuvelen. Statistics Department: A. Chailloux. Western Hemisphere Department: Y. Abdih, P. Alonso-Gamo, N. Chalk,

E. Kopp, D. Leigh, A. Werner Wainfeld, P. Williams. Alternate Executive Director: A. McKiernan (CO), P. Sun (CC). Senior Advisors to Executive Directors: M. Alle (AF), A. Del Cid-Bonilla (CE), P. Pollard (US), S. Potapov (RU), G. Preston (AP). Advisors to Executive Directors: P. Al-Riffai (MI), L. Cerami (IT), D. Crane (US), K. Florestal (BR), J. Garang (AE), T. Hemingway (UK), M. Ismail (AE), M. Merhi (MI), G. Nadali (MD), A. Nainda (AE), A. Park (AP), M. Svenstrup (US), S. Vitvitsky (US), J. Montero (CE).

## 2. UNITED STATES—2018 ARTICLE IV CONSULTATION

Mr. Claver-Carone and Mr. Vitvitsky submitted the following statement:

The U.S. economy is on an improved growth trajectory, supported by tax reform, deregulation, and a pro-growth economic policy agenda that will raise U.S. productivity and strengthen labor force participation. Year-to-date economic indicators point to an economy that will expand by around 3.0 percent this year. Job growth has averaged approximately 200,000 per month over the first half of this year. Unemployment has continued to decline and, at 3.8 percent in May, is the lowest since 1969. Business investment has accelerated notably since late 2016, with year-over-year growth rising steadily over six consecutive quarters. Consumer sentiment remains buoyant and inflation has firmed, gradually climbing to levels at or near the Federal Reserve's target. In this context, we agree with Fund's staff view that "the near-term outlook for the U.S. economy is one of strong growth and job creation."

However, we significantly disagree with the IMF's real GDP growth projections in 2020 and beyond, its potential GDP estimates, and its long-term fiscal projections. We believe that staff understate the positive longer-term impact of tax reform and deregulation. The tax reform's lower corporate tax rate, temporary new investment expensing provisions, and deductions for pass-through businesses will boost business investment and, along with other changes, catalyze more efficient capital allocation. Regulatory relief and other pro-growth initiatives will improve the business climate. Additionally, the Administration plans to reduce nondefense discretionary (NDD) spending over time that, together with a growing economy, will put the nation on a sounder fiscal path and reduce public debt as a share of GDP. Altogether, the Administration's economic policies will spur greater investment in facilities and workers, boost productivity and wage growth, and draw more workers into the labor force. These deeper structural reforms will lift the U.S. economy to a higher sustained growth path.

That said, we welcome Fund staff's independent and candid views on the U.S. economy.

Economic Projections: Our authorities expect real GDP growth to be 3.1 percent in 2018, remaining slightly above 3.0 percent through 2020. Although the IMF's projections for 2018 and 2019 (2.9 and 2.7 percent) are slightly lower than ours, we broadly agree with Fund staff views on the near-term economic outlook.

Fund staff project much lower growth from 2020 onwards, in large part due to the temporary nature of some of the tax provisions. We believe that the Fund's model underestimates the longer-term growth effect of the new tax law by focusing on its fiscal mechanics rather than the structural change. According to staff, the key features of the bill are "fiscal stimulus" in the early years followed by "fiscal tightening" in later years.

This approach misses the purpose of the tax reform, which is to promote structural changes that boost economic growth. The effect of tax cuts, temporary full expensing provisions, and regulatory relief comes from businesses responding to the policy changes. The tax cuts and temporary full expensing provision will incentivize large-scale capital investment, which will boost the quantity and quality of the overall capital stock. The Administration's infrastructure investment plans will also substantially improve the capital stock over time. Finally, the Administration's deregulation agenda—aimed at increasing dynamism in the community banking sector, the energy sector, and labor markets—will interact with higher quality human and physical capital to lead to a sustained increase in productivity growth.

Lowering the corporate tax rate also provides incentives for managers to focus more on creating profitable businesses, deepening the private capital stock, and investing in their work forces. The new law also provides smaller pass-through businesses with up to a 20 percent tax deduction, helping them compete with big companies and enhancing their ability to hire and train workers new to their industry. Altogether, these changes will raise productivity growth and strengthen labor force participation, counter the effect of demographic changes, and enhance human capital.

Fiscal Policy: Anchored by tax reform, our fiscal policy strategy supports growth and is oriented to address medium-term challenges. The Administration's budget priorities also aim to better control federal spending, particularly NDD expenditures, while allocating greater federal outlays for defense and supporting greater infrastructure spending. The December 2017 comprehensive personal and corporate tax reform was the most significant reform since 1986. Core elements of the tax plan include the following:

A reduction in the U.S. corporate tax rate from 35 percent to 21 percent. For many years, the United States had the highest corporate tax rate among major economies, which discouraged investment in the United States. The 21 percent rate is slightly below the OECD average and is not a "race to the bottom." Instead, since the new rate is accompanied by tax reform and changes in international tax provisions, it could stimulate a race to better policies globally.

The alignment of the U.S. international tax system with the territorial systems of most U.S. trading partners and implementation of many recommendations from the G-20/ OECD BEPS project, consistent with the theme of combating stateless income.

Imposition of a U.S. tax on low-taxed excess earnings of controlled foreign corporations of U.S. parented groups on which U.S. tax was previously deferred, as well as limitation of base erosion via interest and other deductible payments, both of which are consistent with BEPS goals.

Simplification of the personal tax system and temporarily lowering marginal tax rates across all income levels, with the largest benefits for the middle class. The bill also reforms the burdensome Alternative Minimum Tax, almost doubles the standard deduction, and bolsters the child credit system to support working families.

The FY 2019 Budget projects a deficit of 4.7 percent of GDP in FY 2019, a moderate increase from the estimated 4.2 percent of GDP for FY 2018. Over the ten-year budget window, the Administration's proposals aim to reduce NDD spending by over 40 percent in real terms, and restrain spending in mandatory programs, including by reforming health care. We recognize these objectives will require considerable effort.

Additionally, the Administration's infrastructure plan adds $200 billion in federal spending over FY 2019-2028, aimed at generating $1.5 trillion in overall public and private investment. Of the $200 billion in the infrastructure initiative, $100 billion will create an Incentives Program that matches states/localities up to 20 percent for new dedicated revenue streams for qualified infrastructure investments. These measures will improve the U.S. overall capital stock and thereby boost potential growth. Higher growth will fuel higher government revenues, which, coupled with a decline in NDD spending, will put the headline deficit on a downward path as a percent of GDP.

Monetary Policy: The Federal Reserve continues to make progress toward its goal of maximum employment and price stability. The labor market has continued to strengthen, with the unemployment rate falling to 3.8 percent in May from 4.3 percent a year earlier. Job gains have been strong in recent months, while wage growth has moderately increased. Broad measures of labor market slack have also fallen, though the degree of slack remains somewhat inconclusive.

Inflation has moved up from a year ago, with personal-consumption expenditure inflation close to the Federal Open Market Committee's (FOMC) target of 2.0 percent. The FOMC judges that the economy will continue to expand at a moderate pace over the medium-term and that labor market conditions will remain strong. Inflation is expected to run near the FOMC's 2.0 percent objective over the medium-term, and risks to the economic outlook appear balanced.

The FOMC expects that improving economic conditions will warrant further gradual federal funds rate increases to sustain a healthy labor market and stabilize inflation around its target. According to the FOMC, the stance of policy remains accommodative. At the same time, the FOMC has repeatedly stated that the monetary policy path is not on a preset course and will remain data dependent. The FOMC remains committed to clear policy communication.

Furthermore, the FOMC began implementing a balance sheet normalization program last fall. The approach has been well-communicated and has been implemented in a regular and predictable manner. The balance sheet is not intended to be an active tool for monetary policy in normal times, while the FOMC is prepared to adjust the details of its approach to policy normalization considering economic and financial developments.

Financial Regulation

The President recently signed the Economic Growth, Regulatory Relief, and Consumer Protection Act. This legislation modernizes and recalibrates financial regulation to help banks, particularly community and regional banks, more efficiently and effectively allocate capital to businesses and consumers. This bill strikes the appropriate balance between addressing risks to the financial system and facilitating economic growth.

More broadly, we believe that the U.S. financial system is on strong footing, with moderate financial stability risks. Most large U.S. banks remain well-capitalized and highly liquid, and reliance on short-term wholesale funding has continued to decline. Higher valuation pressure across a range of asset markets has not been accompanied by increased leverage in the financial sector. Recent financial market volatility has not materially impacted financial sector soundness, and large financial institutions are well positioned to absorb further financial market stress should it materialize.

Trade/External Sector

The United States has one of the most open trade policy regimes and economies in the world. We seek to promote fair and reciprocal trade, and to press for a level playing field for U.S. firms. Importantly, the Administration believes that all countries should remove barriers to trade.

However, the Administration has clearly articulated that the United States will no longer accept being in a position in which the unfair practices of our trading partners harm U.S. firms and workers. To that end, policies are intended to address circumstances where injurious market distortions have occurred; where critical U.S. national security concerns are relevant; or where the playing field for U.S. firms and workers is otherwise not level.

The Administration's trade policy agenda seeks to address serious, long-term challenges that have been facing the multilateral trading system. We strongly disagree with Fund staff's assessment that our recent trade measures would move the globe further from an open, fair, and rules-based trade system. Instead, the Administration's trade policies seek to move the global economy closer to a free, fair, and reciprocal trading system.

Competition Policy

We note Fund staff's focus on competition issues and policy in the United States, which we believe deserve academic attention by the relevant experts At the same time, we disagree with staff's approach to the topic and their conclusions. Evidence pointing to a broad trend in increased market power is inconclusive. We note that this is a developing literature, and not all researchers have found the markups to be trending upward. Further, analysis on higher estimated markups does not necessarily provide a reliable measure of market power. A higher estimated markup also could be the result of costs being driven down, with some portion of the marginal cost savings passed through to consumers.

Moreover, the relationship between higher markups and competition policy is unclear, making it difficult to define any policy implications, including staff's recommended tax scheme. We do not see a strong economic argument for imposing a tax that could discourage firms from lowering their costs to their own benefit and that of their customers.

Mr. Tombini and Mr. Saraiva submitted the following statement:

We thank staff for the candid report, which covers a broad array of important issues, and Mr. Claver-Carone and Mr. Vitvitsky for an informative and forceful statement. Amid low unemployment and well-behaved inflation, growth has been robust and the near-term outlook for the U.S. economy remains positive. The strong overall performance, supported by the tax reform and favorable financial conditions, has been instrumental to boost global activity, but risks over the medium term seem higher. The expansionary fiscal stance at the current stage of the economic cycle increases risks of overheating in the medium term. Consequent overreliance on monetary policy would have potentially large and widespread global impacts. We take note of the authorities' more sanguine view on the impact of tax reform and deregulation on potential output, which would avert many of the risks mentioned by staff.

As the largest globally systemic economy, developments in the U.S. feed into important spillovers for the rest of the world. One of the most relevant features of the current global juncture is the ongoing monetary policy normalization by the Fed, and the ensuing tightening of international financial conditions. Recent episodes of volatility show that, even when well-communicated and mostly anticipated, moves by the U.S. monetary authority are prone to reverberate globally. Given the sizeable fiscal stimulus, staff argues that the Fed will need to raise policy rates at a faster pace, a policy response that has not been priced by markets. Could staff elaborate more on the impact of such course of action on global financial conditions? Also, taking into account that the normalization of monetary conditions includes the shrinking of the Fed's balance sheet, we missed a more specific analysis on possible effects from the latter. Staff's comments are welcome.

Staff growth forecasts do not seem overly conservative, while the authorities' broad assumptions and growth prospects in the medium term lie more on the optimistic side. Staff considers that ongoing policies and reforms would have modest effects on potential output, while the fiscal stimulus would considerably worsen an already unfavorable trajectory for the public debt. The authorities see potential output being bolstered by an investment-friendly environment, with higher growth supporting fiscal consolidation, underpinned by measures to significantly reduce federal outlays and compensate for lost revenue from last year's tax overhaul. While agreeing that significant savings could come from increasing overall efficiency at the federal government level, the planned 44 percent real reduction in discretionary nondefense spending in a ten-year horizon seems challenging.

A key source of divergence between staff and the authorities relates to the different assessments of the expected net effects from the Tax Cuts and Jobs Act (TCJA). While conceding that the TCJA contains many positive features, staff considers that most of the objectives could be more efficiently achieved through other measures, with better equity and revenue results. Although sympathetic to staff's reasoning, we wonder if the alternative menu presented could overcome typical political economy constraints, which have hampered major changes in the U.S. tax framework for decades. While the jury is still out for a more thorough assessment of TCJA's costs and benefits, enacting such a complex piece of legislation is indeed a historical accomplishment. Taking into account that the TCJA is a reality, we would call for a continued and close monitoring by the Fund of both its domestic impacts and external spillovers.

Streamlining financial regulation is a legitimate goal, which nevertheless must be well communicated to avoid sending wrong messages. A carefully crafted communication should clearly show that recent regulatory simplification does not backtrack on the revamping that took place after the global financial crisis. Staff positive appraisal of the ongoing recalibration and simplification of financial regulation gives comfort. However, a more holistic assessment of the measures and their interaction is still warranted. Staff considers that near-term financial stability risks remain relatively subdued, but medium-term risks are regarded as elevated and should be closely monitored. Among other factors, risks would reflect stretched equity market valuations, weakening of underwriting standards, and increased role of procyclical passively managed financial products. The banking system is assessed as resilient and authorities consider that risks from nontraditional institutions—such as asset managers and the insurance sector—remain moderate.

We appreciated staff's candid analysis on outward spillovers of U.S. policies and expect similar exercises to be ever more present in Article IV reports of systemic economies. If history provides good guidance, a significant tightening of global financial conditions will become a high impact event—especially to countries with high levels of foreign currency debt and gross rollover needs. We are already seeing negative spillover effects in some economies, even though the pace of tightening so far has been highly anticipated by market participants. It is fair to think that a faster and possibly not anticipated pace of monetary policy normalization could bring more pronounced impacts.

Finally, we concur with staff's call for all relevant partners to constructively engage in resolving trade and investment disagreements without resorting to unilaterally imposed barriers. Sound economic theory and overwhelming evidence show the immense benefits brought by increasing global trade in the last decades. The U.S. has historically played a pivotal role on this process. Even if distortions are present in some cases and more needs to be done to mitigate negative effects of globalization on specific segments of the population, we should continue to pursue an open, fair, and rules-based international trade system. Unilateral trade measures that have been announced by the U.S. risk generating an escalation of tit-for-tat reactions, which would leave everyone worse-off.

Mr. De Lannoy and Mr. Josic submitted the following statement:

We thank staff for their detailed report and Messrs. Claver-Carone and Vitvitsky for their useful buff statement. We broadly concur with staff's policy recommendations, and have the following comments, particularly on the importance of staff's critical assessment of the U.S. trade policy.

As staff notes, the U.S. is experiencing its longest post-war expansion and unemployment is at its lowest level since the 1960's. The near term outlook is benign with strong growth, while inflation is estimated not to significantly overshoot the 2 percent target under the baseline scenario. However, we also concur with staff that policy uncertainty has increased, and that pro-cyclical policies, which have boosted near-term prospects, are creating vulnerabilities and have clearly increased the risks of spillovers in the medium-term.

The unfavorable debt trajectory affects the ability to respond to future shocks. Staff rightly points out that there is clear evidence that the U.S. economy is at full capacity. With that in mind, the pro-cyclical fiscal policy is not welcome at the current stage of the business cycle, especially when current debt-dynamics are estimated to be unsustainable in the long run. We therefore agree with staff that this could elevate risks in the medium-term. Such pro-cyclical fiscal stance has further increased the size of fiscal consolidation needed to put the debt-to-GDP ratio on a downward trajectory.

We share staff's view that the monetary policy stance is appropriate and well communicated. However, the authorities should be cautious about the possible faster-than-expected rise in inflation and a faster tightening of the monetary cycle in the U.S. due to the ongoing expansionary fiscal policy. If materialized, this could not only increase the risks and vulnerabilities in the domestic economy, but also precipitate a marked reversal of capital flows in some regions. Does staff perceive the Phillips curve coefficient to remain relatively low despite a pro-cyclical policy in times of a positive output-gap, or have inflation expectations become anchored in a way that surprises are unlikely?

On the external sector, we take note that the U.S. external position in 2017 was moderately weaker than implied by the medium-term fundamentals and desirable policies, leading to a moderately overvalued exchange rate. However, the EBA estimated cyclically-adjusted current account gap has increased from -1.0 percent of GDP in 2016 to -1.5 percent of GDP in 2017, mostly due to increase in unidentified residual. Can staff clarify this?

Staff correctly underlined the negative consequences of protectionist policies, and rightly underscored the need for the U.S. to work constructively with its trading partners to mutually reduce the remaining trade barriers and to resolve trade and investment disagreements without resorting to tariff and non-tariff barriers. Protectionist policies such as those recently enacted by the current U.S. administration undermine global confidence and could end up as a negative supply shock, both in the U.S. and its trade partners. We therefore strongly agree with staff that the goal should be to strengthen the rules-based, multilateral trading system. In this vein, we welcome the authorities' views, as emphasized in Messrs. Claver-Carone and Vitvitsky's buff statement, that they seek to promote a free and fair trading system. Finally, we are interested to learn more about the findings of the U.S. administration's study regarding the causes underpinning the U.S. trade deficit (page 24), which according to staff has been completed by the U.S. authorities but has not been made public. Staff's comments are welcome.

Decreasing labor productivity and income inequality should be addressed to increase the potential output as envisaged by the authorities. As was recently pointed out in the IMF's World Economic Outlook, the U.S. stands out with particularly deep decreases in labor participation for both women and men in the prime-age, which is strongly associated with longer-lasting harm from technological progress. In order to counteract these forces as well as the long-term challenges of aging, the authorities are encouraged to create such labor market policies that would improve the job-matching process and help workers balance family and work life. Lastly, any tax reform should avoid further income divergence between those in the top and lower quintile. Does staff have any estimates of the neutral rate of unemployment in the U.S., considering that civilian employment-population ratio is currently 3 percentage points lower than in the pre-crises period, while the unemployment rate is surprisingly 0.6 percentage points lower?

Lastly, we agree with staff that adjustments in financial regulations should ensure that the post-crisis regulatory reform agenda and the current risk-based approach to regulation are preserved. In this vein, potential adjustments in the regulatory framework should only be focused on the reduction of complexity and possible regulatory uncertainty, not on a wide range deregulation. Adhering to full implementation of the 2015 FSAP recommendations would further improve the resilience of the financial system.

Ms. Horsman, Ms. McKiernan and Ms. Young submitted the following statement:

Solid growth, low unemployment, and well-contained inflation risk bode well for the U.S. economy in the near term, but these near-term dynamics potentially mask underlying imbalances in the economy that could undermine longer-term growth. Some of these challenges include unsustainable debt, low savings, weak productivity, rising income polarization, and unfavorable demographics. Poorly calibrated policy responses could trigger a sharp and costly adjustment in the medium term.

We thank Staff for a frank assessment of the U.S. economy and, in particular, for strong emphasis on spillovers. We also appreciate elaboration provided in the buff of Messrs. Claver-Carone and Vitvitsky. We generally agree with shared diagnoses between Staff and the authorities on the core concerns, but like Staff, we agree that some of the authorities' policy responses could be better optimized in the interest of the U.S. economy and its citizens, as well as its trading partners and the global economy.

Outlook

We broadly agree with Staff's baseline projection for growth. However, uncertainty pervades markets, both within the U.S. and globally, fueled to a large extent by escalating trade actions and, more generally, unpredictable policy responses. We question the assessment that it is a risk of 'medium' likelihood as per the risk matrix. Many countries, including the U.S., are already seeing negative economic impacts, including through discouraged or delayed business investment due to rising uncertainty and disruptions to efficient global supply chains. These impacts will only worsen if the situation continues and escalates.

We note that the authorities view tariffs as a step towards creating the leverage needed to achieve more free, fair, and reciprocal trade. We agree that excessive global imbalances are a legitimate concern, however, we disagree with the authorities' approach to tackling this issue, as we believe their chosen course of actions will be detrimental to the U.S. economy, its trading partners, and the global economy. Not only will such trade actions fail to address the root causes of global imbalances, they will in fact exacerbate them. A disorderly unwinding of chronic excessive global imbalances is in no one's interest.

Policy adjustments are warranted on the part of the U.S., but also on the part of many of its major trading partners. We commend Staff's work in this Article IV (and others) on a more rigorous, transparent, and consistent approach to assessing the root causes of excessive imbalances. We urge all members to candidly and urgently assess their own role and to ensure they are contributing to unwinding excessive global imbalances in an orderly manner to support stronger, more sustainable, and equitable growth for all. For their part, we urge the U.S. authorities to focus on actions to increase overall savings and strengthen export competitiveness, as recommended in the Staff Report.

Fiscal Policy

The authorities are running a potentially costly gamble with fiscal policy that is both procyclical and regressive. With potential growth estimated around 1 ¾ percent of GDP, we agree that critical investments are essential to unlocking higher growth, including through investments in productive infrastructure and human capital. In this regard, we commend the authorities' ambitious plans to leverage other sources of infrastructure capital. Could Staff comment on the realism of the authorities' expected leverage ratio (i.e., 7:1) and the extent to which such investment would be incremental? We share Staff's concerns that some fiscal measures are poorly targeted at the root causes of weak productivity and business investment, while growth multipliers are questionable, particularly at this stage in the economic cycle. This runs the risk of further increasing already unsustainable public debt, widening global imbalances, disrupting global capital flows, and fueling on-going trade tensions with limited impact on long-term growth. The absence of a credible medium-term plan to put public finances on a sustainable path further undermines the integrity of the fiscal path and has the potential to cause market disruptions.

Tax Policy

An overhaul of the U.S. tax system was no doubt long overdue. As set out in the Staff Report, the premise of reforms under the Tax Cut and Jobs Act (TCJA) seems reasonable, namely in lowering corporate income tax in line with peers, broadening the tax base, and reducing profit-shifting opportunities. That said, the report appropriately notes some important concerns regarding its execution: its structural and fiscal sustainability, its regressivity, and questions about the compliance of certain measures with multilateral standards.

The business investment response to reform is uncertain and worthy of attention. There is limited historical evidence upon which to base an assessment and, in any case, fundamental shifts in business organization, structure, and concentration over the past decade or so reduce the helpfulness of past cases. The inability to integrate impacts of the TCJA's international provisions—rightly so due to unsettled details or precedent—creates further uncertainty around the business response. We encourage continued work that explores business investment impacts in the U.S. and beyond its borders.

Profit shifting has undermined the U.S. tax system and the reform takes serious action in this area. More broadly, the international tax architecture will need to evolve with the changing nature of the digital economy. However, we think it would be unhelpful for the Fund to label the new structural international provisions within the TCJA as 'innovative' or 'ingenious'. While they have novel features, they also raise important questions about compliance with tax treaties, new BEPS standards, and trade rules. Unilateral and uncoordinated actions run the risk of introducing greater complexity and potentially conflicting with on-going efforts to address profit shifting in a coordinated way (most notably under OECD BEPS work), thus potentially exacerbating spillovers to the rest of the world. Greater nuancing that teases out the unique features (for example, overcoming challenges to the identification of intangibles by using the excess of a return on tangibles as a proxy) would make a more useful contribution to international dialogue, while stronger encouragement of the U.S. authorities to continue to engage collaboratively on sustainable tax solutions that are fair, transparent, and internationally consistent would be appropriate.

The potential for spillovers from the tax changes are significant but highly uncertain at this stage. We welcome the considerable empirical work by Staff in the context of this Article IV, where the complexities render even a domestic assessment challenging. Understanding implications for other jurisdictions is even more difficult. High level modelling of simplified versions of the reform can provide illustrative impacts. However, we think it is very important that the limitations of such models be openly acknowledged; the results should be explicitly caveated and presented in a way to avoid any sense that they are the Fund's considered prediction of what is likely to happen.

The Fund's role at this stage should be to continue monitoring macro developments both within the U.S. and in partner countries that substantiate (or refute) its preliminary hypotheses, while advocating for multilaterally consistent approaches that work for all. Premature predictions that others will respond by lowering corporate taxes (based on modeling of average historic reaction functions) can unduly undermine fiscal positions, particularly when the political economy may not support immediate offsets and growth impacts may be questionable, particularly at this stage in the global recovery.

Financial Sector Policy

It will be important to preserve gains in strengthening financial oversight, while undertaking steps to improve their efficiency, scope, and calibration. Given globally integrated financial markets, consistent implementation across all jurisdictions is needed to ensure the global financial system is resilient and fair to all. We encourage the authorities to analyze the effects of their reforms or refinements so that any unintended consequences can be identified and addressed in a coordinated manner. We underscore Staff's call on the authorities to remain engaged in developing the international financial regulatory architecture and to be fully committed to agreed international standards.

Further work may be warranted to better understand the macro financial linkages across various developments affecting the most vulnerable borrowers, including a deterioration in the quality of personal credit, chronic unemployment of prime-age males, and regressive tax measures and expenditure cuts to social programs that penalize the poorest.

Monetary Policy

Monetary policy provides an important anchor in an otherwise unpredictable policy environment. We agree that the Fed's continued adherence to the principles of data dependence and clear communication should guide the normalization path. This will be particularly important in light of potential surprises on the up- and downside and the consequent implications for spillovers. We take note of the potential (and in some cases, real) impact on capital flows in some emerging markets and stress the importance of bolstering buffers to weather potential volatility. Could Staff comment on the potential impact of escalating trade barriers on inflation?

Conclusion

The U.S. plays a central role in the global economy. As noted in the buff, it is one of the most open trade policy regimes and economies in the world. Its size and interconnectedness mean its own policies touch everyone. At the same time, the U.S. is not immune to policy actions in other countries. This underscores the importance of redoubling our efforts to work together to build on and improve multilateral systems to ensure that they work for all.

Mr. Meyer and Mr. Lieber submitted the following statement:

We thank Messrs. Claver-Carone and Vitvitsky for their concise buff statement and staff for the well-laid out report. We broadly concur with the staff appraisal. The U.S. economy experiences a very long period of expansion amidst good near-term prospects with strong growth and job creation. However, with unemployment at only 3.8 percent it appears to be beyond full employment. Prices have been rising steadily with core PCE inflation expected to be above two percent by mid-year. End of last year, broad-based tax cuts have been introduced in the U.S. as a stimulus program. Against this backdrop, the risk of overheating is imminent.

We strongly support staff's concern about the mid- and long-term impact of a pro-cyclical fiscal policy. As staff points out, an expansionary fiscal policy is not advisable at this stage of the business cycle. All the more, we caution, in line with staff, against accelerating the already unsustainable upward dynamic in the public debt-to-GDP ratio. Tax cuts and growing discretionary spending add to the fiscal pressures induced by population aging. Stress tests conducted by staff help shed light on the risks to the public debt dynamics. Staff's external sector assessment also highlights the contribution of U.S. fiscal policies to global imbalances. The report notes that a general government primary surplus of about 1¼ percent of GDP (compared to a projected deficit of 3 percent in 2018) will be necessary to put the debt-to-GDP ratio on a downward path, which would also result in a lower current account deficit.

