

Global Rebalancing: *An American Perspective*

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March 18, 2011

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

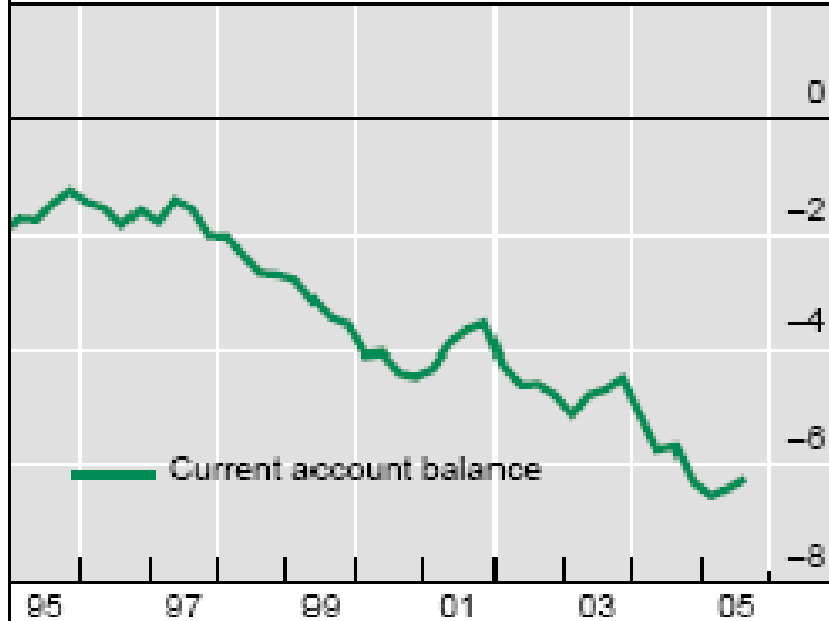
America unbalanced

- 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 \approx \$5T
- Borrowing by Federal government to finance deficit
- Borrowing by households to finance consumption

