

© OECD, 2004.

© Software: 1987-1996, Acrobat is a trademark of ADOBE.

All rights reserved. OECD grants you the right to use one copy of this Program for your personal use only. Unauthorised reproduction, lending, hiring, transmission or distribution of any data or software is prohibited. You must treat the Program and associated materials and any elements thereof like any other copyrighted material.

All requests should be made to:

Head of Publications Service,
OECD Publications Service,
2, rue André-Pascal,
75775 Paris Cedex 16, France.

Assessment and recommendations

Helped by supportive demand management, economic activity has accelerated

The US economy has performed very well since the early 1980s. Since then, real GDP growth has been the highest among G7 countries and well above the OECD average. In per capita terms real incomes remain much higher than in nearly all Member countries. Productivity gains picked up markedly in the second half of the 1990s, and there has been a further acceleration of late. Following a period of sluggish growth and massive policy stimulus, the economy has now enjoyed nearly a year of strong expansion, growing by about 5 per cent (annualised) over the past three quarters. Since mid-2003, the recovery has broadened – spreading from spending by households and government to business capital formation – and has gained considerable cyclical momentum. This should ensure continued growth at above-potential rates in the near term – even though macroeconomic policies are likely to become less stimulatory – so that the output gap that opened in 2001 may close around the middle of next year. To be sure, significant downside risks to this positive outlook remain. While the current account balance is not a policy target, the persistence of a large external deficit could put upward pressure on long-term interest rates. And the unusually slow improvement in the labour market might crimp confidence and spending. On the other hand, the further pick-up in productivity and hence potential output in recent years and the high level of profitability bode well for a continued robust economic expansion, increasingly led by business investment.

But sustaining good economic performance poses a number of policy challenges

The US Administration has emphasised strong economic growth as a top priority; assuring such an outcome will be a challenging task. Indeed, although the economy has been quite resilient, manifesting a solid capability to adjust to adverse shocks, policymakers face a number of hurdles,

which need to be cleared in order to ensure a sustained recovery and continued strong growth over the medium and long run. Major policy challenges in this regard are to:

- Reduce public dissaving by strengthening budgetary discipline and placing the public retirement and health-insurance systems on sound financial footings.
- Ensure policy settings are consistent with an orderly unwinding of the external deficit, based on a strengthening of national saving and exports, rather than weaker investment and growth.
- Lock in price stability and adapt the central bank's communications policy to the new low-inflation environment.
- Continue to re-build financial-market confidence by vigorously implementing and enforcing corporate governance and accounting reforms.
- Further enhance product-market competition to maintain higher productivity growth.
- Avoid protectionism and continue to build support for free trade.

This does not mean that there are not other areas that need attention and where reform efforts or policy changes should be considered, especially to address environmental problems and tackle a broad range of social issues. These social and environmental challenges, in particular, were extensively covered in the last *Survey* and are hence not revisited in depth.

Budgetary discipline must be restored

The federal budget has moved from a surplus of nearly 1½ per cent of GDP in fiscal year 2001 to a deficit of 3½ per cent in 2003 and a projected 4¼ to 4½ per cent this year. This rapid deterioration is attributable to sharply reduced tax receipts following the recession and the demise of the stock-market bubble combined with tax cuts and the rapid expansion of defence, “homeland security” and other discretionary outlays. While the cyclical drag on public finances should fade soon, recent policy changes on both the revenue and outlay sides imply that, under realistic assumptions and absent corrective action, the deficit will remain substantial

over the next ten years by both US historical and international standards. At that time, the retirement of the baby boom generation will be in full swing, putting enormous pressure on entitlement programmes. Now that the recovery has taken hold, measures to reduce the deficit are urgently needed if the beneficial effects on long-run national income from recent marginal tax-rate cuts are not to be outweighed by the adverse consequences of the fall in public and national saving. These measures should aim both at curbing outlays and, to the extent revenues have to be raised, broadening the tax base. In its 2005 Budget the Administration proposes to halve the deficit by 2009 through unprecedented restraint on non-security expenditure. However, even if that objective were achieved, it might nonetheless not be ambitious enough in view of the Administration's intention to make the recent tax cuts permanent, its defence aspirations, the need to deal with the surging numbers of taxpayers who will be subject to the Alternative Minimum Tax and the serious demographic effects on entitlement spending that would then be just around the corner.

This requires a renewed commitment to budget-control mechanisms...