The Federal Reserve has continued the carefully managed and well-communicated process of monetary policy normalization. In order to further strengthen communicational efforts, the Fed very recently announced to conduct more frequent press conferences. We share staff's view that monetary policy is set to face challenges in times of excessive fiscal stimulus and strong growth. We agree that the Fed's data-dependent approach should be continued. However, we would be more cautious in advising the Fed to deliberately accept a (modest) overshooting of the inflation target.

An open, fair and rules-based international trade system has proven to offer important gains to all countries and contributes to global economic growth. Complex international and regional supply chains have developed and, among others, U.S. multinational companies benefit from this. We appreciate staff's direct and clear elaboration on the global risks of catalyzing a cycle of retaliatory trade responses and expanding the circumstances under which import restrictions are applied.

Ongoing policy uncertainties imply unusually large risks to U.S. and international economic developments. We feel that staff could have gone further in mentioning strategies of deliberate unclear or aggressive communication of and disruptive approaches to economic policies as a more general risk to the world economy. Financial market volatility and questions or risks around legal certainty can, among others, influence (domestic and international) investment decisions and disturb long-term sustainable growth.

We acknowledge staff's elaboration on rebuilding fiscal space and on strategies for a sustained and balanced medium-term fiscal consolidation. Among other points, the U.S. has comparably high health care costs. While reforming the health care system is continuously subject to political controversy, bipartisan efforts to put it on a sustainable but also affordable path would be helpful. Moreover, we echo staff's call to strengthen indirect taxation, but do not share the recommendation to move the U.S. business tax to a cashflow tax, as this is a theoretical concept which has never proven its suitability in practice and may create new tax loopholes. Also, the cashflow tax has a similar tax base as indirect taxation, which is why we think it is warranted to focus on strengthening the latter.

Increasing potential growth is one key factor for sustainable economic developments in the U.S. We recognize the valuable list of recommendations around macro-structural policies that staff has laid out in this context. Many of these suggestions go hand in hand with mitigating the downsides to U.S. workers affected by globalization or technological progress and encompass training and social assistance. Improving education from an early age on, tackling funding challenges for college education and expanding vocational programs and apprenticeships for workers are important steps in a society that faces structural shifts in labor demand and aims to regain competitiveness. In addition, a skills-based immigration system, as proposed by the staff, would facilitate labor force participation and compensate for aging demographics. Recommendations by staff around strengthening health care coverage and family benefits could contribute to higher living standards for low- and middle-income households. However, raising the minimum wage should be done with care to avoid obstructing the job market. As staff has elaborated in this and—in more detail—in previous reports, more steps could be taken to tackle poverty and income inequality. In this regard, staff rightly cautions against risks of further income polarization likely to result, in the mid- and long-term, from the recent changes to the personal income tax.

We also agree with staff that strong short-term incentives for business investments introduced with pro-cyclical policies could imply distortions to investment decisions. Focusing on short-term oriented investment opportunities is likely to increase risks and add to search for yield, but not necessarily to potential growth. In this context, staff might also elaborate further on the linkages between recent initiatives to lower environmental standards in the U.S. and long-term sustainable investments—among others in light of recent strong capital formation in the energy sector.

We agree with staff that the U.S. has been strengthening its financial oversight structure since the global financial crisis. We acknowledge the increased stability of the U.S. banking sector achieved through enhanced capital and liquidity requirements as well as improved risk management practices. Tailoring certain regulatory requirements, in particular for small banks, can be reasonable. However, we underline the importance of maintaining a robust financial regulatory regime. We concur with staff that care should be taken that recently initiated regulatory tailoring does not deviate materially from international standards. In this context, we strongly agree with the staff's reasoning that potential interactions between various regulatory changes and pro-cyclical impacts need to be analyzed further.

We caution against a potentially less stringent or efficient supervisory culture. Rhetoric can be misleading as rightsizing of regulation as well as tailoring on the one side and deregulation on the other side are very different approaches. In this respect, we appreciate the staff's recommendation to strengthen the FSOC in its efforts to identify risks and respond to financial stability threats. In addition, in light of recent political discussions about the regulatory framework, focusing on a consistent long-term strategy is a suitable way forward. In this context, simplifying the institutional structure in the

U.S. regulatory landscape and implementing a distinct division of tasks could strengthen oversight further while decreasing regulatory burden in a reasonable way.

Mr. Gokarn and Mrs. Roy submitted the following statement:

We thank staff for the informative Article IV report and Messrs. Claver-Carone and Vitvitsky for their candid buff statement.

We note and agree with staff's overall positive assessment of the current status of the US economy. At the present juncture, growth is expected to improve further in the near term, unemployment is at its lowest level since the late 1960s and inflation is expected to soon rise above the target level. However, the government is pursuing a pro-cyclical fiscal policy which is expected to double the deficit as a percentage of GDP in 2019 from its level in 2015 as also raise the debt to 90 percent of GDP by 2024 with deleterious effects on growth. CBO projects that debt will grow to 96 percent of GDP by 2028 and further to a record 152 percent by 2048, although the precise magnitudes are highly uncertain. Also, the current account deficit is projected to increase to around 3.5 percent of GDP by 2019-20, due to higher import growth resulting from the fiscal boost to demand in the US. Further, the higher US current account deficit is expected to increase global imbalances with the various attendant risks such as a sudden exchange market disruption in future and increased public support for protectionism. After the extraordinarily low volatility that prevailed in global markets in 2017, we witnessed a sharp spike in volatility in early February this year which could be repeated going ahead if global imbalances continue to climb with adverse consequences for overall exchange market stability. What policy measures does the administration envisage to reduce the current account deficit?

The inflation rate is expected to increase at a faster pace primarily following the pro-cyclical fiscal policy and expected increase in unit labor costs. While the US Fed has been raising the policy rate gradually, it is likely to quicken the pace if inflation overshoots, to achieve its dual mandate. In executing its monetary policy decisions, the Fed's continued adherence to the principles of data dependence and clear communication will be vital. This is also critical for avoiding international spillovers from reversal of capital flows to EMDCs. We have already seen that owing to the current level of US monetary policy normalization, capital flows to EMDCs have exhibited an overall deceleration which has affected some countries adversely. In case of further intensification, it may lead to wider distress. What is the likelihood of an increase in the pace of the monetary policy rate hikes relative to that currently envisaged?

While the US has maintained a very open trade regime, there has been public concern that the open trade has resulted in loss of employment and output in the US. Various steps have been taken by the administration to impose new tariffs or otherwise restrict imports into the US. These measures could reverse the open global trade system, with adverse effects for both the US economy and for its trading partners through trade barriers, interrupting global and regional supply chains and impacting EMDCs through increased financial market or commodity price volatility associated with these trade actions, as mentioned in the staff report. If trade barriers do intensify, then the volume and value of trade will be affected and thus there will be a direct impact on the jobs and incomes in the countries involved as trade routes shift and production is re-located to avoid the incidence of tariffs. These trade-related disruptions, coupled with the impact of monetary policy normalization mentioned above, could amplify global vulnerabilities. While discussions with US' trading partners could yield valuable gains for all and avoid the disruptions, it is also necessary to create specific safety nets for the trade-affected population in the respective economies. Have the authorities envisaged specific policies for ameliorating labor market and the income distribution issues arising from trade?

While the financial system looks healthy, there are rising vulnerabilities in some areas. We would like to emphasize that the important gains made in strengthening the financial oversight structure since the global financial crisis should be preserved. The recent measures to recalibrate and simplify financial regulations increase risks for financial stability. We agree that consideration should be given to continuing to apply stress-tests at a regular frequency for those banks that have assets between US$100-250 billion and that deregulation should not weaken the ability of supervisors to take early remediation and risk mitigation actions for BHCs with assets below US$250 billion. We also agree that medium-term financial vulnerabilities have been steadily building and medium-term financial stability risks are elevated as is evident from the weakening in auto, credit card, agricultural and student loans and looser underwriting standards for corporate credit, in the presence of a recent buoyancy in the banking sector profits. In the current bullish scenario with expensive global assets, strong US business confidence, low unemployment, and a big fiscal stimulus, bankers should not take on too much risk, thereby increasing the likelihood of an uptick in non-performing assets and escalating financial stability risks going ahead. US financial stocks are already seeing a sharp sell-off for the year as investors grow more uneasy about the outlook for big banks. Staff comments on the adequacy of safeguards against a risky credit boom are welcome.

While there does not appear to be much common ground between the views of the staff and authorities regarding competition policy, it is evident that the big corporates are getting bigger with both organic and inorganic growth and monopoly power is increasing, especially in the tech sector. While tech companies render some useful services to members, the unfettered monopoly power of some tech companies is giving rise to data markets with questionable practices, with implications for privacy and national and international security concerns. In addition to the current goal of antitrust policy to promote business efficiency, it should focus more on the original goal of antitrust policy predicated on the welfare of citizens, whose personal data is being exploited in exchange of "free" products and services by some tech companies. It is encouraging that the Federal Trade Commission is planning hearings on competition and consumer protection, which could take care of some of the emerging concerns. Judicious regulation of the huge platform technology companies may be necessary to rein in the potential abuse of their monopolistic dominance, analogous to the problems which arose from the regulation-lite treatment of the activities of the largest financial institutions in the pre-crisis period. Staff comments on this issue are welcome.

Mr. Hurtado and Ms. Arevalo Arroyo submitted the following statement:

We thank staff for the report and Messrs. Claver-Carone and Vitvitsky for their informative buff statement. We broadly agree with staff's analysis of the American economy and will present some comments for emphasis.

As stated in past discussions, we still hold the view that it is difficult to claim that there is fiscal space in the U.S. economy. We consider that the level of public debt-to-GDP, the current and increasing size of the fiscal deficit and the potential impacts of tax cuts warrant a stronger fiscal consolidation path than the one planned to start in 2020. We note the difference of views regarding growth projections and believe the authorities' fiscal consolidation plan might be on the optimistic side. Moreover, the authorities seem to believe that the fiscal measures will pay for themselves—that the ratio of debt-to-GDP will actually decline because of them. Is that assumption correct? The table in page 16 shows projections by the IMF and the CBO. Could staff provide a similar table including the corresponding projections by the Treasury Department?

While we concur that the U.S. Tax Code had room for improvement and that the Tax and Cuts and Jobs Act will have positive short-term impact on growth, we agree with staff that it is at a high budgetary cost. However, we note that the upper deciles of the income distribution will be the most benefited from the personal income tax and that these changes will increase income polarization.

The Federal Reserve should continue to have data-driven monetary policy decisions, with increased clarity in communications in the event a faster tightening pace is warranted.

Infrastructure investment should be adequately targeted to socially beneficial projects.

We wonder to what extent the US$200 bn in direct federal funding will catalyze US$1.5 trillion in spending by state, local and private sector. Staff comments are welcome on the ways in which private investment is planned to be attracted.

We strongly agree that the global economy benefits from an open, fair and rules-based international trade system. We agree with staff that the U.S. and its trading partners should work constructively towards resolving trade disagreements without resorting to distortive policies. In this regard, we note staff´s analysis on Box 6 that underscores the potential benefits to all three countries of a successful renegotiation of NAFTA. Can staff expand on the assumptions and mechanisms behind the calculations of the impact of a successful NAFTA negotiation on Mexico and Canada?

As pointed out in the report, the U.S. current account deficit is likely to increase significantly. On the other hand, corresponding surpluses will likely come from Germany, Canada, China and Japan, as noted. Nevertheless, we would like to suggest that, given the internal imbalances of the US economy, the current account deficit would persist even if those economies reduced their own imbalances. Staff comments are welcome.

Implementation of the post-GFC financial regulation has contributed to strengthening the U.S. Financial System. While we agree there is to some extent room for refinement and simplification, we encourage authorities to complete the international reform agenda. We agree with staff that the interaction of the proposed changes causes concern considering that medium-term financial vulnerabilities are building up and that risks remain on the upside. As in the past, we wonder why financial sector deregulation is not considered in the RAM. We also agree that oversight of non-banks should be strengthened. Staff comments are welcome regarding actions to strengthen oversight related to fintech and cyber risk.

We note, that there are still several recommendations from the 2015 FSAP that continue to be unaddressed. We observe the partial implementation of the recommendations on limited information collection and sharing, as well as the lack of progress on a comprehensive housing finance reform. Staff comments are welcome on the authorities' proposed plans for privatization of 'Fannie Mae' and 'Freddie Mac.'

We very much welcome staff's analysis of market power in the US economy and look forward to more consideration of this topic in Fund Surveillance. Staff analysis, in line with our views, suggests there is increasing evidence that market power has been growing in the last decades across many economies. However, we would caution against drawing strong implications, because it is based on a sample of US publicly-traded firms, which is probably not representative of the whole population of US firms. Could staff provide more details regarding the representativeness of the US sample?

Mr. Agung, Mr. Machmud and Ms. Ong submitted the following statement:

We thank staff for a candid and well-written report, and Messrs. Claver-Carone and Vitvitsky for their informative buff statement. The US economy is at a favourable point in the cycle. Growth is strong, unemployment is low, inflation is rising toward target and financial markets are buoyant. With these positive underpinnings, the macroeconomic policy mix should be geared toward enhancing sustainability, building resilience and promoting inclusive growth. We note the divergence of views between staff and the authorities on the medium-term impact of policies effected since the last Article IV consultation. Overall, we support the staff appraisal and particularly appreciate the thorough discussion of cross-border spillovers from domestic policies. The following comments are for emphasis.

The fiscal strategy should balance cyclical considerations and structural spending needs. With the economy beyond full employment, an expansionary fiscal stance may be counterproductive. A credible medium-term consolidation plan should enhance debt sustainability while creating fiscal headroom for macro-structural reforms to address, inter alia, weak productivity growth, income inequality and demographic challenges. We note however staff's assessment that the administration's announced fiscal plans will not durably raise potential output but will substantially aggravate the federal deficit and debt. We are concerned about the potential widening of external imbalances that this approach may yield.

Tax reforms are likely to have far-reaching effects, both domestically and internationally, that bear close monitoring. We thank staff for their efforts in analyzing the extensive changes effected by the Tax Cuts and Jobs Act (TCJA). We agree that the TCJA has many positive features that could make the US tax framework simpler and more competitive. However, like staff, we are concerned about the domestic distributional consequences of the tax reform—particularly given the extensive discussion in last year's Article IV about rising income polarization and high poverty rates in the US. We encourage the authorities to continue to explore ways to enhance the progressivity of the tax system. Have staff explored how the tax reforms will affect state finances? Could staff also discuss whether there would be fiscal costs associated with making permanent the full expensing provision for business investment? We appreciate that the international implications of tax reform will depend on the responses of corporates and policymakers alike. We call on staff to continue monitoring potential spillovers and encourage the authorities to continue to engage actively with international counterparts, both bilaterally and through international fora. We continue to think that the impact of the tax reforms on financial markets, especially currency markets, bears close watching. Staff have made several useful suggestions for ways to enhance the effectiveness of the TCJA in stimulating investment, reducing inequality and countering tax competition and profit shifting within an international context. In staff's view, is there legislative appetite for further changes to the TCJA?

We commend the Federal Reserve for advancing monetary policy normalization in an orderly, gradual, data-dependent and well-communicated manner. Interest rate hikes in 2017 were smoothly digested by markets and balance sheet normalization is under way. Looking ahead, we are acutely aware of the uncertainties that monetary policy will have to navigate, including the impact of a procyclical fiscal policy on wages and inflation and the implications of escalating trade tensions. Could staff discuss the implications of trade frictions for monetary policy, noting that the effects could manifest either as a demand shock as confidence effects weigh on investment, or a cost-push shock to US businesses? We are already beginning to see the potential implications of tightening global financial conditions for emerging markets; an inflation surprise would compound these risks. To what extent should monetary policy consider the impact of its actions on global financial conditions, particularly USD funding conditions, noting that stress in international markets can generate spillbacks to the US economy?

We are deeply concerned about ratcheting trade tensions. We underscore that the resulting fallout may be macro-critical for the broader Fund membership, many of whom are deeply integrated into global value chains and highly dependent on an open international trading system. We join staff in exhorting the US to work constructively with its trading partners to resolve trade and investment disagreements, while taking active steps to support workers at home that have been displaced by globalization. The priority is to avoid a vicious cycle of retaliatory measures that could shake confidence and disrupt the global economic momentum. We thank staff for their work on the positive GDP impact from a successful renegotiation of NAFTA, noting that the quantitative estimates will be sensitive to the specific terms of the new agreement. Conversely, we wonder if staff have estimates of the potential impact in the event that renegotiations fail or members withdraw from NAFTA, and if this analysis could be incorporated into the joint IMF/WB/WTO paper on reinvigorating trade? We agree with staff that bilateral trade balances should not be viewed as a policy anchor or target. We note from the external sector assessment that the staff-assessed current account gap has increased to 1.5 percent of GDP for 2017, from 1.0 percent for 2016. Could staff clarify the role of refinements in the EBA methodology versus changes in fundamentals and policy settings in this assessment?

As the US continues to recalibrate its financial sector policy, it will be important to continue to preserve post-crisis financial stability gains. Several sensible adjustments have been made to the post-crisis regulatory framework. Measures such as the amendment of thresholds for classification of systemic bank holding companies, proposals to amend the application of the Volcker Rule, and modifications to the enhanced supplementary leverage ratio, could help ensure that regulations are more risk-appropriate. We also see merit in increasing the transparency and rigor of the FSOC’s designation process for systemic institutions. In implementing these changes, it is important that supervision and enhancement remain robust, and that the drive for efficiency does not come at the expense of financial system soundness and stability.

Mr. Ostros and Ms. Sand submitted the following statement:

We thank staff for another excellent report on the U.S economy. We are again impressed by the independent and candid analysis and policy advice, which proves that the Fund lives up to its role as an external, independent assessor. We also thank Mr. Claver-Carone and Mr. Vitvitsky for the informative buff statement.

We broadly agree with staff's appraisal and policy recommendations and would like to offer the following comments for emphasis.

We recognize the strength of the U.S. economy which is doing even better than last year and is expected to enter the longest expansion in recorded history within the next few years. We share staff's assessment of the near-term economic outlook, with the economy already operating slightly beyond potential and expected to receive further stimulus by sizeable fiscal easing. We note that such a strongly procyclical fiscal policy has not been seen since the 1960s, and that it will elevate the risks to the U.S. and global economy. Again, we see a missed opportunity for the U.S. to focus on and address the medium- and longer-term imbalances that weigh on its future growth outlook. Challenges relating to high levels of poverty and inequality, an aging population, low productivity growth, and declining labor force participation rates that require policy action to ensure sustainable and equitable growth going forward. If not dealt with appropriately, these factors will further lower the economy's growth potential. We would reiterate the Managing Director's message that countries, including the U.S., should take advantage of the current juncture and "fix the roof while the sun is shining". We thank staff for again emphasizing these still-significant medium to longer-term policy challenges in this year's report, while somewhat shifting the focus over to key policy decisions of the current administration (fiscal easing, tax reform, and trade measures).

On fiscal policy we share staff's concern regarding the procyclical fiscal policy at a late stage in the business cycle and associated risks. Importantly, while noting the relatively modest impact on potential output of the planned expansion in the fiscal deficit we concur with staff that it should be reversed to not further exacerbate the unsustainable upward dynamic in the public debt-to-GDP ratio. We highlight the need for the U.S. to adopt measures on both the revenue and expenditure sides to ensure that public finances are on a sustainable path over the longer term. Based on historical evidence, we express our concern that initially temporary measures will be extended and made permanent, further weakening the medium-term fiscal stance.

The course of monetary policy normalization should remain gradual and data dependent, and effective communication on future rate adjustments is key. We note this is duly emphasized in both the staff report and the buff statement, and would stress that continued effective communication on policy intentions is important to mitigate potentially adverse spillovers. That said, based on the Fed's exemplary handling and communication so far, we trust that monetary policy will continue to be well handled. We also welcome the ongoing gradual and well communicated balance sheet normalization process, which seems like the appropriate step to take, alongside the ongoing normalization of policy rates. We note with concern the risk of a faster-than-expected rise in inflation on the back of the planned expansion in the federal deficit, which could lead to a more rapid rise in interest rates and a stronger U.S. dollar. This could lead to increase market volatility both in the U.S. and abroad with negative spillovers to other countries and be especially disruptive for vulnerable emerging market economies. We would also emphasize that the elevated valuations in financial markets, particularly in the US stock and bond markets, bear the risk of a sharp correction.

We agree that the Tax Cuts and Jobs Act (TCJA) contains some positive shifts in the U.S. corporate tax code, including measures to broaden the tax base and remove previous distortions. However, there remains scope to strengthen various provisions as outlined in the staff report. Some features of the TCJA also appear discriminatory and violate existing international obligations, in particular under the WTO, and we encourage staff to continue to work on the spill-over aspects of the reform. We also share the view that the changes to the personal income tax, while having some positive aspects, are likely to exacerbate income polarisation as higher income groups benefit disproportionately from the personal income tax cuts. We support the recommendations related to targeting tax relief (Earned Income Tax Credit) and other supports to lower-income groups. The U.S. could also increase its revenue-to-GDP ratio through a greater reliance on indirect taxes.

We agree with staff's positive assessment of the health of the financial system, although potential medium to longer-term risks stemming from financial deregulation could be further analyzed. Regarding specific risks to financial stability, we notice that U.S. corporate sector vulnerabilities have steadily increased. Although a turn in the corporate credit cycle is not imminent and the share of vulnerable firms remains relatively low, underlying risks may increase, as the removal of Fed policy accommodation progresses further. We also strongly support staff's call for maintaining the current risk-based approach to regulation, supervision and resolution as a robust financial regulatory regime in the U.S. is important for the global financial system. We also want to reiterate the need to strengthen regulation and supervisory oversight of nonbanks.

We fully support staff's recommendation for the U.S. and its trading partners to work constructively towards ensuring an open, rules-based international trading system. We stress that trade barriers are harmful for global trade and are likely to be ineffective in reducing bilateral trade imbalances. Rather the pro-cyclical U.S. fiscal stance is contributing to a weaker current account and thereby contributing to widening global imbalances, which is unfortunate.

To end, we find the section on competition policy and the macroeconomic effects very interesting, and would encourage staff to further explore this area going forward.

Mr. de Villeroché, Mr. Castets and Mr. Chotard submitted the following statement:

We thank staff for a very clear and comprehensive report, as well as Mr. Claver Carone and Mr. Vitvitsky for their insightful buff statement. As the largest economy in the world, economic policies implemented in the United States have significant and worldwide spillovers through the fiscal, trade, financial and monetary channels. We therefore thank staff for having well integrated both the domestic and global implications of the US policies. We share the thrust of the staff report and make the following comments for emphasis:

Recent Macroeconomic Developments and Outlook

We positively note that the US economy experiences solid growth and full employment. However, as rightly pointed out by staff, this short-term dynamism is fueled by an expansionary, procyclical policy mix, which creates vulnerabilities and reduces growth prospects over the medium term. We reiterate that the current account deficit results from a protracted saving/investment imbalance and that the expansionary fiscal stance will exacerbate further this imbalance in the years to come. This should thus not be used to justify inward-looking policies. On the short-term outlook, we deem that staff projections may be slightly optimistic, as the rebound in private investment might not be as strong as expected, as testified by the rise in dividends and share buybacks in the aftermath of the adoption of the tax reform. Staff comments are welcome.

Fiscal Policy

We are concerned about the pro-cyclical nature of the stimulus package, which entails risks for the US and the global economy as a whole.

We agree with staff that the planned expansion in fiscal deficit will exacerbate public debt issues, deepen current account deficits, while reducing room for maneuver for other necessary public spending, and, eventually, increase risks of overheated economy in the short term and recession in the long run. It will likely lead to a faster tightening of the monetary policy, with implications both at the domestic and global levels. Considering the position of the US economy in the economic cycle, this expansion is concerning.

On the public debt dynamics, while the characterization of the US public debt as “unsustainable” can seem excessive, we fully support staff’s call for putting the public debt on a medium-term downward path. Additionally, we note that the authorities and staff disagree on the public deficit level in the years to come, staff projecting a general government deficit over 5 percent of GDP from 2018 to 2022. The authorities argue that the rise of the public deficit will be limited by stronger growth than projected by staff and spending cuts (totaling 44 percent in discretionary nondefense spending). The perspective of further spending cut is a matter of concern given the already low level of public spending and of public services compared to other advanced economies while public investment appears warranted to tackle the macrostructural challenges faced by the US (well-presented in Box 5). In this regard, we encourage the authorities to consider raising additional tax revenues as an alternative, notably through the introduction of a federal sales tax and a carbon tax, as recommended by staff.

As regards the aggregates used, we wonder why staff refers to the federal government aggregates and not the general government aggregates in the case of the United states in the core of the report. Referring to the latter would ensure comparability, notably with other advanced economies.

Tax Reform

We fully support staff analysis that, while a major tax reform was overdue, the reform adopted will increase inequality and has the potential to exacerbate tax competition, while maintaining incentives for profit shifting practices. Regarding business taxation, we encourage the authorities to consider abolishing FDII and revamping GILTI and BEAT mechanisms by targeting them only to countries with aggressive taxation rates and to transactions aimed specifically at shifting profits. This would ensure less economic distortion and prevent any unjustified side-effects on regular business transactions, thereby permitting full alignment with OECD and WTO principles, which is not the case as of now. Regarding expensing mechanisms, we are somehow surprised by staff recommendation to make full deductibility permanent since the potential impact of such a measure, including on public finances, is not detailed in the report. Staff comments are welcome. Regarding household taxation, we support the staff's recommendation on recalibrating the rate structure so as to reduce income inequality. However, we may have appreciated deeper analysis on the impact of the adopted reform on inequalities, which may significantly increase due to the reform and harm US growth in the long term. We would encourage staff to take this into account in their future projections. Staff comments are welcome. Lastly, regarding the spillover of the reform, we keep being concerned on the risk that the US tax reform will fuel race-to-the-bottom behaviors, eventually leading to sub-optimal levels of public spending and welfare internationally. In this regard, referring to the OECD average CIT rate is unhelpful since marginal effective rates drive investors decisions, not statutory average rates. Additionally, staff itself recognized the pressure created on other IMF members in recent concluding statements[1] and working papers[2]. While this risk is not analyzed in the staff report (apart from an allusive mention in para. 24), we would encourage them to do so in their next works. Staff comments are welcome.

Monetary Policy

We share staff views on the US monetary policy. Specifically, we encourage the central bank to clearly detail its strategy regarding future interest rates increases, in order to give visibility to markets. Additionally, we encourage the FED to maintain its adherence to the principles of data dependence and clear communication going forward.

External Sector and Trade

We remain concerned by recent US decisions on trade, notably vis-à-vis European countries, and encourage them to remain committed to a fair, open trade regime. We fully share staff appraisal regarding risks associated with recent protectionist measures taken by the US, and urge the authorities to remove recent unilateral trade measures, which will damage

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[1] See the Concluding statement for Canada published on June, 4 2018 : "It is time for a careful rethink of corporate taxation to improve efficiency and preserve Canada's position in a rapidly changing international tax environment. Given its centrality to the architecture of the tax system as a whole, this requires a holistic review, which Canada has not had for some time. The U.S. tax reform increases the urgency of moving ahead with the review. Its impact remains highly uncertain, but the potential effects, through both real activity and profit shifting, could be substantial."