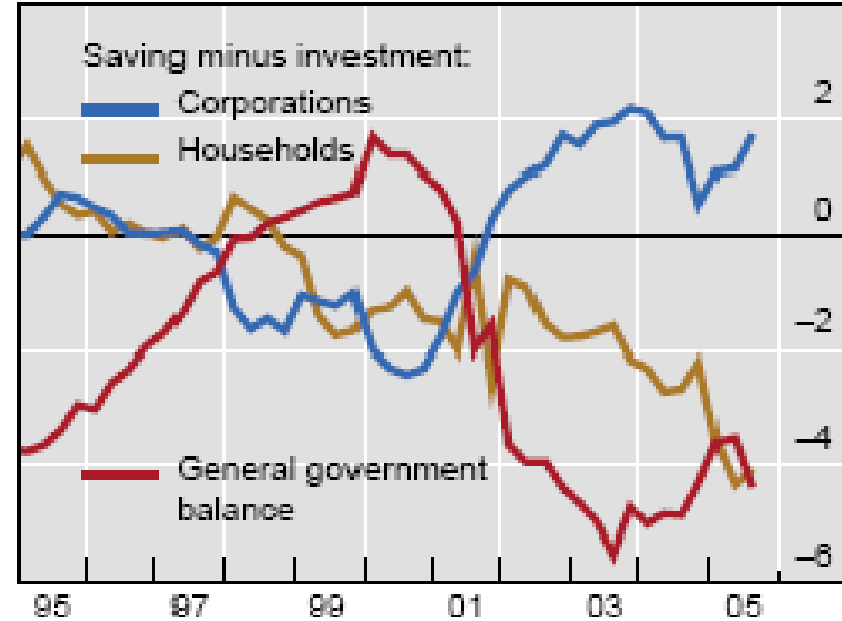
A different kind of borrowing

Graph 1: Domestic counterparts of the US current account deficit¹

US current account



Domestic counterparts

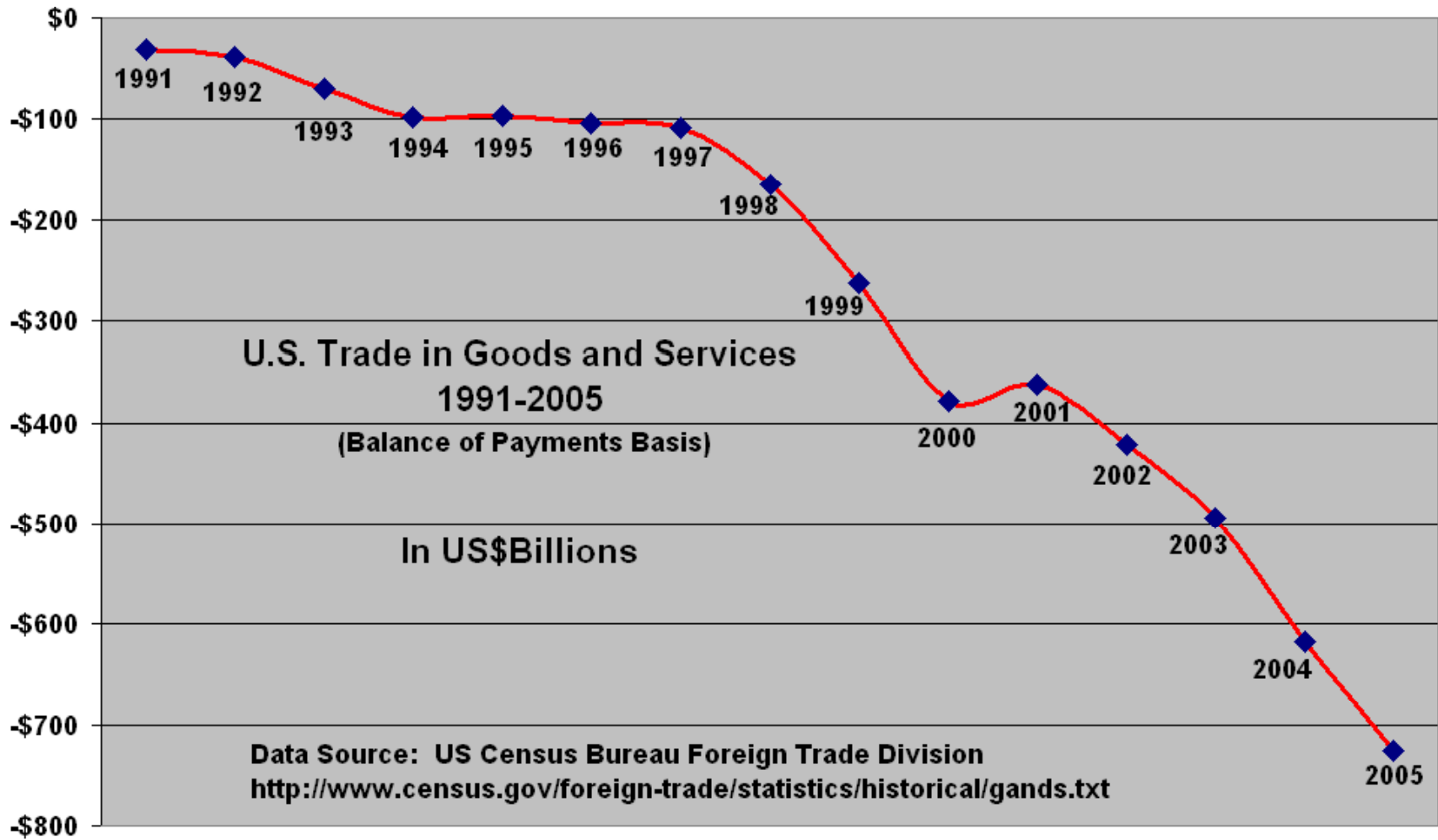


¹As a percentage of GDP.

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



A well-worn path

Spending on non-tradables
soars. 2000-2007, services
prices rise 25 percent, durable
goods prices decline 13 per
cent

