1 Editors Overview

Stijn Claessens, Simon Evenett and Bernard Hoekman

IMF, University of Amsterdam and CEPR; University of St. Gallen and CEPR; World Bank and CEPR

We recognise that the process to ensure more balanced global growth must be undertaken in an orderly manner. All G20 members agree to address the respective weaknesses of their economies.

- *G20 members with sustained, significant external deficits pledge to undertake policies to support private savings and undertake fiscal consolidation while maintaining open markets and strengthening export sectors.*
- *G20 members with sustained, significant external surpluses pledge to strengthen domestic sources of growth. According to national circumstances this could include increasing investment, reducing financial markets distortions, boosting productivity in service sectors, improving social safety nets, and lifting constraints on demand growth.*

G20 Framework for Strong, Sustainable, and Balanced Growth
G20 Pittsburgh Summit, 24/25 September 2009

Such was the concern about the adverse consequences for the world economy of "imbalances" that G20 Leaders, meeting in Pittsburgh in September 2009, adopted a framework that contained a number of pledges to take action at the national and international level (see text above). This action followed a growing body of expert opinion that took the view that large, persistent current account imbalances in the major industrialised economies and emerging markets since 2000 had, at the very least, contributed to the global financial crisis witnessed in 2007-8 and to the subsequent Great Recession.

The purpose of this eBook is to provide policymakers and their advisers with up-to-date, comprehensive analyses of the central facets of global economic imbalances and to identify and evaluate potential national and systemic responses to this challenge. As will become clear, the world economy has experienced substantial current account surpluses and deficits before, and several of our contributors discuss the contemporary relevance of these episodes. Most contributors focus on important very recent developments, such as the pressures for fiscal retrenchment experienced in Europe during the second quarter of 2010.

These developments may well shape how global economic imbalances are tackled in the months and years ahead.

Since expert opinion remains divided on some critical aspects of the rebalancing question, we have not sought to present a single view. Given the diversity in national economic circumstances it would be surprising if a single set of policy prescriptions was valid across the board. Consequently, drawing upon different areas of expertise concerning the international economy, we have assembled cutting-edge analyses of all of the key questions raised by challenge of global economic imbalances. Many of our contributors have advanced proposals for reform that could usefully be explored in national and international fora.

The multi-faceted nature of global economic rebalancing

A challenge facing senior officials and analysts is to comprehend the many different dimensions of the rebalancing of the global economy and how they might relate to one another. A first order of business is to define terms. What constitutes an imbalance? How is it measured? Second, causal and normative considerations arise. What factors cause imbalances? Since it is the persistence of these imbalances that is regarded as detrimental to national economies, it is necessary to understand the factors that account for persistent imbalances. Comprehending the different types of harm created by persistent imbalances is a distinct matter made all the more interesting given claims advanced over the past two years that global economic imbalances contributed to the worldwide financial paralysis and subsequent output collapse in 2008 and 2009, respectively. Ascertaining whether there are systemic costs to global imbalances is a necessary first step in any discussion of potential national, regional, or multilateral responses.

If one is convinced that imbalances are bad for a national economy or systemically, attention then turns to normative prescriptions. While these can and should be informed by conceptual analysis, surely it is helpful to turn to the historical record to examine how previous instances of serious global imbalances have played out. Such evidence plus other considerations can inform an assessment of what public policies must change and whether collective actions are needed. Such an assessment ought to consider the political viability of reform proposals in all of the major affected jurisdictions. Given the constellations of interests often invested around existing sets of national institutions and policies, politically viable reforms may fall far short of the first-best or preferred technocratic option.

Lastly, moving from the national to the systemic level, questions arise as to whether new international rules, conventions or processes are needed to discourage the creation of persistent imbalances in the first place or to correct imbalances when they occur. Such analyses have to take into account the operation of any self-correcting mechanisms at work in the global economy as well as instances where global markets fail to deliver optimal adjustment by leading nations.

The contributions to this volume

With these considerations in mind, we organised the contributions to this volume around six questions. Doing so allows authors to focus on different aspects of the global rebalancing challenge, and helps each element of the policy challenge to be appreciated more easily. Of course, decision-makers need to take a comprehensive view of the many facets of global economic imbalances, recognising the connections between the national, regional, and multilateral levels, between the politics and economics of the challenge, as well as drawing from contemporary circumstances and historical experience. The six questions are:

1. How large are contemporary current account imbalances? Why do they persist?
2. What are the systemic costs of imbalances?
3. What are the lessons from previous attempts to rebalance the global economy?
4. What would rebalancing entail? Which policies must change? Is collective action needed?
5. What is the political viability of proposals to rebalance national economies?
6. Are new system-wide accords needed to promote rebalancing or to discourage persistent imbalances?

Implications for policymaking

While the answers to these questions vary and there is no clear consensus, we draw out ten implications for policymaking from the contributions to this book. No doubt, further analysis and deliberation will refine—and possibly contradict—some of the suggested implications. Still, given the high profile attached to global imbalances, it is worth stating them, not least to demonstrate how different facets of the rebalancing challenge relate to one another.

1. Many analysts subscribe to the view that the large current account imbalances of the past decade were, at least in part, a contributing factor to the recent global financial crisis. Even if imbalances do not represent a threat to the operation of an open global economy, they risk undermining public support for such openness.
2. While imbalances are typically viewed as a macroeconomic phenomenon, their persistence in recent years suggests that there may be underlying structural features of national economies and the international financial system that influence their magnitude.
3. To the extent that such structural features are important causes of national imbalances, the optimal policy mix extends beyond demand management tools. Shifts in expenditure patterns of the magnitude necessary to eliminate some of the current account imbalances must imply inter-sectoral shifts in resources within economies. This process of reallocation will undoubtedly be affected by supply side measures (see Box 1 for a discussion of the relevance

of this observation for national service sectors). And at the international level, governance and other reforms are needed to reduce the incentives of some countries to accumulate foreign exchange reserves beyond what is reasonably needed.

