

## General Discussion: Overview Panel

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*Chairman: Jacob Frenkel*

*Mr. Frenkel:* Thank you very much for these inspiring remarks. We now have a broad range of issues. The floor is open for a limited period of time.

*Mr. Ball:* I would like to address this primarily to Minister Persson. I have a comment and question about the role of monetary policy in the current Swedish situation. I thought it was interesting that you said that the fundamental cause of the fiscal problems was the collapse in demand in Sweden. Of course, that is the natural explanation for the unemployment problem, as well, the huge increase in unemployment. If one asks why demand collapsed, it seems an obvious possible culprit is the fact that Sweden has adopted a zero inflation target and consequently has instituted tight monetary policy to disinflate. I would just like to ask—and I hope this isn't a radically left-wing idea in this group—whether possibly in this instance the costs of reducing inflation have been greater than the benefits? Even though it is certainly valuable to reduce inflation, I wonder whether it is worth the huge fiscal problems you talked about and the great increase in unemployment. And then, of course, there is a closely related question: Should policymakers in Sweden think about reversing this process to some degree? Given the problem of the collapse in demand, do we need more expansionary monetary policy to stimulate demand, even if this perhaps risks inflation creeping back up a little bit? Might that not be a good idea overall?

**Mr. Frenkel:** Thank you. Minister.

**Mr. Persson:** I can answer this very short. The answer is no. The responsibility of monetary policy is up to the central bank. I see that my governor has left the room, so perhaps I can take the opportunity, but I won't, because we have the same perspective on this question. A small country like Sweden, with extreme international dependence and a big export sector, cannot have inflation above our main competitors abroad. So it was necessary for us to do this and we had to stick to it. There was no option.

**Mr. Frenkel:** Thank you very much. Peter Kenen.

**Mr. Kenen:** A very brief intervention to reflect upon an implicit conflict between the tenor of much of the discussion in the last two days and the Minister's remarks a few moments ago: A policy package must be seen to be fair, and burdens must be shared. But let me remind you that much of our discussion about the social insurance programs has been a discussion of intergenerational conflict, where there are unambiguous gainers and losers. How one squares this with the notion of equity, I'm not sure. In fact, I don't see how one can. I think Pete Peterson is right to say that one has indeed to mobilize the young to balance the political situation, although it won't achieve equity. Let me add just one further comment—and I think it bears also on Jim Wolfensohn's remarks. The social consensus after World War II that provided the political support for the building of the welfare state has, I think, been replaced in most of the developed countries with a much more divisive political situation. Deep distinctions between "them" and "us"—sometimes with racial overtones—have made it, I think, much more difficult to reach agreement on any of these issues. If we do not confront that political reality, all of our talk about the optimal design of policy becomes irrelevant.

**Mr. Frenkel:** Thank you. Marty Feldstein.

**Mr. Feldstein:** Just a comment on what Peter Kenen just said about winners and losers. I think one can look at the proposed reforms in Social Security in a somewhat different way. If we don't

reform social security, then the current younger generation will be losing more. And this is cutting back on their losses and asking—as Pete Peterson did—current retirees to also make some sacrifices. But, the younger generation under current law is being called upon to face higher taxes in the future and larger sacrifices.

**Mr. Frenkel:** Minister Persson, please.

**Mr. Persson:** Yes, the strongest support, I think, in Sweden is from the young, because this is a question of having a fair distribution between the generations, because they have to pay the debt service in the future and they realize that. It is still possible for me in Swedish society to have a discussion with the pensioners about that and to tell them they also must think about the next generation. And so far, I have had political support for that type of dialogue.

**Mr. Frenkel:** Thank you. Joe Stiglitz.

**Mr. Stiglitz:** I have a couple comments. First, to Minister Persson: You argue that what enabled Sweden to address its deficit was a crisis; yet in the United States I think there is a bipartisan resolve to address the fiscal deficit, and yet there isn't quite a crisis. Although it's not a crisis, there are underlying economic trends that have been of great concern. In particular, the slowdown of productivity growth plus the increasing inequality has been, for a significant fraction of the population, declining real wages and incomes. Although it is not a crisis, that may be part of the underlying political economy that is driving some of what is going on. That leads me to the second point, which is to reiterate the point that Marty made, that one of the important aspects of deficit reduction is how it forces the rethinking of allocation decisions. And that, of course, leads to the question of the importance of reducing the deficit in the right way; that if you reduce the deficit by cutting back on growth-enhancing investments and innovation in R&D, you actually adversely affect economic growth. But I actually would like to argue that it goes beyond just issues of education to broader problems of things like EITC, poverty-alleviation programs. As Pete Peterson pointed out, more than one out of five children in the United States is in poverty. We know