Tradables and Nontradables prices

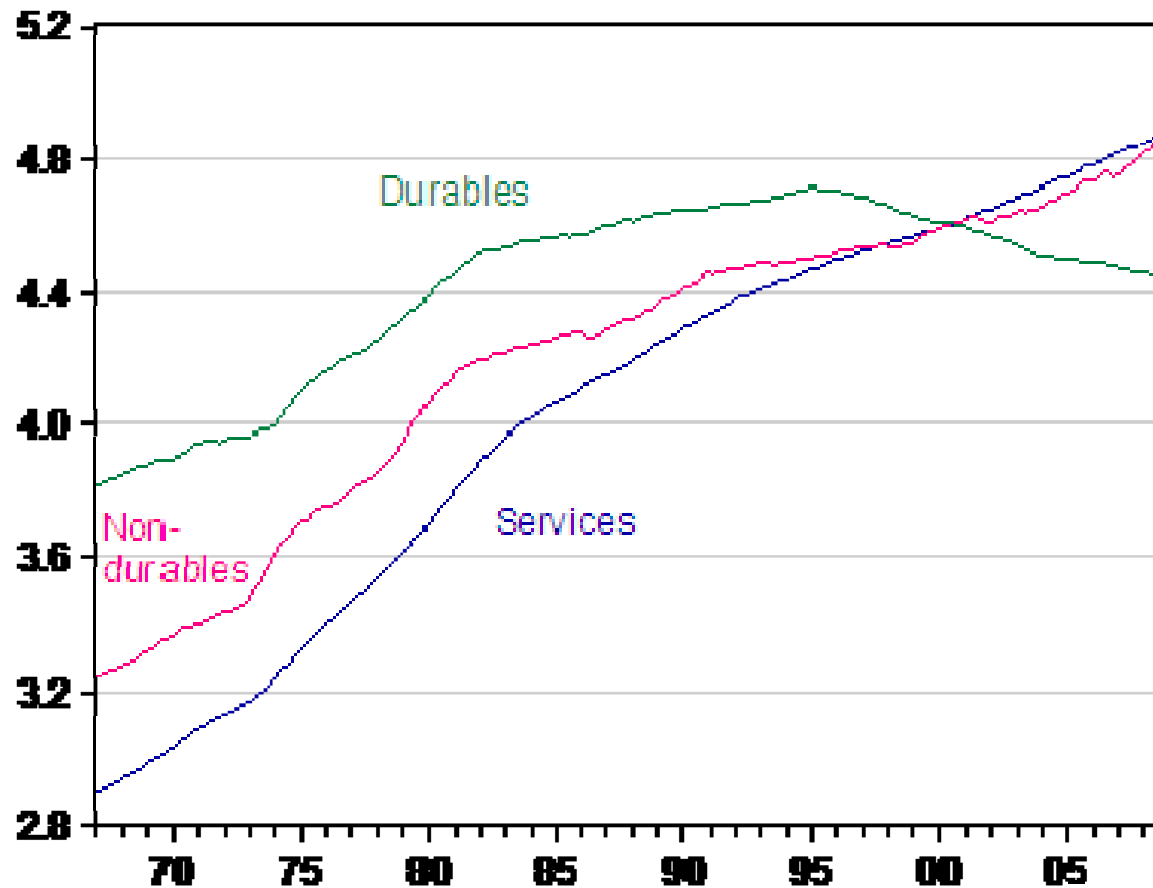
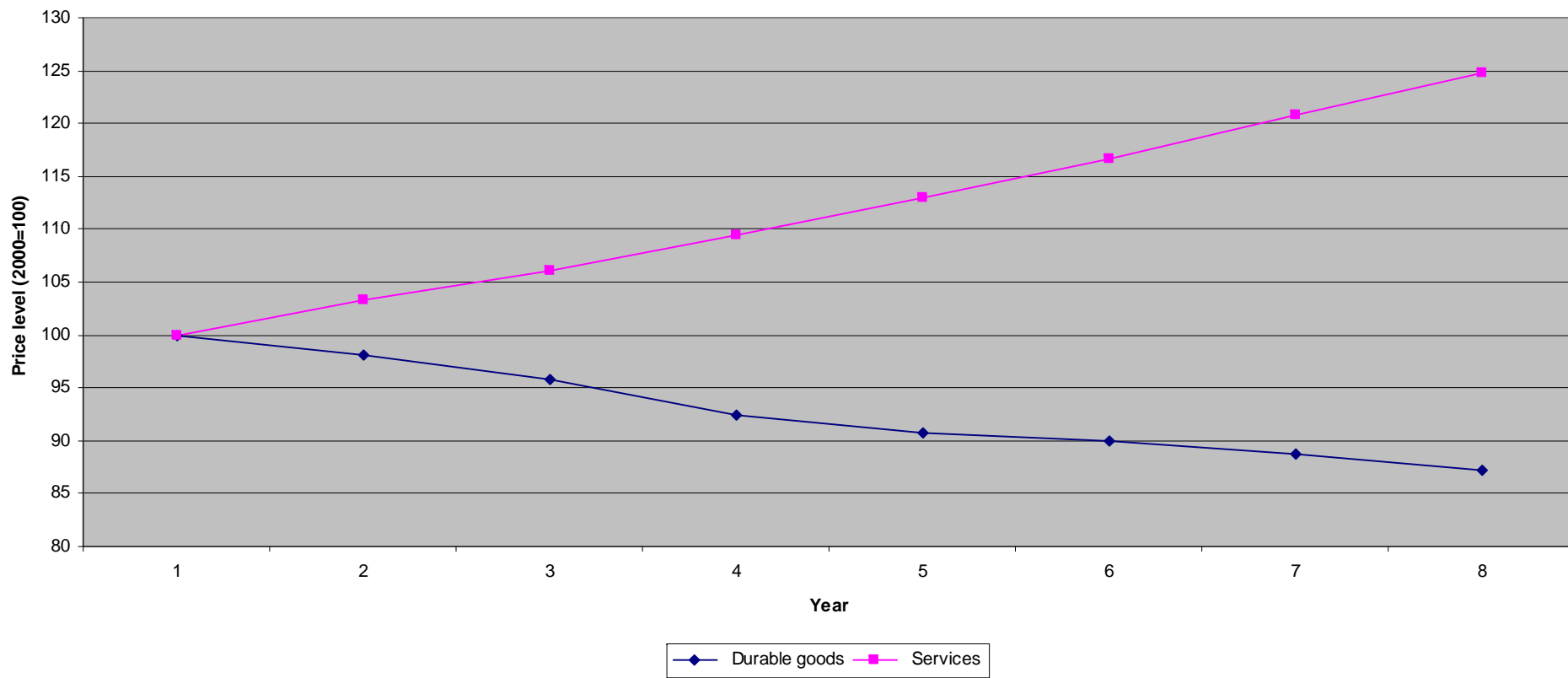


Figure 2: log price deflator for services consumption (dark blue), nondurables consumption (pink) and durables consumption (dark green). Source: BEA NIPA release of 30 October 2008 and Menzie Chinn's calculations.

