



Global Imbalances

An Asian Perspective

C.P. Chandrasekhar



Defining imbalance

- G20 finance ministers and central bankers meeting at Paris a month ago had difficulty identifying indicators of global imbalance
- China reportedly objected to the use of the exchange rate, the current account balance or the size of the foreign reserve as indicators



The compromise

- Agreement to focus on public sector deficits and debt, private savings rates and external imbalances “composed of the trade balance and net investment income and flows”
- Problem not resolved as it is unclear as to what constitutes “balance” in terms of these indicators



The principal imbalances

- Differential growth rates accompanied by rapid expansion in exports of the faster growing countries
- Excessive debt financed investment and consumption in some countries, especially the US, which is home to the world's reserve currency
- Imbalances in the savings-investment gap



The principal imbalances 2

- Current account deficits and surpluses
- Net capital inflows and outflows across countries
- Imbalances in per capita carbon emissions in the context of global warming
- Are some or all of these substantially avoidable in a world of nation states?



A brief historical excursus

- Capitalism was always characterised by imbalance, with differential development in its metropolitan centres, the colonies that were sources of raw materials, markets and surpluses and the “regions of recent settlement” that were also “vents” for unemployed labour in the developed countries.
- This was inevitable if growth was dependent on access to a “hinterland”



The post-war experiment

- This creates a problem for late developers since there is inadequate space under the sun to grow
- Attempt to resolve this under import substitution strategies which sought to expand the home market by creating policy space with protection
- The transition away from this to more outward oriented strategies restores importance of external markets even for late developers



Differential growth rates

- Uneven development a feature of global growth, especially since the industrial revolution
- Change: such unevenness involves high growth in the less developed and low growth in some (not all) developed economies
- Reason: Liberalisation of trade and foreign investment rules in a context of strict limits on labour migration
- Capital and technology are mobile while labour is not, resulting in migration of economic activity to countries with a reserve of unemployed labour.

Explaining the differential

- Productivity increases but the reserve army does not disappear and wages stagnate as productivity rises
- Implications for wages in the developed countries as well, but differential persists
- Rise in surplus and deficiency of demand due to underconsumption, which affects adversely the developed
- Underconsumption leads to a current account surplus
- No savings glut, but investment famine



Aggravating factors

- Public and private debt-financed spending at the core to combat deflation leads to widening deficits
- Dependence on cheap imports to keep growth going without inflation
- Desire for current account surpluses in a context of liberalised capital flows to developing countries to prevent capital flight and currency crises



Aggravating factors 2

- The effect of underconsumption in the periphery is realised in the form of increased unutilised capacity at the core, necessitating public expenditure that increases the current account deficit
- Push for further liberalisation of trade and investment
- So problem is not of a “savings glut” but of a consumption and investment famine



Undervalued RMB?

- China's share of world exports of goods and services rose from 3.5% in 2000 to 6.4% in 2005 and 8.4% in 2009.
- But was this due to lower wages or an undervalued currency?
- In either case an appreciation of the currency is unlikely to deliver a correction of global imbalance



Reason

- Even if the appreciation of the RMB is significant, the US may not gain, because the reduction in China's exports to the US may not result in increased demand for US goods but for imports from third countries.
- Note: China's share in Low and Middle income country exports rose from 17.3% to 25.7% to 28.4%