Bipartisan agreement on the need for sustained deficit reduction was a critical factor behind the improvement in public finances in the 1990s. This agreement produced and sustained the 1990 Budget Enforcement Act (BEA). But its main provisions – statutory caps on discretionary spending and the pay-as-you-go requirements for mandatory spending and revenue measures – expired at the end of fiscal year 2002. Although fiscal discipline began to erode when surpluses emerged in the late 1990s, until then the BEA seemed to provide an effective restraint on both spending and revenue measures. The international evidence suggests that fiscal rules are unlikely to be effective in the absence of a strong underlying dedication to fiscal prudence. Should there be a new bipartisan commitment to deficit reduction, reinstatement of all of the BEA's main provisions would probably facilitate the return to budget balance. In this context, it would be useful to improve the transparency of the budget outlook by accounting more clearly for the rapid accumulation of liabilities under entitlement programmes and thereby focusing stronger attention on the key choices that will have to be made to put government finances on a

sustainable path. Recent Congressional and Administration proposals, if implemented, would go a long way to address these issues.

... while long-term fiscal pressures need to be tackled as soon as possible

While the retirement of the baby-boom generation has drawn nearer and life expectancy has continued to increase, no progress has been made in recent years to put entitlement programmes on a sturdier financial footing. Under baseline assumptions, spending on Social Security, Medicare and Medicaid is projected to rise from just over 8 per cent of GDP currently to nearly 18 per cent by 2050. As time progresses, the cost of restoring the programmes to actuarial balance will rise rapidly. The Social Security programme should be safeguarded through a combination of revenue increases and benefit reductions, such as reducing replacement rates for high income earners and indexing the full-benefits age to life expectancy. The financial position of Medicare and Medicaid is considerably worse, given the rapid growth of health-care costs, and has deteriorated further as a result of the recent addition of a prescription drug benefit to Medicare. To keep its cost increases in check, it will be necessary to restrain the growth of costs per enrollee, particularly under the new prescription drug benefit. Controlling costs is an equally demanding and important challenge for Medicaid, where long-term care expenses are projected to rise rapidly as the eligible elderly population continues to grow. Allowing greater scope for the authorities to negotiate with producers the prices paid for drugs provided under the new prescription drug benefit might lessen the impact of projected increases in drug expenditures on the financial condition of both Medicare and Medicaid. Policymakers must recognise the unpalatable arithmetic of the current entitlement programmes and take early action to rein in the inexorable rise in their costs.

... as well as a broadening of revenue sources

Restraining both discretionary and mandatory spending, while necessary, is unlikely to be sufficient to restore the budget to balance over the longer term. To the extent that revenues have to be raised, this should be done primarily by broadening the tax base rather than by reversing recent reductions in marginal tax rates. Considering the low aggregate tax burden compared to other member countries,

statutory and marginal effective tax rates remain rather high, reflecting the heavy reliance on income taxes, in particular at the federal level. To broaden the tax base of the personal income tax, the deductibility of mortgage interest (regardless of the use of the loan) and of charitable donations should be phased out, as should the unlimited exclusion of employer health insurance plan premia. As to the corporate income tax, base-broadening efforts should focus on exemptions that reduce revenues and create inefficiencies, such as sectoral tax shelters. In any case, there is significant scope to improve revenue yield by better enforcement. If the yield from broadening existing income tax bases is ultimately insufficient, a further move to a consumption-based tax system through the introduction of a nation-wide value added tax (VAT) should be considered. While introducing a VAT would be complicated in the US context, in which most states rely heavily on sales taxes for their revenues, such a step would be an efficient approach to raising revenues and might also help to boost household and national saving.

Such moves would contribute to a smooth unwinding of the potentially destabilising external deficit,...

The current account has been in almost uninterrupted deficit since the early 1980s. With the usual cyclical improvement hardly visible during the recent recession, it has reached record levels and is currently running at around 5 per cent of GDP. As a result, net external claims on US residents have grown to some 25 per cent of GDP, still less than the net liabilities of many other countries but rising of late by an average of several percentage points of GDP per year. An adjustment in the current account balance could involve a number of domestic and foreign factors that affect the global demand for dollar assets. At some stage, those assets may come to occupy too large a share of foreign portfolios, even though their relative returns remain favourable. The flow of private capital into the United States has slowed somewhat in the last two years. Although governments – especially in Asia – have stepped up their purchases of US assets, this slowdown may have contributed to the decline in the dollar on foreign exchange markets since early 2002. This should help arrest the rise in the external deficit but, in the interest of global growth prospects, stabilisation of the foreign debt ratio cannot rely exclusively on dollar depreciation. Faster domestic demand growth abroad

will be required, as will an increase in US national savings and some long-lasting competitiveness gains independent of exchange-rate changes.