[2] See notably Tax Spillovers from U.S. Corporate Income Tax Reform, by Sebastian Beer, Alexander Klemm, and Thornton Matheson : "Combined with the shift toward territoriality, this may intensify tax competition".

both the US and its international partners. Could staff update the directors on the latest developments in trade measures and their potential impact on US firms' location? More generally, we invite staff to deepen their quantitative assessment of a perpetuation of trade restrictive measures between the US and its partners, both for the US and the rest of the world.

Financial Sector

We note that staff deems that recent modifications in financial regulations as improvements, but regret that staff provides little analysis about their consequences on financial stability. Indeed, while we noted that staff considers that medium-terms risks to financial stability are elevated, we would have appreciated deeper assessment of the consequences of the recent changes in financial regulation on financial stability and credit growth trends. Specifically, we wonder about (i) the risks associated with banking regulation now being more focused on systemic banks, with non-systemic banks under less scrutiny, (ii) the regulators' capacity to monitor systemic risk by activity, (iii) the risk of greater differentiation between US and non-US financial institutions, (iv) the risk of lesser protection for consumers, and (v) the reasons why staff does not propose any recommendations regarding the real estate credit sector.

Structural Reforms

We thank staff for the insightful focus on competition trends in the US economy. The trends at work of more rents for some companies and less consumer-friendly competition framework appear somehow worrying. We encourage staff to continue monitoring these developments, in particular as regards the potential impact of a decrease of the competition intensity on the labor share, and detail their recommendations in this regard, notably as regard the strengthening of anti-trust and anti-concentration policies.

Mr. Daïri submitted the following statement:

We thank staff for a well-articulated report and candid and forward-looking policy assessment and advice, and Mr. Claver-Carone and Mr. Vitvitsky for their informative buff statement. We note the significant differences in view between staff and the US authorities on key policy issues, even though there is agreement on the favorable near-term outlook. We are in broad agreement with the staff appraisal.

Output and employment gains have continued to build on the strong momentum of the past few years, supported by a favorable external environment, including sustained economic recovery of US major trading partners, and a strong pro-cyclical fiscal expansion. The near-term growth momentum has picked up, and the US economy is already beyond full employment, but medium-term vulnerabilities have increased since the last consultation discussions, with significant negative cross border spillover potential. The current growth spurt is temporary as the US economy is expected to revert to subpar potential growth within 3-4 years, at the time when US economic leadership would be much needed. Under the conditions of full employment and capacity constraints, wages and unit labor costs are expected to continue to firm up while demand pressures are likely to persist due to the availability of relatively cheap credit. For the first time since the great financial crisis (GFC), and after a prolonged period of easy money and a weakening of financial safeguards due to deregulation, financial vulnerabilities seem to have re-emerged.

The strong, pro-cyclical, and temporary fiscal stimulus was unwarranted and carries serious long-term risks. There are issues regarding its size as well as its composition. Tax cuts and spending increases boost the fiscal deficit, worsen the already unsustainable debt dynamics, and leave no fiscal space to spend on infrastructure to raise potential output and address long-standing issues of social security and healthcare reforms. Further, under conditions of full employment and capacity constraint, the fiscal stimulus raises risks of a positive inflation surprise, forcing an earlier-than-expected US monetary policy normalization with its attendant adverse impact on stretched US assets prices and highly leveraged US households and corporations, and spillover effects on global financial conditions and many emerging markets' access to capital and their debt situation. With the possibility of monetary policy tightening peaking around the time that the fiscal stimulus dissipates, risks of US recession in 3-4 years are real.

The Tax Cut and Jobs Act (TCJA) has many positive features, as elaborated in the staff report, but falls short of easing the middle-class tax burden or addressing the pressing needs of the American working poor, and tends to increase income polarization further. Non-defense spending cuts of 40 percent in real term over the next decade are unlikely to spare the programs that serve the poor. Changes in corporate taxation and expending provisions will likely incentivize short-term investment financed by debt, adding to corporate leverage, but their temporary nature would increase uncertainties on long term investment decisions. Additionally, the favorable taxation of un-repatriated profits of US multinationals is already befitting shareholders at the expense of investment or labor remuneration. The TCJA is costly, and the modest and the temporary pick up in growth will not pay for the tax cuts. Staff suggestion of revenue measures, including a carbon tax and a federal consumption tax, to offset the revenue loss from the tax cuts and finance higher growth-enhancing infrastructure spending, merits serious consideration.

The quick escalation of trade frictions possibly into an open trade war among the largest economies is indeed worrisome. The United States has been traditionally one of the strongest proponents of an open, fair and rules-based trade system. The recent US decision to impose tariffs and other trade restrictions on its main partners, compounded by the retaliatory responses, is one of the gravest multifaceted risks in many decades to hard-gained global prosperity. The welfare losses are likely to go beyond the disputing parties and disrupt the global supply chains, thus harming all countries, rich and poor. It is also likely to have serious adverse consequences for the US products and labor markets in the form of higher consumer prices and migration of US jobs.

The US financial system, and particularly the banking system, has been fortified in the aftermath of the GFC to safeguard against future crises that could emanate from the same vulnerabilities as before, or from new sources in an increasingly complex and fast changing global financial landscape. The recent trend has been to roll back or weaken some of the financial safeguards enacted over the last decade. While some changes are positive, striking the right balance between "recalibrating" financial regulations and preserving adequate safeguards is vital. In particular, the proposal to lessen the compliance requirements for the Volker Rule should be considered with caution so as not to create regulatory uncertainties. The oversight of nonbanks also needs strengthening, and the reform of the housing finance system, which was at the root of the GFC, needs to be accelerated.

Mr. Beblawi and Ms. Abdelati submitted the following statement:

We thank staff for a well-articulated report that rightly touches on the implications of recent policy directions. We broadly share the staff assessment and key messages of the report. We congratulate the U.S. for the pick-up in economic growth, and the very favorable near-term outlook, which is delivering the longest expansion in recorded U.S. history and the lowest unemployment in half a century. However, staff warns that the fiscal stimulus will result in significant fiscal deficits in the next few years that will add to the already unsustainable public debt, contribute to raising global imbalances, raise the risk of recession, and have negative spillovers. Moreover, the planned fiscal stimulus would require the Fed to raise policy rates at a faster pace, with potential adverse spillovers to the domestic and global economy.

We thank Messrs. Claver-Carone and Vitvitsky for the informative buff statement that explains the authorities' view on how the tax reform, deregulation, and infrastructure spending will create structural changes in the economy leading to higher investment, more efficient capital allocation, and improved business climate. Together, these will raise the economy's potential output and productivity, enhance human capital, and strengthen labor force participation. Accordingly, the authorities disagree with staff's projected slowdown in growth rates from 2020 and believe the Tax Cuts and Jobs Act would raise annual growth rate by over 0.7 percent over ten years. It would be helpful for staff to refer to examples, from the U.S. or elsewhere, of the pro-growth impact of fiscal expansions and deregulation, and the lessons learned as many countries also strive to achieve similar durable transformational change.

We share staff's view on the merits of striving to achieve the positive and desirable changes in the Tax Cuts and Jobs Act, while avoiding the high price tag, by combining them with measures that replace the lost revenue. More targeting of the personal income tax relief and redesigning the international provisions to impose a minimum tax on low-tax jurisdictions offer promising avenues that deserve careful consideration. Increases in indirect taxes may also be worthy of consideration, given their low rate compared to other advanced economies and, importantly, the extremely high level of household consumption, which contributes to global imbalances. The shift to a territorial system with a minimum tax on offshore profits is broadly consistent with previous staff advice, but we note staff's call for some design improvements. One staff recommendation is to eliminate the lower tax rate for exporters, and we would welcome staff views on an alternative non-distortionary export promotion incentive.

Box 5 provides a useful summary of macro-structural policies to boost potential growth, reflecting the policy recommendations of earlier staff reports. We note agreement in a few areas, namely in the urgent need to address infrastructure needs, as reflected in the expected $200 billion in federal spending on infrastructure and expectation that this will translate into $1.5 trillion in infrastructure spending by state, local, and private providers. There is also some agreement on the potential to achieve savings through an upgrade of information technology. In most other areas, there seems to be a divergence of views on structural policy priorities. We would underscore the critical importance of elevating education, relieving its financing burden, and providing non-college career tracks, in order to maintain the competitive edge of the U.S. economy and keep pace with technological changes.

Constructive trade negotiations with trading partners are of paramount importance. The rising tide of trade barriers and its implications for both the U.S. and its trading partners, and for third parties is a major concern at this time. We, therefore, concur with staff's call for all relevant partners to constructively engage in resolving trade and investment disagreements, without resorting to imposition of tariff and non-tariff barriers.

It is also critically important to preserve the important gains made in strengthening financial oversight since the global financial crisis. We share staff's call for future changes to preserve the risk-based approach. We are encouraged by the administration's stated commitment to preserve the improvements made since the passage of the Dodd-Frank Act.

We appreciate the staff's discussion of international spillover risks. Clearly, there is a near-term growth benefit to a range of countries from the fiscal stimulus. On the other hand, the shift in the policy mix toward a tighter monetary stance will exacerbate already growing concerns about financial tightening and the implications for a more marked reversal in capital flows. We trust this will be taken up more in the upcoming flagship reports.

Mr. Kaizuka, Mr. Saito and Mr. Minoura submitted the following statement:

We thank staff for the informative report and Mr. Claver-Carone and Mr. Vitvitsky for their insightful statement. We appreciate the staff's timely and comprehensive analysis on macroeconomic policies under the current U.S. administration. In light of a large impact of the U.S. policy changes on the global economy, the staff's analyses including spillover effect are very useful for prospecting the global economy going forward. As we broadly concur with the thrust of the staff appraisal, we would like to offer some comments as follows:

Macroeconomic Policy Mix

As the U.S. economy is considered to be beyond full employment under the strong growth and job creation, it is essential to pay close attention to consequences of the current procyclical fiscal policy.

## Fiscal Policy

We note of the divergence of the views between staff and the authorities about the impacts of the current fiscal policy package on the prospects for medium-term growth. While staff see that medium-term growth will return to its longer-term trend (of 1¾ percent) as the demand stimulus fades out, the authorities assume a higher no policy change baseline (of 2.2 percent) and expect average growth of 3 percent, incorporating long-run growth effects arising from the policy mix such as infrastructure investment, tax reform and de-regulation. We welcome staff's elaboration on differences of assumptions behind the divergence of the views on medium-term growth.

We take note of the staff's estimation that primary fiscal surplus of around 1¼ percent of GDP is needed to put the debt-to-GDP ratio on a downward path. We share the staff's concern that the procyclical fiscal policy leads not only to adding burdens to an already-unsustainable public debt, but also to growing current account imbalances, which would contradict to the administration's intention. Moreover, given the fiscal pressures arising from aging population, we agree with staff that measures allowing the public debt-to-GDP ratio to fall and creating the fiscal space for policies to promote investments in human and increase medium-term growth are needed. We also share the staff's view that policies should be designed to reform social security, contain healthcare cost inflation and increase the federal revenue-GDP ratio against the urgent needs for infrastructure spending. As for sources of infrastructure financing, the authorities assume that direct federal funding would catalyze US$1.5 trillion in infrastructure spending by state, local and private providers. We welcome staff's comments on feasibility of the authorities' plan.

## Monetary Policy

We support the Federal Reserve's view that it is appropriate to continue raising policy rates gradually to achieve its dual mandate of price stability and maximum employment. In executing its monetary policy decisions, it is important to keep the principles of data dependence and clear communication as well as pay close attention to market reactions, so as to avoid a surge in market volatility.

While the tax cut and the increase in the public expenditure would accelerate a pace of the Fed's normalization through increasing inflationary pressure, these policies could put upward pressure on long-term interest rates, which leads to increasing financial market uncertainty. At the same time, spillover effects for other countries, especially for the emerging markets, should be monitored closely. In this regard, we would like to know the staff's view on impacts of reduction in U.S. dollar liquidity by balance-sheet shrinking of the Fed on the emerging markets' capital flows.

We welcome the staff's analysis on the impact of a nonlinear Phillips Curve. While we take note of the authorities' comment that there was little empirical evidence to suggest that the Phillips Curve was possibly steeper at lower levels of unemployment, risks of intensified upward wage and price pressures, driven by supply constraints, should be monitored carefully.

Tax Cuts and Job Act (TCJA)

We commend that the TCJA contains many positive steps including reduction in the scope of personal income tax deductions and stronger incentives for private investment. Meanwhile, we take note of the staff's view that it would be preferable to move the U.S. to a cashflow tax permanently, in order to further increase the effectiveness of the business tax reform. At the same time, as the net effect of the tax policy changes provides greater benefits to those in the upper deciles of the income distribution, it would be preferable to recalibrate the rate structure, eliminate loopholes and limit the use of the pass-through deduction so as to concentrate tax relief to those earning close to or below the median income.

Regarding the international provisions included in the TCJA, we welcome the staff's analyses on spillover effects and direction of adjustments. Nevertheless, as there are still uncertainties on its implementation, we encourage staff's timely information sharing including influence for foreign firms. We agree with the staff's appraisals that the Global Intangible Low Taxed Income (GILTI) provision should be imposed on a country-by-country basis so that it falls on all profits earned in low tax jurisdictions, rather than on the average global profits of multinationals that are in excess of a deemed 10 percent return on tangible assets, and that the Foreign Derived Intangible Income (FDII) should be eliminated to avoid the economic distortion that arises from providing a more favorable tax treatment for exporters. Furthermore, the FDII is also considered to have some problems from the perspective of Countering Harmful Tax Practice (Base Erosion and Profit Shifting project, Action 5). As for the Base Erosion Anti-Abuse Tax (BEAT), we share the staff's concerns that it is also likely to be punitive for a range of legitimate commercial activities that are not linked to tax avoidance, and the effect could be amplified as foreign tax credit or deduction is not allowed. To mitigate these shortcomings, this provision should be applied only to those transactions that are designed to transfer profits to related parties that are located in low tax jurisdictions.

The series of reforms included in the TCJA would not only have impacts on personal consumption and investment in the U.S., but also provoke other countries' reactions such as tax rate changes, and eventually affect the global economy through trades and capital flows by altering global demand and allocation of production. We encourage staff's further analysis on quantitative spillover effects of the TCJA with taking into account the factors above comprehensively. We also expect staff's real-time analysis on this topic once economic data become available to see consequences of the TCJA, and encourage timely information sharing with the Board.

Trade Policy

While the U.S. has traditionally maintained a very open trade regime and has got many benefits from it, the administration has imposed broad-based trade actions and reviews in the past few months. These measures could not only undermine the global trading system based on the WTO rules, but also have serious impacts on the global economy through the increase of the uncertainty for firms and market disruption by worsened investor sentiment. Moreover, these negative effects are expected to be amplified under the current multi-layered global value chain structure.

We agree with the staff that protectionism and economic isolationism benefits no countries including the U.S. and that the global economy needs to be able to rely on an open, fair, and rules-based international trade system. While we can agree with the importance of reducing market distortions and unfair trade measures, trade restrictions are not appropriate measures to mitigate them. Rather, it is important to maintain the current open and fair rules, and resolve trade and investment disagreements by strengthening the rules-based, multilateral trading system. In this regard, we underscore the importance of quantitative analysis on macroeconomic impacts of trade policy changes and welcome staff's comments on prospects for future analysis. To mitigate downsides for trade-affected workers, policy efforts should focus on training, temporary income support, and job search assistance.

Financial System Oversight

We welcome that the authorities have strengthened the financial oversight structure since the global financial crisis. We also positively take note that useful steps are underway to recalibrate and simplify financial regulations and better tailor them to underlying risks, including the total asset threshold for bank holding companies (BHC) and the calculation of the Supplementary Leverage Ratio. Meanwhile, it is also important to preserve the current risk-based approach to regulation, supervision and resolution. Regarding the resolution framework, we concur with staff that it is important to avoid limiting the flexibility of the resolution regime, hindering rapid action, and complicating cross-border resolution.

Competition Policy

We appreciate the staff's timely analysis on the increases in market power and markups led by "superstar" firms. While we understand that the staff's analyses on relationships between market power and investment spending or labor share are consistent with those of Gutiérrez and Philippon (2018)[3] and Autor et al. (2017)[4], we would like to know if there are any differences or new findings compared to the previous works. Regarding the labor share of income, other factors including a lower price of investment goods or trades and offshoring could have affected the declining trend of the labor share. We would appreciate it if staff could share the views on how large is the role of rising market power on the labor share, compared to those of the other factors.

Mr. Alogeel and Mr. Keshava submitted the following statement:

We thank staff for a comprehensive report and Mr. Claver-Carone and Mr. Vitvitsky for their insightful buff statement, which outlines the impressive performance and favorable outlook of the U.S. economy, supported by tax reform, deregulation, and a pro-growth economic policy agenda. Indeed, we are pleased that growth is set to accelerate, the labor market is exceptionally robust, and inflation has firmed, gradually climbing to levels at or near the Federal Reserve's target while inflation expectations are well anchored. It is also encouraging that the normalization of monetary policy is proceeding smoothly, banks' capital buffers are healthy and NPLs are low, financial stability vulnerabilities are moderate, and consumer sentiment remains strong. In this connection, we welcome staff's assessment that the near-term economic outlook is one of strong growth and job creation. At the same time, we note the disagreement between staff and the Administration on the prospects for long-term growth.

[3] Gutiérrez, Germán, and Thomas Philippon. 2018. "Ownership, Concentration, and Investment." AEA Papers and Proceedings, vol. 108, pp. 432-37. 2018.
[4] Autor, David, David Dorn, Lawrence F. Katz, Christina Patterson, and John Van Reenen. 2017. "Concentrating on the Fall of the Labor Share." American Economic Review, 107 (5): 180-85.

We take note of the Administration’s fiscal strategy, anchored by the recent tax reform, and based on reducing nondefense discretionary spending, restraining those in mandatory programs, including by reforming health care, and supporting greater infrastructure spending that would put the headline deficit on a downward path to 1.1 percent of GDP by 2028 and lead the federal debt to peak at 82 percent of GDP in 2022, slowly declining thereafter. Since considerable efforts will be required to achieve these objectives, as rightly noted in the buff statement, close vigilance and timely policy adjustments, as needed, would be essential.

The raising of the target range for the federal funds rate by the Federal Reserve continues to be smooth, thanks to the continued adherence to the principles of data dependence and clear communication. Here, we are reassured to note that the path for inflation remains consistent with the symmetric inflation objective with any mild overshoot of the inflation target expected to be temporary. We also welcome staff’s assessment that the near-term net effect of higher U.S. growth and the expected increase in interest rates would be beneficial for most economies.

Since a robust financial system oversight in the U.S. has positive spillovers on the rest of the world, we welcome the important gains made in strengthening the financial oversight structure since the global financial crisis. We also welcome the results of the supervisory stress tests released last week, which show that the largest bank holding companies are strongly capitalized and would be able to continue lending to households and businesses during a severe global recession. While we note the authorities’ assessment that risks from institutions outside the regulated perimeter (insurance industry, asset management, crypto currencies, etc.) are moderate, close vigilance needs to be maintained to safeguard financial stability.

On trade, it is important for trading partners to work constructively together to reduce trade barriers and to resolve disagreements at the earliest in a cooperative manner. As noted in the recent WEO, global growth strengthened in 2017 with a notable rebound in global trade after two years of weaknesses, to an estimated real growth rate of 4.9 percent. It will be important to build on this encouraging performance to sustain the global upswing.

Finally, we have general comments on the approach to cover analytical work through Working Papers (WPs) in Article IV staff reports. WPs have a disclaimer that these papers “describe research in progress by the author(s) and are published to elicit comments and to encourage debate". At the same time, we note that eight WPs have been referenced in the main text of the staff report with a few WPs published only this month and a few others still to be published, but many of the conclusions of the WPs are reflected in staff's analysis. For example, the section on competition policy seems to draw upon the WP on "Global Market Power and its Macroeconomic Implications", which was published only on June 15, 2018 and probably did not benefit from an extensive feedback from the relevant experts in this field. In this context, we agree with the comments of Mr. Claver-Carone and Mr. Vitvitsky that competition issues and policy in the United States deserves academic attention by the relevant experts. We would welcome staff comments on the Article IV staff report review process with regard to the drawing upon the conclusions of WPs. Moreover, one of the reasons for the selective use of SIPs going forward is that SIPs tend to get considerably less attention on imf.org compared to Article IV staff reports and concluding statements. Do WPs have a better reach than SIPs? Staff comments would be welcome.

With these remarks, we wish the U.S. authorities continued success.

Ms. Riach and Miss Chen submitted the following statement:

We thank staff for their detailed report and Mr. Claver-Carone and Mr. Vitvitsky for their insightful buff statement. We broadly agree with the staff assessment. The U.S. economy is doing well, with growth set to accelerate and unemployment levels not experienced for several decades. Consumer and business confidence is high, including among small and medium sized firms. However, there are questions as to whether the short-term stimulus will bring long-term costs, and we agree that risks are tilted to the downside in the medium term.

We welcome staff discussion of the international spillover effects of various policy changes. The US dollar is the global reserve currency and the performance of its economy has significant impact on the rest of the world. While we welcome the US driving the current global growth momentum, we urge the authorities to remember that its choices have significant implications on the global system. In an ever increasingly connected system, it is in all our interests that the global system remains stable.

Fiscal Policy

We welcome staff's work on the implication of the recent tax reform, and appreciate staff drawing the risks not just to the US economy but also potential spillovers to the rest of the membership. We agree with staff that the current fiscal plans are unsustainable, and question the likelihood of the medium-term consolidation starting in an election year as planned. We urge the authorities to reconsider any further fiscal expansion, and put in place a credible strategy to ensure public finances are sustainable, which includes raising the medium-term growth prospects.

Whilst we respect the sovereign right of the US to reform their tax system, this right should be exercised in line with the international obligations to which it has signed up. We have specific concerns with respect to the deduction for “foreign derivative intangible income” and Base Erosion and Anti-Abuse Tax. These measures appear to contravene the US’s international obligations, and risk major distortive impact on international trade. We support staff’s call to eliminate the deduction for foreign derived intangible income and limit the BEAT to transactions that are designed to transfer profits to related parties located in low tax jurisdictions.

Monetary Policy

We agree with the staff’s view that the pace of policy rate normalisation should remain gradual and determined by the incoming data. We also welcome the ongoing gradual and predictable runoff of the Federal Reserve’s balance sheet which helped mitigate the risk of sharp or outsized asset price reactions.

We endorse the staff’s view that a key risk for the outlook is that inflation might accelerate faster than previously expected as the economy is already close to full capacity, which could result in a tighter monetary policy path. We emphasise that the elevated valuations in financial markets, particularly in the US stock and bond markets, bear the risk of a sharp correction. A sudden tightening in financial conditions can be especially disruptive for vulnerable emerging market economies.

Trade

We stress that trade barriers are harmful for global trade and are likely to be ineffective in reducing bilateral trade imbalances. We fully support the staff view that the US should work constructively with its trading partners towards ensuring an open, rules-based international trading system, as highlighted by the estimates on the positive, multilateral growth effects from a successful NAFTA renegotiation.

Financial Regulation and Financial Stability

We agree with staff that important gains have been made to strengthen the financial oversight structure since the global financial crisis. While we recognise there may be scope for fine-tuning stringent regulatory requirements for small and non-systemic banks, we agree with staff that the risk based approach to regulation, supervision and resolution should be preserved. We urge the authorities to remain engaged with the international financial regulatory architecture.

Significant, and rising, corporate leverage together with deteriorating underwriting standards also carry potential financial stability implications. Various signs from the market - including corporate debt to GDP at its highest outside a recessionary period; investment grade bond issuance at another record year and leveraged loans market growing exponentially at a time when cov lite loans are at unprecedented highs—suggest a build-up of vulnerabilities in the corporate sector, we urge staff and authorities to monitor these developments closely.

Mr. Jang, Mr. Johnston, Ms. Preston and Mr. Kim submitted the following statement:

We thank staff for their comprehensive report and Mr. Claver-Carone and Mr. Vitvitsky for their buff statement. The US has long been a global leader in trade, openness and liberalization. The US economy is performing well, with a long expansion, low unemployment and muted inflation. However, we echo staff's concern that the current situation is unsustainable in terms of both the fiscal and external balance, and that spillovers would add to global imbalances and fuel competition in tax rates.

We broadly agree with staff's appraisal, including the forecast of US growth, assessment of the impact of policy choices on domestic fiscal sustainability and potential for negative outward spillovers. We acknowledge there is a discrepancy in potential growth projections between staff and the authorities which gives rise to different policy conclusions. However, we agree with staff's assessment of the risks from pro-cyclical policy and we anticipate a slowdown in 2020 as the fiscal impulse from tax cuts and increased discretionary spending abates. This policy will also exacerbate an already unsustainable debt dynamic in the medium term. In addition, we welcome staff's analysis on the outward spillovers from US policy choices and note that these have the potential to increase future risks to the broader global outlook. In particular, a faster pace of monetary policy normalization could create additional burdens for non-US corporates, households, and sovereigns that have borrowed heavily in US dollars, and could precipitate a reversal of capital flows from some EMDCs.

We welcome staff's analysis of the spillovers from trade policy and encourage the Fund to continue to promote the benefits of an open, fair and rules-based international trade system. We note the inconsistency between a trade policy that is aimed at narrowing external imbalances and a domestic fiscal policy that boosts demand, including for imports. What is staff's estimate of the impact of new trade measures on the US trade balance? Furthermore, the staff report points out that the US has traditionally maintained a very open trade regime which has helped raise living standards. Do imports make up a larger share of lower-income households' budgets, compared to wealthier ones? If so, do US tariffs on imported goods have the potential to disproportionately affect the living standards of lower-income US households? We also note that uncertainty around the future of US trade policies may pose a short-term drag on business investment. This could be the case, not only for exporting businesses, but also for import-exposed businesses waiting to see if tariffs are a long-term policy fixture.

We note that wage growth has been subdued, despite close-to-full employment. The decomposition in Box 1 shows that labor market slack has almost disappeared. We also agree with staff's view that structural change related to technology, globalization and market concentration could put downward pressure on wages. Moreover, this downward pressure may be related to the US industry structure which is dominated by the service sector and means that, for example, it is highly possible that new employment is being created in retail sales where many people earn the minimum wage, or close to it. Staff comments are welcome.

We broadly agree with staff's assessment that recent developments in US financial regulation primarily focus on easing the regulatory burden for smaller banks and rolling back requirements for large banks where they exceed international standards. However, the core post-crisis framework, and consistency with Basel standards, generally remains intact. Any changes to regulation should limit financial stability risks, within the international standards. We also agree that further analysis by staff is warranted, once the proposed rules are finalized.

We would like to see more analysis of the US housing market in the next Article IV report. Recent OECD analysis has highlighted that US housing affordability is coming under pressure, in part due to housing supply shortages. Moreover, future increases in the policy rate will increase households' mortgage expenses.