Price trends 2000-2007



A well-worn path

Concentrated in principal
non-tradable, housing

The housing boom

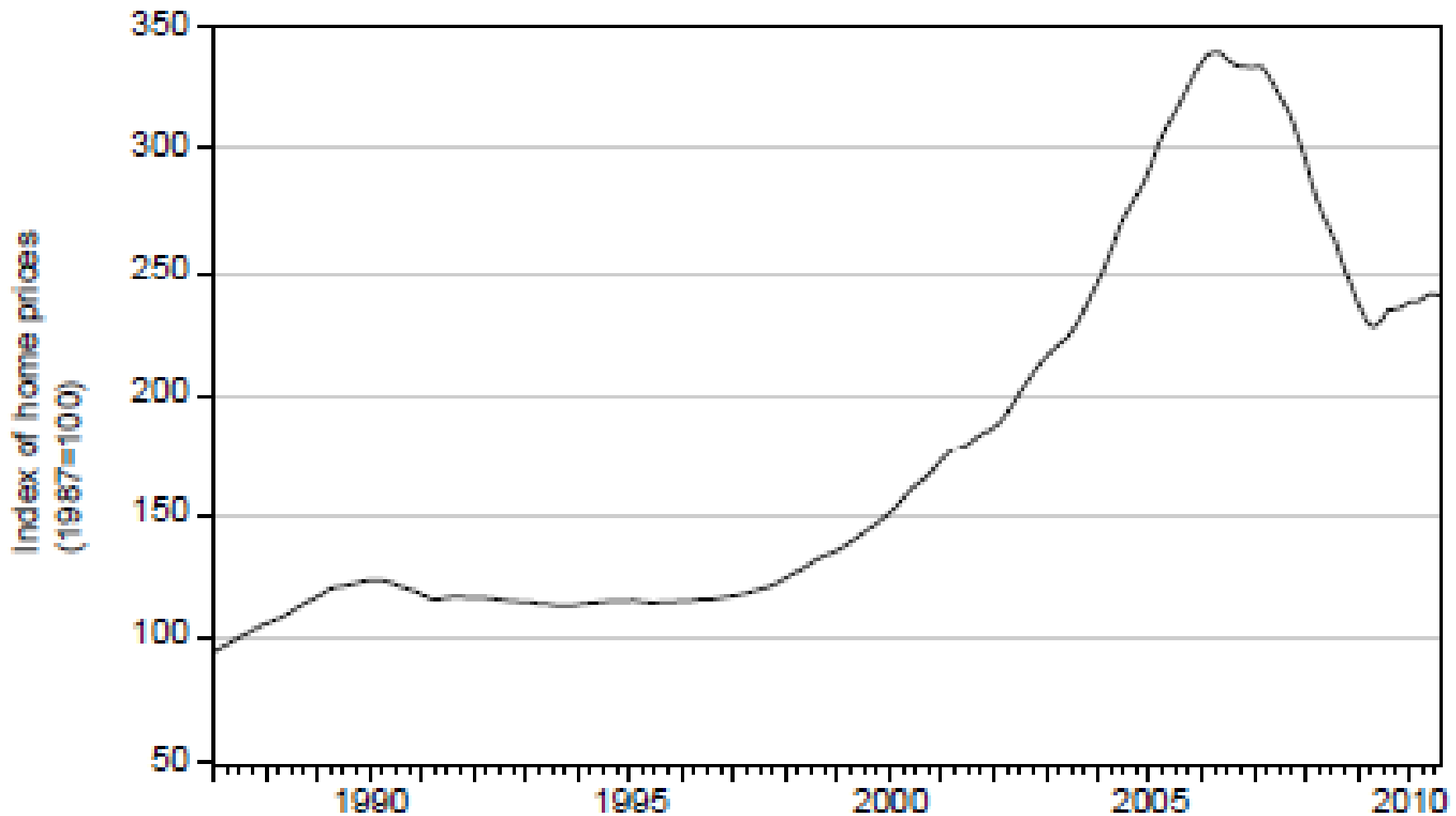
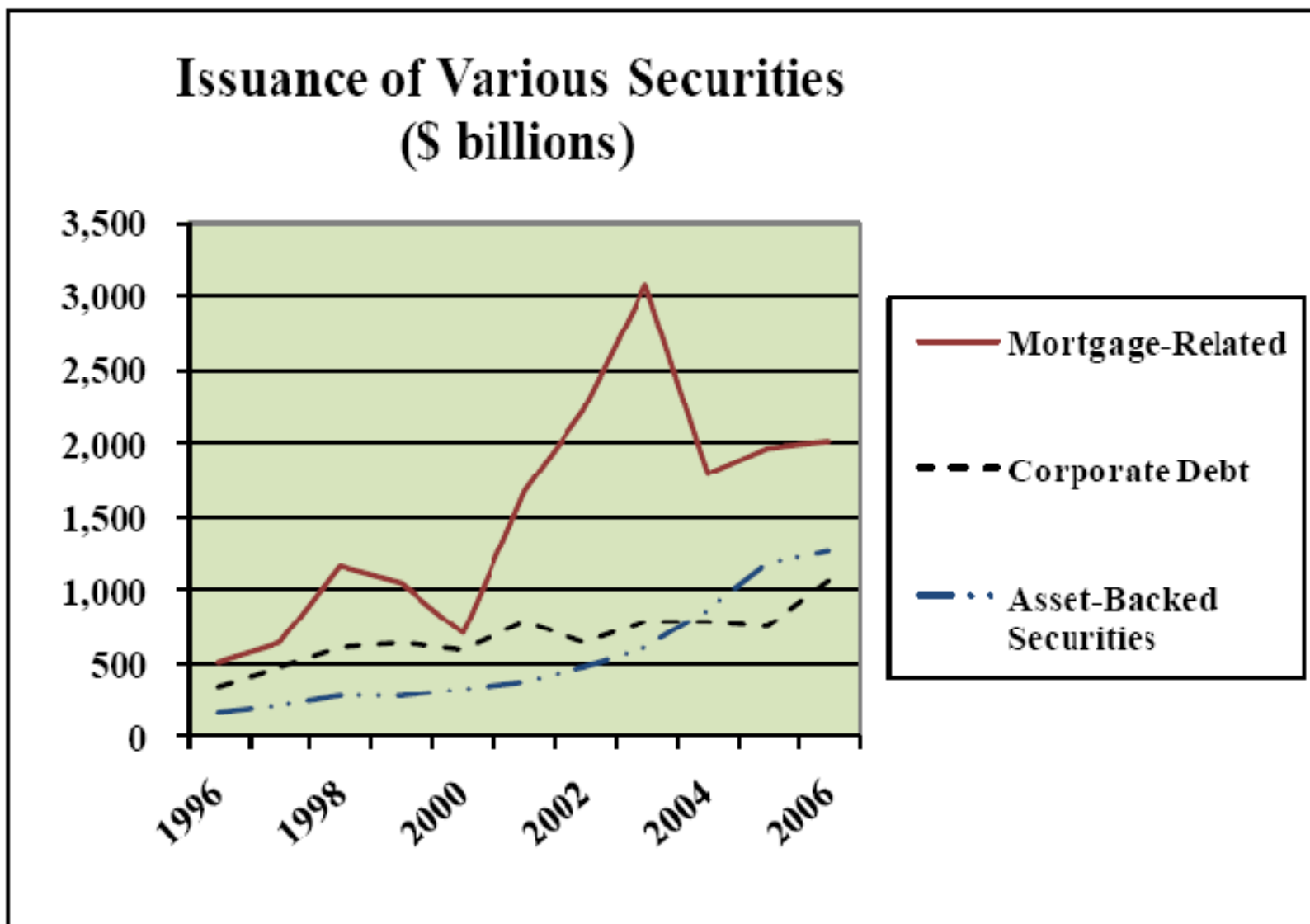