... which is attributable to a lack of domestic saving

Underlying the current account deficit is a rising gap between domestic saving and investment, which is covered by foreign saving. If that deficit is to be reduced in relation to GDP, either domestic saving will have to increase or investment to fall, again relative to GDP. Increasing saving can be achieved by raising net exports relative to domestic demand, decreasing consumption relative to income or reducing public spending relative to taxation. The fiscal stimulus of the past few years has been helpful in promoting recovery; but if current prospects of future budget deficits are realised, interest rates will be higher, barring a considerable rise in private savings. This would imply slower growth in the capital stock, productivity and economic potential. There are a number of factors that would allow the current account adjustment to occur gradually, including the dollar's role as a reserve currency and the scarcity of equally attractive investment alternatives, owing to the favourable features of the US economy (deep capital markets, a flexible labour market, a healthy investment climate and robust productivity trends). Nonetheless, ensuring a smooth adjustment process that avoids endangering both domestic and international growth prospects will require policies that bolster investor confidence by strengthening corporate governance and curbing emerging protectionism and, more fundamentally, effective measures to shrink the budget deficit over time.

In the current low-inflation environment, clear communication by the monetary authorities is particularly important,...

By keeping the federal funds rate exceptionally low, the authorities have successfully geared monetary policy to engineering the pick-up in activity. However, the unusual situation of having core inflation at a rate that is slightly *below* the perceived official comfort zone increases the need for clear communication between the monetary authorities and the public, for two reasons. *First*, if core inflation continues to slow, the Federal Reserve will have to prevent inflation expectations from falling, since that would raise real interest rates, braking the expansion unnecessarily. *Second*, in the more likely event that the recovery progresses sufficiently strongly to gradually eliminate spare capacity, the authorities

will need to make it clear to investors that some increase in inflation from current levels is acceptable and should not be mistaken for a weakening of their commitment to price stability. In either case, the Federal Reserve should provide clear guidance to markets regarding its own assessment of the economic outlook and policy response conditional on prospective developments.

... while adjustments to the policy framework may enhance the effectiveness of managing expectations

Responding to this need for effective communication, the Federal Open Market Committee (FOMC) has recently made several changes to the contents of the statements released following its meetings. It has separated the balance of risks assessment for inflation from that for output growth. Moreover, it has added a more forward-looking element by its recent indications that monetary policy can remain accommodative for a “considerable period” or be “patient”. While these changes have provided valuable information, further steps toward greater clarity could help to inform markets about the FOMC’s assessment of future economic developments and policy responses. In particular:

- The FOMC may also want to release its own projections more frequently and for a broader range of variables and a longer horizon than currently.
- An earlier release of the FOMC meeting minutes – now published only after the following meeting – should be considered.

The Federal Reserve recently set up a group to study some of these questions. More fundamentally, with the explicit approval of the relevant Congressional committees, the FOMC should consider quantifying its working definition of the price-stability objective mandated by law, specifying a suitable price measure and a desired long-run average value or range.

Restoring financial-market confidence would be assisted by progress in corporate governance reform,...

Besides the bursting of the stock-market bubble and geopolitical uncertainties, corporate governance and accounting scandals have played an important role in denting investor confidence in the last few years. While the stock market has regained substantial ground, underlying concerns about governance and accounting remain latent, and a renewal of such shocks would be seriously detrimental. Further reforms in this area would be conducive to strengthening the foundations for sustained growth and underpinning the integrity of financial markets. In response to widespread corporate malfeasance, the 2002 Sarbanes-Oxley Act stiffened penalties for fraud, enhanced both auditor independence and regulation of the accounting profession and increased both disclosure requirements for public companies and the responsibility of their executives for financial reporting. Considerable progress has been made in implementing the legislation, and early assessments of the reform's impact are largely positive, though concerns have been voiced that some provisions of the Act – such as the requirement for chief executives to certify financial statements – would adversely affect business behaviour. In addition, the listing requirements of the major stock exchanges have been strengthened with respect to corporate governance provisions. However, renewed scandals in recent months (involving the New York Stock Exchange and the mutual funds industry) have demonstrated that there is still unfinished business in the area of corporate governance reform:

