Executive summary

Rebalancing the economy after the crisis

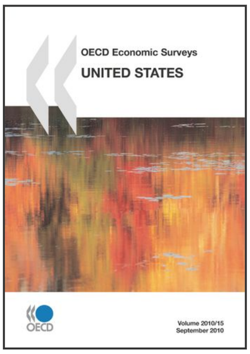
Buoyed by substantial policy support and improving financial conditions, the economic recovery is progressing. Monetary policy should remain accommodative to support the economy as fiscal policy tightens, but the ground work for eventual interest rate increases is already being laid, a task that should continue. In the labour market, additional support for job training and enhanced education may be required to reintegrate workers whose skills will become degraded from long periods of unemployment or whose skills will no longer match up with the needs of employers. The reform effort should focus on policies that contributed to the imbalances. In particular, as the housing market recovers and home prices rise, public support to homeownership should be decreased to curb incentives for overinvestment in housing. Implementation of financial reform needs to better address problems of incentives in the banking sector and tackle problems of moral hazard. Higher public and private saving and stronger exports would limit the extent that large current account imbalances re-emerge and would support matching efforts that should be taken in surplus countries.

Restoring fiscal sustainability

As other OECD countries, the United States is exiting the recession with a large budget deficit and a rising public debt. This could eventually raise concerns among bond-market participants, though they have thus far shown no concern with the ability of the United States Government to fund its debt. The Administration has proposed to reduce the federal deficit from about 10½ per cent of GDP in 2010 to 3% in 2015, which would stabilize the debt-GDP ratio. Measures have been identified to cover most of the fiscal effort and a bi-partisan commission was mandated to suggest complementary actions. While this is welcome, it would stabilize the debt-GDP ratio at almost twice the pre-crisis level, leaving little freedom to deal with contingencies and complicating further the long-term problem of population ageing. Further consolidation measures should be taken post 2015 to put the debt-GDP ratio on a downtrend during the second half of the decade. To achieve this goal, spending restraint is unlikely to suffice, so taxes will also have to increase. In order to limit the negative impact on economic incentives, base-broadening by phasing out distorting tax exemptions should be the first priority. In the long term, it will be necessary to restrain the growth in entitlement spending, notably for Medicare and Medicaid.

Implementing cost-effective policies to mitigate climate change

Emissions of greenhouse gas (GHG) by human activities are causing potentially very costly climate change. As a major emitter of carbon, the United States has a pivotal role to play in an agreement to reduce emissions. The cost-effective way to reduce these emissions is to price them and to support the development and deployment of emission-reducing technologies, which will reduce future abatement costs. These are the approaches that the current Administration is following as it endeavours to put in place a comprehensive climate-change policy. The House of Representatives passed legislation along these lines in 2009 but the Senate has not done so. If such legislation is not passed, the US Environmental Protection Agency (EPA) will progressively extend regulation to reduce emissions from motor vehicles to all other sectors. This would be a less cost-effective approach to reducing emissions and is unlikely to deliver emission reductions compatible with likely US commitments in any global agreement.



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