the effects of poverty are long-lasting. We know the probability is very high that the proportion of those who grow up in poverty will wind up being a burden on the state, will wind up in prisons. And we know that some states now are spending more on prisons than on education. And that is a reflection of the failure over the last fifteen years to address some of these underlying problems of poverty. The third point I want to raise very briefly is I was interested in the discussion of how one thinks about the allocation process, and Alan Auerbach emphasized one tool. One tool that hasn't been talked about very much is capital budgeting. That reemphasizes the point that one ought to distinguish between consumption expenditures in the public sector and investment decisions, even if you don't have a formal capital budget. And that brings me to the general point that the Minister raised, which is the importance of having fairly shared burdens and the concern that some of us have had in the recent discussion, that some of the proposals in the United States have not been based on fairly shared burdens. For instance, there has not been a significant attack on corporate welfare in a way that there was in Canada, which Mr. Martin talked about yesterday. The one big success I guess we have had so far is the attack where we have eliminated the milk subsidies, which was something like \$2 million a year. But large amounts of other aspects of corporate welfare still maintain. I think that one of the real problems right now is that many of the deficit-reduction programs being advocated involve program cuts that are being used to finance tax cuts for the wealthy. I know some people believe some of those tax cuts will generate large amounts of economic growth. But I think the evidence on that is not that great. And the social distinction that it gives rise to really makes the difficulty of deficit reduction even greater.

**Mr. Frenkel:** Thank you. Some of the remarks have an exclamation mark at the end of them rather than a question mark. I assume we will define this one as an exclamation mark. Michael Bruno.

**Mr. Bruno:** Mr. Persson, my comments regard industrial countries that have a deficit of 10 percent and also the equal sharing of the burden. If one may draw at all from the experience of a nonindustrial country with large deficits, a reduction of the deficit from 10 percent

to zero has invariably led to growth benefits—namely, it is a positive sum gain. That has been true for all less-developed regions. To what extent would you say that is correct? In your case, I would make the argument that not only do you want to care for the equal sharing of the burden, but since the cake will be bigger over time, there will be more to redistribute. This wouldn't have been the case if you had continued to have a deficit of 10 percent. Politically, this would help you. It doesn't solve the problem, because the pensions are fair.

**Mr. Frenkel:** Minister.

**Mr. Persson:** I have chosen to be very careful about the assumptions about growth—very careful, because that is the most sensitive factor in all my calculations. So I have growth rates for about 2.5 percent after three years' succession. Then I have growth rates in the coming year for about 2 percent. That is necessary, because I also have to face the question that was put to Paul Martin yesterday: What will happen if there is a downturn in the business cycle? I can now say in my calculations, I have already built that in. I have security for that. But, of course, you are right. A lot of examples give us good support for anticipating better growth for the future. If I were to get better growth, all my calculations would be much, much better, and we would be in a very favorable situation. But, it is not my interest in this phase of the consolidation program to point to that. My interest is to say to the Swedish people, you still have a very deep crisis. Don't think of new benefits, just think of four very hard years. And, if I begin to focus on growth and new income, I think I perhaps will lose my grip. Call it whatever kind of tactic you want to call it, but I think it is necessary at this phase.

**Mr. Frenkel:** Bruce MacLaury.

**Mr. MacLaury:** This is a comment and a question for Jim Wolfensohn, if I may. First, Jim, I'm very glad that you were persuaded to speak to us within ninety days of your taking office and didn't wait for six months. You could not be more eloquent after another ninety days. My question addresses the point that was iterated and reiterated throughout the discussions of yesterday and today on

fiscal policy, that there is an essential need for credibility of government and governments, and the sustainability of their policies—both economic and social policies. I think we know from the past that a number of the developing countries have not had what one can call governments that are stable or policies that are sustainable. The question is: To what extent can the World Bank influence those policies and the stability of the government in its own way? We think of conditionality as being a feature of the IMF rather than of the World Bank primarily. But my question is: Can the World Bank use its influence to sustain policies and credibility?