- Guaranteeing the independence and strengthening the oversight of corporate boards. The still complaisant attitude of compensation committees is an indication that more needs to be done by investors, the exchanges and the authorities.
- Enhancing shareholder rights by providing access to the director nomination process, as proposed by the Securities and Exchange Commission, which should allow investors to vote for and remove individual directors.
- Pressing ahead with governance reforms in the mutual funds industry given its major role in the US economy.
- Ensuring that regulatory agencies are provided with sufficient resources to complete the reform agenda

and to upgrade enforcement, while encouraging them to become more pro-active in their operations.

- Reforming incentive-based executive compensation to further enhance managerial performance. Requiring the expensing of stock options would make compensation more transparent and avoid inappropriate incentives facing managers, such as boosting earnings in the short term at the expense of long-term outcomes.
- Achieving greater harmony between US and international accounting standards and resolving questions about auditor oversight, thereby reducing pressures for the extraterritorial application of US regulatory oversight in this area.

... eliminating the special status of government-sponsored housing finance companies...

Two of the leading government-sponsored enterprises (GSEs), Freddie Mac and Fannie Mae, which have become major players in financial markets, have also been investigated for accounting irregularities. In view of their rapid growth and systemic importance, their regulation and supervision needs to be tightened, and the Administration has made proposals to this end, including relocating the regulatory authority to the Treasury Department. But reforms should go beyond that by eliminating their special status. This status has led to the market perception of an implicit government guarantee and hence slightly lower borrowing costs, allowing them to expand strongly and move into activities beyond their original mandate of supporting the secondary market for residential mortgages. In any case, the marginal funding advantage is an inefficient way of promoting homeownership – most of the benefits go to the shareholders of the two GSEs – and such promotion is separately undertaken by multiple tax preferences granted to owner-occupied housing. Altering the GSEs' status, however, may not be sufficient to eliminate their implicit government guarantee. Without reducing the size of the GSEs' portfolios, investors may still perceive them as "too big to fail". Limits could be placed on the growth of their mortgage-related asset portfolios, so that mortgage-backed securities traded in public markets, and not GSE debt, become the dominant source of secondary-market funding for mortgages.

... and improved regulation of corporate pension plans to avoid under-funding

Given their adverse impact on corporate finance and potential risks to plan participants and the Pension Benefit Guaranty Corporation (PBGC), weaknesses in the regulatory framework applicable to defined-benefit corporate pension plans need to be addressed. They have allowed substantial under-funding and have led to a huge financial deficit of the PBGC. The Administration has made proposals to improve liability measurement, disclosure and safeguards against under-funding by financially troubled companies. A more comprehensive reform of the system will be necessary though, because its problems are partly structural, reflecting its poor incentive characteristics. In doing so:

- It would be ill-advised to provide funding relief, as is being discussed in Congress, with no simultaneous offsetting action to address systemic under-funding associated with lax funding rules.
- It would be prudent to use a conservatively low discount rate to calculate pension obligations, while aiming at greater accuracy and transparency.
- The government pension insurance agency should be given greater flexibility so as to charge higher premiums to firms generating more risk to the system.

Regulatory reform has enhanced competition in many sectors and boosted aggregate economic performance

The economy's good performance for more than a decade can in part be traced to regulatory reform efforts in a broad range of industries, aimed at enhancing competitive forces as a means to improving efficiency, thereby stretching production possibilities. These efforts began in the 1970s and accelerated in the 1980s and have meant that competitive forces have now been stronger in the United States than in most other OECD countries for some considerable time. Robust product-market competition has probably increased pressures for flexible adaptation in labour markets. This, in turn, has favoured the quick adoption of productivity-enhancing technologies and the re-employment of workers displaced both by such innovations and by trade liberalisation. Nonetheless, despite favourable productivity trends and the generally pro-competitive thrust of policies, improvements remain possible in various areas.

But there is room to improve the competition policy framework,...