Ms. Erbenova, Mr. Just and Mr. Mehmedi submitted the following statement:

We thank staff for the comprehensive report and Mr. Claver-Carone and Mr. Vitvitsky for their informative buff statement. The near-term prospects of the US economy are favorable, driven by the pro-cyclical fiscal stimulus and a welcome recovery in private investment. Unemployment is almost at the lowest level in 50 years, job growth remains strong, wages are growing broadly in line with labor productivity, while core PCE inflation has risen to or near the Federal Reserve's target. But now, with the economy already operating above full employment, the strong procyclical fiscal policy has elevated the medium-term vulnerabilities for the US economy. The sustainability of public finances and debt as well as the potentially faster-than-expected rise in inflation as capacity constraints become more binding, are of concern. In addition, a shift toward inward-looking protectionist policies and rising trade tensions could exacerbate the risks for both the US and global economy. We remain concerned about the increasing inequality and demographic challenges and consider the recently adopted Tax Code a missed opportunity to address these challenges and create space for growth-enhancing infrastructure investment. We share the thrust of staff's appraisal and would like to offer the following comments.

A sustained, well-paced, and balanced fiscal consolidation is needed to steadily reduce the public debt-to-GDP ratio while creating fiscal space for investment in infrastructure and human capital. The combined effect of the tax cuts and spending increase will drive the federal government deficit to above 4.5 percent by 2019 and put debt on an upward trajectory. While we note the authorities' intention to start implementing a modest fiscal consolidation by 2020, we agree with staff that reforming the social security and healthcare system, coupled with revenue-increasing measures, is necessary to achieve a primary fiscal surplus and reverse the upward trend of public debt. In this vein, the fiscal consolidation path should be gradual and take account of the distributional impact. The recently approved budget bill for 2018-19 provides little incremental funding for much-needed infrastructure investment. While expanding public investment spending remains critical to boosting growth, the increase should be targeted toward high priority and growth-enhancing projects.

While the depth and liquidity of the U.S. Treasury market as well as its safe-haven status at times of distress represent a mitigating factor for relatively high external financing requirements, we wonder at what point this privilege will fail to shield the US from the deterioration in market confidence.

We would appreciate staff's comments about the feasibility of the authorities' intention to cut non-defense discretionary spending by 44 percent over a ten-year horizon and appropriate US$200 billion in direct federal funding to address infrastructure needs.

Despite the many positive provisions of the Tax Cuts and Jobs Act (TCJA), the high budgetary costs of the changes to the personal income tax, with greater benefits going to the upper deciles of the income distribution, will exacerbate income polarization. We welcome the simplification of the tax code and the reduced corporate income tax which should incentivize investment and lessen the incentive for base erosion and profit shifting. At the same time, while we recognize the positive changes to the personal income tax, including the elimination of most itemized deductions, we regret the regressive nature of the tax cuts and note that the relative burden on low- and middle-income households will rise as various provisions expire. This will further exacerbate income polarization in the US. The far-reaching and innovative features of the TCJA's international provisions, including the move to a modified territorial system with a minimum tax on offshore profits, are important steps to simplify the corporate tax system. We are nevertheless concerned that the Base Erosion and Anti-Abuse Tax and Foreign Derived Intangible Income could be discriminatory and may violate existing international obligations under the WTO.

The continued adherence of the Federal Reserve (Fed) to solidly anchor inflation expectations and clear communication will be vital as it moves forward with the monetary policy normalization. We welcome the recent decision to hold a press conference after every FOMC meeting, beginning January next year, which will further enhance its communication strategy. While gradual increases in the federal funds rate are consistent with the solid expansion of economic activity, we note that the Fed may need to raise policy rates at a moderately faster pace in view of the strongly procyclical fiscal policy. However, staff's projections on inflation, which are above those of the FOMC participants, may not fully materialize in view of the modest wage growth and the slack in the labor market. Considering that the yield curve in the US has been flattening, as the difference between the two and 10-year Treasury yields has narrowed to less than 50 basis points, representing the slimmest spread since September 2007, we are wondering what the implications for the medium-term outlook could be.

The multilateral trading system should be preserved. We note that the authorities have undertaken several trade policy actions and reviews, which have catalyzed a cycle of retaliatory trade responses. Against this backdrop, we are concerned about the rising trade tensions and unilateralism and underscore the importance of relying on a fair, open, and rules-based trading system. While the short-term impact of the recently announced tariffs could be modest, we caution that trade tensions are already weighing on sentiment and a full-blown trade war could trigger a global recession.

Structural bottlenecks weigh on the medium-term growth potential. Prompt implementation of overdue macro-structural policies are essential to boost potential growth, and make it more broad-based and inclusive. Tackling poverty, social and interstate immobility could contribute to improving productivity but will require policy measures aimed at upgrading the federal and state social systems, enhancing the quality of public education as well as its affordability, and improving the health care system. While we take note of the authorities' statement that the evidence pointing to a broad trend increase in market power is inconclusive, we encourage them to carefully monitor the risks from rising industry concentration.

We welcome the important strides made in strengthening the financial system oversight. To build onto this progress, we encourage the authorities to continue with the implementation of the outstanding FSAP recommendations to address risks and vulnerabilities, including on regulation and supervision, macroprudential policies, and insurance sector. Given that the housing financing and the U.S. housing market have not been reformed comprehensively, concrete progress is needed on this front. We take note of the authorities' efforts to recalibrate regulation by evaluating the effectiveness and efficiency of regulation. We agree that tailoring financial regulations to the size and business model of different institutions can help level the playing field for banks provided that underlying risks continue to be in the supervisors' focus. The authorities should remain committed to the current risk-based approach to regulation, supervision, and resolution planning while adhering to the agreed international standards. Staff comments on the ongoing amendment of the Volcker Rule and whether the proposed amendments strike the right balance between self-policing by banks and necessary enforcement are welcome.

Mr. Armas, Mr. Lopetegui and Mr. Vogel submitted the following statement:

We thank staff for the comprehensive report and Mr. Claver-Carone and Mr. Vitvitsky for their insightful buff statement.

We welcome the robust growth rates projected for the U.S. economy for 2018 and 2019 but there is uncertainty about economic growth beyond that horizon. We note from Table 1 that the projected growth rate for this year (2.9 percent) is about double compared to the figure expected for 2023 (1.4 percent) as staff considers the impact of U.S. policy actions more cyclical than permanents ones, as opposed to authorities' view where they estimate a larger impact on productivity growth. In this regard, we reiterate our call to continue enhancing the exchange of views guided by sound analytical frameworks and under a risk-management approach as we have to recognize the uncertainties about the magnitude of different policies on potential GDP. Therefore, it is important to keep in mind the risk of higher international rates if the fiscal impulse leads only to a transitory positive output-gap for the U.S. economy.

Clearly, the Tax Cuts and Jobs Act will mold the U.S. economy from different angles. In this regard, it is important to assess how these measures will impact on some of the issues that have emanated more concern, at least over the past decade. The staff report poses an important dose of uncertainty regarding the reform's impact on the risks that fiscal policy would have on the dynamic of the public debt-to-GDP ratio. On the other hand, the authorities view the Tax Cuts and Jobs Act as "an historic achievement that will spur economic growth while providing middle-class families with a significant tax cut". Will these fiscal stimuli wane after a few years of being implemented or will they last much longer? Will fiscal policies create more fiscal space to allow the country to meet its substantial infrastructure and social needs? Staff's views are welcome.

How will policies and reforms affect the country's society as a whole, and particularly its most vulnerable sectors? The staff report mentions the authorities' view on spending cuts saying that "over the ten-year budget horizon, [they] would result in a 44 percent real reduction in discretionary, nondefense spending" and that "no negative growth effects are anticipated from those various reductions in federal programs". What is the staff's assessment on how these measures would impact on poverty rates and inequality?

We tend to share staff's view that "for most economies, the near-term net effect of higher U.S. growth is expected to be beneficial". At the same time, since mid-April we have observed further turbulence in emerging markets, perhaps with a stronger impact in those with higher vulnerabilities, but the effects have been felt in a more generalized way and have coincided with additional uncertainty regarding the expected increase in U.S. interest rates. As noted in the staff report, a greater risk of an inflation surprise could stem from expansionary fiscal policies, thus the global economy and emerging markets, in particular, should carefully monitor this topic, preparing themselves for an eventual faster pace of the normalization process. This said, we would like to note that the Federal Reserve's program of balance sheet normalization has been well communicated and is being implemented in a gradual and predictable manner.

We note from Box 2 of the report the likelihood that the relationship between inflation and economic slack may be nonlinear, steepening as the economy pushes further through full employment. Box 5 illustrates that macro-structural policies boost potential growth providing sensitive and timely recommendations to increase the labor force and enhance its skills, which is an important way to cushion the effects of the above-referred relationship.

We are confident that the country will reinforce policies and changes implemented after the crisis with the objective of removing the roots of the fragilities. In the financial system, there have been some important reforms that have aimed to address its regulatory framework and to tackle a perverse system of incentives. While we could understand the authorities' intention to make financial regulation efficient, we would encourage them to take note of what staff underscores in paragraph 33 regarding the significance of assessing the important interactions between the various regulatory changes that the authorities are proposing. This is a critical issue and maybe staff could elaborate further on the differences when changes are taken in isolation and combined effects when taken as a whole system.

Staff rightly emphasizes the importance of an open, fair, and rules-based international trade system, which has been essential to improve social and economic conditions worldwide for about 70 years. The system has also been critical to minimize grave regional and global disputes. Therefore, we urge all sides of eventual disputes to work constructively, trying to consider medium-term benefits for all involved parties. We believe also that a more open international trade system is needed to improve worldwide potential GDP growth.

With these comments, we wish the United States and its people every success in their future endeavors.

Mr. Inderbinen and Ms. Andresen submitted the following statement:

The performance of the US economy is solid, but risks have increased. Economic growth is broad-based and current indicators suggest that GDP will grow above potential through 2019. Thanks to low unemployment and elevated confidence indicators, private domestic demand is expected to provide strong support to the momentum. We note, however, that the fiscal and trade policies pursued by the authorities imply significant risks, both domestically and outside the US.

The substantial revenue losses implied by the fiscal stance will result in a marked increase in the deficit. The tax reform, combined with the approved spending increases, adds to public debt that is already unsustainable and creates downside risks. Unfavorable public debt dynamics could lead to constrained space for policies aimed at reducing income inequalities, addressing infrastructure needs, and more broadly for structural reforms to improve productivity and raise US living standards over the longer term.

We see a need for corrective measures to address potentially distortive effects of the tax reform. The tax burden for companies will decline and households' disposable income will increase as a consequence of the tax reform, which is expected to boost growth in the near term. However, the reform's medium- and long-term impact is uncertain, particularly due to the strong procyclicality of fiscal policy. We also encourage the authorities to address the tax reform's increased risk of income polarization. In addition, we support staff's recommendations to improve tax policies, including the recommendation to make the Base Erosion Anti-Abuse Tax (BEAT) better targeted, so as to avoid punitive effects on legitimate commercial activities.

The current monetary policy stance is appropriate, but vigilance is needed. The Fed's gradual approach toward monetary normalization is appropriate against the backdrop of the current robust economic environment, low unemployment and inflation very close to the Fed's target. Looking ahead, it will be important to continue to adhere to the principle of data dependence, to be vigilant and stand ready to promptly contain additional inflationary pressures that may arise from the sizeable fiscal stimulus, and possibly from trade policies.

We welcome the sound condition of the US financial system and note that a prudent approach is warranted when recalibrating the current oversight structure. The important improvements made in the supervisory framework since the global financial crisis have helped strengthen the resilience of the financial sector. However, some of the more recent adjustments might soften the oversight framework. Meanwhile, credit quality and underwriting standards have apparently weakened in some segments. Therefore, we highlight the importance of remaining prudent and forward-looking in order to ensure that the oversight framework preserves its overall effectiveness and to avoid the build-up of systemic risks. Careful analysis of the interactions between the proposed regulatory changes would be warranted, as they may have a systemic impact beyond the US. Moreover, we share staff's view that it will be critical that the US remain committed to international standards and actively engaged in the international regulatory debate.

An open and rules-based trading system is indispensable for economic growth, job creation, productivity and investment. We are very concerned about the protectionist policies pursued by the US administration, and the ensuing escalation of trade tensions. We share staff's view that these developments can have substantial adverse effects, also at a global scale, by (i) discouraging investment and job creation, (ii) undermining the rules-based global trading system, (iii) interrupting global and regional supply chains, and (iv) increasing market volatility. In this context, we were surprised to see in the Risk Assessment Matrix that staff considers the negative impact of a potential retreat from cross-border integration to be of a "medium" magnitude only. Staff's comments on this would be welcome. We call on all member countries to refrain from harmful protectionist policies and to work constructively with trading partners and within the rules-based multilateral framework to resolve trade disagreements.

Mr. Leipold and Mr. Spadafora submitted the following statement:

We thank staff for an informative report and Mr. Claver-Carone and Mr. Vitvitsky for their candid buff statement. We broadly agree with the staff's assessment and policy recommendations; we offer some comments for emphasis.

Current macroeconomic conditions in the U.S. broadly fit the definition of a Goldilocks economy: growth is accelerating and expected to reach above-trend pace, unemployment is at record lows and inflation is close to the Federal Reserve's target. However, there are significant short- and medium-term risks that stand to generate material international spillovers. In particular, the generally beneficial net effects of the U.S. fiscal policy for growth in its trading partners in the short term may be appreciably undermined by the uncertainty generated by the proposed or enacted unilateral trade measures and the attendant risk of triggering a vicious cycle of retaliatory trade responses.

We concur with staff that the main short-term risk is an inflation surprise, which might arise from a nonlinear Phillips curve (in the region with a positive output gap above 1 percent). The likelihood of an inflation surprise is also exacerbated by persistent uncertainty on the degree of slack in the labor market. Higher inflation could imply a faster-than-expected rise in monetary policy rates that in turn might lead to significant international spillovers via tightened global financial conditions. Recent volatility in financial markets reflects their heightened sensitivity to changes in expectations regarding the future path of monetary policy, which we agree should remain data dependent.

In Box 2, in both the linear and nonlinear cases the FRB/US model foresees higher policy rates and lower core inflation rates when compared with the G20 MOD model. Can staff explain if other factors other than alternative monetary policy rules can account for these different dynamics?

Looking ahead, we agree with the staff's assessment that current policies, while underpinning the favorable economic outlook for the short term, may at the same time be creating a number of medium-term vulnerabilities, including a rise in global imbalances.

Staff's and the authorities' views diverge significantly on the growth outlook from 2020 onwards and the attendant evolution of the fiscal balances. This divergence reflects different views on whether the recent tax reform has mainly a cyclical (demand-side) or, rather, also a structural (supply-side) impact. While staff see the fiscal policy stance mainly as a procyclical (modest) impulse to an already strong aggregate demand, to be followed by some fiscal tightening (given the intended temporary nature of some of the tax provisions), the authorities are more confident that the fiscal measures are structural in nature and, along with regulatory relief and the infrastructure plan, could thus generate also a lasting supply-side response. The latter would result in higher business investment, labor force participation, productivity and ultimately potential growth; as a side effect, tax cuts would "pay for themselves" to a certain (albeit uncertain) extent and the higher sustained growth would place the public debt-to-GDP ratio on a downward path.

Although we believe that the growth-enhancing potential of the recent tax reform might be stronger than past cases – because it is centered on substantial cuts to corporate tax rates rather than on personal income tax rates – there seems to be a broad consensus that the expected extra growth could at best only reduce the static cost (in terms of lost revenue) of the tax reform. Although we recognize the authorities' intention to reduce nondefense discretionary spending, we share the staff's view that the current procyclical fiscal stance is set to deteriorate the already unsustainable trend of public finances while exacerbating global imbalances and raising the risk of a faster-than-expected increase in the monetary policy rate. As noted before, the latter can pose considerable risks of generating a tightening of global financial conditions and, in the worst-case scenario, disruption in the U.S. and abroad, particularly for the more vulnerable emerging market economies.

Against this background, we share the staff's call for restoring fiscal sustainability and rebuilding fiscal space as policy priorities. A rebalancing of fiscal policy with greater reliance on revenue, notably indirect taxes, would create the fiscal space for increasing public spending on infrastructure and, more generally, for policies (listed in Box 5) that raise medium-term potential growth while improving the sustainability of public finances. Given the expected increase in income polarization from the recent changes in the personal income tax rates, we also agree with the staff's call for better targeted tax policies to support low- and middle-income households and reduce income inequality.

Trade Policy

We agree with staff that the trade measures recently taken or proposed by the administration have a concrete potential of moving the global economy away from an open, fair and rules-based trade system, with adverse effects – effectively listed by staff in paragraph 29 –for both the U.S. and its trading partners. These measures are also a source of near-term risks and have already had an impact by initiating a vicious cycle of retaliatory trade responses; this has generated increased volatility in financial markets and commodity prices and, more worryingly, significant uncertainty that adversely affects investment decisions by firms at the global level. Furthermore, bilateral trade barriers are unlikely to be effective in reducing bilateral trade imbalances.

We appreciate the simulations in Box 6 on the potential growth effect of a renegotiated NAFTA agreement. The key result is that the all-important automotive sector, a well-known powerful driver of growth, would record an increased production in all three NAFTA signatories.

Financial System Oversight

The U.S. financial system exhibits healthy conditions as a whole; as underscored by Mr. Claver-Carone and Mr. Vitvitsky. most large U.S. banks remain well-capitalized and highly liquid with lower reliance on wholesale funding.

Recent steps to better tailoring financial regulation to reduce regulatory uncertainty and compliance costs seem to be warranted. However, as noted by staff, their combined effects may increase financial stability risks. We support staff's call for maintaining the current risk-based approach to regulation, supervision and resolution. It is essential that the U.S. remain fully involved in the international discussion on financial regulatory architecture in order to preserve and improve the post-crisis progress in strengthening the resilience of financial markets, intermediaries and institutions at the global level.

Mr. Mahlinza and Mr. Tivane submitted the following statement:

We thank staff for the insightful report and Mr. Claver-Carone and Mr. Vitvitsky for their helpful buff statement.

The U.S. economy's upward trajectory remains robust, aided by a fiscal stimulus, supportive financial conditions, and renewed business confidence. The window of opportunity brought by this cyclical upswing, however, comes with costs, including financial stability risks, and increased market volatility over the medium term. Relatedly, the outward spillovers arising from the widening of fiscal imbalances, coupled with uncertainty prompted by an escalation of trade tensions, could potentially weigh on the growth rebound recently seen across AEs, EMEs, and LIDCs. Going forward, we agree that a prudent fiscal plan to tackle the debt vulnerabilities and create fiscal space for supply-side reforms needed to lift productivity growth and improve distributional outcomes would be warranted. We broadly concur with the staff appraisal and policy proposals and would like to offer the following comments for emphasis:

The fiscal stimulus package is expected to raise output growth, boost job creation, and incentivize private investment. These positive gains, however, could trigger a wide set of risks to the U.S. and global economy, including a steady rise in public debt-to-GDP ratio, intensified inflation pressures, international spillover risks, and increased global imbalances. We note the administration's assessment that, on balance, the faster growth induced by the Tax Cuts and Jobs Act (TCJA) would contribute to reduce the fiscal deficit by roughly 0.25 percent per annum over the next ten years. Nonetheless, a sustained fiscal consolidation that envisages reversing the upward trend in debt dynamics and deepens revenue reforms, would create room for infrastructure investments, human capital accumulation, and other structural policies to support higher medium-term growth.

The recent changes to the U.S. tax code, are an important step towards easing tax distortions, incentivizing private investment, and addressing cross-border profit shifting challenges. While the tax reform is expected to bolster productivity growth, we would suggest that the authorities prioritize revenue-enhancing reforms while containing higher budgetary costs usually associated with tax policy changes of such magnitude. Further, we note that the changes to the personal income tax are likely to exacerbate income polarization as various tax provisions expire. Staff comments on the likelihood of implementing some of their rate structure recalibration proposals would be welcome.

The Federal Reserve’s continued adherence to the principles of data dependence and clear communication of the monetary policy normalization process is key to achieving its dual mandate. We note that risks to economic outlook and to inflation prospects are assessed to be broadly balanced. We agree with staff’s advice that the Fed would need to raise its policy rate faster to ease upward inflationary and wage pressures that could arise with the ongoing strengthening of the economy. We also welcome the Fed’s well communicated balance sheet normalization process, which seems to have progressed in line with the stated policy normalization principles. Further, the U.S. financial architecture has shown increased resilience since the global financial crisis, however, further steps should be taken to strengthen the oversight on nonbank financial institutions while addressing risks related to rising leverage, weakening of underwriting standards and cyber-security challenges. We would also encourage the U.S. authorities to continue supporting the international financial architecture agenda.

Finally, the authorities’ recent actions towards inward-looking trade policies have triggered a wave of retaliatory measures from its trading partners that could have far-reaching consequences to the rules-based global trade system. Additionally, the ensuing outward spillovers could have a devastating impact on several economies, particularly emerging markets and development economies through increased market volatility. We note the authorities’ concerns that steel and aluminum imports threaten to impair their national security, but we strongly share staff’s views that the U.S. should work constructively with its trading partners with a view to resolve trade and investment disputes without resorting to trade and non-trade barriers. That said, we welcome the authorities’ commitment to the WTO reform agenda. At the same time, the authorities have indicated that the lack of progress in international fora has warranted some of the trade actions they have taken.

Staff comments on measures that could be taken to ensure faster progress at international fora would be welcome.

Mr. Sembene and Mr. Alle submitted the following statement:

We thank staff for an informative report and Mr. Claver-Carone and Mr. Vitvitsky for their insightful buff statement.

We welcome the continued expansion of the U.S. economy. Growth is strong and set to accelerate further, inflation is muted and unemployment has fallen to historical lows. Moreover, the outlook is favorable and should further strengthen with the authorities' planned policies aimed at supporting long-term growth. Going forward, the authorities are well-advised to put their policy focus notably on reducing the deficit and curbing public debt, further strengthening financial sector oversight to reduce systemic risks, and stepping up macro-structural policies to boost potential growth. In doing so and given the potential international spillovers from the U.S. economy and policymaking, the authorities are encouraged to strike the right balance between the immediate policies needed for domestic purposes and the imperative of preserving a stable larger and mutually beneficial global economy.

We note the disagreement between staff and the authorities regarding the prospects of long-term growth. Staff estimate potential growth to decline over the medium-term to around 1¾ percent at a 3-4 year horizon while the U.S. authorities project an average growth of 3 percent over 2018-28. We would like to hear staff's views on the factors underlying the authorities' projections, notably the planned US$1.5 trillion investment in infrastructure, the impact of the overhaul of the U.S. tax system, higher labor force participation, and a continuing process of de-regulation. What is staff's assessment of the growth impact of these factors?

As regards the macroeconomic policy mix, we see merit in the adjustment of the monetary stance to accommodate the effects of the fiscal stimulus. While we welcome the impact of the authorities' procyclical fiscal policy on potential GDP and employment, we are concerned about the ensued fiscal deficit and associated effects on the debt burden. The balance of risks stemming from the tax cuts seems to be tilted to the downside. We share staff assessment that the federal government deficit—projected to exceed 4.5 percent of GDP by 2019—would exacerbate an already unsustainable upward dynamic in the public debt-to-GDP ratio. Moreover, inflation may rise further and earlier as growth in potential output is bound by capacity constraints. The international spillovers risks are particularly worrisome. A marked reversal of capital flows would entail damaging disruptions to many emerging market economies. Likewise, a long list of emerging and frontier market economies, including African countries which heavily issued dollar-denominated sovereign bonds in recent years could suffer from the shift in the U.S. policy mix.

Regarding specifically the Tax Cuts and Jobs Act (TCJA), we view some of its objectives as broadly appropriate, including reducing the scope of personal income tax deductions, lowering marginal tax rates, creating incentives for private investment, tackling base erosion and cross-border profit shifting, and reducing debt bias. We are however of the view that many of these objectives would be best achieved through multilateral efforts. Furthermore, staff assessment clearly shows that the budgetary costs of the tax policy changes are onerous. In this regard, while taking note of the many positive aspects of the changes to the personal income tax, we are puzzled by the fact that the net effect of the changes provides greater benefits to those in the upper deciles of the income distribution; and that the policy changes do little for the working poor and for relieving the tax burden on low- and middle-income households. We urge the authorities to make further steps in this direction, given the macroeconomic importance of addressing the pressing needs of the poor, income polarization and inequality issues. Likewise, as time and trade partners help uncover potential negative international tax policy spillovers, the U.S. authorities should stand ready to make changes needed to curtail global tax competition.

Against this background, fiscal policy going forward should aim at putting the debt-to GDP ratio on a downward path. To this end, new tax policy measures could have helped increase the federal revenue-GDP ratio. But we understand from the authorities that staff-proposed broad-based carbon tax and federal consumption tax were improbable sources of revenue. Could staff elaborate further on the authorities' arguments? We learn that the authorities' fiscal consolidation will be centered on the yields from an unleashed American economy, resulting from tax cuts and deregulation, on the one hand, and on spending restraint, on the other hand. While we wish the authorities well in their strategy, we would like to point to the significant risks it carries.

On trade policy, while we see the legitimate calls of the U.S. for fair trade and a levelled playing field, we are concerned about the potential disruptions that unilateral policy actions may cause to the global economy. We encourage the U.S. authorities to rely on relevant international bodies including the WTO and bring before them incriminated cases of unfair trade practices, notably related to aluminum and steel imports, technology transfer, intellectual property, and innovation.

We note the authorities' view that the banking system is not an imminent source of financial stability risk, and that risks from non-regulated institutions are assessed to be moderate. We concur with staff that the FSOC should continue its efforts to respond to emerging threats to financial stability. In this regard, it is required to improve data sharing among regulatory agencies, particularly related to the activities of nonbanks, for enhancing the understanding of the nature of financial system risks, interlinkages and interconnections. Annex IV of staff report depicts a low implementation rate of FSAP recommendations. Could staff elaborate on the reasons for this weak implementation?

Beyond the macroeconomic policy mix, the authorities should forcefully implement macro-structural policies to boost potential growth. To meet the objective of unleashing the American economy, tax policies should be complemented with structural policies. As discussed by staff in Box 5, page 18, efforts should particularly emphasize: raising the federal minimum wage; improving education especially in the areas of science, technology, engineering and mathematics programs; expanding apprenticeship and vocational programs to workers of all ages; expanding the labor force by providing family friendly benefits and undertaking a skills-based immigration reform. Growth would also benefit from measures to enhance intra and inter-industry competition.

Finally, the U.S strong partnership with Africa has served both parties well in several cross-cutting areas. In particular, many countries in our Constituency have benefited from U.S-backed initiatives such as the African Growth and Opportunity Act (AGOA) and the Millennium Challenge Corporation (MCC). Our authorities look forward to further strengthening this mutually beneficial cooperation.

Mr. Mozhin and Mr. Palei submitted the following statement:

We thank staff for the concise and well-focused report and Mr. Claver-Carone and Mr. Vivitsky for their BUFF statement. In the near term the U.S. economy will grow at a fast pace of almost 3 percent annually. The current account deficit is still relatively moderate, and it is expected to widen modestly. Long-term inflation expectations remain anchored, and credibility of monetary policy is high.

We appreciate the authorities' direct and frank reaction to the report and recognize that some differences in views between the authorities and the IMF staff are natural and generally welcome. However, the large divergence of opinions on most of the basic issues of macroeconomic analysis seems to us very unusual and disturbing.

