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PRESS RELEASE: US Economy Resilient in the Face of Shocks, Long-Term Outlook Favorable

Washington, DC - October 27, 2005 - Strong domestic demand, solid productivity growth, high corporate profits, robust business investment and rising employment have combined to keep the US expansion on track, according to the *Economic Survey of the United States*, released by the Organization for Economic Cooperation and Development (OECD) on Thursday, October 27, 2005.

The *Survey* underscores the resilience of the US economy in the face of shocks, including soaring energy prices and devastating hurricanes. GDP growth is projected at 3.5 percent through 2006 – a notch above estimated potential – with core inflation remaining in check.

“The ability of the US economy to cope with shocks over the past four or five years has been very impressive,” said OECD Chief Economist Jean-Philippe Cotis in remarks to reporters.

This positive growth outlook is not without risks, however. With the US external deficit moving towards 7 percent of GDP and surpluses building up in Asian countries such as China and Japan, a disorderly adjustment of current account imbalances cannot be ruled out.

However, the *Survey* also stresses that policies that encourage domestic saving, reinforce federal spending discipline and accelerate much needed tax reform, increase the likelihood that these positive economic trends continue over the long-term.

“The real side of the US economy is very effective,” Mr. Cotis said. “However on the fiscal side, it would be better to move to a more coherent policy framework.”

Among the areas where further progress is needed:

- Although strong growth in personal and corporate income tax receipts has helped to cut the unified budget deficit to below 3 percent of GDP, current fiscal policies are unlikely to substantially reduce the deficit moving forward: more resolute action is needed.
- Under current rules, projected spending on entitlement programs such as Social Security, Medicare and Medicaid is set to rise from 8 percent of GDP at present to 18 percent in 2050 – a trend that could lead to unsustainable future deficits.
- The increasing complexity of domestic corporate and income tax law and the proliferation of deductions, exemptions, credits, and tax shelters have substantially narrowed the tax base and created distortions which harm incentives to save.

The report also offers suggestions for dealing with these challenges, including:

- Eliminating the interest deductibility on home equity loans and phasing out the deductibility of interest on loans for purchase, construction or improvement of houses. These deductions, in effect

subsidize consumption and residential investments; their removal could bolster domestic saving and a better allocation of investments.

- Moving towards a system of consumption taxation and replacing the inefficient corporate income tax with a federal value-added tax (VAT). With a broad base, such a VAT would probably raise enough revenue to reduce reliance on income tax revenues and exempt an even larger share of the population from paying federal income tax. States could likewise replace their corporate income and sales taxes with a coordinated VAT, much like what Canada managed some time ago.
- Enacting public pension reform to speed up the transition from 65 to 67 for the age at which full benefits are paid, indexing it to increases in longevity thereafter. In addition, the federal government should increase the early retirement age from 62 to 64 to stimulate participation in the labor market.
- Capping the exclusion of employer-provided health insurance premiums. This would ensure that households have the strongest possible incentives to seek out the cheapest health care available.
- Encouraging foreign governments to help ease the adjustment of the global current account imbalances by bolstering domestic demand (mainly in Europe) and moving more resolutely towards flexible exchange rate regimes (in Asia).

In addition, the *Survey* addresses the need to improve the performance of the US education system (at the compulsory level), the desirability of assistance programs to support workers displaced by globalization effects, and strategies for improving energy efficiency and reform.

The *Survey's* suggestions are intended to help ensure long-run fiscal sustainability and strengthen the economy's resilience in the event of further shocks, such as an unexpected rise in inflation, renewed concern over the external deficit, or a continued rise in oil prices. They do not, however, detract from an overall outlook that is very favorable, according to Mr. Cotis.

"We are confident that the US economy is facing the current situation quite well."

For future reference:

The OECD will provide a comprehensive outlook of GDP performance through 2007 for all OECD countries, including the United States, in its [OECD Economic Outlook No. 78](#), scheduled for preliminary release on November 29, 2005.

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