Since basic competition law has not changed for decades, antitrust policy has evolved through court decisions. By international comparison, penalties and enforcement are severe, and private litigation is unusually important. The high risks of sanctions and treble damages for violations have encouraged efforts to undo or weaken enforcement actions and often entailed exemptions, special treatment or anti-competitive state regulation. Several changes seem appropriate:

- Anomalous exemptions from law or jurisdiction should be eliminated to improve coherence and promote competition.
- The antitrust immunity of government enterprises should be terminated; it has no logical basis, and, indeed, no other OECD country exempts government-related firms from competition enforcement.
- State constraints on competition should be vigorously challenged under the Interstate Commerce clause, as they undermine the national commitment to rely on competitive forces.

... and challenges remain regarding intellectual property rights,...

The strengthening of intellectual property rights (IPRs) since the early 1980s has been accompanied by an expansion in R&D and a surge in patents. Some problems have followed the shift to stronger IPRs, notably the increase in patent litigation. The United States has greater patent protection than most of its trading partners. The significant protection afforded to IPRs is one factor contributing to the much higher level of branded drug prices and hence of health spending than in other countries. In assessing whether the strength of patent rights in the United States has moved beyond the optimal level, the question is whether too much current income and output is sacrificed for the additional innovation generated. While a comprehensive assessment of the costs and benefits of IPR policies is still lacking, some measures may be advantageous, including:

- Considering the adoption of an opposition system for patents similar to that in the European Union (giving broader rights for grants to be challenged), with a view

to limiting litigation costs and improving the quality of the patent review process.

- Making agreements that stop entry by generic drug firms through payments from branded drug firms illegal, while maintaining the possibility of patent dispute settlements without payments.

... telecommunications regulation...

The telecommunications industry has changed significantly over the last 20 years in response to both rapid technological progress and regulatory reform. Competition for long-distance service entered a new phase in the mid-1980s when AT&T was broken up, and the 1996 Telecommunications Act then began the national effort to spur local service competition. Over this period, alternative infrastructure competition and cable broadband competition have also emerged. While local service competition has recently taken root, policy changes may still be needed to ensure that entry in local voice services and broadband are not thwarted by dominant carriers. These changes should also be compatible with the need to increase overall investment by all carriers in advanced network facilities that provide broadband access to all areas. In this respect, an early resolution of outstanding policy issues would be desirable, in particular:

- Given its positive effects on competition in local voice services and on investment in new services, unbundling of certain network elements should be continued for the foreseeable future where competitors' ability to enter is impaired.
- With a view to aiding broadband deployment, unbundling requirements for incumbent telephone carriers should be maintained, and cable firms should be required to open their lines using older technology to independent internet service providers.
- Reviewing the inter-carrier compensation regime, including reduction of current access charges, should be high on the policy agenda.

... and, likewise, electricity regulation

Regulatory reform in the electricity sector was driven by many of the same factors that had influenced efforts in telecommunications: successful liberalisation in other industries,

technological progress and dissatisfaction with induced distortions to prices across states and different customers. Unlike in other areas where the United States has often been a leader in reform, US experiments followed those in a number of other OECD countries. Despite the opportunity to learn from such experience, their success has been decidedly mixed. Although the California meltdown in 2000-01 reflected flaws in the regulatory framework rather than the impact of competition, it has chilled enthusiasm for reform throughout the country. Nonetheless, the August 2003 blackout in the northeast has highlighted the urgency of policy measures to increase regional transmission integration and encourage investment in generation and transmission in order to both improve security and efficiency. A number of initiatives could improve efficiency through increased competition, including:

- Encouraging the integration of electricity markets, which have developed on a state-by-state or small region basis, by implementing a proposed standard market design.
- Commencing reforms to the transmission system, which is currently characterised by balkanised asset ownership, in order to ensure efficient investment in capacity.
- Removing distortions to competition that are implemented through tax and subsidy systems (such as differential tax treatment of public utilities) or that arise from public ownership of some electricity generators.

Energy and environmental policies seem unlikely to achieve even timid objectives efficiently

While some progress has been made in the environmental field, there remain several areas of concern, including ozone protection, air pollution reduction and mercury targets. In its Clear Skies initiative, the Administration set a new target for reducing major pollutants through cap-and-trade policies, but it opposes targets for greenhouse gas (GHG) emissions. A credible alternative to the Kyoto protocol commitments on global warming is still lacking, although GHG emissions are heavy and hence in need of market-based restraint. Proposed energy legislation focuses almost entirely on supply increases through costly hand-outs to producing sectors, while measures to restrain demand by price or other means are notably absent. One result of this

reticence is that the fuel efficiency of the automotive fleet has been stagnant over the past decade at some 6 per cent below earlier peak levels as the fleet has grown heavier and its typical engine more powerful. The government persists in setting separate (“CAFE”) standards for cars and light trucks – although it has announced tighter standards for the latter for the coming three model years, narrowing the gap somewhat – thereby accommodating the increase in the light-truck share of new vehicle sales from one-tenth when the programme began in 1979 to around one-half most recently.