We are concerned that the tax reform in the U.S. will lead to much larger fiscal deficits in the foreseeable future. Staff and the Congressional Budget Office, independent fiscal council in the U.S., expect fiscal deficits expanding to almost 5 percent of GDP by 2021. The primary deficit is likely to remain close to 2.4 percent of GDP, while a significant primary surplus is necessary for the stabilization of the public debt-to-GDP ratio. The warning about unsustainable public debt dynamics is well-articulated in the staff report. We welcome the detailed analysis of benefits and costs of the tax reform, and broadly support staff's call to address more forcefully the distributional consequences of the adopted package. We also agree that, in its current form, the fiscal policy leaves little room for the investments in infrastructure necessary to increase potential growth.

Staff and the U.S. authorities disagree on the nature of economic growth in the coming 18-24 months. Staff see it as a cyclical uptick above potential, since the economy is already beyond full employment. On the other hand, the U.S. authorities believe that staff's estimates of growth potential are incorrect, and, more importantly, that the economy will move to a permanently higher growth path. The U.S. authorities insist that staff missed the purpose of the tax reform, as, in their view, it goes well beyond the ordinary fiscal stimulus and, instead, aims at structural changes that will allow to lift productivity. We find it important to evaluate the likely effects of structural reforms on output, as staff do for many of its members. At the same time, we frequently find expectations of very large positive effects on output from structural reforms in the advanced economies to be overly optimistic. We thank staff for the table on economic forecasts on page 17. However, it does not seem to reflect the views of the U.S. Treasury. For illustrative purposes, it would be helpful to add to this table the numbers reflecting the authorities' forecast.

Major disagreements on the evaluation of current developments and policy implications, in our opinion, are a sign of growing policy uncertainty emanating from a very large economy and, hence, of higher risks to international economic and financial stability. While staff refer to these risks as medium-term, we feel that the risk of dislocations is more imminent, especially in relation to the likelihood of tighter global financial conditions. In this respect, we note, for example, that both the FOMC median "dot" chart and the current IMF forecast of policy interest rates in the U.S. now clearly point to the need for "overshooting" (page 15). Staff comments on their classification of the risks in the monetary policy area would be appreciated.

The authorities and staff disagree on the likely consequences of the U.S. international trade policy. In this area, it would be useful to better understand the effects of growing trade tensions on the U.S. economy, on the one hand, and on the trading partners, on the other hand. As an example, in Box 6 in the report staff offer estimates of the effects on GDP of the NAFTA countries. The benefits of the so-called "successful NAFTA renegotiations" for the U.S. growth appear to be miniscule, while for the other two economies they are substantial. Given that the U.S. economy is large and relatively closed, would similar conclusions hold true for trade policy effects on a broader group of countries? In any case, we agree with staff that unilateral actions may undermine the existing complex rules-based international trade system and increase the transitional costs of its possible improvements.

In our opinion, under the current circumstances highlighted in the report the Fund should be more vocal about the need to fortify the international financial safety net and to strengthen its own role in it, including its capital base.

We note that there is no Selected Issues Paper. Many working papers mentioned in the text have not been completed yet, so they can hardly provide timely analytical support. In the absence of the SIP, the analysis may appear to be less rigorous than in the previous staff reports. The new format obviously did not increase traction of the Fund advice with the U.S. authorities, although this outcome can hardly be attributed exclusively to the format of the paper. These observations call for a more careful consideration of the benefits of the SIPs.

Mr. Jin, Ms. Liu and Ms. Ma submitted the following statement:

We thank staff for the comprehensive report and Mr. Claver-Carone and Mr. Vitvitsky for the buff statement. We broadly agree with staff's assessment of the U.S. economic performance, outlook, and appraisal on macroeconomic policies. The U.S. economy is now growing at a level higher than full employment, thanks to its procyclical fiscal policy, but risks increased internal and external imbalances over the medium term. Like many others, we are deeply concerned about the recent unilateral protectionism undertaken by the administration. We strongly disagree with the authorities' view on its trade relations with other countries as well as its view on the Chinese economy. Escalating trade tensions would pose significant risks to the global economy, create financial market volatilities and disruptions, and be detrimental to the U.S. economy as well.

We concur with staff's view that procyclical fiscal policy will run at a cost in the medium term, in the form of increased fiscal deficit, unsustainable public debt, a rise in external imbalances, and a more dramatic reversal of capital flows, which could be very damaging to emerging markets with weak fundamentals. The implications of the U.S. policy shifts to debt sustainability in the LICs should also be incorporated in the staff's assessment.

The issues sometimes perceived to be associated with globalization, such as structural unemployment, regional imbalances, and inequality, among others, should be first examined and addressed through the adjustment of domestic policies, rather than placing the blame on trading partners and resorting to unilateral protectionism that could severely damage the rules-based multilateral trading system that actually benefits the U.S.—the major rules-maker—the most.

We fully support the Fund's view that trade balance should be viewed from a multilateral, rather than a bilateral, perspective. One should not ignore its large surplus in service items and only emphasize the deficits in goods items under the BOP. It will be misleading to notice the U.S. trade deficits only and overlook the U.S. multinationals established in other countries that sell much larger amount of goods compare to U.S. exports. As a major reserve currency issuing country, the U.S. cannot deny its practice of issuing IOUs to settle its trade deficits for many years. It also cannot deny the capital inflows contributed by its surplus trade partners that financed its fiscal deficits and lowered the cost of investment and household borrowing. It should be of concern to surplus countries the fairness of their trade with the U.S. because a large part of their exports has been paid with IOUs.

We support staff's discussions and conclusions on competition policy. The market power of corporations across a range of major U.S. industries illustrates the distortions caused by market concentration, monopoly, and oligopoly, although these are private companies rather than SOEs. It also demonstrated that market distortions are not necessarily caused by public ownership, but rather by the lack of market competition. We encourage staff to make further analysis on distortions in the U.S. economy caused by large subsidies in agriculture, and whether the prolonged low policy interest rates in the past decade that may have over depreciated the USD could lead to a stronger than normal rebound of the USD and reversal in capital flows.

The authorities labeled the Chinese economy as a non-market system. This is more an excuse for the authorities' discriminative trade practices against one of its major trade partners. The U.S. multinationals in China, such as Apple and GM, profit greatly from what the U.S. administration regards as a non-market economy. The share of net sales of Apple and GM in China is about 20 and 18 percent respectively of its global total. Measured by trade/GDP ratio composed by the World Bank, the United States' 27 percent ranked the fifth from the bottom among all economies, which is lower than China's 37 percent, Japan's 31 percent, and the European Union's 30 percent (excluding intra-EU trade). Measurement of openness should not only be based on indirect indicators such as tariff rates, but rather on final results, namely how much in the end one purchases from and sells to the rest of the world. We welcome the authorities' strong commitment to the WTO and call on the administration to honor its commitments and reflect them when handling trade disputes with its trading partners.

Lastly, regarding the U.S. fiscal policies, we think the authorities' arguments on increasing revenues and reducing expenditures sounds quite impressive. We wonder why this has not been taken into staff's consideration and how it will help improve the fiscal position. Staff's comments are welcome.

The representative from the European Central Bank submitted the following statement:

We would like to thank Mr. Claver-Carone and Mr. Vitvitsky for their clear buff statement and Staff for their informative report.

We welcome Staff's focus on the key policy decisions of the current administration relating to fiscal easing, tax reform and protectionist trade measures, which continue to generate significant uncertainty, also in a global context. We support many of the report's findings and policy recommendations for mitigating near-term risks and addressing still-significant longer-term policy challenges.

We broadly share Staff's assessment of the positive near-term economic outlook and the likely modest impact of the tax reform on potential growth. The upward pressure of tight labor market conditions on wage growth, together with a continued improvement in investment, and still favorable financial conditions support expectations of solid growth in the near-term. In addition, recent fiscal policy changes, including the tax reform and the two-year budget deal, will serve to push real GDP above potential in the near term. On potential growth, we agree with Staff that the tax reform is likely to have modest supply-side effects. Thus, we consider that the US administration's view of the long-term growth potential appears quite optimistic. Moreover, the current policies deprive fiscal space needed for reforms to raise potential growth and do not allow the rebuilding of fiscal buffers which would be required in the event of an economic slowdown.

While we agree that risks are becoming tilted to the downside in the medium term, recent developments also point to increasing downward risks in the near term. The materialization of concerns regarding a protectionist shift in US trade policy and broader disengagement from multilateral economic policy fora are likely to weigh on sentiment and business investment decisions, which is already reflected across financial markets. In Staff's report we particularly welcome the explicit reference to the interaction of fiscal policy with tighter financing conditions and adverse spillovers to the global economy, as well as its contribution to widening external imbalances.

On the external sector, we broadly agree with Staff's assessment of the US current account position, which appears moderately weaker than implied by medium-term fundamentals. The net international investment position, albeit improved somewhat this year, remains highly negative in view of large negative valuation effects in the post-crisis period. We strongly agree with Staff's assessment that the US current account deficit largely reflects a saving-investment imbalance, and attempts to unwind external imbalances through raising trade barriers would likely prove ineffective and counterproductive to raising living standards.

With regard to fiscal policy we share Staff's concerns on the timing of fiscal easing at a very late stage in the cycle and its associated risks. Importantly, while noting the relatively modest growth impulse anticipated by Staff in the near term, we concur with Staff's views on the potentially significant costs implied by the current fiscal policy trajectory over a longer time horizon. These take the form of: (i) aggravating already prominent fiscal sustainability concerns; (ii) reducing policy space for reforms that help raise potential and heightening risks of a pro-cyclical fiscal tightening during a future downturn; and (iii) widening current account deficits which add further to global imbalances. We note that Staff's forecast incorporates a gradual fiscal consolidation over the medium term stemming from the assumption that the tax cut and spending will only be temporary. However, it should be highlighted that based on historical evidence, initially temporary measures are often extended and made permanent, adding to concerns over the medium term fiscal stance. We therefore see a need to adopt measures on both the revenue and the expenditure side to ensure that public finances are on a sustainable path over the longer term. These measures should also ensure that concerns over social inclusion are not exacerbated further.

On monetary policy, we agree with Staff's view that the pace of policy rate normalization should remain gradual and determined by incoming data. We also welcome the ongoing gradual and predictable runoff of the Federal Reserve's balance sheet which helped mitigate the risk of sharp or outsized asset price reactions. We endorse Staff's view that a key risk for the outlook is that inflation might accelerate faster than previously expected as the economy is already close to full capacity, which could result in a tighter monetary policy path. We emphasize that the elevated valuations in financial markets, particularly in the US stock and bond markets, bear the risk of a sharp correction. A sudden tightening in financial conditions can be especially disruptive for vulnerable emerging market economies.

We broadly concur with Staff's positive assessment of the health of the financial system as a whole and stress that further rollbacks should be avoided and that the current financial regulatory framework needs to be preserved. Regarding specific risks to financial stability, we notice that US corporate sector vulnerabilities have been increasing steadily. Although a turn in the corporate credit cycle is not imminent and the share of vulnerable firms remains relatively low, underlying risks may increase, as the removal of policy accommodation progresses further. Moreover, looking at the 2015 FSAP recommendations, we believe that many remain unaddressed. In particular, a reform of the housing finance framework is key to creating a more sustainable and resilient system. We would welcome legislative measures that responsibly reduce the role of government agencies in the mortgage market and transfer risks of mortgage default to the private sector. Concerning recent initiatives on financial deregulation (i.e. rollback of the regulation for small banks and proposed changes on the Volcker rule), it is important to stress that further rollbacks should be avoided and the current financial regulatory framework needs to be preserved so as to safeguard financial stability and not to trigger a competitive race to the bottom in financial and regulatory oversight.

We stress that trade barriers are harmful for global trade and are likely to be ineffective in reducing bilateral trade imbalances. We fully support Staff's view that the US should work constructively with its trading partners towards ensuring an open and rules-based international trading system, as highlighted by the estimates on the positive, multilateral growth effects from a successful NAFTA renegotiation in the report. In this context, a more in depth discussion on the harmful impact of trade barriers on the US and the global economy by Staff would have been welcome. Beyond trade policy, a broader disengagement of the US from multilateral institutions, such as the G7 and G20, remains an important risk factor for the global economy.

Ms. Horsman made the following statement:

Before I start, I would like to commend the staff for what has no doubt been a challenging assessment. The policy environment has been fast moving and uncertain.

We issued a comprehensive gray statement, so I would simply like to make two points, both of which are guided by the theme of working together toward mutually beneficial outcomes.

First, on excessive global imbalances, we may each have unique arguments to defend our own position individually; but collectively, are we on a sustainable path? We appear to be on the brink of a disorderly unwinding. The answer is likely no. We all have a part to play, including the United States, to undertake appropriate domestic adjustments to achieve our collective goal of more balanced, sustainable, and equitable global growth. To be clear, we do not condone the approach the U.S. authorities are taking. Indeed, Canada is the target of some of the U.S. measures. But this does not negate the fact that we all have an interest and a role to play in helping to reset the discourse.

Second, we need to be vigilant to ensure that our policy advice takes spillovers into account and, therefore, will lead to mutually beneficial outcomes. I would highlight two ways we can achieve this. First, U.S. policy actions, like those of other countries, must be consistent with international standards. This is not to say that the rules of the game cannot be improved, but we must continue to urge the United States to be at the table in helping improve them in a collaborative way. This applies across many policy areas, including tax, trade, and financial sector fora.

Second, Fund advice must be consistent with optimal multilateral outcomes. Trade is an example where the Fund’s advice is consistent with optimal multilateral outcomes. The Fund has rightly said that the United States and its trading partners should work to reduce trade barriers and to resolve trade and investment disagreements without resorting to the imposition of tariff and non-tariff barriers.

On tax, however, I will give three examples where we have concerns that the Fund's advice does not give enough attention to optimal multilateral outcomes: First, by using laudatory language, like "innovative," to describe some of the U.S. corporate tax measures that many are concerned may pose issues in terms of compliance with WTO, tax treaties, and the base erosion and profit shifting (BEPS) minimum standard on intellectual property (IP) regimes. Second, by prematurely calling on other countries to respond directly or indirectly in a manner that may undermine fiscal positions based on what are at this point highly uncertain impacts. And third, by recommending a shift to a cash flow tax system with no comprehensive discussion of ideal overall approaches to taxation or international norms. I would also note that the cash flow tax is a largely academic concept and would echo Mr. Meyer's comment that the cash flow tax is impractical and its benefits unproven.

This brings me back to my starting point, that we all need to be at the same table to understand the impacts of U.S. policies and see if there are refinements and appropriate responses that would be mutually beneficial to all.

The United States is an important economic partner and ally for Canada and for this chair's entire constituency. We are committed to finding ways to continue to build on our strong, important, and mutually beneficial relationship.

Mr. Hurtado made the following statement:

I would like to associate myself with everything that Ms. Horsman has said, especially regarding trade policies. The U.S. policies in general are very important for the totality of this chair as well. Having said that, I would like to make three points which are somehow related to what we wrote in our gray statement.

First, from the outset, the report says that public debt is already unsustainable in the United States. I have a problem interpreting what that means for the United States, given that the dollar is a reserve currency, which means the markets take this differently from other currencies. My question to the staff is—and I know this is difficult and unknown—but I would like to know what that means exactly, because in the case of another economy, unsustainability means that at some point, people will stop taking bonds from that country and then it will run out of cash. What would be the consequence of unsustainable public debt for the U.S. economy?

The second point is that in paragraph 12, there is a recommendation by the staff to embark on a fiscal adjustment that would result in a primary surplus of one-quarter or one-half, depending on the general or the Federal Government. But the important point is that it is a big fiscal primary deficit. The adjustment that is being proposed is an adjustment of about 3.5 percentage points of GDP, which is very high for any economy, and especially for the U.S. economy. Is my understanding of the size of the adjustment correct? In addition, over what period is this recommendation being made? Is that for three years, four years, five years? Also, it is not clear what the authorities' views are on this, because the relevant section of the report does not speak directly about this point.

Finally, we believe that the current account deficit in the United States is due to internal imbalances. We asked a question related to that, and we got received that answer. The United States may be embarking on a vicious circle because of the trade and fiscal policies. Because of the fiscal policies, these imbalances are growing, so the current account deficit will continue to grow while the administration at the same time is also applying some trade measures in order to replace the trade deficit. This is very inconsistent, and I would appreciate the staff's comments on that.

Mr. Alogeel made the following statement:

We thank the staff for their work and Mr. Claver-Carone for his helpful buff statement.

We issued a gray statement and would like to highlight a few points. We welcome that the U.S. economy is performing well, with a favorable outlook, supported by tax reform, deregulation, and a pro-growth economic policy agenda. We particularly welcome the staff's assessment that the net effect of higher U.S. growth and the increase in interest rates is expected to be beneficial for most economies.

We agree that increasing federal spending on infrastructure is urgently needed to boost potential growth. In this regard, we take positive note of the administration's plan to leverage federal spending to generate substantial investment by state, local, and private providers.

It is also encouraging that the normalization of monetary policy is proceeding smoothly, thanks to the continued adherence to the principle of data dependence and clear communication.

In the financial area, we welcome the important gains made in strengthening the financial oversight structure since the global financial crisis. The positive result of the supervisory stress test released last week is also welcome.

Finally, we thank the staff for the response to our question on the extensive use of working papers in drawing the staff's conclusions and policy recommendations. Our comment was meant to be of a general nature, applicable to all Article IV reports, and not specific to the United States.

From disclaimers in the working paper, it is clear that these papers describe research and progress, and they are published to elicit comments and encourage debate. We feel that on many topics, it would be beneficial to get feedback from relevant experts rather than rush to make the conclusion of a working paper a staff policy recommendation. The section on competition policy in the U.S. report is an example where extensive feedback from academic experts in this field would have been useful, including to help gain traction.

With these remarks, we wish the U.S. authorities continued success.

Mr. Jang made the following statement:

I thank the staff for a comprehensive paper on the U.S. economy. We already issued a gray statement, so I would like to comment on three points.

First, I agree with the staff's view that U.S. monetary policy has the potential to trigger broader volatility and risk aversion. An unexpected normalization in U.S. monetary policy could result in capital outflows and to tighter financial conditions in emerging market and developing countries (EMDCs). Moreover, heightened uncertainty in the financial market could dampen investment and consumption in terms of outward spillovers. Therefore, we underscore that the Fed's continued adherence to the principles of data dependence and clear communication will be vital.

Second, like other Directors, we believe that an open and rules-based international trading system should be preserved. We underscore that trade barriers are harmful for global trade. They are also likely to be ineffective in reducing bilateral trade imbalances. We agree with the staff's view that the U.S. should work constructively with its trading partners toward ensuring an open, rules-based international trading system.

Lastly, we welcome the staff's analysis on the U.S. competition policy's role in maintaining the vitality of the U.S. economy. There is some evidence that the growing dominance of large firms has weighed on the aggregate labor share in advanced economies. I would like to see some analysis of each sector in which this effect is most prominent.

Mr. de Villeroché made the following statement:

I thank the staff for the report. We broadly share the analysis of this succinct report. I will make a few comments. The discussion that we are having today is extremely important because of the size of the U.S. economy and because, like many Directors, we are increasingly concerned by the growing imbalances.

Looking at the fiscal stimulus package, we are concerned by something which is definitely procyclical. Today's acceleration of growth in the U.S. could be paired with a slower pace of growth in the coming years, given the position of the U.S. economy in the cycle. We believe it is a risky strategy to keep an open fiscal deficit in the range of 5 percent for a few years when the economy is running above its potential.

Looking at the details of these reforms, we have some criticism as well. First, on the level of public spending in the United States, we see a case to increase public spending on infrastructure, education, and social protection. We see the reform as broadly regressive in terms of social impact.

Second, we fear that this reform will have a negative spillover on corporate income tax worldwide in terms of fueling a race to the bottom. It is an issue that we discussed already with the staff. I believe it has been recognized in a recent bilateral surveillance report that it is putting pressure on other countries to cut their corporate income tax.

Third, there are many mechanisms, complex reforms, but we question their consistency with OECD rules and WTO principles.

Looking at the external sector, we are increasingly concerned by the way the United States addresses its imbalances. The United States has a current account deficit, which is likely to grow larger due to these procyclical policies. We believe the rationale of looking at bilateral trade balances is the wrong way to start a discussion on trade. Most of the responsibility definitely goes to these domestic imbalances, which are reflected in the external account. We would like to tell our U.S. friends again to refrain from taking protectionist measures. They will hurt the U.S. economy. They will hurt the world economy. Instead, they should address domestic imbalances first.

On the financial sector, there was some backtracking. We believe that more is needed to assess the consequences of this backtracking, and we look forward to having more discussion in the coming months in terms of surveillance on the financial sector.

Mr. Tombini made the following statement:

We have issued a gray statement, so I would like to add a few comments.

The U.S. economy has performed well for quite a while, showing an impressive mix of robust growth, very low unemployment, and well-behaved inflation. Consumer sentiment remains buoyant, and the near term is favorable, with the economy expected to enter the longest expansion in the country's history. This is not a small feat. However, I understand that what many of us are worried about is how such a short-term outlook will unfold into the medium term. In this regard, some concerns expressed in the staff report and in most gray statements are warranted. After all, the health of the U.S. economy is important to the health of the world economy, as some of my colleagues have mentioned. Having said that, I want to touch on three points.

First, I would like to hear more from the staff about the apparent and somewhat puzzling decoupling between the strong job market and the still-dormant wage growth. While I can see that structural change might be playing a role—and there is a box on that issue in the report—I would still deem cyclical facts to be relevant. With unemployment continuing on a historical dive, at some point we should expect wages to react in a more forceful way. While understanding the uncertainties involved in this debate, I wonder whether there is a specific variable—focusing, for example, on a segment of the market, such as wage by age brackets—that could provide an early indication of stronger wage reaction to the labor market tightening.

My second point regards the revamping of financial regulation, given the sheer size and interconnectedness of the U.S. financial markets. It goes without saying that the actions here not only are scrutinized globally but also tend to set worldwide precedents. It is important that the United States continues to lead by example. I recall that the engagement of all major players was instrumental to develop the needed financial regulation overhaul in the aftermath of the global financial crisis.

As I noted in my buff statement, there is scope for streamlining and recalibrating measures taken at the height of the crisis, but it is still critical not to backtrack from what has been achieved. I trust that recent regulatory measures are still marginal and do not affect the overall picture, as they were basically focused on small financial institutions. Going forward, it is crucial to preserve a level playing field and to ensure that everyone is still on the same page.

Finally, I have said in my statement, it is important that we avoid a deterioration in the trade relationships worldwide. We appreciate the staff's call and the Managing Director's vocal intervention on many occasions for a cooperative approach to trade disputes, reinforcing the rules-based multilateral framework, and bolstering an open and fair trade system.

Finally, I want to join Mr. Hurtado in his quest for some clarification on the term "unsustainable debt." I cannot associate myself to this idea, being from a country which is one of the largest holders of U.S. debt. I wanted to see what that means, and I am looking forward to the staff's response.

Mr. Saito made the following statement:

As we have issued a gray statement, I would like to offer three comments for emphasis.

First, on the macroeconomic policy mix, as the U.S. economy is beyond full employment, it is essential to pay close attention to the consequences of the current procyclical fiscal policy. We share the staff's concern that procyclical fiscal policy risks not only adding burden to public debt but also to growing current account imbalances, which would contradict the administration's intention. At the same time, the tax cuts and the increase in public expenditures would put additional pressure on inflation and would accelerate the pace of monetary policy normalization, which could lead to increasing financial market volatility. In this regard, I take note of the staff's response to our question that the macroeconomic impacts of the planned balance sheet roll-off is limited. However, spillovers that affect both interest rate increase and balance sheet reduction in other countries, especially for the emerging market economies, should be monitored closely.

Second, on the Tax Cuts and Jobs Act (TCJA), the series of reforms will not only have impacts on domestic demand in the United States but also will provoke other countries' reactions, such as taxrate changes, and eventually affect the global economy through trade, capital flows, and allocation of production. We encourage the staff's further analysis on the quantitative spillover effects of the TCJA and encourage timely information sharing with the Board.

Finally, on trade policy, the recent broad-based trade measures could not only undermine the global trading system but also will have serious impacts on the global economy through an increase in uncertainty of firms and investors. Moreover, these negative effects will be amplified under the current multilayered global value chain structure. We agree with the staff that protectionism benefits no countries, including the United States, and that the global economy should rely on the open, fair, and rules-based international trade system. As Mr. Hurtado pointed out, trade imbalances reflect domestic imbalances and should be resolved by appropriate macroeconomic and structural policy measures. At the same time, given the deepened global value chains, like Mr. de Villeroché, we believe trade imbalances should be treated as multilateral problems, not as bilateral problems. In this regard, we underscore the importance of a quantitative analysis by the Fund on the macroeconomic impacts of trade policy and are looking forward to the joint paper with the World Bank and the WTO. I ask the staff to elaborate on the detailed topics that the paper will cover.

Mr. Ostros made the following statement:

I will start by thanking the staff for a good report based on sound economic analysis and with frank recommendations. This is important for the institution. We need that type of intellectual integrity and frank advice in a period of time when not everybody is contributing to that. This can be a report that truly matters in the global debate.

The U.S. economy continues to perform well. It is experiencing a remarkably long period of expansion after the swift and decisive actions during the banking crisis, the fiscal stimulus during the recession, and with the support of well-handled and well-communicated monetary policy.

As clearly pointed out in the staff report, although the near-term outlook is good, the U.S. economy faces several risks at the longer horizon. In particular, the planned fiscal expansion at the point when the economy is judged to be operating above capacity does not strike us as a good idea. This procyclical fiscal policy gives rise to several significant risks and spillovers, both to the United States itself and to other countries around the world.

I appreciate the emphasis on international spillover risks in the report and how the expansionary U.S. fiscal policy will contribute to an increase in global imbalances.

The report nicely sums it up. The procyclical policy runs the risk of further increasing already unsustainable public debt, widening global imbalances, disrupting global capital flows, and fueling ongoing trade tensions, since it will probably also contribute to widening the current account deficit in the United States, while at the same time, having little impact on the U.S. economy's long-term growth potential. Unfortunately, this policy choice by the U.S. administration leaves little room for investment in the urgently needed supply-side reforms that would have boosted growth potential, raised living standards for the majority of Americans, and helped achieve more equal opportunities for all.

On the envisaged deregulation of the financial markets, we take note of the message from the staff that the steps proposed to better tailor financial regulations are likely to have a modest impact on financial stability risks, but I also note that the staff notes that there are potential important interactions between the regulatory changes, for which the outcome can be hard to predict. It might add to the procyclical stance of the overall policy. A combination of expansionary fiscal policy and a deregulatory agenda on the financial markets warrants close monitoring.

Like the staff, I also encourage the authorities to strengthen oversight over the large and growing non-bank sector.

Finally, we fully support the staff's recommendations for the United States and its trading partners to work constructively toward ensuring an open, rules-based international trade system. I associate myself with Ms. Horsman's intervention, which was clear and remarkably strong on trade issues.

Mr. Just made the following statement:

We thank the staff for the comprehensive and well-written report and echo Mr. Ostros's comments about the excellence of this paper. We have issued our gray statement and would like to provide some comments for emphasis.