Distribution of deficits

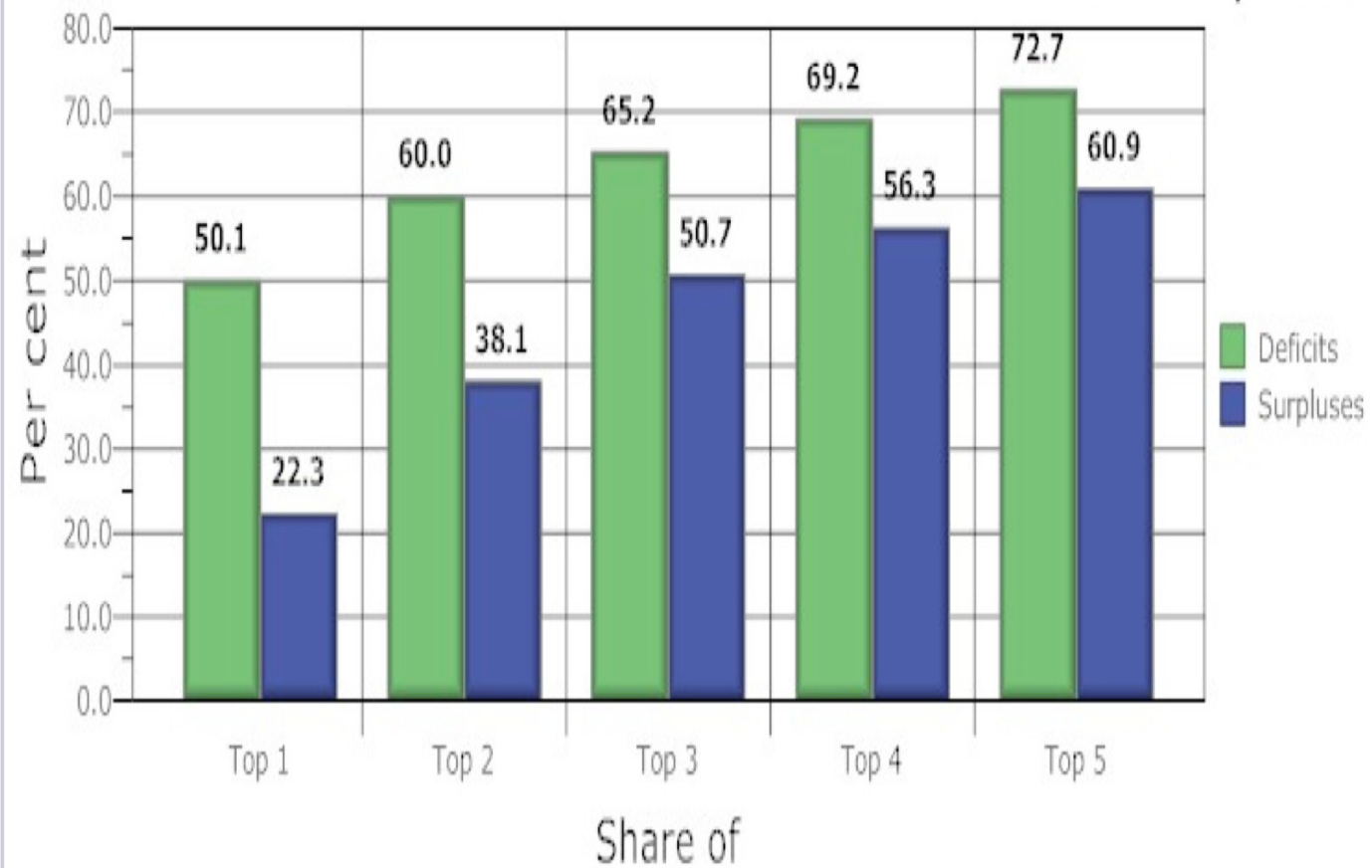
- In the case of 163 countries in 2007 there were far more deficit countries (108), than surplus countries (55).
- Yet, US, with the highest current account deficit, accounted for half of the total deficit of all deficit countries.
- Spain, which followed the US, contributed just 9.9 per cent of the total deficit. The top five deficit countries (United States, Spain, United Kingdom, Australia and Italy) accounted for 73 per cent of the total deficit of the sample countries.



Distribution of surpluses

- China with the largest surplus, contributes 22 per cent of the total for 55 countries
- Much smaller than the 50 per cent of the aggregate deficit notched up by the US.
- Germany, which followed China in terms of the size of its current account surplus, contributed 15.8 per cent of the total surplus of these countries
- The top 5 surplus earners (China, Germany, Japan, Saudi Arabia and the Russian Federation), had a combined share of 61 per cent, not short of the 73 per cent contributed by the top five deficit earners.

Distribution of Current Account Deficits and Surpluses





Implication for US-China debate

- If the adjustment has to be undertaken by the surplus earners, then more than one country will have to be involved
- An excessive emphasis on just China's currency "undervaluation" not appropriate.
- This is not to suggest that China should not aim to rebalance its domestic economy by reducing the savings rate and increasing the share of consumption in GDP or by reducing the role of exports and expanding the role of domestic demand in driving growth.



Lessons from Europe

- Germany, with rapid rates of innovation and reserves of relatively cheaper labour garnered through unification, has been able to flood Eurozone markets with its exports.
- Many European countries have been increasingly relying on construction and services to sustain growth
- Cannot compete with devaluation
- Growth often requires public expenditures that are not easily funded with tax revenues. Deficits on the budget and the current account are therefore the norm.



Implications

- Uneven development among members of the Eurozone leads to a substantial degree of regional imbalance.
- Germany accumulates surpluses, while "backward" members of the Eurozone accumulate deficits.
- Thus, perhaps what is needed is an alternate paradigm of development.