Agricultural and some trade policies need to change course

The United States is committed to further trade liberalisation in global, regional and bilateral contexts. However, its repeated resort to import-restricting measures – even though often consistent with WTO rules – has somewhat eroded its leadership role in the world trade arena. Anti-dumping and countervailing duty sanctions against Canadian softwood lumber and safeguard actions regarding steel and Chinese textiles are the most prominent examples. The United States has yet to implement certain rulings issued by the WTO’s Dispute Settlement Body, notably those concerning the so-called Foreign Sales Corporation provisions in the US tax code. The recent discontinuation of the steel tariffs and a provisional agreement in the long-standing dispute on softwood lumber are welcome steps, although the former has been accompanied by the imposition of a licensing and monitoring programme and the latter would still severely limit market access by a quota system, adding permanently to the cost of homebuilding. Hence:

- Actions to restrict access to domestic markets or to impede firms’ and governments’ ability to source globally should be avoided, both because they imply higher prices and lower real incomes for consumers and tend to impede structural adjustment and flexibility and because they encourage protectionist tendencies worldwide.
- US leadership to successfully conclude the Doha round is essential. In this context, the authorities might need to consider how bilateral and regional trade agreements can best support and complement progress in multilateral trade liberalisation. The limited

coverage of key protected sectors such as agriculture in bilateral agreements underlines the need to press for comprehensive trade liberalisation multilaterally.

Agriculture is both the source of many trade disputes as well as a sticking point in the present global trade negotiations. While agricultural support relative to farm revenues is below that in some other OECD regions, it is likely to increase as a result of recent policy changes. The gains from these support measures go overwhelmingly to large-scale farmers and entail losses to consumers, taxpayers and foreign producers, especially those in developing countries. Recent policy changes risk accentuating both production distortions and trade tensions and are not in line with the long-term OECD policy reform objectives. It would be desirable to roll back the extra support given to farmers in the past few years and reverse the move away from market-based outcomes implied by recent legislation. This would strengthen the United States' leadership role in the world-trade arena where it has tabled ambitious proposals for agricultural liberalisation in the context of the Doha Round.

Some social policies also need attention

There are also ongoing challenges on the social policy front. Health insurance coverage has begun falling again, following a temporary improvement in the late 1990s. This represents a significant economic cost to the extent that a lack of insurance leads to poorer health outcomes and earlier death. In contrast to health coverage, fears that the cyclical downturn would reverse the sharp drop in welfare caseloads following the reforms in the mid-1990s have proved unfounded. On the other hand, poverty rates have edged up again, and, although they are still below their previous peak in the 1990s, they are very high for some population groups. Continued efforts are necessary to ensure that improvements in social conditions in the 1990s, highlighted in the 2002 *Survey*, are not reversed.

Summary

Economic performance over the past two decades has been impressive. Underpinned by an increased reliance on competitive forces, which have been stronger than in most other Member countries for some time, productivity and output have accelerated significantly. In recent years, helped by timely macroeconomic policy responses, the

economy has demonstrated its capacity to adjust to adverse shocks, so that the per capita growth gap against other countries has widened further. The outlook is for this to continue in the next few years, with real GDP expanding by around 4 per cent per annum. Nonetheless, there are a number of challenges that need to be addressed to sustain these laudable economic outcomes. By far the top priority is to confront the current and projected federal budget deficits. The fiscal stimulus of the past few years has been helpful in supporting the recovery, but if public dissaving is not reduced, interest rates may be higher, ultimately implying slower growth in economic potential. Increased budget discipline, and indeed significant reform on both the spending and revenue sides of the budget, will be necessary because of the impending demographic pressures on government finances. Corrective fiscal measures will also assist the unwinding of the current account deficit, which is unusually large for this stage of the cycle. As the Federal Reserve begins to move the federal funds rate back to a more neutral level, it will need to be especially attentive to the clarity of its communications with the markets. Further corporate-governance and accounting reforms would help to underpin confidence of domestic and foreign investors, thereby facilitating orderly current-account adjustment. Less reliance on import restrictions and maintaining a leadership role in trade liberalisation would favour structural adjustment at home. Furthermore, despite the generally pro-competitive thrust of antitrust and other regulatory policies, a number of areas deserve attention, notably intellectual property rights, telecommunications and electricity, where further reforms would be welfare enhancing.