Like other Directors, we concur that the near-term outlook for the U.S. economy is one of strong growth and job creation. However, the procyclical policies, coupled with the increased trade tensions, add even more question marks to the sustainability of the U.S. medium-term outlook. Equally concerning is that vulnerabilities most likely will increase, with potential adverse spillovers to the domestic but also to the global economy.

The recent changes to the U.S. tax code are, overall, commendable, but the price tag for the budget and their regressive nature are unfortunate, as it will have an impact on the health of public finances, and will further exacerbate income polarization. A stronger fiscal consolidation path than the one envisaged by the authorities in 2020 is warranted, and the authorities should take due consideration of domestic distributional consequences.

We join the strong concerns voiced by Directors about the escalation of trade tensions and protectionism. We note that an open, fair, and rules-based trading system is indispensable for global economic growth, job creation, and investment.

We take note of the authorities' intention to promote fair and reciprocal trade, an objective that we share in principle, but how this will be done in practice is subject to debate.

We caution that bilateral trade balances should not be viewed as a policy anchor or targets. Like Mr. Jang and Mr. Gokarn, we are worried about the distributional impacts of the trade tariffs, as it seems to affect, to a large extent, low-income households in the United States.

Overall, we acknowledge the authorities' overarching objective of boosting medium-term growth potential. The measures most likely will achieve this objective in the short term. We are less confident whether this will result in a permanent shift of the growth trajectory. We are also concerned that these measures will worsen poverty and inequality. Many of the features of the American dream, such as upward social mobility across the country, appear in retreat; life expectancy and other health indicators are worsening. Strengthening health care coverage, possibly more active labor market policies, improving the quality and the affordability of education, and expanding family benefits would all contribute to creating higher living standards for low- and middle-income households.

Equally, we have increasing doubts about whether the market concentration—especially in the tech sector—will actually reduce the dynamism that propels the United States to be a technological leader also in this field. These risks should be carefully monitored by the authorities.

Mr. Agung made the following statement:

The U.S. economy is doing well, and it is in all of our interest to see this strong performance continue in a sustainable way.

We issued a gray statement that broadly concurred with the staff appraisal, and we believe all the key policy discussions have been thoroughly covered in Directors' gray statements. I would like to highlight two comments.

My first point is about surveillance. As Directors have emphasized, the United States is an anchor of the global economy and the international monetary system. Its actions have direct macro-critical implications on the rest of the membership, especially for the small, open and emerging economies like those in my constituency, which are price-takers in the global trade and financial market. The recent intensifying trade tensions, for example, have put additional market pressures on emerging markets beyond the impact of tightening monetary policy. We commend the staff for sending strong and consistent messages through this report both on the cross-border spillovers from domestic policies and on the need for constructive multilateral engagement on key policy challenges. This is exactly the type of discussion envisaged in the Integrated Surveillance Decision (ISD). We hope a similar approach will be taken for Article IV reports of other major economies. We note that for the United States, the key themes of the staff's advice are similar across the different policy discussions on tax, trade, and regulation. Policy objectives may be directionally sound, but the measures need to be well calibrated and have due regard to the multilateral architecture and dynamics.

My second point is about traction. In many policy areas, there seems to be a significant divergence of views between the staff and the authorities. Like Mr. Mozhin, we are concerned that these differences relate to fundamental macroeconomic issues. I am interested to hear from the staff to what extent their advice has traction with the authorities and how this can be further improved. I would like to invite the staff's comments on this.

Mr. Mkwezalamba made the following statement:

We thank the staff for this important report on the United States, which touches on important issues to the global economy, particularly at this juncture, including: the tax reform, the current trade tensions, but also monetary policy normalization.

We have three points to make. First, given the importance of the U.S. economy, we believe an appropriate fiscal policy stance is important for the global economy. Therefore, striking the right balance between the need to address the debt vulnerabilities and creating fiscal space for structural policies aimed at boosting potential growth is greatly encouraged. In this respect, we want to call for continued engagement between the Fund and the authorities on fiscal policy.

Second, we note that the Fed's monetary policy normalization has progressed well so far, underpinned by a clear communication strategy. However, we share other Directors' views that an accelerated pace of normalization could increase financial market uncertainty, trigger capital flow reversals, and increase debt vulnerabilities, particularly in emerging markets and low-income and developing countries (LIDCs). Hence, we join other Directors in encouraging the staff to monitor closely the impact of U.S. policy developments on debt sustainability in LIDCs.

Finally, on trade, we reiterate our concern about the current tensions and their potential impacts on the global economy. We note that this is diverting attention from the vital agenda of making hay while the sun shines. Therefore, we strongly support calls for a constructive dialogue between the U.S. authorities and their trading partners to address the trade and investment disagreements through relevant international bodies.

Mr. Jin made the following statement:

We thank the staff for the comprehensive and balanced report and their candid policy recommendations, and Mr. Claver-Carone and Mr. Vitvitsky for the informative buff statement. We have issued a gray statement, and I would like to add and highlight a few points.

It is good to see that the U.S. economy is growing robustly and that people have widely benefitted from strong growth, high employment, and still low inflation. At the same time, we concur with the staff's view that procyclical fiscal policy will run at a cost in the medium term.

Regarding the longer-term perspective, there is great uncertainty, and the discussion in certain areas has been insufficient. We wonder whether one should take into consideration the implication of possible technological innovations on potential growth. For example, quantum computing, artificial intelligence, robotics, the fifth-generation cellular network, the application of block chains, the Internet of Things, and advanced manufacturing, could potentially boost the long-term growth rate, like what happened in the late 1980s and 1990s when personal computers, and the digital and internet revolution erupted. Will history simply repeat itself or evolve in a different pattern? The staff may need to incorporate the implications of these alternative evolutions. The staff's comments are welcome.

The U.S. tax reform has far-reaching implications. The broader impact of the act and its spillovers on investment, capital flows repatriation, as well as tax legislation in many other countries needs a more in-depth analysis and continued monitoring. In addition, the implications of the U.S. macroeconomic policy shifts on debt sustainability in low-income countries (LICs) should also be touched upon in the staff assessment.

Like many other Directors, we are deeply concerned about the recent unilateral protectionism undertaken by the administration. We fully support the Fund's view that trade balance should be viewed from a multilateral, rather than a bilateral perspective.

A country's external imbalances should be first examined and then addressed through the adjustment of domestic policies, rather than resorting to unilateral protectionism. This could severely damage the rules-based multilateral trading system from which the United States benefits the most as the major rule-maker.

We welcome the authorities' strong commitment to the WTO and call on the administration to honor its commitments and engage constructively with its trading partners.

Mr. Meyer made the following statement:

I thank the staff for a clear and candid report. We congratulate the United States for their overall very well-performing economy, increasingly leaving behind the legacies of the global financial crisis. As many Directors and the staff highlighted, U.S. economic policy decisions have major implications for the world's economy at large. It is against this backdrop that we have been quite outspoken in our gray statement, where we expressed worry about the way forward.

We share the staff's and almost all Directors' strong concerns about the heavily procyclical fiscal policy, which is risky given that a credible fiscal consolidation strategy for the United States has already been missing for years, long before this administration. While we take note that the administration expects higher growth from its policies and envisages significant spending cuts going forward, this will not be easy to be achieved in the political process, to say the least.

Based on historical evidence, temporary tax measures are often made permanent, adding to concerns over the medium-term fiscal stance. On the TCJA more broadly, as the Canadian chair highlighted, the complexities render even a domestic assessment challenging, while understanding implications for other jurisdictions is even more difficult. Therefore, we encourage the staff to continue looking into the issue and the authorities to review certain elements to permit full alignment with OECD and WTO principles, as mentioned also by the French chair.

We have some concerns around some of the measures and the regulations, where we questioned whether lowering environmental standards might lead to investment that is not sustainable in the longer term. We asked a question. There was no answer. I assume that the staff will answer that question when they comment.

On trade, we once again emphasize the invaluable role that an open, fair, and rules-based international trade system plays for the world economy, including the United States. We call on all parties to solve trade disagreements in an orderly way and within the existing multilateral institutions.

Beyond trade policy, the full engagement of the United States in multilateral cooperation in global fora remains of crucial importance, particularly given the potential significance of spillovers at the current juncture as advanced economies normalize their macroeconomic policy stances following years of accommodation.

Mr. Claver-Carone, let me end on a more personal note. I could cite numerous of your Presidents, like Mr. Kennedy and Mr. Reagan, whose words even decades after they were spoken still resonate deeply with the German people as symbols of our close relationship and as a symbol of the

U.S. constant endeavor to strive for an open and prosperous world. Let us work together in this spirit. I wish all the best to your authorities.

Mr. Inderbinen made the following statement:

We issued a gray statement in which we commended the solid economic outcome but also emphasized some of the increasing risks. We noted that the current fiscal and trade policies entail uncertainty both to the United States domestically and in terms of spillovers.

On the fiscal side, we emphasized the static revenue losses implied by the current stance. These will most likely leave the authorities with less options for policy going forward, including to reduce income inequality and improve infrastructure.

In this sense, we share Mr. Hurtado's reservations about the way the staff applies the concept of fiscal space to the United States. The statement that there is some fiscal space even when its use is not advised, can be misleading when the staff at the same time identify the need for an adjustment of the primary fiscal surplus of close to 4 percent of GDP to put debt back on a sustainable path, as they do in the Debt Sustainability Analysis (DSA).

Like others, we emphasize the merits of a rules-based multilateral trading system, and we share the concerns of many other chairs on current trade tensions. Mr. Claver-Carone and Mr. Vitvitsky emphasize in their buff statement that the United States currently maintains a highly open regime which, as the staff point out, has traditionally benefitted both the United States and the global economy.

Finally, on the financial sector, we emphasize the achievements in improving the supervisory framework since the global financial crisis, and we advocate for prudence in recalibrating the current oversight structure. Like Ms. Erbenova and Hurtado, we underline the importance of further progress in implementing the Financial Sector Assessment Program (FSAP) recommendations, including the reform of housing finance.

Finally, like, Mr. Leipold, Ms. Riach, and Ms. Horsman, we emphasize the importance of the continued engagement of the U.S. authorities in the international discussions on regulatory reform.

Mr. De Lannoy made the following statement:

I agree with Mr. Ostros that the report is of high quality and that, on many fronts, the U.S. economy is performing very well and has been for a few years now.

We associate ourselves fully with Ms. Horsman's clear intervention. Like many Directors, we share the concerns about the negative consequences of protectionist trade policies and underscore the need for all involved to work together toward a constructive solution.

We also support Mr. de Villeroché's and Mr. Saito's call for staff to further deepen their quantitative assessment of protectionist trade policies.

On the ageing population, we agree with Mr. Saito that measures to create fiscal space for policies to promote investment in human capital and increase medium-term growth are needed. Like many Directors, we also encourage the authorities to address increasing income inequality.

Mr. Leipold made the following statement:

In joining others in praising the quality of the staff report, I would like to follow up on three issues raised in other Directors' gray statements; namely, on trade tensions, monetary policy, and selected issues papers.

On trade tensions, in our gray statement, we underscored that the risks from escalating tensions are already materializing in the short term. They may already be significantly affecting economic activity in the United States and abroad virtually as we speak. We associate ourselves with those chairs who question the fact that in the risk assessment matrix, the risks of a retreat from cross-border integration are characterized as being of a medium-term likelihood and having a medium impact. We would tend to be inclined to bring the timing forward, and raise the intensity and the impact.

We will be making some general comments about the adjustment of global payments and balances in the context of the June consultation later. Suffice it to say that, like other chairs, we believe that the actions undertaken by the administration do not work toward furthering such adjustment. Indeed, the approach taken based on bilateral trade actions does not address the root causes of global imbalances and stands, rather, to exacerbate them.

The staff sums it up well when it stresses that as a result of these measures: "Global imbalances are expected to rise, that the various attendant risks that such imbalances convey, including possibly catalyzing public support for increased protectionism." Kudos to the staff for putting it so pithily and clearly.

More generally, in light of the fundamental contributions given until very recently by the United States to the creation of an open global trade system that has been beneficial for all, we do regret the change of course. I was stunned by today's report regarding a possible withdrawal from the WTO. I have no idea if there is any truth to that and, in fact, I wonder if Mr. Claver-Carone can either confirm or deny. But if there is any truth to it, it is very worrisome. This comes at the same time as the European Council has today stressed the WTO's role in preserving and deepening the rules-based multilateral system.

Beyond trade, there is also this broader disengagement of the United States from multilateral institutions, such as the G7, which is a further significant risk factor for the global economy, as rightly noted by the European Central Bank (ECB) observer in his statement for the meeting. We fully share Ms. Horsman's points about being in this all together.

On monetary policy, we share the key messages that policy should remain data-dependent and clearly communicated. We join those chairs that welcomed the recent announcement by Fed Chairman Powell to hold press conferences at every Federal Open Market Committee (FOMC) meeting. That is a very good step.

In our gray statement, we supported the view that an inflation surprise is perhaps the most relevant risk going forward. In this regard, despite uncertainties regarding the degree of slack in the labor market, it may be the case that such slack is now running out. That is the message that we get from the chart in Box 1, as noted also by Mr. Jang and his colleagues. It goes without saying that the disappearance of slack may clearly increase the risk of an inflation surprise.

Finally, on selected issues papers, we share the views expressed by Messrs. Mozhin and Palei where they note that some working papers have not been completed yet, so they can hardly provide timely analytical support.

But I have a more general question. Following our discussion on streamlining a fortnight ago, we would be interested to know whether the revised guidance has been provided to staff, reflecting the outcome of that exchange; and if so, we would like that to be shared with the Board. We conceded that it was not appropriate to look at it ex ante, but we would certainly like to see it ex post.

Ms. Riach made the following statement:

I join other Directors in thanking the staff for their sound and frank assessment, as set out in the papers. We broadly agree with the assessment. We congratulate the U.S. authorities on the strong economic performance. Consumer and business confidence are remarkably high, including among small- and medium-sized enterprises (SMEs), the workhorses of the U.S. economy.

There is no doubt that strong growth in the United States has a positive impact on the global economy, and that has clearly been seen over the last two years. However, given the United States' place at the center of the global economy, policy uncertainty and the direct impact of trade action by the U.S. authorities brings grave risks to all of us—to the global economy and to the international system. With this in mind, I strongly endorse Ms. Horsman's remarks and join her in calling on the U.S. authorities to continue to engage positively with their international partners.

On the fiscal side, we support the staff's assessment and the concerns that they raise about the potential procyclical nature of the current fiscal position. Like Mr. Meyer, we note the historical difficulty of reversing so-called temporary tax measures and raise concern about the challenge of the planned medium-term consultation, particularly given that it is due to begin in an election year.

On the reform of the tax system, we absolutely support the U.S. authorities' sovereign right to reform their tax system and to set the corporate tax rate as they see fit. But in an ever-increasingly integrated global market, it is important that we all adhere to the international rules to which we have signed up. This is essential if we are to address shared concerns around the taxation of multinational companies. In this regard, I share Ms. Horsman's concerns about staff's assessment of the tax reform package as innovative.

On financial services, I join Mr. Tombini in urging the U.S. authorities to continue to lead by example both on the banking and non-banking sectors. We also note signs of increased vulnerabilities in the corporate sector, including increasing corporate debt-to-GDP ratios, and we urge the authorities and the staff to continue monitoring this closely.

Finally, I join other Directors in expressing concern about the actions of the U.S. authorities on trade and urge them to continue working closely with us all.

Ms. Roy made the following statement:

I join others in thanking the staff for their report and Mr. Claver-Carone and Mr. Vitvitsky for their buff statement. We have issued a gray statement, but I would like to mention some points for emphasis.

We broadly agree with the staff’s appraisal and policy recommendations. We also share the views in other gray statements on the causes for concern about the policy developments in the United States recently. In fact, the extent of consensus in the gray statements is remarkable in this case, given the importance of the United States for the global economy.

We share the common concern in all gray statements relating to the size and composition of the procyclical fiscal stimulus, which carries risks for the fiscal deficit, debt, and hardly leaves any room to spend on infrastructure or to address the longstanding issue of rising income polarization. It could be improved by combining it with indirect taxes, as suggested by the staff, and also improving the progressivity of the tax system and the macrostructural measures suggested by the staff.

We also agree with Mr. Mozhin and the staff that unilateral actions in the trade area may undermine the existing rules-based international trade system and increase the transitional costs of its possible improvements.

While we agree with the importance of reducing market distortions and unfair trade measures, tariff and other trade restrictions are likely to cause more harm than good to the U.S. economy and the rest of the world, as trade routes would shift and production would be relocated to avoid the incidence of tariffs; and hence, these should be avoided.

Three other issues we would like to point out relate to inflation, spillovers, and financial stability. In connection with inflation, the staff’s advice could have been a bit stronger and more clear cut. We support Mr. Meyer and Mr. Inderbinen that the U.S. Fed should continue to be vigilant and stand ready to promptly contain additional inflationary pressures that may arise from sizable fiscal stimulus and trade policies.

On international spillovers, along with Mr. Jin, Mr. Sembene, Mr. Leipold, and others, we appreciate the staff's discussion of the international spillover risks from the fiscal stimulus through higher inflation and quicker tightening of the monetary policy stance, which will have adverse implications for EMDCs through a more marked reversal in capital flows.

We note that following the current level of U.S. monetary policy normalization, a reversal in capital flows to EMDCs has already affected some countries adversely, and more may follow if outflows worsen. We support Mr. Beblawi's suggestion to discuss the spillovers further and in greater detail in the upcoming flagship reports.

On financial stability risks, we share the views of the staff, Mr. Tombini, Ms. Riach, and others, that though near-term financial stability risks remain relatively subdued, medium-term risks are elevated and can be especially disruptive for vulnerable emerging market economies. In this scenario, we agree with Mr. Agung, Mr. Ostros, and others, that in implementing measures to recalibrate and simplify financial regulations, it is important that supervision, regulation, and resolution measures remain robust and that the drive for efficiency does not result in increased risks for financial stability.

I fully associate myself with Ms. Horsman's comments, and I believe that given the risks, the Fund should begin strengthening the global financial safety net so that it can help its members, as required. Also, we wonder whether the staff could provide some information and/or views on whether more efforts toward resolving the global imbalances could be taken, as it was done in 2006.

Mr. Armas made the following statement:

I thank the staff and Mr. Claver-Carone and Mr. Vitvitsky for their buff statement. We issued a gray statement, so there are just two ideas to emphasize.

First, I have seldom seen such diverging views about macroeconomic forecasting. We reiterate our call for continuing exchange of ideas on this matter under a sound analytical framework. With the U.S. economy probably being the most studied economy in the world, it is all the more important to conduct productive discussions based on evidence from solid research. In that regard, I congratulate the staff´s efforts towards that end in this Article IV report.

At the same time, there is always uncertainty in forecasting, especially regarding the impact of policies and regulations on potential growth, which is the main issue at stake here. However, following a risk management approach, a reasonable option may be to rely initially on a given number of possible outcomes, keeping in mind that some policies may be adjusted in the future if they do not work as expected.

The question about debt sustainability is a crucial one, considering that we are talking about what is, in practice, the world´s international currency. Historically, the response to concerns about debt sustainability in the U.S. has been to raise taxes, so as to ensure the government's ability to fulfill its obligations. I do not see this pattern changing in the foreseeable future. The staff´s comments on this matter would be welcome.

The second issue I wish to emphasize is international trade. I will just add that we should keep in mind that lower trade barriers are good for the economy as a whole, but we should also admit that the progress in this field has been limited because growth has not been inclusive enough. We should pay attention to industries and population segments that are transitorily affected by trade reform.

Mr. Sembene made the following statement:

We have issued a gray statement, and I would like to make a few additional remarks in light of today's discussion.

First, I would like to welcome the strong performance of the U.S. economy as well as the low unemployment in recent months. I commend the U.S. authorities for their contribution to these positive outcomes. That being said, we also share colleagues' concerns about the current U.S. policies; in particular, the procyclical fiscal policy and trade policies. In the latter regard, we are concerned about the potential adverse spillovers not only to the global economy but also to EMDCs in particular. We echo the calls made by Directors about the need for the U.S. authorities to contribute to the promotion of an open and fair rules-based trading system. We would also agree with Ms. Horsman on the need for the authorities to avoid imposing tariff and non-tariff barriers to trade.

On monetary policy, we agree with the staff that clear communication on monetary policy normalization will be important going forward. As Mr. Mkwezalamba has indicated, inappropriate space and ineffective communication with regard to monetary policy could adversely impact the stability and prospects of the global economy, particularly the prospects of EMDCs. We would encourage the Fed to continue that clear communication approach, as it has done until now.

I call on the staff to continue to sustain in future Article IV reports the focus on income inequality and the related policy implications. That would be extremely critical, as some Directors have noted.

Finally, I associate myself with what Mr. Ostros has indicated about the importance for the staff's advice to remain candid, particularly at this juncture. Not only that would serve the U.S. authorities well, but the whole membership would be much better off if we heed this candid advice.

Mr. Mozhin made the following statement:

Like many others, I would like to begin by thanking Mr. Chalk and his team for an exceptionally well-written report. We have also issued a gray statement, and I will only make a few points for emphasis.

I agree with Ms. Horsman, Mr. Hurtado, and Mr. Jin, that the main driving force of the U.S. current account deficit is domestic policies, especially the very low level of domestic savings in the United States, which in turn, is the result of a significant public dissaving, fiscal deficits. But even taking this into account, I notice that the size of the current account deficit in the United States in recent years has been rather small, taken in a historical context—about 2.4 percent of GDP. This makes it even more difficult to understand this all-out preoccupation by the U.S. authorities with the size of the current account deficit and trade deficit.

On top of this, part of this current account deficit must be the result of what is called the Triffin dilemma: the role of the U.S. dollar as an international reserve currency; the need for foreign central banks and others—private banks, the corporate sectors—to accumulate dollars, to purchase dollar-denominated assets. In that respect, I would like to ask a question. How much of the current account deficit in the United States could be explained by the Triffin dilemma, and whether there have been any good papers analyzing this affect. If not, I would suggest that our own staff could look into this issue and try to analyze it perhaps in the context of the selected issues paper next year, with the approval of Mr. Leipold.

Second, I also notice that the labor force participation rate is not expected to increase. The projection in the staff report is that there will be little, if any, increase in the labor participation rate in the United States. I wonder why this is so. With the labor market so tight and the expectation of salary increases, why is there no expectation of an increase in the participation rate?

I will now make the point that I make every year. There is not a word in the report about governance and corruption issues in the United States. How should I interpret that—that there are no governance and corruption issues having any macroeconomic impact? I am not expecting any response to this. It is not a question. I take note of this.

The Deputy Director of the Western Hemisphere Department (Mr. Chalk), in response to questions and comments from Executive Directors, made the following statement:[5]

I will go through some of the questions. I think Directors let us off a little lightly. Before doing that, I would just like to thank Directors for their support for the team's work. As Directors recognized, this was not an easy consultation. There were differences of views, but I would like to thank the U.S. authorities for their collegial and professional approach in dealing with us. I know we can be a bit of an annoyance sometimes, but they were always generous with their time and with their ideas.

Turning to some of the real sector issues. It is indeed a bit of a puzzle why, with this strong job market, there are not more wage increases. Over the past several years, we have done three or four different projects, looking to see if there is some structural break in the relationship between either wages and unemployment or inflation and slack; whether something has changed after the financial crisis as a result. Despite our best efforts—and we really wanted to find a break in the structural relationship—we could not. The U.S. economy is behaving as it has done for many years. There are strongly anchored inflation expectations, and these drive much of the nominal magnitudes in the economy, including in wages and in inflation. There has been a very flat relationship between unemployment or slack and either wage

[5] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

or price inflation. It is there. We have detected it. It is certainly switching from becoming a drag on inflation, when there was significant slack in the system, to becoming more of a driver of inflation in both wages and prices. But it is not a large effect, and it will take some time to filter through.

We also keep coming back to the basic tenet that wage inflation is low in the United States because the U.S. worker is not productive. That is a mix of many different factors. We have seen a shift in the industrial structure in the United States. We have seen, increasingly, people being pulled back into the labor force at a relatively low wage and in relatively low productivity tasks. It is also a part of the product of the income polarization that we have focused on over the last few years. And some part of it is linked to demographics as well. As the population ages, there is much less dynamism and much less wage dynamism as well.

In terms of the early wage and inflation indicators that we looked at, one that we look at closely is the Atlanta Fed's Wage Growth Tracker which, rather than looking at the whole labor market as an entirety, looks at the microdata for the individuals in the labor market and tracks them through time and looks at what happens to an individual's wage through time. The advantage of that is there is not the composition effect, which has clouded the underlying wage picture in the United States over the past several years. As more workers are being drawn into the labor force, who were previous not in the labor market, those workers have typically been at the lower end of the wage distribution and relatively low skilled. That composition effect has been compressing average nominal wages. Once we strip that out, there is actually much more underlying wage inflation; the wage inflation by this measure is upwards of 3 percent. The advantage of this indicator is that it tells us that there is wage inflation in the system. Eventually, once the supply of detached worker runs out, that underlying wage inflation should assert itself. Particularly, if one looks in that data, one can identify workers who have switched jobs and not switched jobs. The wage inflation for the workers who are switching jobs, which is becoming increasingly common as the labor market tightens, is quite high, around 3.5 percent. So, there is wage inflation in the system, but there are also many other things going on, including measurement issues, that are compressing it. As I said, I do not believe there has been any structural change to the wage and price inflation process. We have not found any evidence of that.

Why is labor force participation not rising with this relatively strong and healthy labor market? I believe what we are seeing, and what we have seen for several years, is two forces at work. The economy is strong and it is pulling people back into the labor force, but the demographics are pulling in the opposite direction. We are seeing increasing numbers of people who are moving out of the labor force by retiring. The population is ageing. Eventually, that demographic force will take over, and we will see a continual downward path for labor force participation going forward. Right now, these two effects are equilibrating and offsetting each other. But that probably will only last for the next few years. If we look further out, we should expect labor force participation to decline, which is why one of our recommendations, for many years, has been immigration reform. With the aging of the population and the decline of the labor force, a replenishment is required, in terms of both the skills and the volume of workers in the U.S. economy. Immigration reform is actually an important supply-side measure that we have argued for.

On Mr. Meyer's question on environmental standards and investment, it seems pretty clear, at least anecdotally, that the rollback of environmental standards, particularly in the energy sector, is encouraging investment. The problem with trying to quantify that is that it is also happening at a time when energy prices are high or rising. Energy investment in the United States is doing extremely well now. We are seeing a lot of investment particularly in the shale area and in natural gas. We have seen a lot of construction, for example, in liquefied natural gas plants in the U.S. to begin exporting that natural gas. We do not know how much of that is attributable to regulation. One can talk to different people. Many on the Republican right will say it is all deregulation. That this is evidence of deregulation. However, we believe that probably much of it is due just to the higher price of energy. The investment is in shale and natural gas. We are not seeing much investment in coal, even though there are efforts to roll back regulatory and environmental standards for coal.

On some of the fiscal questions to deal with, I am a little surprised with Directors' questions about our assessment that the U.S. debt is unsustainable. We have had this view for a long time.