Figure 2-1: The housing boom. Case-Shiller home price index for 10 major cities, seasonally adjusted, 1987-2010. 1987=100. Source: Standard and Poors.



A well-worn path

And in housing finance



Source: Gary Gorton, "The Panic of 2007," NBER Working Paper 14358

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

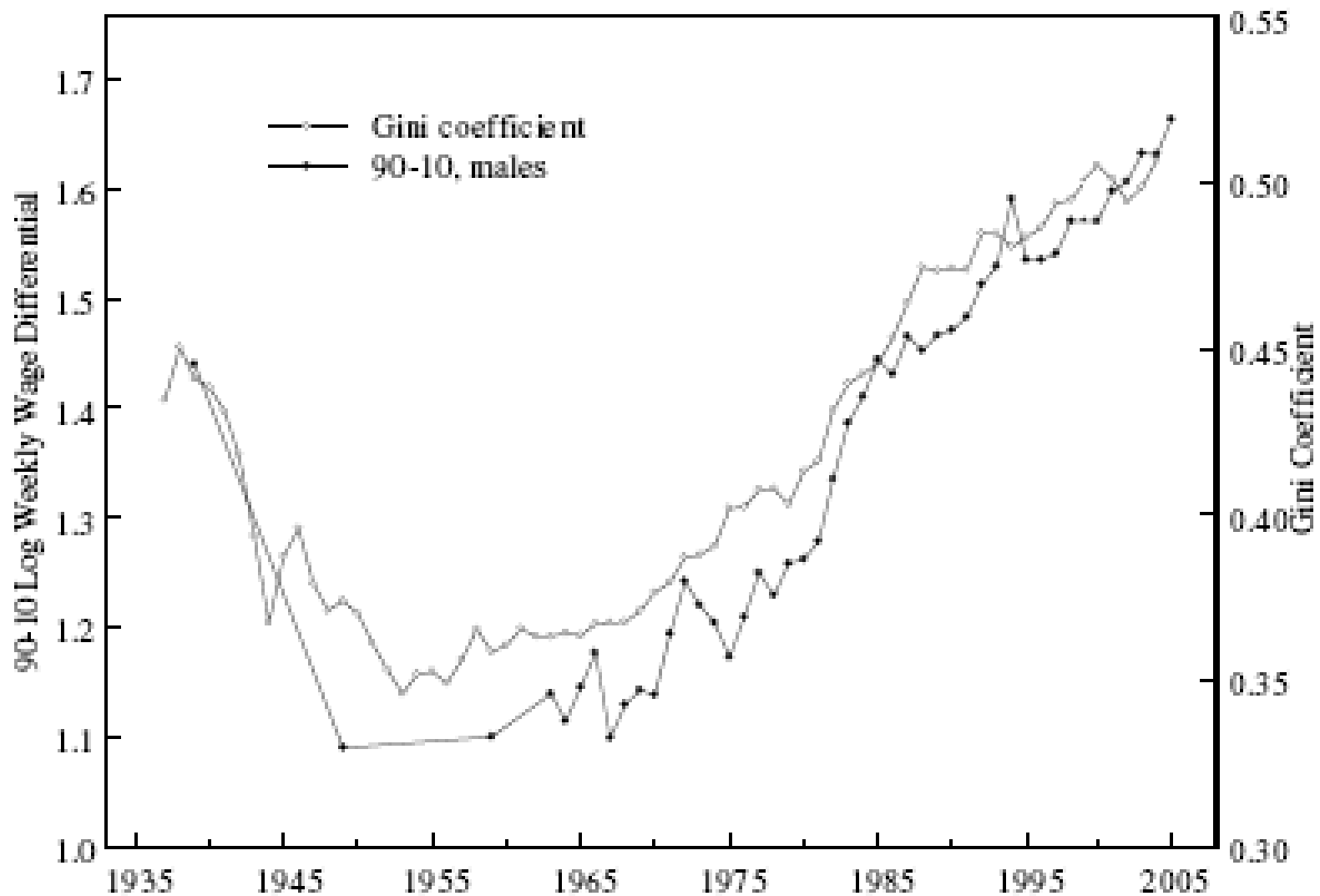
The politics of American rebalancing

- 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