Table of contents

Assessment and recommendations	9
I. Sustaining strong growth and social cohesion: key challenges	25
The economic situation	25
The policy stance	36
Near-term prospects and risks	37
Key challenges	39
Notes	59
Bibliography	61
<i>Annex 1.1. Progress in structural reform</i>	63
II. Ensuring fiscal sustainability and budgetary discipline	67
The federal fiscal position and outlook	67
Sub-federal budgets and joint federal-state programmes	84
Longer-term challenges: imbalances in entitlement programmes	86
Reinforcing budget discipline	89
Notes	94
Bibliography	97
<i>Annex 2.1. Long-run effects of fiscal policies on national income</i>	100
III. Maintaining price stability	103
Avoiding deflation	103
Challenges in communicating the policy stance	108
Strengthening the policy framework	110
Notes	113
Bibliography	114
IV. Improving confidence in financial markets	117
Exchange-rate and stock-market developments	117
Corporate governance and accounting reforms	119
Bankruptcy and private pensions	126
Distortions from government-sponsored enterprises	131
The impact of Basel II	134
Notes	136
Bibliography	137

V. Product market competition and economic performance	139
Overview	139
Competition legislation and enforcement	141
Strong competitive forces have contributed to good economic performance	146
Barriers to foreign trade are relatively low	148
Intellectual property rights	153
Regulatory policies and competition	158
Concluding remarks	173
Notes	177
Bibliography	182
<i>Annex 5.1. Prices for voice and electricity services</i>	187
<i>Annex 5.2. California's experience with reform of retail electricity markets</i>	189
<i>Annex 5.3. Tort reform</i>	191
<i>Annex 5.4. Public procurement</i>	193

Boxes

1.1. Jobless recoveries	30
2.1. Provisions of the Jobs and Growth Tax Relief Reconciliation Act (JGTRRA)	71
2.2. The Medicare Prescription Drug, Improvement, and Modernization Act of 2003	75
2.3. The Alternative Minimum Tax	80
5.1. Recommendations regarding product market competition	174

Tables

1.1. Contributions to GDP growth	25
1.2. Labour market and household indicators	28
1.3. Reconciliation of household and payroll employment	30
1.4. Labour market indicators during and after recessions	31
1.5. Balance of payments	35
1.6. Near-term outlook	38
1.7. Capital flows into the United States	42
1.8. The non-elderly without health insurance	55
2.1. Marginal income tax rate provisions	71
2.2. Marriage penalty relief provisions	72
2.3. Effects on budget deficit	73
2.4. AMT participation and effects	81
2.5. Long-term paths for primary spending	86
4.1. Top 10 firms presenting claims since 1975	129
5.1. Recent trends in output, employment and productivity	147
5.2. Ratio of the domestic to the world price, 1991-93	151
5.3. Retail electricity rates	167

Figures

1.1. Aggregate economic indicators	27
1.2. Labour costs, productivity and profits	29
1.3. Financial indicators and current account	34
1.4. Net international investment position of the United States	40
1.5. Gross saving and investment	41
1.6. Baseline and adjusted federal budget surplus	44
1.7. Long-term projected entitlement spending	45
2.1. CBO's changing unified budget projections	68

2.2. Sources of change in unified budget projections	69
2.3. Budget outcomes under alternative policies, 2004-2014	78
2.4. Net state and local government saving	85
3.1. Total and core inflation	104
3.2. Rates on selected Treasury securities	106
3.3. Inflation expectations	107
3.4. Nominal and real federal funds rate	107
4.1. Exchange-rate and stock-market developments	118
4.2. Private pension under-funding and PBGC financial position	128
4.3. Rapid expansion of government-sponsored enterprises	132
5.1. Competition law enforcement	144
5.2. Indices of regulations affecting product market competition	148
5.3. Gross domestic expenditure on R&D as a percentage of GDP	149
5.4. Domestic patent grants	154
5.5. Market shares and prices in long-distance telephone services	160
5.6. Number of competitive local exchange carriers across the United States	162
5.7. Status of state electric industry restructuring activity	168
5.8. Average wholesale price of electricity in California, 2000 and 2001	169
<i>Annexes</i>	
A5.1.1. OECD composite basket of residential telephone charges	187
A5.1.2. OECD composite basket of business telephone charges	188
A5.1.3. Electricity prices for households	188