What does that mean? The dictionary definition, which I looked up on my phone, is that it is something that is not able to be maintained at the current rate or level. That is a good example of the U.S. fiscal position. They cannot maintain this fiscal deficit at the current rate or level. They cannot keep adding to the debt at the pace they are adding to the debt.

We cannot say when that will have to stop; but looking at the medium-term horizon, by 2027, we estimate Federal debt in the hands of the public at around 90 percent of GDP. It is a reserve currency and the level of debt can go higher. But the direction is not sustainable. I often think of this as like getting on the Beltway at three in the morning and going the wrong way. You can do that for a while, and it can be fun. But at some point, there is a truck coming the other way, and you cannot predict when that will happen. That is the notion of sustainability that we mean here.

Certainly, markets are totally willing to finance these extremely low rates. When one talks to markets, they basically feel that somehow, the political dynamics down the road will mean that there will be an adjustment to bring the debt onto a sustainable trajectory. They do not know when it will happen. However, the history in the United States has been that the full faith and credit of the United States really does mean the full faith and credit of the United States. They do adjust to meet their debt obligations. That is what we see in spreads and in terms of ratings. The institutional framework for paying the debt is quite strong.

I would add to that while the U.S. history has been that way, we are still seeing unprecedented fiscal developments. As we noted in the report, one has to go back to the Vietnam War and President Johnson to see something similar. This degree of fiscal expansion never happened in peacetime in the United States. And the United States typically has an antipathy towards procyclical fiscal policies. They generally tend to be countercyclical, and for good reason.

I cannot say that this is a temporary change in fiscal behavior, but there is a lot of political divisiveness. There is a difficult situation with Congress. And we do not know whether the United States will get back to its normal countercyclical behavior, which is why we flagged this as a risk.

On the tax side, I will use the dictionary again since American English is not my first language. When we said that the new tax provisions were “innovative”, what we meant was they feature new methods that are advanced or original. These are new methods. We have not seen these provisions before in the global tax system. It was not meant to be a compliment. It was just meant to be a statement of fact. Many of the anti-avoidance provisions and international provisions in the U.S. tax reform we have never seen before. We do not know exactly how they will play out, and there is great uncertainty associated with them. Maybe we could have used a more pejorative term, but that is the language we used.

I also would not want to have a misinterpretation in bilateral surveillance products that we are providing policy advice in this Article IV for countries other than the United States. Given our spillover mandate, we felt that we should give some sense of the incentives that are being created by the U.S. tax reform for other countries. We show that there is more of an incentive now that encourages other jurisdictions to compete on tax. Maybe there is more of an incentive to offer accelerated depreciation or to lower statutory tax rates. That was not meant as policy advice to other countries though. That was meant to indicate what we see as the likely directions of other countries responding to the U.S. changes. Certainly, we do mention it in the report. Obviously, every country is case by case, and they are constrained by their own fiscal position as to what they can do. The Fiscal Affairs Department (FAD) has been talking to a range of countries on how to react to the U.S. tax reform. It was not meant as prescriptive. It was just meant as a description of what we saw as the incentives that were being created.

Finally, there was a question on advice and traction. We do not have traction in the United States. I will be very clear about that. We are a small player in a complicated system, with divisive politics, where the decisions on policies are made to meet a number of domestic constraints. Given the complexity of the system, our goal is to create a domestic debate in the public about what policies are and what they should be. I do not believe we are under any illusion that we create traction either with the administration or with Congress. This is not limited to this administration. It is also true of past administrations.

It would be nice to think we have traction. I do believe we have a public presence and profile, particularly on some of the technical issues like trade and tax. We may be at least a catalyst for debate. But that is different from traction.

The staff representative from the Western Hemisphere Department (Mr. Leigh), in response to questions and comments from Executive Directors, made the following statement:

I would like to answer a question about the size of the fiscal adjustment that we are recommending.

Our idea is to aim for a primary surplus at the Federal Government level of about 1.5 percent of GDP. That is up from where it is now, which is about minus 2.5 percent of GDP. That is an adjustment of about 4 percentage points of GDP. Where does the size of that adjustment come from? That is what we estimate would be required to bring debt firmly on a downward path toward prudent levels within about 10 years, getting nearer to where public debt was before the crisis—around 65 percent of GDP.

On the pace, we are not recommending an overnight adjustment. Our scenario assumes getting there on average over the medium term, over the next 5 to 10 years. But as Keynes said, the time for austerity is the boom. So this is the time, if any, to frontload that adjustment.

When it comes to the measures to do that, there is an amazing creativity of measures in the Congressional Budget Office, 200 pages of ways to do that. We have had a number of recommendations in previous reports that are still relevant today. But growth is an important way of facilitating this adjustment. That is where I echo some of my colleagues' recommendations on immigration reform and so on.

I would like to then touch on a related question about potential growth. How much technological innovation is now in the numbers? I would say we are definitely reflecting total factor productivity (TFP) advancements in our forecasts. We have a forecast just below 2 percent of GDP in the medium term. Could it be higher? I hope so. The discussions we have had concern how to ensure that the technological progress is harnessed by the majority of Americans to raise growth.

I would mention one point, which is education. That starts from pre-K, and extends to putting more resources into research universities. To do that, the authorities need the fiscal space, which is where I started.

The staff representative from the Strategy, Policy, and Review Department (Mr. Kaufman), in response to questions and comments from Executive Directors, made the following statement:

I will address three issues. One is the global risk assessment matrix (G-RAM) and the coverage of trade in the G-RAM. The G-RAM is updated periodically to remain current following careful consultation among staff. The staff is currently revising the G-RAM, which will naturally take account of recent developments on the trade front. As in the past, we will share the matrix with the Board over the summer.

There was a second question about whether there was revised guidance on the use of selected issues papers and working papers. The short answer is no, there is not yet a revised guidance, which is still under work.

> The third was a question about the joint IMF-World Bank-WTO trade paper, the nature of the paper and the coverage. The paper will look into areas that have great potential to increase productivity and growth nationally and globally. These includes trade in services; e-commerce; barriers behind the border, such as regulatory ones, and the need for regulatory coherence; and also trade-related investment issues, which reflect the fact that in a world of global value chains, there are increasing complementarities between trade and investment. The second part of the paper will also look into modalities to address these trade policy frontiers at the WTO, including making use of flexible approaches, such as plurilateral agreements.

Mr. Mozhin expressed surprise at the staff's explanation that the low labor participation rate was due to population aging. He noted that according to the Bureau of Labor Statistics, the participation rate was roughly the share of the working population in the overall population. He asked if the staff had seen any other data on the share of the working population in the working-age population.

Ms. Horsman made the following statement:

> I would like to come back to Mr. Chalk's comments on the use of the word "innovative." despite what the dictionary might say, all of our authorities are trying to promote innovation because of the linkage that it has with growth, and it is considered to be a positive thing in every country. I would just like to challenge the use of that word. While we were sitting here, Mr. Leipold also said that there is a synonym, which is "unprecedented." We could argue about what the dictionary says, but we can all agree that we all see innovation as a positive thing.
>
> In response to his comment that the staff was not trying to provide advice but simply a description of incentives, again, it is semantics.
> The incentives are speculative at this point. We do not have full information on the regulations. All the companies are still struggling to figure out what they will do in terms of these rules and how they will restructure their affairs. So to say what the incentives are does suggest what countries might be thinking about doing or should be thinking about doing. The Fund's role should be to encourage countries to stay within the multilateral context and to coordinate the efforts to fight against profit shifting that is not healthy.

The staff representative from the Western Hemisphere Department (Mr. Leigh) responded that the unemployment rate was 3.5 percent, which meant that 96.5 percent of the population of working age was working. There were people who were dislocated from the labor market; particularly males between 21 and 54. He remarked that the lack of participation among this demographic group was a puzzle, with many theories, including crime, drug addiction, and incarceration, but the staff did not have an answer. Nevertheless, most of the U.S. population that could work was working.

The Chairman made the following statement:

> Perhaps we can come back to Mr. Mozhin with more clarity on that proportion of the population that is participating and that is effectively working.

The staff representative from the Western Hemisphere Department (Mr. Leigh) responded that the unemployment rate was 3.5 percent, which meant that 96.5 percent of the population of working age was working. There were people who were dislocated from the labor market; particularly males between 21 and 54. He remarked that the lack of participation among this demographic group was a puzzle, with many theories, including crime, drug addiction, and incarceration, but the staff did not have an answer. Nevertheless, most of the U.S. population that could work was working.

> I will just make a comment in response to Ms. Horsman. I would like to salute Mr. Chalk’s modesty, because I do believe that there is a level of traction that is exercised by the team working in conjunction with the Treasury teams. I was personally a witness to that. Every year, I visit with the Treasury. I have lunch with the Chair of the Fed. I do not think that is an exercise in vain. This is borne out by the fact that the Secretary of Treasury, upon the issuance of our concluding statement, also releases a press statement to sometimes agree, to sometimes disagree, to sometimes identify where we disagree. The fact that we were not exactly on the same page in relation to forecast both this year minimally and much more so the following year is an indication that what we say matters. It does not mean there is an agreement on the policy recommendations that we give, but there is definitely a level of traction.
>
> Second, I would also observe that in different fora—particular, when there is a large number of players at the table, including around this table, the G20 table, or the G7 table—we do rely extensively on the advice and recommendations that we find in various Article IV reports concerning those countries in order to project our recommended policies more broadly. I believe that there are multiple levels to exercise that traction. This takes place on a strictly bilateral basis, which I believe is working, though it could work better, and it is also a factor of the size of the economy and the size of the teams with which we are working. But it is also working at a multilateral level, where we try to elevate the debate.

Mr. Claver-Carone made the following concluding statement:

I thank the staff for the report, and Directors for their thoughtful and heartfelt comments. As this chair has emphasized in the past, we always welcome the Fund's independent and candid views on the U.S. economy. I would like to focus my remarks on four policy-related issues and two process-related issues.

On policy, the Fund's projections for 2018 and 2019 had been consistently below ours. Throughout 2017, we had expected close to 3 percent growth for each of these years. Indeed, when we talked about 3 percent growth while incorporating tax reform, the Fund and other forecasters were at best skeptical. Now consensus forecasts expect growth to come in around 3 percent this year. Given the Fund's recent track record with these forecast projections for the U.S. economy, we are not particularly confident in Fund staff's projections going forward either. I take note of the Managing Director saying she hopes she was wrong, and I think we all should. As such, we strongly disagree with the staff's economic projections in 2020 and beyond.

Second, we believe the Fund is being too mechanical in its model by characterizing tax reform as a stimulus in the early years and tightening in the later years. The purpose of tax reform was not short-term stimulus. It was to foster structural change to the economy. Tax reform, along with deregulation and infrastructure investment, will boost the quantity and quality of capital stock in the economy and lead to a sustained increase in productivity growth. Altogether, these pro-growth policies will lift the U.S. economy to a higher growth path, which we expect to be close to 3 percent over the next 10 years. This higher U.S. growth path will undoubtedly benefit the rest of the world. Let me stress: We object to the continual use of the term "fiscal stimulus" when describing tax reform. It is tax reform, plain and simple. Moreover, the staff and many chairs discussed the risk of economic overheating in the United States. Again, we believe our policies will boost potential growth to around 3 percent over time and that there is still some room to boost labor participation rates.

Third, on monetary policy, several chairs brought up the risk of a faster-than-expected normalization. I would like to reiterate the message from our buff statement: the monetary policy path will remain data-dependent and the Fed remains committed to clear policy communication.

Fourth, the United States has and will remain one of the world's most open economies in terms of trade policy. The various indicators of straight openness and tariff rates—whether from the OECD, the World Bank, the WTO, and/or the United Nations—consistently show the United States economy to be very open, with relatively little tariff and non-tariff barriers to trade. Indeed, the United States compares extremely favorably with all other countries on trade indicators. The discrepancies on tariff rates and non-tariff barriers are particularly striking in comparison to some of our largest partners; for example, China. A Fund staff working paper from February entitled *A Multidimensional Approach to Trade Policy Indicators* presents data that show that the U.S. economy is one of the most open in the world. The data presented also show how many of our largest trading partners do not come across as favorably, leading to an unlevel playing field for U.S. companies and workers. With all the talk that we have had about—and some of the concerns expressed—about inequality—and I would note Mr. Armas mentioned those left behind—that is precisely our concern and what we are trying to address.

Let me stress: We seek to promote free, fair, and reciprocal trade, and to press for a level playing field for U.S. firms and U.S. workers. To that end and in the spirit of Mr. Meyer's remarks, let me repeat what President Trump proposed at the recent G7 and what Secretary Mnuchin reiterated just this week to our European allies: Let us have a true free trade agreement—no tariffs, no tariff barriers. We are open to that. Ultimately, we hope this will be an inflection point for those who are now criticizing the United States. I am confident that we can end up with a freer and fairer trading system than what exists today.

On process, from my count, Fund staff has written seven working papers on various elements of the U.S. economy. Some of these papers are clearly macro relevant to the U.S. economy, such as two on tax reform. Of these papers, which are very technical and quite long, only one was shared with my authorities before Article IV consultations began. If Fund staff and management are going to characterize working papers as useful for both sides, we suggest that Fund staff needs to share these papers with us well in advance.

Finally, and for the sake of traction and just a constructive critique on the process, we did not find it particularly useful for Fund staff to focus on hypothetical situations related to tax reform during the meetings themselves. We do not feel that an Article IV consultation is a classroom academic exercise. We feel it is one of surveillance, oversight, and analysis, as stated in the charter. In several cases, we heard terms as "would it not have been better if you had done X or Y?" Our tax reform law is what it is. It has already been passed by our Congress in our democratic process. Hypotheticals of what Congress should have done or could have done were, frankly, a waste of our authorities' time, and we urge the staff going forward to assess the potential economic impact, not hypotheticals, because we truly want for there to be that traction.

This was also the case in one meeting that was requested on foreign investment, where, frankly, the staff was not prepared for that meeting. Let us be thoughtful of what we do so that we can improve and increase that traction because it already does exist, as the Managing Director pointed out.

I would also address what Mr. Leipold asked with regard to the WTO. Not only are hypothetical not helpful but, frankly, chasing headlines is not helpful either.

Now that this is all said and done, I appreciate this effort. It has been instructive. It was a very constructive experience throughout. Now we look forward to toasting staff for this great work and management and our Directors at our July 4 party this afternoon. I look forward to it with all of you.

The Chairman noted that the United States is an Article VIII member and no decision was proposed.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They welcomed the strong performance of the U.S. economy, with accelerating growth, low unemployment, and muted inflation. They also welcomed the favorable near-term outlook and the prospect of marking the longest economic expansion in its recorded history. At the same time, Directors observed heightened policy uncertainty and medium-term vulnerabilities, including rising public debt, trade tensions, and income inequality. They stressed that developments and policy actions in the United States have significant implications for the rest of the world, and encouraged the authorities to take that consideration into account in their policy decisions.

Directors recognized the objectives of the fiscal strategy and tax reform, with its many positive features, in supporting growth and promoting structural changes to unleash the economic potential. They observed that, at the current stage of the business cycle, the expansionary fiscal policy stance, while boosting U.S. and global output in the near term, could increase risks and uncertainties in the medium term. Specifically, Directors cautioned that the procyclicality of the budget and tax policy plans would adversely affect the fiscal deficit, debt sustainability, and global imbalances. They encouraged the authorities to rebalance fiscal policy, increase the revenue-to-GDP ratio through a greater reliance on indirect taxes, and prioritize infrastructure spending. Directors also saw scope for targeting personal income tax relief at lower-income households, and improving the compliance of tax provisions with the international obligations.

Directors commended the Federal Reserve for pursuing monetary policy normalization in a gradual, data-dependent, and well-communicated manner. They stressed the importance of continued adherence to these principles, while being mindful of potential global spillovers as monetary policy tightens. Directors concurred that, given the sizable fiscal stimulus, achieving the dual mandate of maximum employment and price stability would likely require a faster pace of policy rate increases. They pointed to an inflation surprise as an important risk that, if realized, could create volatility in financial markets, with negative global consequences.

Directors raised significant concerns over recent trade policy proposals that could have damaging effects beyond the U.S. economy, trigger retaliatory responses, and undermine the open, fair, rules-based multilateral trading system. Directors urged the authorities to work constructively together with their trading partners to reduce trade barriers and resolve trade and investment disagreements without resorting to harmful unilateral actions.

Directors noted medium-term risks to financial stability, including those related to high equity market valuations, rising leverage, weakened underwriting standards, and cyber risks. Managing these risks would require high-quality and independent supervision. Directors stressed the need to preserve the current risk-based approach to regulation, supervision, and resolution; strengthen the oversight of nonbank financial institutions; and remain committed to agreed international standards. They looked forward to further progress in implementing the remaining recommendations of the 2015 FSAP.

It is expected that the next Article IV consultation with the United States will be held on the standard 12-month cycle.

APPROVAL: March 3, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

**Outlook**

**1.** ***Does staff have any estimates of the neutral rate of unemployment in the U.S., considering that civilian employment-population ratio is currently 3 percentage points lower than in the pre-crises period, while the unemployment rate is surprisingly 0.6 percentage points lower?***

- Staff estimates the neutral rate of unemployment to be around 4.3 percent over the next 5 years (although there is significant uncertainty surrounding this estimate).

**2.** ***On the short-term outlook, we deem that staff projections may be slightly optimistic, as the rebound in private investment might not be as strong as expected, as testified by the rise in dividends and share buybacks in the aftermath of the adoption of the tax reform. Staff comments are welcome.***

- The rebound in private investment has so far been in line with staff projections. Staff forecasts at the time of the January WEO had nonresidential private fixed investment in 2018Q1 at 5.8 percent (seasonally adjusted annual rate, saar). The latest reading of Q1 data showed business investment growth of 6.2 percent. The June 2018 IMF working paper "Determinants of U.S. Business Investment," outlines staff's views on this topic.
- There is little evidence that financial measures (like share buybacks, M&A, dividend increases) have crowded out investment spending.[6] Buybacks are related to the tax treatment of unrepatriated profits. In general, U.S. firms are liquid and have cash on hand to fund profitable investment projects. There does not appear to be an identifiable trade-off between adjustments to firms' capital structures and investment decisions.

**3.** ***We welcome staff's elaboration on differences of assumptions behind the divergence of the views on medium-term growth.***

- The administration's medium-term growth forecasts are based on additional policies that are not currently part of the baseline scenario (in line with the WEO conventions, staff forecasts are based on a judgment about the most likely path of policies). Paragraph 4 of the staff report identifies the main differences between staff and authorities' medium-term forecasts.

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[6] Please see the IMF working paper "Determinants of U.S. Business Investment" by Emanuel Kopp, which has already been published.

4. ***We also agree with staff's view that structural change related to technology, globalization and market concentration could put downward pressure on wages. Moreover, this downward pressure may be related to the US industry structure which is dominated by the service sector and means that, for example, it is highly possible that new employment is being created in retail sales where many people earn the minimum wage, or close to it. Staff comments are welcome.***

- Wage growth does appear to have been compressed somewhat during this recovery as a result of a change in the composition of jobs and hours (with a relative increase in lower-paid jobs) but the evidence does not suggest that either the mix in occupations of shift in industrial composition in the U.S. has been a large factor behind low wage growth (see Elvery and Vecchio, 2015 or Mancuso, 2015).
- Staff's own work (Y. Abdih and S. Danninger, "Understanding U.S. Wage Dynamics", 2018) suggest the primary forces behind low wage growth are a large level of slack (following the 2008-09 recession) and low productivity growth with some relatively modest effects arising from offshoring and automation.
- There is more evidence that income polarization and "hollowing out", an important issue that has been identified in past consultations (see Alichi et al "Income Polarization in the United States" (2016) and Alichi et al "Hollowing Out: The Channels of Income Polarization in the United States"), are in part related to a changing industrial structure (as well as factors such as routinization and offshoreability of particular job types).

5. ***It would be helpful for staff to refer to examples, from the U.S. or elsewhere, of the pro-growth impact of fiscal expansions and deregulation, and the lessons learned as many countries also strive to achieve similar durable transformational change.***

- The U.S. and international evidence, from numerous peer review studies, indicates that fiscal expansions can have strong and persistent effects on the *level* of real GDP (but not a persistent effect on the growth rate). (See Chalk, Keen and Perry, 2018, "The Tax Cuts and Jobs Act: An Appraisal" for a discussion of the evidence).
- The evidence on the effects of deregulation and other structural reform in advanced economies also suggests that such policy changes can raise the long-term *level* of output, but that their effects on the *growth rate* are typically transitory. (See Chapter 3 of the April 2016 World Economic Outlook.) Further, the United States already ranks very highly in terms of having a business environment that is conducive to innovation, investment, and productivity (it is ranked second out of 173 economies in the 2017/18 Global Competitiveness Report, for example). As such, the scope for a significant growth-enhancing improvements in deregulation is more limited than in many other countries which have more restrictions.

6. ***We would like to hear staff's views on the factors underlying the authorities' projections, notably the planned US$1.5 trillion investment in infrastructure, the***

***impact of the overhaul of the U.S. tax system, higher labor force participation, and a continuing process of de-regulation. What is staff's assessment of the growth impact of these factors?***

- Staff forecasts include the effects of changes to the tax system (see Chalk, Keen and V. Perry, "The Tax Cuts and Jobs Act: An Appraisal for details) which will add to the level of GDP but not create a permanent effect on the growth rate (in contrast to the U.S. authorities' views). Staff has long argued for measures to encourage labor force participation and boost infrastructure investment (see Box 5 of the staff report) although, again, such measures are likely to raise the level but not the growth rate over a longer horizon. Staff also sees some merit in targeted streamlining of federal regulations but is unable to identify empirical evidence of potentially large effects on GDP from such changes (possibly in part because, in many cases, it is state-level regulations that are the binding constraint).

**7.** ***We thank staff for the table on economic forecasts on page 17. However, it does not seem to reflect the views of the U.S. Treasury. For illustrative purposes, it would be helpful to add to this table the numbers reflecting the authorities' forecast. The authorities seem to believe that the fiscal measures will pay for themselves –that the ratio of debt-to-GDP will actually decline because of them–. Is that assumption correct? The table in page 16 shows projections by the IMF and the CBO. Could staff provide a similar table including the corresponding projections by the Treasury Department?***

- See below comparison with the Office of Management and Budget projections from April 2018 budget documents.

**Economic Forecasts** (percent)

| | 2017 | 2018 | 2019 | 2020 | 2021 | Longer run |
|---|---|---|---|---|---|---|
| | | Projections | | | | |
| **Real GDP Growth (annual average)** | | | | | | |
| IMF | | 2.9 | 2.7 | 1.9 | 1.7 | 1.7 |
| CBO | 2.3 | 3.0 | 2.9 | 2.0 | 1.5 | 1.8 |
| OMB | | 3.0 | 3.2 | 3.1 | 3.0 | 2.8 |
| **Budget balance (federal government, percent of GDP)** | | | | | | |
| IMF | | -4.1 | -4.6 | -4.5 | -4.7 | -4.4 |
| CBO | -3.5 | -4.0 | -4.6 | -4.6 | -4.9 | -4.6 |
| OMB | | -4.2 | -4.7 | -4.5 | -3.9 | -1.4 |
| **Debt held by the public (federal government, percent of GDP)** | | | | | | |
| IMF | | 76.9 | 77.2 | 78.5 | 80.5 | 89.9 |
| CBO | 76.5 | 78.0 | 79.3 | 80.9 | 83.1 | 94.4 |
| OMB | | 78.8 | 80.3 | 81.3 | 81.7 | 74.6 |

Sources: CBO projections are from the Budget and Economic Outlook April 2018; OMB projections (authority's views) are from OMB projections of the FY 2019 budget. For the fiscal variables long-run refers to 2027

**Fiscal policy**

**8.** ***Could Staff comment on the realism of the authorities' expected leverage ratio (i.e., 7:1) and the extent to which such investment would be incremental? We wonder to what extent the US$200 bn in direct federal funding will catalyze US$1.5 trillion in spending by state, local and private sector. Staff comments are welcome on the ways in which private investment is planned to be attracted. As for sources of infrastructure financing, the authorities assume that direct federal funding would catalyze US$1.5 trillion in infrastructure spending by state, local and private providers. We welcome staff's comments on feasibility of the authorities' plan.***

- At present, as noted in paragraph 13, there is no incremental federal budget allocation for the next two years to fund infrastructure spending.
- It seems unlikely that there would be sufficient financing from either subnational governments or the private sector to achieve such a ratio of federal to non-federal funding of infrastructure.
- Streamlining regulations, expanding PPPs and other steps could help facilitate infrastructure spending but it is difficult to pinpoint ex ante the potential size of these effects.
- An important constraint on infrastructure funding is the fact that the municipal bond market is very tax-favored in the U.S. (as well as being a very liquid and tradable market). As a result, it makes it difficult for privately-funded infrastructure projects to compete with municipal bonds as an asset class. Historically, the U.S. has had only limited amounts of private investment financing, particularly outside of toll roads

**9.** ***Have staff explored how the tax reforms will affect state finances? Could staff also discuss whether there would be fiscal costs associated with making permanent the full expensing provision for business investment? Regarding expensing mechanisms, we are somehow surprised by staff recommendation to make full deductibility permanent since the potential impact of such a measure, including on public finances, is not detailed in the report. Staff comments are welcome.***

- Given the diversity of tax structures at the subnational level, staff have not examined the implications for state finances (but certainly this will be important given many state systems are based off of the Federal tax base and the TCJA makes important changes to deductions in the personal income tax, including those for state and local taxes).
- The temporary expensing provision in the TCJA (which begins to be phased out in 2023) was estimated to lower revenues by US$124bn from 2018-23 (statically costed). There would be some additional incremental revenue cost to making the expensing permanent but, in large part, this would be a timing effect (expensing lowers revenues in the near-term but, since the investment would not be depreciated,

it yields revenue gains in future years). In addition, even that cost should be more-than-offset by denying interest deductibility for new, debt-financed capital spending and by the dynamic costing effects of incentivizing new investment.

**10.** ***Staff have made several useful suggestions for ways to enhance the effectiveness of the TCJA in stimulating investment, reducing inequality and countering tax competition and profit shifting within an international context. In staff's view, is there legislative appetite for further changes to the TCJA? Further, we note that the changes to the personal income tax are likely to exacerbate income polarization as various tax provisions expire. Staff comments on the likelihood of implementing some of their rate structure recalibration proposals would be welcome.***

- While always hard to judge, there does not appear to be scope for legislating further tax changes in Congress.

**11.** ***Regarding household taxation, we support the staff's recommendation on recalibrating the rate structure so as to reduce income inequality. However, we may have appreciated deeper analysis on the impact of the adopted reform on inequalities, which may significantly increase due to the reform and harm US growth in the long term. We would encourage staff to take this into account in their future projections. Staff comments are welcome.***

- Staff does not have access to the micro-level data that would be necessary for a full distributional analysis of the tax reform and thus relies on the expertise of the Joint Committee on Taxation (cross-checked with work by the Tax Policy Center and Tax Foundation).