**Mr. Wolfensohn:** Well, again making a broad generalization which can be criticized in the particular, if you take a segment of countries where there is this fragility in government and where you are asking governments to take the sort of long-term economic decisions of the type we're talking in terms of education, health, transportation, infrastructure, training of the governments themselves in terms of human resources, where those governments are changing and are under these acute social pressures to which I referred, there is a significant role for the World Bank to be there as a stable friend to help from government to government. The issue I think which we face at the moment is that in the volume of literature which I read before I came to the bank and I've read since, the bank has been significantly criticized as being an institution which has not always been a partner, but has been dictating along with the IMF in terms of what we think is the appropriate conditionality and the appropriate future for the countries. And, I think the challenge for us, in order to fill the gap, Bruce, is that we have to be true partners. We have to be perceived to be working with the local countries, with whatever government is in power, to be reliable, to be stable, to be modest in a process which is extraordinarily difficult. And, if we could be in that position, then you can be adviser to successive governments. And you can be a source of stability. That is a tough road, but it is road that I think the bank should pursue and a function which I very much hope that we will be able to do in the years ahead.

**Mr. Frenkel:** Thank you. The penultimate remark. Terry Burns.

**Mr. Burns:** Thank you very much. I would like to support the case that Marty Feldstein has made. We should not underestimate the difficulties inherent in the political process, and a lot of the discussion that we have had today emphasizes this. Most political choices are very difficult. I have watched politicians at very close quarters for fifteen years, and possibly uniquely find that my opinion of them has not diminished. If anything, my view of them has been enhanced, as I have watched the complex problems they wrestle with. I am impressed that the most difficult choices arise when the costs and benefits of decisions get out of line; when costs emerge today and the benefits come later; or where the benefits emerge today and the costs come later. That is why with monetary policy we have seen the move toward independent central banks and institutional arrangements which relieve the tension between the short-term and longer-term effects of policy changes.

The case for the balanced budget comes out of the same stable. Anything we can do to prevent the political process avoiding difficult choices by increasing public borrowing is to be welcomed. I have been struck by the absence of support at this meeting for legislating for balanced budgets, and I think that does reflect the technical difficulties inherent in any legislation—particularly with regard to variations over the cycle. But we have also seen—and I think it has been very impressive from both the finance ministers we have heard this morning—the importance of precommitment and the reputation of the people involved in their determination to improve public finances.

Institutional change can help. Take, for example, the problem governments often have with handling capital expenditure in the public sector; the costs arise today and the benefits are spread over time. In this case changes to the accounting framework can help by giving us a better measure of the actual resources involved. Even more important, we have seen the benefits of privatization. I have been impressed by the way in which privatization in the United Kingdom has avoided many of the problems inherent in capital expenditure decisions. The public sector has had a good deal of difficulty in the past finding the resources for capital expenditure.

It has been much easier to generate finance for the capital programs of large utilities since they have been in the private sector than it ever was when they were in the public sector.

And my feeling is that many of the same lessons go for the huge problem of intergenerational differences in terms of costs and revenues inherent in social security decisions. It has been fascinating for me to see the way in which the discussion has concentrated on this issue. This is the clearest case of the need for people to make commitments knowing that sooner or later they are going to have to pay the bills. Anything we can do in terms of an institutional framework to make that choice more transparent is likely to improve our chances of making the right decisions. That is the strongest case for moving from pay-as-you-go schemes to funded schemes. Similarly, the case has been made in the papers for privatizing pensions and it is possible that privatization could play an important part improving decisionmaking in this area as well.

As much as people may be determined today to solve the deficit problem, what we have seen in many other walks of policy, is that it is crucial to put in place an institutional framework which makes sure that these ideas persist and that they do not become simply the fad of the day and that somewhere down the road we all turn our attention to different issues.

**Mr. Frenkel:** Thank you. The final remark by John Taylor.

**Mr. Taylor:** After Terry's remark I just wanted to say not all of us have that many problems with balanced budget rules. In my paper, I tried to find ways to make these kinds of rules work and that's a good topic for the future. One other solution, which we didn't mention, is political reform—things like term limits, which I think is more applicable to the United States. This could very well deal with some of the political problems that Pete Peterson raised. And lastly, I would just like to link what we did a little earlier with Jim Wolfensohn's remarks. When you are thinking about budget cutting and the implications for the international financial institutions, remember that one of the real reasons to reduce budget deficits is to



increase saving and, in particular, world saving. The United States now is really a drain on world saving. If that could be turned around, it would have an enormous impact—on world growth, interest rates, and development in other countries.

