

The Global Economy in the Post-Crisis World: Prospects for the Great Rebalancing

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Introduction

- Global imbalances contributed to this crisis
 - global imbalances (savings glut)→ liquidity surfeit→lax lending
- Rebalancing is happening
 - US current account deficit down from peak of 6 1/2 % and China's current account surplus down from peak of 11 percent
- But cyclical developments may not persist
 - China's currency is depreciating
 - Asia may continue export-led growth strategy
 - US consumer may go back to profligate ways
- How do we reconcile national interests of self-insurance and export-led growth with international imperative of avoiding global imbalances? Two distinctions:
 - Self-insurance motive with export motive
 - Small countries versus large (the China issue)
- Can there be successful international cooperation and if so how?

Self-Insurance Versus Multilateral Insurance

- Current account surpluses and reserve build-up is manifestation of self-insurance motive
- Ideal solution is for each country to forego self-insurance in return for multilateral insurance (easy, quick disbursing liquidity in a crisis)
- IMF could issue SDRs or guarantee to provide liquidity in crisis
 - IMF has created new Flexible Credit Line
- Successful “multilateral” insurance in this crisis: US Federal Reserve swap line to Mexico, Singapore and Korea
- Tragedy is that it reflects failure of IMF as provider of multilateral insurance at least for Asia
- IMF has stigma problem
 - Problems of eroding legitimacy (Asian financial crisis of 1990s)
 - Problems of inadequate leverage (when has surveillance ever changed beggar-thy-neighbor policy?)
 - Asymmetric surveillance

Self-Insurance Versus Multilateral Insurance (contd.)

- IMF is not an International Monetary Fund but a Euro-Atlantic Monetary Fund
 - Example of Latvia in current crisis
 - Current account surpluses and reserve build-up is manifestation of self-insurance motive
- Serious governance is a prerequisite for IMF becoming effective provider of multilateral insurance
 - Selection of Managing Director
 - Quota reform (Europe is the worst offender)
 - Veto of US and Europe
- Prospects??
- Not just a supply problem (existing powers unwilling to give up) but also demand (Asian countries have not really asserted themselves)

Self-Insurance Versus Regional Insurance

- Chiang-Mai initiative
- Recently strengthened
- But still linked to IMF and the emergence of China and the RMB as international currency

Is there a role for the WTO?

- In contrast to IMF, WTO has more legitimate governance structure. Effective dispute settlement system:
 - Perceived as less asymmetric
 - Two-way disputes
 - Countries can initiate
 - Enforcement
- Moreover, global imbalances and current account surpluses have an insurance motivation but also a trade/export motivation
 - Hence legitimate to involve WTO
- Need a new rule in WTO that would say: undervalued exchange rates caused by government action would be deemed to be akin to export subsidies and import tariffs and hence prohibited.

New Rule: Implementation and Caveats

- IMF would make technical determination of undervaluation a la its BOPs role in Articles XII and XVIII (Korea Beef and India QRs on consumer goods)
 - Distinguish IMF as a political forum and as repository of technical expertise

Historical Digression

- Problem of getting countries with current account surpluses to adjust (Asymmetric adjustment problem)
- Keynes and Scarce Currency Clause of the IMF
- Right idea but wrong institution
- Our proposal tries to rehabilitate by drawing upon comparative advantage of WTO (enforcement) and IMF (technical expertise)

International Politics of Exchange Rate/China

- There will have to be a new rule which has to be negotiated. But how?
- US tried bilaterally and failed
 - Administration--Paulson
 - Congressional legislation mostly abandoned (ambivalence of mobile capital)
- But it come back under President Obama
 - strength of immobile capital and unions
 - Larry Summers' speech: US does not want to revert to running deficits because of economic and strategic reasons
- But China's exchange rate is as much of a concern to developing countries (Brazil, Mexico, Asia, Turkey, and Africa).
- Need a broad coalition of developing countries to come together
- But reluctance to express this concern

Politics of Exchange Rate

- But China is China. Need carrots as well
- Possible carrots (Bretton Woods II process)
 - Prospect of market economy status in the WTO
 - Quota reform in the Fund
- But it is possible that no carrots and sticks can induce China to cooperate
- Only if China see it in self-interest will there be change