**12.** ***Lastly, regarding the spillover of the reform, we keep being concerned on the risk that the US tax reform will fuel race-to-the-bottom behaviors, eventually leading to sub-optimal levels of public spending and welfare internationally. While this risk is not analyzed in the staff report (apart from an allusive mention in para. 24), we would encourage them to do so in their next works. Staff comments are welcome.***

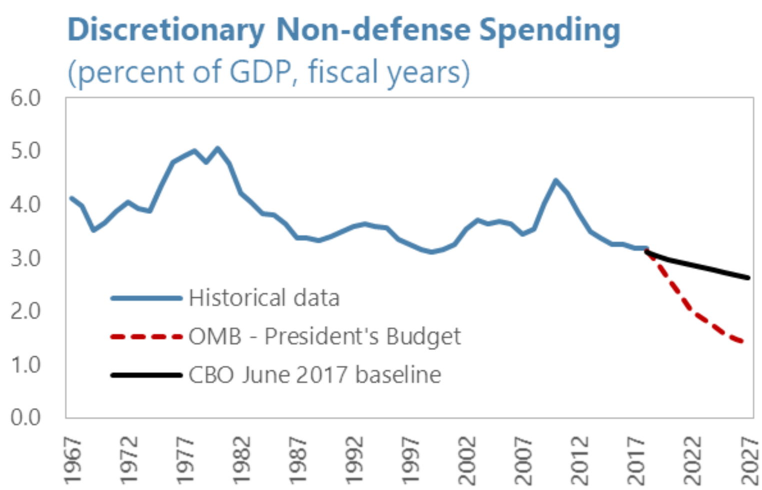
- Staff does not regard the U.S. change in statutory business tax rate as a race to the bottom. The lower statutory tax rate is regarded as a positive change (paragraph 19) Rather they are realigning their tax rate with that of other OECD countries which should have a positive effect on investment. Further, provisions of the reform (notably the GILTI and BEAT) do aim to contain tax competition and dis-incentivize U.S. firms from realizing profits in offshore jurisdictions (as described in paragraph 24).

**13.** ***One staff recommendation is to eliminate the lower tax rate for exporters, and we would welcome staff views on an alternative non-distortionary export promotion incentive.***

- Staff do not favor export promotion incentives and, instead, would prefer a simple, broad-based corporate tax system that treats domestic and foreign sales equally.

**14.** ***We would appreciate staff's comments about the feasibility of the authorities' intention to cut non-defense discretionary spending by 44 percent over a ten-year horizon and appropriate US$200 billion in direct federal funding to address infrastructure needs. Staff report mentions the authorities' view on spending cuts saying that "over the ten-year budget horizon, [they] would result in a 44 percent real reduction in discretionary, nondefense spending" and that "no negative growth effects are anticipated from those various reductions in federal programs". What is the staff's assessment on how these measures would impact on poverty rates and inequality?***

- The proposed reduction in discretionary non-defense spending (of around 44 percent in real terms over the next 10 years) would result in historically unprecedented levels of federal spending (falling from what are already historically very low levels). This will imply a significant reduction in the federal workforce but it is difficult to extrapolate what this may mean for poverty and inequality (it would depend on where those displaced workers are employed in the private sector).



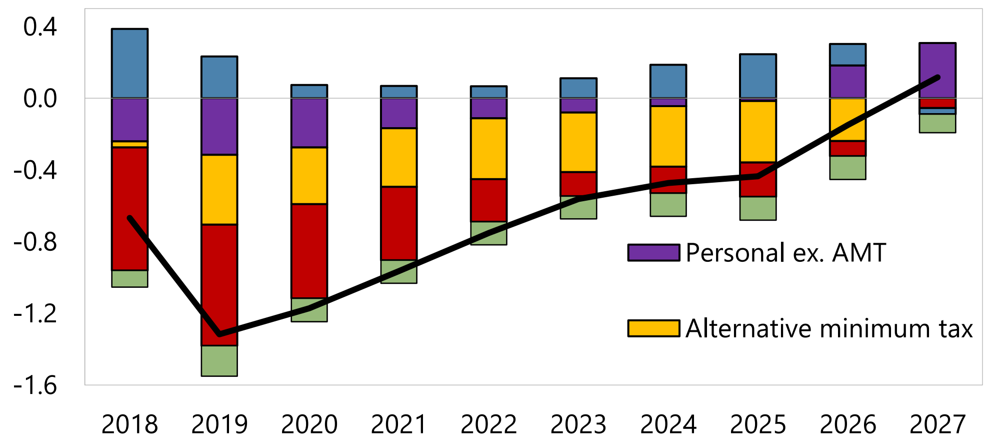
Sources: Congressional Budget Office (CBO) and the Office of Management and Budget (OMB).

- As discussed in the staff report (paragraph 13) a significant increase in infrastructure spending is urgently needed.

**15.** ***The authorities view the Tax Cuts and Jobs Act as "an historic achievement that will spur economic growth while providing middle-class families with a significant tax cut". Will these fiscal stimuli wane after a few years of being implemented or will they last much longer?***

- The staff expect that the fiscal stimulus will provide positive boosts to growth only until 2020. The design of the TCJA implies a front-loaded loss of revenues (see picture) and, without Congressional action, discretionary spending will revert to its baseline level starting in 2020.

**U.S. Tax Cuts and Jobs Act (TCJA) Impact on Tax Revenue**
(percentage points of GDP; static costing*)*




Sources: IMF staff estimate, based on the Joint Committee on Taxation's costing.

**16.** ***Will fiscal policies create more fiscal space to allow the country to meet its substantial infrastructure and social needs? Staff's views are welcome.***

- To meet the infrastructure and social needs, the U.S. will have to increase the federal revenue-GDP ratio through increased reliance on indirect taxes (paragraph 12).

**17.** ***We understand from the authorities that staff-proposed broad-based carbon tax and federal consumption tax were improbable sources of revenue. Could staff elaborate further on the authorities' arguments?***

- The authorities believe they would be unable to build a majority in Congress to legislate such taxes.

**18.** ***We think the authorities' arguments on increasing revenues and reducing expenditures sounds quite impressive. We wonder why this has not been taken into staff's consideration and how it will help improve the fiscal position. Staff's comments are welcome.***

- Staff base their outlook on the fiscal policies on a judgment about the most likely path of policies, drawing on the CBO's assessment of policies that have already been legislated. Staff see the likelihood of the policies underlying the President's budget as being unlikely to receive support in Congress (as evidenced by the passage of the Bipartisan Budget Act for FY2018-19 upon which staff near-term fiscal forecasts are based).

**Monetary policy**

**19.** ***Staff comments on their classification of the risks in the monetary policy area would be appreciated.***

- The principal risk facing monetary policy is that linked to the risk highlighted in the staff report from undertaking a sizable fiscal stimulus with the economy already past full employment. This creates a greater risk of inflationary pressures which the Federal Reserve would potentially need to respond to by moving at a faster pace than in staff's forecasts. This could create volatility and disruption in asset markets, a tightening of global financial conditions, and potentially downside risks to other countries (particularly those that have borrowed heavily in U.S. dollars and/or have a significant rollover need).

**20.** ***Given the sizeable fiscal stimulus, staff argues that the Fed will need to raise policy rates at a faster pace, a policy response that has not been priced by markets. Could staff elaborate more on the impact of such course of action on global financial conditions?***

- A sizable fiscal stimulus while the economy is at full employment will likely mean that the Fed will need to raise rates at a faster pace to achieve maximum employment and price stability. Policy rates will likely need to rise above the neural level temporarily. If realized, this would tighten global financial conditions through a rise in the U.S. dollar, an upward move and steepening of the U.S. yield curve, and potentially declines in equity markets and increases in spreads on a range of fixed income instruments.

**21.** ***Also, taking into account that the normalization of monetary conditions includes the shrinking of the Fed's balance sheet, we missed a more specific analysis on possible effects from the latter. Staff's comments are welcome. In this regard, we would like to know the staff's view on impacts of reduction in U.S. dollar liquidity by balance-sheet shrinking of the Fed on the emerging markets' capital flows.***

- Staff regard the macroeconomic effects of the planned balance sheet roll-off as limited. Staff estimates that balance sheet reduction under the announced plan could potentially have a monetary policy impact equivalent to no more than a 22 basis point rise in the federal funds rate over the next two years. Even this relatively small effect is likely to be overstated since market pricing already incorporates an expectation of the balance sheet reduction over the medium-term that the Fed has communicated (see 2017 Article IV report, paragraph 27). As such, the effect on emerging market capital flows from changes to the balance sheet are likely to be small.

**22.** ***Does staff perceive the Phillips curve coefficient to remain relatively low despite a pro-cyclical policy in times of a positive output-gap, or have inflation expectations become anchored in a way that surprises are unlikely?***

- Staff estimates suggest that the slope of the Phillips curve has been both stable and low since the 1990s (Abdih et. al., 2016, "What is Keeping U.S. Core Inflation Low: Insights from a Bottom-Up Approach" or S. Laseen, 2016, "Did the Global Financial Crisis Break the U.S. Phillips Curve?").
- Both survey and market-based measures of inflation expectations have remained well anchored reflecting the credibility and track record of the Federal Reserve which mitigates the risk of a sustained inflation surprise.
- Nonetheless, there have been few historical episodes where unemployment rates are as low as they are currently and so there is thus a risk that the slope of the Phillips curve could be steeper at very low levels of unemployment (as discussed in Box 2 of the staff report).

**23.** ***Could Staff comment on the potential impact of escalating trade barriers on inflation? Could staff discuss the implications of trade frictions for monetary policy, noting that the effects could manifest either as a demand shock as confidence effects weigh on investment, or a cost-push shock to US businesses?***

- An increase in tariffs on certain U.S. imports would modestly raise the *level* of prices (less than one-third of the personal consumption expenditures basket is goods and a fraction of that is expected to be subject to trade barriers). However, this would be a one-off effect on inflation, assuming (as is likely) that inflation expectations remain well anchored. The Fed would likely look through this one-off price level effect and react only to second-round effects which are likely to be small. Similarly, the effects of such trade barriers on U.S. output are likely to be small (although the impact of a prolonged period of policy uncertainty is difficult to quantify).

**24.** ***What is the likelihood of an increase in the pace of the monetary policy rate hikes relative to that currently envisaged?***

- An inflation surprise, driven by capacity constraints becoming more binding and the economy pushes further through full employment, represents an important risk to the outlook. If realized, then the pace of policy rate hikes will increase relative to that currently envisaged as outlined in Box 2. It is difficult to assign a likelihood to such an outcome but it is not envisaged in staff's baseline forecast.

**25.** ***To what extent should monetary policy consider the impact of its actions on global financial conditions, particularly USD funding conditions, noting that stress in international markets can generate spillbacks to the US economy?***

- The Federal Reserve responds to such developments to the extent that they affect domestic employment and price stability. Previously staff work has, however, found very limited “spillbacks” to the U.S. economy from changes in U.S. monetary policy. Nonetheless, the Federal Reserve’s continued adherence to the principles of data-dependence, transparency, and clear communication will be central to mitigating undue impact on global financial conditions.

- The Fed’s plans for balance sheet normalization were well-telegraphed at an early stage. The FOMC made sizable efforts to provide predictability and clarity, which has helped reduce the risks of market volatility and negative spillovers to others, including potential capital outflows. Indeed, staff is of the view that the monetary effects on the US are small. And continued clear communication will maintain the Federal Reserve’s estimable track record of smoothly normalizing U.S. monetary policy while minimizing volatility.

**26.** ***Considering that the yield curve in the US has been flattening, as the difference between the two and 10-year Treasury yields has narrowed to less than 50 basis points, representing the slimmest spread since September 2007, we are wondering what the implications for the medium-term outlook could be.***

- Staff forecasts incorporate a continued very flat (although not inverted) yield curve. Historically, an inverted yield curve in the U.S. has been a strong predictor for a recession. However, it is unclear—with structural changes to financial regulation that have affected the demand for high quality liquid assets and with U.S. Treasuries being in high demand as an international reserve asset—whether an inversion of the yield curve at this stage in the cycle would be an accurate predictor for recession.

**27.** ***In Box 2, in both the linear and nonlinear cases the FRB/US model foresees higher policy rates and lower core inflation rates when compared with the G20 MOD model. Can staff explain if other factors other than alternative monetary policy rules can account for these different dynamics?***

- The primary difference in the two model simulations is the monetary policy rule underlying the model. In the FRB/US the Fed is assumed to follow an optimal control policy while in G-20 MOD the Fed is assumed to follow a forward-looking Taylor Rule. There are other structural differences in the model also that account for some of the difference with the FRB/US being a much more complex and large-scale model with various behavioral relations embedded into it. Even in a linear case, FRB/US tends to have a property of a lower variability in inflation and a slower movement of macroeconomic variables than in the G-20 MOD.

**Financial sector**

**28.** ***Staff comments on the adequacy of safeguards against a risky credit boom are welcome.***

- Staff see a limited likelihood of a "risky credit boom". Underwriting standards for bank credit is relative tight when compared with pre-crisis standards; much of the mortgage debt is being securitized through the government-sponsored entities; and corporate debt markets in the U.S. are differentiating between different quality borrowers. Further, the positive outlook for the economy mitigates near-term risks. There are, nonetheless, pockets of vulnerability (described in paragraph 3) including underwriting standards in corporate credit and medium-term risks are elevated.

**29.** ***Staff comments are welcome on the authorities' proposed plans for privatization of 'Fannie Mae' and 'Freddie Mac.'***

- Fannie and Freddie remain in conservatorship. The authorities and administration have not proposed specific plans or issued legislation to reform the U.S. housing finance system.

**30.** ***Staff comments on the ongoing amendment of the Volcker Rule and whether the proposed amendments strike the right balance between self-policing by banks and necessary enforcement are welcome.***

- The complexity, and in some cases ambiguity, of the regulation has long been considered a problem that creates regulatory uncertainty, raises compliance costs, and has been difficult to enforce (in practice, it is difficult to clearly distinguish proprietary trading from hedging).
- Staff has argued that structural measures such as the Volcker Rule are a second-best form of regulation. Nonetheless, it is unclear how the revised rule will be enforced, how much latitude banks will have for self-policing, how the financial institutions themselves may respond to the changes, and whether or not loopholes may be created that undermine financial stability. To mitigate these potential risks, strong supervisory oversight will be essential.

**31.** ***While we could understand the authorities' intention to make financial regulation efficient, we would encourage them to take note of what staff underscores in paragraph 33 regarding the significance of assessing the important interactions between the various regulatory changes that the authorities are proposing. This is a critical issue and maybe staff could elaborate further on the differences when changes are taken in isolation and combined effects when taken as a whole system.***

- Staff does not have access to the supervisory and institution-by-institution data that would be needed to estimate the potential financial stability implications of changes to U.S. financial regulations either in isolation or the combined effects.

**32.** ***Annex IV of staff report depicts a low implementation rate of FSAP recommendations. Could staff elaborate on the reasons for this weak implementation?***

- The authorities have taken on board and implemented many of the 2015 FSAP recommendations. However, in a number of cases, the authorities have either opted for other solutions or decided not to implement the FSAP recommendations.

**33.** ***Staff comments are welcome regarding actions to strengthen oversight related to fintech and cyber risk.***

- Supervisors need to have the flexibility to adapt their approach to fintech supervision in response to the fast-evolving nature of technology. Authorities need to collect data and boost their understanding of financial institutions' technology and business models, their evaluation of cyber risk appetites and breach trends, and their analysis of the evolution of the economic environment and implications for banks' activities and risk profiles. Perhaps more critical than other areas of financial supervision—given the speed of change in the overall landscape—is having the capacity and authority to adapt the supervisory response quickly as threats evolve.
- National authorities and regulators also need to provide the right incentives to ensure cyber events are reported in a timely and accurate way. A reliable cyber risk reporting system is crucial. Standards for cyber risk should require financial institutions to provide internal cyber risk data, at first periodically, and eventually in real-time. Data reliability checks and automated processing would be responsibilities of the standard setters. Due to the criminal nature of cyber-attacks, regulators will need to coordinate with relevant law enforcement agencies. Ideally there would be formal arrangements for a two-way exchange of information between law enforcement agencies and regulators. Many of these issues were discussed in Kopp, Kaffenberger, and Wilson (2017), "Cyber Risk, Market Failures, and Financial Stability," IMF Working Paper, WP 17/185, IMF.

**External sector**

**34.** ***The EBA estimated cyclically-adjusted current account gap has increased from –1.0 percent of GDP in 2016 to 1.5 percent of GDP in 2017, mostly due to increase in unidentified residual. Can staff clarify this? We note from the external sector assessment that the staff-assessed current account gap has increased to 1.5 percent of GDP for 2017, from 1.0 percent for 2016. Could staff clarify the role of refinements in the EBA methodology versus changes in fundamentals and policy settings in this assessment?***

- The EBA estimates the current account norm to be -0.7 percent of GDP in 2017. The changes in the norm (and the gap) reflect refinements to the EBA methodology, particularly revisions to the demographic specifications in the model.

**35.** ***What policy measures does the administration envisage to reduce the current account deficit?***

- We are not aware of any policy measures designed to reduce the current account deficit although the administration has argued that their announced tariffs (outlined in paragraph 28) will reduce the U.S. trade deficit with key trading partners.

**36.** ***Corresponding surpluses will likely come from Germany, China and Japan, as noted. Nevertheless, we would like to suggest that, given the internal imbalances of the US economy, the current account deficit would persist even if those economies reduced their own imbalances. Staff comments are welcome.***

- The U.S. CA deficit is expected to increase in the coming years due in part to the fiscal stimulus and a cyclically stronger position than the other systemic economies. Reducing the imbalances in other systemic economies (e.g. by stimulating domestic demand in surplus economies) is likely to have implications for currencies that would have some corresponding effect on the U.S. current account. However, the spillover effects are likely to be relatively small.

**Trade policy**

**37.** ***Finally, we are interested to learn more about the findings of the U.S. administration's study regarding the causes underpinning the U.S. trade deficit (page 24), which according to staff has been completed by the U.S. authorities but has not been made public. Staff's comments are welcome***

- Staff have not seen the findings from this report.

**38.** ***Have the authorities envisaged specific policies for ameliorating labor market and the income distribution issues arising from trade?***

- The U.S. has maintained a program of Trade Adjustment Assistance that provides support for income support, training, relocation, job search and other reemployment services (as well as separate programs for companies and farmers). A 2012 Department of Labor evaluation of that program showed that the program had increased education and training of participants; that those covered by the program had lower wages and benefits (even after several years) than those who had not participated, particularly for older workers; and those who had received support under the program had a higher probability of being employed.

**39.** ***Can staff expand on the assumptions and mechanisms behind the calculations of the impact of a successful NAFTA negotiation on Mexico and Canada?***

- The results are based on estimates from standard a Computable-General-Equilibrium (CGE) model. The model includes 7 country aggregates (Canada, Mexico, U.S., China, other Asia, EU-27, and the rest of the world) and 17 sectors containing all goods and services produced by each country. The model solves for a new, market-clearing equilibrium solution after all prices and quantities adjust to an economic shock. Results describe a medium-term adjustment period of about 7- 10 years, in which factors are fully mobile but dynamic investment and productivity gains do not yet occur. The specific assumptions underpinning the successful NAFTA scenario are displayed in the table below:

| **Tariffs** | **NTMs in Trade in Goods** | **NTMs in Trade in Services** | **Rules of Origin** |
|---|---|---|---|
| All NAFTA tariffs eliminated | Trade efficiency increased by 1 percent on U.S. trade with Canada and Mexico | AVEs of NTMs in services on U.S. trade with Canada and Mexico reduced by 25 percent | ROO trade costs for NAFTA trade in textiles/apparel and vehicles/parts reduced by one-half |
| Note: AVE = Ad Valorem Equivalent; NTM = Non-tariff measures; ROO = Rules of Origin. | | | |

**40.** ***Conversely, we wonder if staff have estimates of the potential impact in the event that renegotiations fail or members withdraw from NAFTA, and if this analysis could be incorporated into the joint IMF/WB/WTO paper on reinvigorating trade?***

- Staff estimates suggest that the failure of NAFTA and a reversion to non-preferential (MFN) tariffs could reduce long-term real GDP in all three NAFTA countries. The negative effects of a failure of NAFTA negotiations could be amplified if non-tariff trade costs (such as the breakdown of supply chains, delays for inspections and other administrative costs at the border) rise. See table below:

**Failure of NAFTA: Long-run Impact on Real GDP, percent**

| Non-Tariff Trade Costs | United States | Canada | Mexico |
|---|---|---|---|
| **Baseline (2 percent increase)** | **-0.09** | **-0.45** | **-0.48** |
| 10 percent increase | -0.37 | -1.94 | -1.79 |

- The joint IMF/WB/WTO paper on reinvigorating trade will explore areas of trade policy reform that stand to contribute importantly to productivity and income growth. Staff do not intend for this paper to extend to analyses of particular trade agreements.

**41.** ***The benefits of the so-called "successful NAFTA renegotiations" for the U.S. growth appear to be miniscule, while for the other two economies they are substantial. Given that the U.S. economy is large and relatively closed, would similar conclusions hold true for trade policy effects on a broader group of countries? What is staff's estimate of the impact of new trade measures on the US trade balance?***

- It is difficult, in a modelling context, to show significant effects on the U.S. economy (either on GDP or the trade balance) from trade restrictions imposed by the U.S., even with full reciprocation by trading partners.
- However, even the more sophisticated modelling exercises can miss important dynamic effects of trade barriers, including those through the uncertainty created by changing trade relationships.

**42.** ***Could staff update the directors on the latest developments in trade measures and their potential impact on US firms' location?***

- To date no additional trade measures have been enacted by the United States beyond those described in the staff report.
- The U.S. has begun an investigation into whether auto imports "threaten to impair the national security" under Section 232 of the 1962 Trade Expansion Act.
- In addition, Section 301 tariffs on China have been proposed to apply to $200 billion of imports with an additional $200 billion if China retaliates.
- The U.S. also found Chinese companies are dumping aluminum sheet as part of a self-initiated anti-dumping/counter-veiling duties case. The final determination to in this action is pending.

**43.** ***In this regard, we underscore the importance of quantitative analysis on macroeconomic impacts of trade policy changes and welcome staff's comments on prospects for future analysis.***

- WHD staff will soon publish a Working Paper (See footnote in Box 6) containing detailed estimates from several NATFA scenarios including the successful NAFTA scenario discussed in the staff report as well as the macroeconomic impact of the CPTPP trade agreement that was recently signed by 11 countries.

**44.** ***Do imports make up a larger share of lower-income households' budgets, compared to wealthier ones? If so, do US tariffs on imported goods have the potential to disproportionately affect the living standards of lower-income US households?***

- Poorer households tend to spend relatively more on tradable goods than richer households. As a result, prices faced by poorer households are expected to be more severely affected by tariff increases. In the U.S., BLS data shows that spending on goods represents about 25 percent of total expenditures for households in the lowest decile of the income distribution (whereas it is around 18 percent for households at the top decile of the income distribution).
- Studies estimate that the welfare gains from free trade are larger for poorer households. Trade is estimated to have reduced by two-thirds (one-quarter) the price of the household consumption basket of a typical advanced economy low-income (high income) household (see Fajgelbaum and Khandelwal, 2016 and Peterson Institute).

**45.** ***We were surprised to see in the Risk Assessment Matrix that staff considers the negative impact of a potential retreat from cross-border integration to be of a "medium" magnitude only. Staff's comments on this would be welcome.***

- The horizon over which this assessment was made is the medium term, which corresponds to 3 years. Within 3 years, the expected likelihood of a retreat from cross border integration was evaluated to be between 10 and 30 percent (i.e. medium).

**46.** ***The authorities have indicated that the lack of progress in international fora has warranted some of the trade actions they have taken. Staff comments on measures that could be taken to ensure faster progress at international fora would be welcome.***

- There is room to strengthen the multilateral trading system in several dimensions (see Mr. Obstfeld's comments at the most recent WEO press conference). The joint IMF/WB/WTO paper on reinvigorating trade will explore areas of trade policy reform that stand to contribute importantly to productivity and income growth
- It is worth noting that there have been some positive developments in the global trading system that should not be ignored, including the conclusion and recent entry into force of the WTO Trade Facilitation Agreement on a fully multilateral basis.

**Competition policy**

**47.** ***Judicious regulation of the huge platform technology companies may be necessary to rein in the potential abuse of their monopolistic dominance, analogous to the problems which arose from the regulation-lite treatment of the activities of the largest financial institutions in the pre-crisis period. Staff comments on this issue are welcome.***

- Where there is evidence of platform technology companies erecting barriers to entry, restrict supply, or drive up prices, there is a clear role for applying antitrust policies. At the same time, in some cases, network and information externalities associated with such companies may justify an oligopolistic structure.

**48.** ***Could staff provide more details regarding the representativeness of the US sample?***

- Staff analysis is limited to publicly traded firms (due to the availability of data). However, the firms in the sample do account for a large share of economic activity (i.e. have combined sales equivalent to about 80 percent of U.S. GDP) and, as such, should provide a good indication of general trends in the U.S. economy.

**49.** ***While we understand that the staff's analyses on relationships between market power and investment spending or labor share are consistent with those of Gutiérrez and Philippon (2018) and Autor et al. (2017), we would like to know if***

***there are any differences or new findings compared to the previous works. Regarding the labor share of income, other factors including a lower price of investment goods or trades and offshoring could have affected the declining trend of the labor share. We would appreciate it if staff could share the views on how large is the role of rising market power on the labor share, compared to those of the other factors.***

- Much existing work—including in these two studies—focuses on the evolution of market power using *industry-level* indicators, such as market concentration, which do not directly measure the margin between prices and costs at the firm level. In contrast to such studies, staff constructs a *firm-level* indicator of market power—markups of prices over variable costs—and uses that to shed light on the relation between market power and the labor share.
- The staff finding that the labor share declines in firms with more market power is consistent with that of Autor for the United States, and the staff analysis shows that these findings also extend to other advanced economies.
- The staff finding that investment responds to market power in a *non-monotonic* way (with the relation turning negative once markups reach high levels) adds to that of Gutiérrez and Philippon (2018) whose analysis found a *linear* relationship.
- Staff analysis has also examined the role of other factors in driving the decline in the labor share of income since the early 2000s (see Y. Abdih and S. Danninger, "What Explains the Decline of the U.S. Labor Share of Income? An Analysis of State and Industry Level Data", 2017) finding evidence of a strong role for the technological change (including the automation of routine tasks) as well as globalization (import competition and penetration). Rising market power may in part be a channel through which these developments affect the labor share (as discussed by Autor et al, 2017).

**Fund issues**

**50.** ***We would welcome staff comments on the Article IV staff report review process with regard to the drawing upon the conclusions of WPs. Moreover, one of the reasons for the selective use of SIPs going forward is that SIPs tend to get considerably less attention on imf.org compared to Article IV staff reports and concluding statements. Do WPs have a better reach than SIPs? Staff comments would be welcome.***

- Since 2013 the U.S. Article IV has not produced selected issues paper, opting instead to issue working papers for the analytical work underpinning the consultation.
- Analytical work presented in an Article IV staff report—whether in the main text, boxes, or annexes—is subject to the standard review process. A more detailed exposition of this analytical work is sometimes also presented in Selected Issues Papers or working papers. Working Papers have a wider reach than SIPs.

During 2018, the average number of page views for a working paper was more than twice that for the average SIP [1260 compared to 520] in part because they are searchable through academic indexing sites such as SSRN and RePec, in addition to imf.org and IMF eLibrary.