BASIC STATISTICS OF THE UNITED STATES

THE LAND

Area (1000 sq. km)	9 629	Population of major cities, including their metropolitan areas, April 2000 (thousands):	
		New York	21 200
		Los Angeles-Anaheim-Riverside	16 374
		Chicago-Gary-Kenosha	9 158

THE PEOPLE

Resident population, July 1st 2002	288 369 000	Civilian labour force, 2003	146 515 667
Number of inhabitants per sq km	29.9	of which :	
Annual net natural increase (average 1998-2002)	1 592 400	Health services	11 812 800
Natural increase rate per 1 000 inhabitants (average 1998-2002)	5.7	Unemployed	8 776 583
		Net immigration (annual average 1998-2002)	1 116 000

PRODUCTION

Gross domestic product in 2003 (billions of US \$)	10 988	Origin of national income in 2002 (per cent of national income ¹):	
GDP per head in 2003	38 073	Manufacturing	13.7
Gross fixed capital formation		Finance, Insurance and real estate	20.0
Per cent of GDP in 2003	18.4	Services	24.7
Per head in 2003 (US\$)	6 997	Government and government enterprises	13.7
		Other	27.9

THE GOVERNMENT

Government consumption 2003 (per cent of GDP)	15.5	Composition of the 108th Congress as of November 5th 2002:		
Government current receipts, 2003 (per cent of GDP)	30.7		House of Representatives	Senate
Federal government debt held by the public		Republicans	228	51
(per cent of GDP), FY 2003	36.1	Democrats	205	48
		Independents	1	1
		Vacancies	1	-
		Total	435	100

FOREIGN TRADE

Exports:		Imports:	
Exports of goods and services as per cent of GDP in 2003	9.5	Imports of goods and services as per cent of GDP in 2003	14.1
Main exports, 2003 (per cent of merchandise exports):		Main imports, 2003 (per cent of merchandise imports):	
Foods, feeds, beverages	7.5	Foods, feeds, beverages	4.8
Industrial supplies	23.2	Industrial supplies	15.2
Capital goods	40.5	Capital goods	25.3
Automotive vehicles, parts	11.0	Automotive vehicles, parts	18.0
Consumer goods	12.4	Consumer goods	28.5

1. Without capital consumption adjustment.

Note: An international comparison of certain basic statistics is given in an annex table.

This Survey is published on the responsibility of the Economic and Development Review Committee of the OECD, which is charged with the examination of the economic situation of member countries.

•

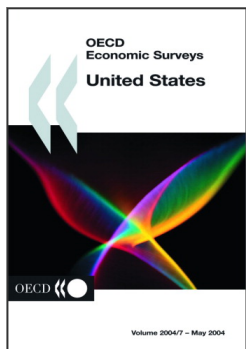
The economic situation and policies of the United States were reviewed by the Committee on 10 March 2004. The draft report was then revised in the light of the discussions and given final approval as the agreed report of the whole Committee on 30 March 2004.

•

The Secretariat's draft report was prepared for the Committee by Hannes Suppanz, Thomas Laubach, Michael Kiley and Michael Wise under the supervision of Peter Jarrett.

•

The previous Survey of the United States was issued in November 2002.



From:
OECD Economic Surveys: United States 2004

Access the complete publication at:
https://doi.org/10.1787/eco_surveys-usa-2004-en

Please cite this chapter as:

OECD (2004), "Assessment and Recommendations", in *OECD Economic Surveys: United States 2004*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/eco_surveys-usa-2004-2-en

This work is published under the responsibility of the Secretary-General of the OECD. The opinions expressed and arguments employed herein do not necessarily reflect the official views of OECD member countries.

This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

You can copy, download or print OECD content for your own use, and you can include excerpts from OECD publications, databases and multimedia products in your own documents, presentations, blogs, websites and teaching materials, provided that suitable acknowledgment of OECD as source and copyright owner is given. All requests for public or commercial use and translation rights should be submitted to rights@oecd.org. Requests for permission to photocopy portions of this material for public or commercial use shall be addressed directly to the Copyright Clearance Center (CCC) at info@copyright.com or the Centre français d'exploitation du droit de copie (CFC) at contact@cfcopies.com.