Conclusion

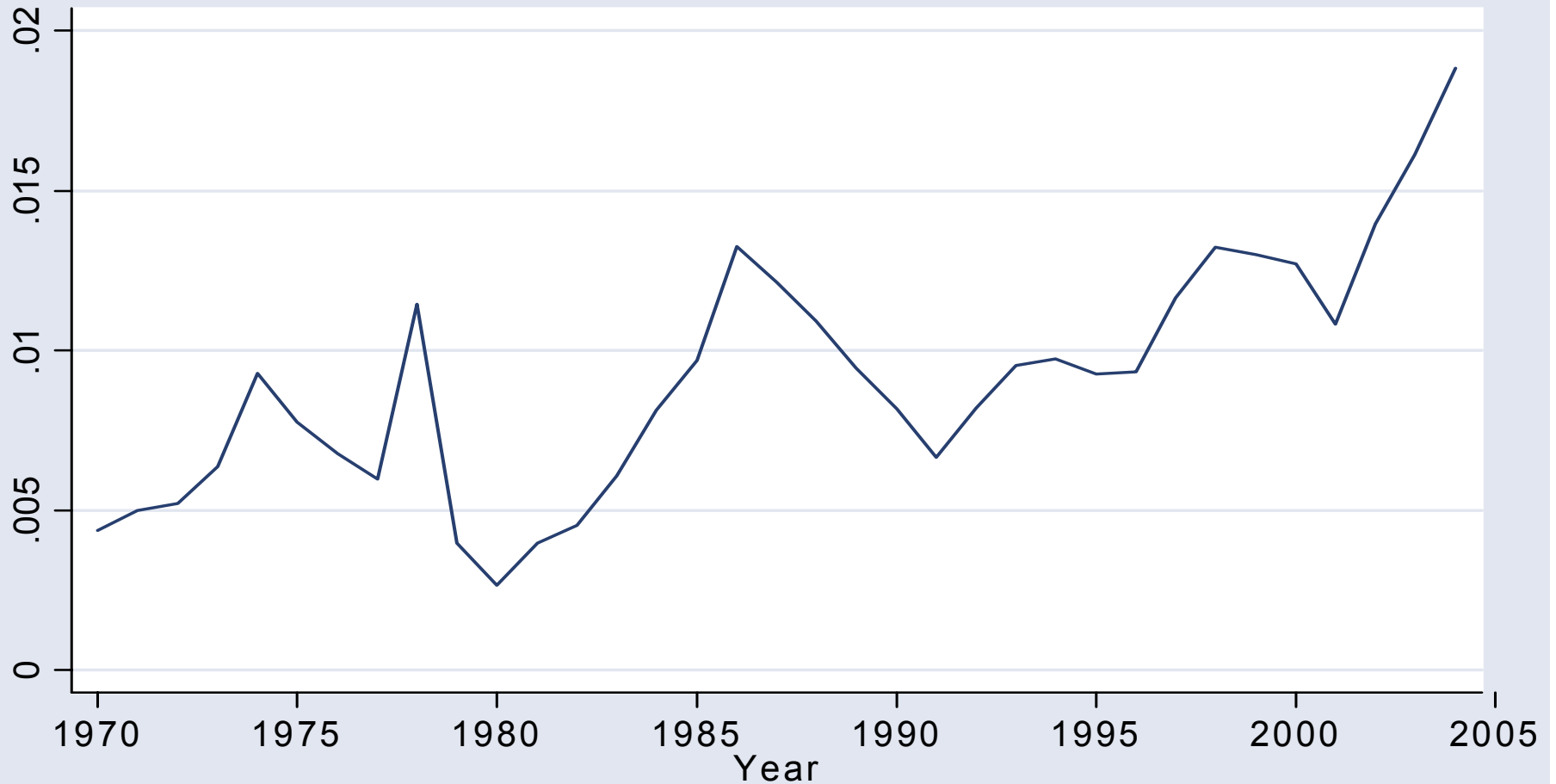
- Global imbalances are a problem
- Need to address insurance and export motivations underlying them
- Prospects may not be bright
- Multilateral IMF solution will require governance reform
- Any multilateral solution will require China's voluntary cooperation

Political Context in US

- US bilateral initiatives:
 - Schumer-Graham
 - Baucus-Grassley
- President-Elect Obama supports against recent currency manipulation bill
- If deep recession + if dollar continues to strengthen, pressures will resurface, especially since pre-existing anxieties about globalization
- Effects on immobile versus mobile factors: Democrats (immobile labor) versus Republicans (mobile capital)
 - Reason why currency bills led nowhere

Wish Come True

Figure 1. World Current Account Surpluses as a Ratio to World GDP



Note: This plot shows the sum of current account surpluses for countries in our sample that report a surplus in a given period as a ratio of the sum of world nominal GDP in that period.

Doubts about Proposal

- Overloading the WTO (Bhagwati and Martin Wolf)
- Turf battles within countries: trade versus central banks versus finance ministries. True but...
- Responsibility for exchange rate management unaffected: small tail of outcomes (undervaluation) subject to trade action
- Precedent for reconciling turf issues: Financial services agreement in GATS.
- Too big to litigate: Yes and no
 - Key question is whether rules agreed as part of a fair bargain