Figure 5: Male Wage Inequality, Gini and 90-10: 1937 to 2005

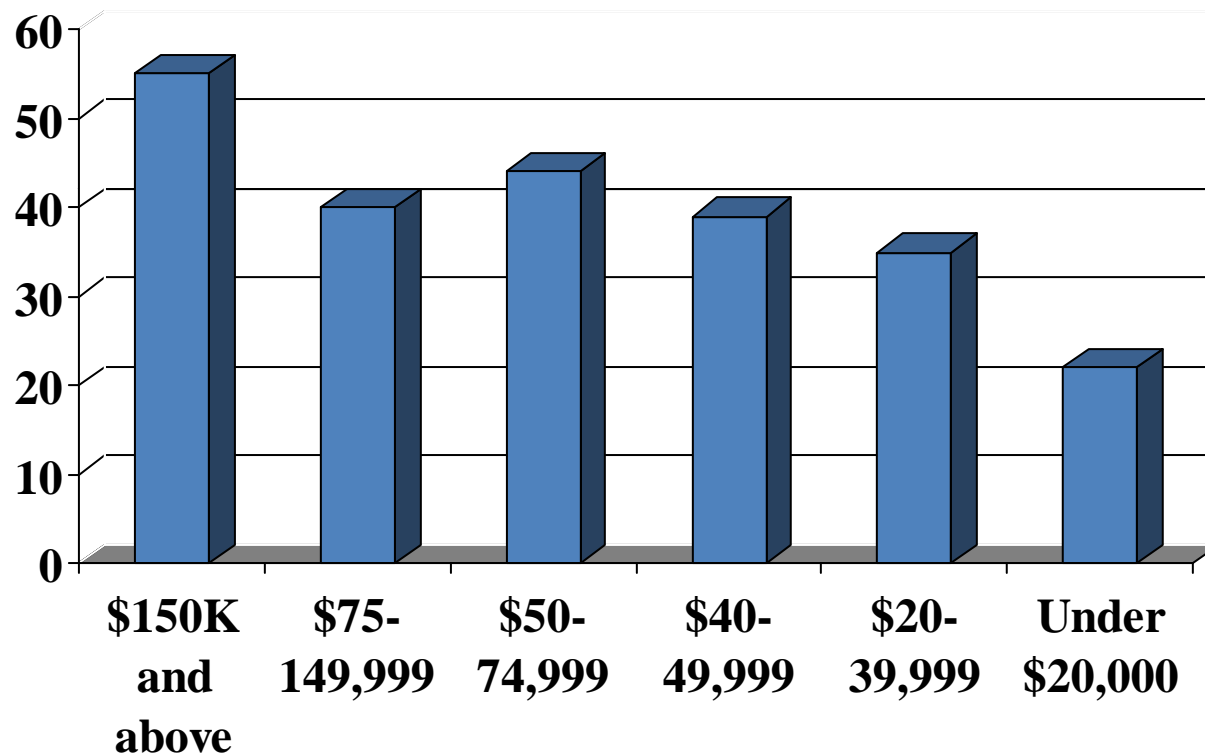


Source: Claudia Goldin and Lawrence Katz, "Long-Run Changes in the U.S. Wage Structure," *Brookings Papers on Economic Activity*, October 2007

American rebalancing and the world

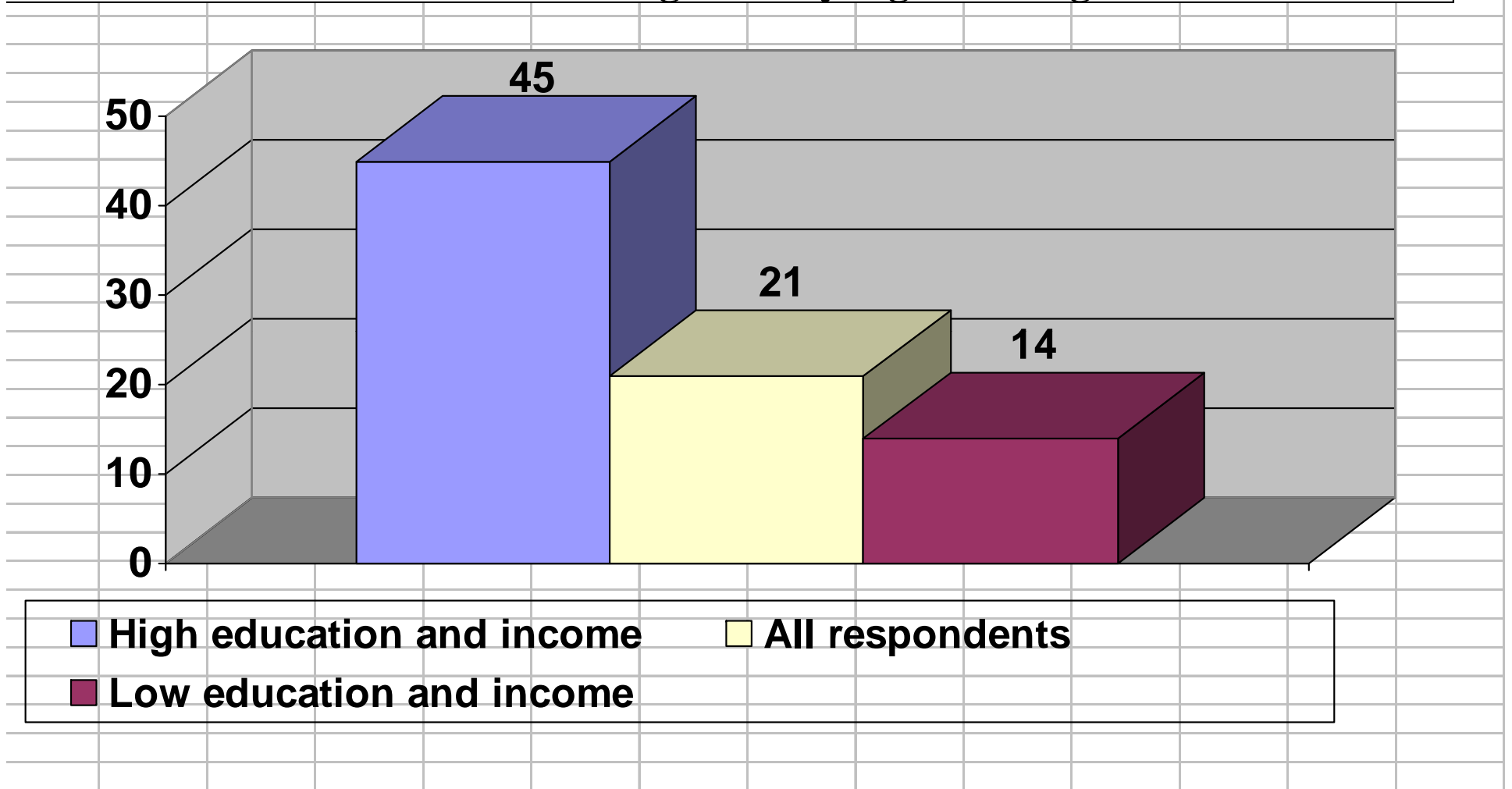
Attitudes toward international
economic policy correlate with
income

Who Feels Helped by Free Trade Agreements?



