Global Rebalancing: An American Perspective

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The American experience

- Capital inflow 2001-2007
- Expansionary monetary policy
- Debt-financed consumption boom
- Bubble in housing and financial markets
- Financial innovation and lax regulation
- The bubble bursts, bank run, recession
- Slow recovery
America unbalanced

- Federal budget from surplus to deficit: $236 billion in 2000 to $413 billion in 2004
- Fed funds rate around 1% 2003-2004 (below inflation)
- Capital inflow of $500 billion - $1 trillion a year for seven years ≈ $5T
- Borrowing by Federal government to finance deficit
- Borrowing by households to finance consumption
A different kind of borrowing

Graph 1: Domestic counterparts of the US current account deficit

- US current account
- Domestic counterparts
  - Saving minus investment: Corporations, Households
  - General government balance

1 As a percentage of GDP.
Source: National data.
A well-worn path

- Borrowing finances consumption
- Spending on tradables soars. Trade deficit grows. Imports from $1.4 trillion in 2001 to $2.4 trillion in 2007; trade deficit doubles to $750 billion by 2006
U.S. Trade in Goods and Services
1991-2005
(Balance of Payments Basis)
In US$Billions

Data Source: US Census Bureau Foreign Trade Division
http://www.census.gov/foreign-trade/statistics/historical/gands.txt
A well-worn path

Spending on non-tradables soars. 2000-2007, services prices rise 25 percent, durable goods prices decline 13 percent
Tradables and Nontradables prices

Figure 2: log price deflator for services consumption (dark blue), nondurables consumption (pink) and durables consumption (dark green). Source: BEA NIPA release of 30 October 2008 and Menzie Chinn's calculations.
A well-worn path

Concentrated in principal non-tradable, housing
The housing boom

Figure 2-1: The housing boom. Case-Shiller home price index for 10 major cities, seasonally adjusted, 1987-2010. 1987=100. Source: Standard and Poors.
A well-worn path

And in housing finance
The collapse

- Turnaround in housing prices
- Run on shadow financial system
- Financial panic, twenty-first century style
- Global impact
  - Other borrowers
  - Global financial system
- The Great Recession
And now, rebalancing

- Imbalances require rebalancing
- Reduce consumption, increase savings
- Reduce imports, increase exports
- Reduce government spending, increase government revenue
- Reduce relative price of non-tradable goods and services
- Nothing pleasant
The politics of American rebalancing

- Who will bear the adjustment burden?
- Heterogeneity of impact of the crisis:
  - Five million people fell below poverty line 2007-2009
  - Mid-2010 unemployment
    - Bottom third households (below $40,000/year): 18%, including discouraged and involuntary part-time 35%
    - Top third households (above $75,000): 4%, including discouraged and involuntary part-time 9%
- Political economy implications: conflict at home and abroad
American rebalancing and the world

Austerity comes on heels of continuing deterioration of income distribution
American rebalancing and the world

Attitudes toward international economic policy correlate with income
Who Feels Helped by Free Trade Agreements?

“Is outsourcing mostly a good thing or mostly a bad thing?”
Percent answering “mostly a good thing”

Source: Calculated from survey on American Public Opinion and U.S. Foreign Policy conducted in July 2006 for the Chicago Council on Foreign Relations; estimates by Benjamin Fordham, University of Binghamton
Looking ahead

- Rebalancing will be painful, conflictual
- Governments, societies have not faced full consequences
- National experiences have major implications for future international path
An academic celebration

• QE was wrong: Global imbalances widely discussed, understood
• Scholars predicted Eurozone problems:
  • Structural heterogeneity
  • Lack of common financial regulation
  • Bailout
• Theory emphasizes distribution of the adjustment burden, internationally and domestically
Looking ahead, positively

- Two central issues
  - Resolution of cross-border debt crises
  - International macroeconomic policy cooperation
- What do theory and history teach?
Debt crisis resolution

• Global imbalances = international capital flows
• Cross-border lending desirable
• But recurrent crises suggest costs may outweigh benefits
• Problem is political, not technical
The problem

- Carefree credit gives rise to bitter burden
- Asymmetry of the adjustment burden
- International bargaining over adjustment skewed in favor of creditors/surplus countries
- Politically difficult, sometimes unsustainable, within and among countries
- Centuries of experience
Political-economic realism

- Problem not technical but political
- Virtually no resolution without burden-sharing
- Delay increases costs
A twist

- A rich and powerful debtor nation
- Financial symbiosis
- No sudden stop
- Debtor’s exit option plausibly more attractive than creditor’s \( \rightarrow \) a different asymmetry?
- A different bargaining dynamic (cf. Bretton Woods)
International macroeconomic policy coordination

- Longstanding agreement: not desirable
- Aggregate welfare maximized by pursuing optimal national policy
- Cooperation does not improve macroeconomic policy
- Frankel: coordination with different models often detrimental
International macroeconomic policy coordination

- Longstanding agreement: not likely
  - Few incentives for national governments to surrender macroeconomic policy
  - Track record extremely limited
- Death reports premature?
What has changed?

• Externalities
  • Extraordinary transmission via financial system
  • Interrelationship with other policies
  • Exchange rates and trade policy

• Political economy
  • Currency policy pressures, directly and via trade policy
  • Incentives to cooperate: big players interested
Does it matter?

- Imbalances unsustainable
- Adjustment will take place
- Already in process
  - In Eurozone
  - In emerging markets
  - In US
- And yet...
Figure 1  G-20 current account imbalances

Note: The upper solid line is the sum of current account balances in G-20 countries that are in surplus and the lower solid line is the sum of current account balances in G-20 countries that are in deficit. The dashed lines are the IMF October 2010 WEO projections of G-20 surpluses and deficits. The dotted lines are forecasts of G-20 surpluses and deficits based on the sum of columns 1 and 3 of table 6.
Implications

- Resolution of debt crises requires burden-sharing, at home and internationally
- As imbalances persist/resurface, pressures for coordination will grow – especially on exchange rates
- Incentives to resolve, and cooperate, have grown
- Barriers to cooperation and resolution remain serious