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IMF Researchers: US Budget Gaps Endanger Global Economy

Wednesday, January 7, 2004 05:21 PM ET



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WASHINGTON (Dow Jones)--Economists at the International Monetary Fund on Wednesday expressed alarm at growing U.S. budget deficits, saying continued deficits could hurt the global economy by roiling currency markets and driving up interest rates.

In a report on U.S. budget outlook, IMF researchers described the state of government finances as "perilous" in the long run and urged Congress and the White House to take steps to quickly rein in the deficits. Although federal tax cuts and spending increases since 2001 bolstered the global economy in the short run, the report said "large U.S. fiscal deficits also pose significant risks for the rest of the world."

A key risk is that the recent slide of the U.S. dollar against other major currencies could become "disorderly," the researchers said. The dollar has declined sharply since early 2002 against both the European common currency and the Japanese yen, complicating the task of European and Japanese monetary policymakers, said Charles Collyns, who heads the IMF team that monitors the U.S. economy.

"We feel there is a substantial risk that the foreign investors' appetite for U.S. assets, and in particular U.S. government assets, will over time diminish," Collyns said in a news conference. "We think to some degree over the past year this has occurred, and this is one of the reasons why there has been weakness in the U.S. dollar." So far, he said, the decline hasn't jeopardized the economic recoveries in Europe and Japan, but the danger to the global economy could grow if the U.S. budget deficits aren't shrunk.

The White House has said it expects the budget deficit to expand to a record \$ 475 billion in fiscal 2004, exceeding 4% of the gross domestic product. U.S. Treasury Secretary John Snow on Wednesday described that level as "entirely manageable," and said the Bush administration expects the deficit to shrink to 2% of GDP within five years.

But the IMF researchers said that won't be enough to address the government's long-term fiscal problems - including financing the Social Security and Medicare programs over the next 75 years. In their report, they said the government faces a \$47 trillion shortfall in its ability to pay for those and all other long-term obligations. Closing that gap would require "an immediate and permanent" federal tax increase of 60% or a 50% cut in Social Security and Medicare benefits.

The dollar's recent decline, the researchers said, suggests that foreign investors are starting to worry about the U.S. government's ability to resolve its long-term fiscal problems. "The United States is on course to increase its net external liabilities to around 40% of GDP within the next few years - an unprecedented level of external debt for a large industrial country," they said in the report. "This trend is likely to continue to put pressure on the U.S. dollar."

The IMF report said the ratio of U.S. public debt to GDP is expected to increase by 15 percentage points over the next decade. If that occurred, global interest rates, adjusted for inflation, would rise by an average of 0.5 to 1 percentage point. "Higher borrowing costs abroad would mean that adverse effects of U.S. fiscal deficits would spill over into global investment and output," the report said.

Congress and the White House can avert those dangers by acting immediately to balance the budgets, the researchers estimated. Allowing the recent tax cuts to expire by 2013 would reduce the budget

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Stocks were likely to rise modestly Thursday morning, as investors mostly hold their positions and look to the latest weekly data on unemployment for clues about the coming December jobs report.

shortfall by nearly half. The researchers also said Congress should consider a tax on energy consumption, arguing that it would "help meet the administration's environmental objectives while also providing substantial support for fiscal consolidation." Such tax increases, they calculated, would have a minimal effect on U.S. economic growth.

-By Joseph Rebello, Dow Jones Newswires; 202-862-9279; joseph.rebello@ dowjones.com

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Symbol	Last	Change
Index		
DJIA	10,568.66	+39.63
Nasdaq	2,088.50	+10.82

Thursday, January 08, 2004 12:12 PM EST.
Quote delayed: 15 minutes Nasdaq, 20 minutes others.

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