Source: Pew Charitable Trusts, Dec. 2006, <http://people-press.org/reports/display.php3?ReportID=299>

“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 → 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?

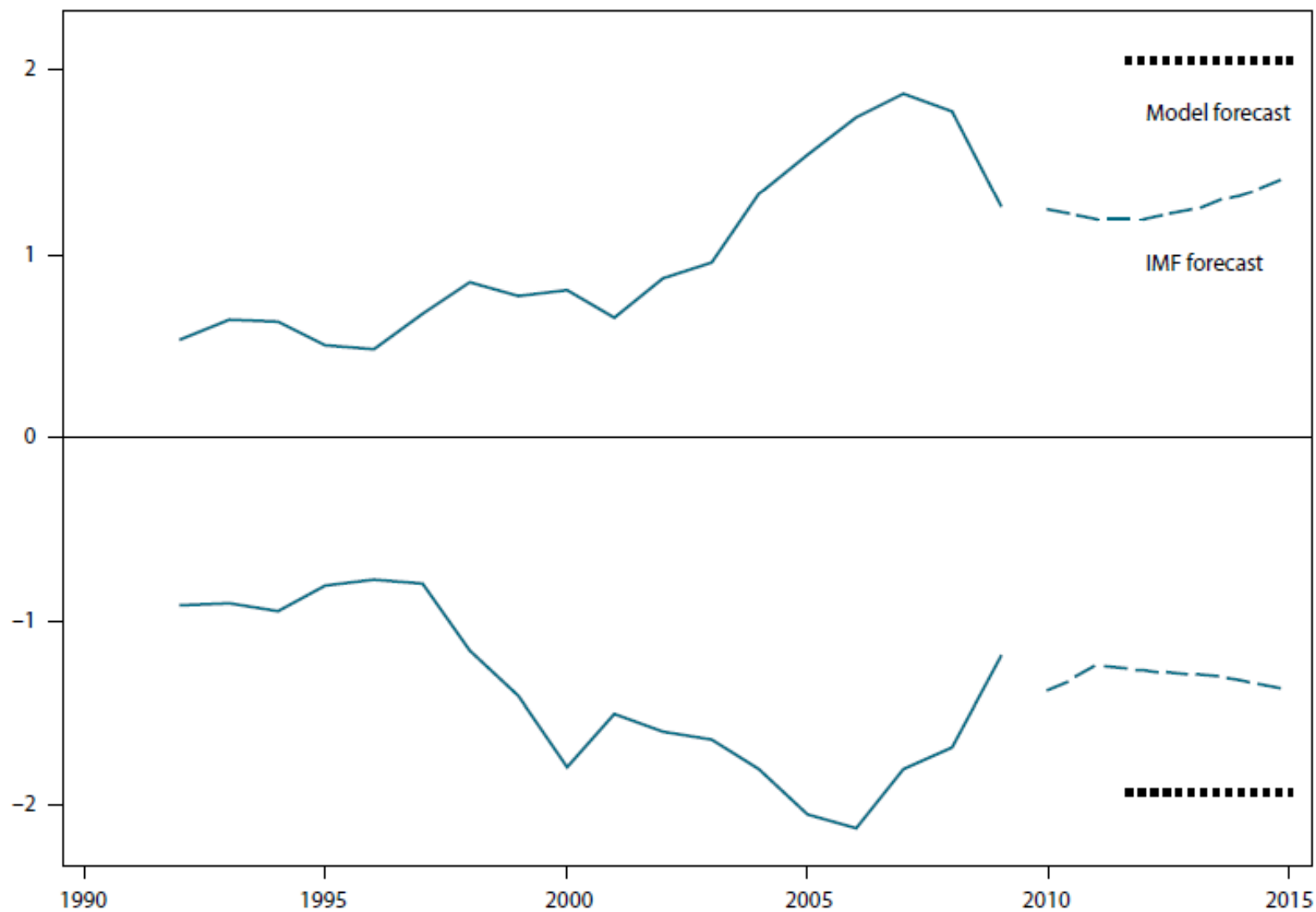
- Externalities
 - Extraordinary transmission via financial system
 - Interrelationship with other policies
 - Exchange rates and trade policy
- Political economy
 - Currency policy pressures, directly and via trade policy
 - Incentives to cooperate: big players interested

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

percent of world GDP



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