4. Making sure imbalance-related policy reforms are not hijacked by vested interests is vital. Deficit countries, for example, should not succumb to a patchwork of industrial policies dressed up as a national reindustrialisation strategy.[1] Neither can large imbalances serve as an excuse to impose capital controls beyond what is prudent from a domestic financial stability perspective.
5. The fact that certain vested interests benefit from the same structural determinants of imbalances strongly suggests that international exhortation, monitoring, and peer pressure processes alone are unlikely to succeed. The limited success of the IMF's consultation exercise on global imbalances in the middle of the last decade bears out this point.
6. Their limited (in principle, zero) financing needs means there is little automatic external pressure on surplus countries to adjust, besides a fear of a low return on foreign savings. A long-standing asymmetry in the international economy is that the market-driven pressures to adjust fall disproportionately on deficit countries.
7. While there has been much mention of coordinated action to address global imbalances, to date the substantive basis of any inter-governmental deal, its political viability in each leading jurisdiction, and the trigger needed to bring such deliberations to a close remain elusive. Nor have reforms of the international financial system proceeded far enough to remove the incentives on the part of some countries to accumulate official reserves.
8. In the absence of an international accord, policymakers must not succumb to fallacies of composition in assessing national policy options. The allure of deflationary solutions to current account deficits is far less when major trading partners are all taking similar steps.
9. Other policy imperatives—such as fiscal retrenchment brought about by financial market fears regarding the sovereign solvency—can counteract measures to reduce or limit imbalances. Some surplus countries are cutting their government budget deficits which, everything else equal, will expand their current account surplus.
10. Measures to promote private sector investment and to reduce personal and corporate savings will need to complement any fiscal retrenchment in surplus countries. Conversely, measures to increase savings have to be adopted in deficit countries. More generally, governments will have to decide how much priority to attach to reducing imbalances compared to other macroeconomic and structural objectives.

1 Followers of the rebalancing debate in the UK and the US, two countries with current accounts that are large shares of their national incomes, will recognise the contemporary resonance of this particular example.

Box 1: Rebalancing and national service sectors

Any serious effort to rebalance the world economy must involve policies that will result in a significant expansion of the variety and quality of the services sector in both the rising economic powers and in deficit countries. It is a truism that modern economies are service economies. Over the last three decades, services have grown from roughly 55% of global GDP to some 70% for the world as a whole. The sector is also important by other measures, including employment shares, cost shares for industry, and sector share of overall FDI. But even though already large, much can and should be done to increase the productivity of services industries in both the OECD and the emerging markets. And much can and should be done to expand the scope for international trade in services.

Given that services are already – by far – the largest component of GDP, rebalancing by definition must involve services. Boosting manufacturing in high-income deficit countries can only make a marginal difference in terms of creating employment given that the sector accounts for only a small share of total value added. Moreover, the competitiveness of manufacturing firms in open economies is determined in (large) part by their access to low-cost and high-quality producer services inputs such as telecommunications, transport and distribution services, financial intermediation, etc. To a significant extent the boost to competiveness that is needed in deficit countries such as Greece that cannot adjust the exchange rate will have to come through adjustments in real wages and through reductions in costs. As services account for most non-labour input costs, action to improve the efficiency of services must be a major focus of policy.

Boosting domestic consumption in surplus countries must also involve an expansion of demand for services – such as the retail sector, construction, the logistics needed to support consumption of a wider range of differentiated products, or services that improve the productivity of workers and firms: education, R&D services, health insurance, etc... This is not just an agenda to increase domestic final consumption. Improving the productivity and efficiency of national services industries can contribute to sustaining high rates of economic growth (Francois and Hoekman, 2010). Information technology and managerial innovations – such as outsourcing – and (then) new concepts of retailing such as the "big box" store format helped to transform and accelerate US productivity in these sectors. Differences in overall productivity growth of OECD countries can be explained to a large extent by variation in business services performance across countries.

Policy variables such as regulation, limits on entry into or scaling up of business services, investment restrictions, etc. affect services performance. Of particular importance is that barriers to trade and international investment are much higher in services than in goods. World Bank analysis has revealed that services barriers are much higher than those for trade in goods in many

countries (Gootiiz and Mattoo, 2009). Moreover, high-income countries are more open than developing countries, although some sectors such as transport and professional services are subject to high discriminatory barriers. Some of the most restrictive policies are found in the fast growing economies of Asia, including China, India, Indonesia, and Malaysia. Lowering these barriers would benefit consumers (households and firms) in these countries by increasing access to lower priced and/or new, differentiated services.

Services are on the table in the WTO Doha round of trade negotiations. As is well known, these negotiations have been at an impasse for several years now. One reason is that the talks have been almost exclusively on trade in goods – policies affecting market access for agricultural and non-agricultural products. Services have not been the focus of a concerted, serious effort to reduce barriers to trade and investment. Given that barriers to trade in manufactured products are low, and that more than 70% of GDP and employment is in services, it is perhaps not too surprising that strong business interest and support for the negotiations has not been very visible. The case for taking action to increase the contestability of services markets is strong in and of itself. But the need for action to rebalance the global economy greatly increases the salience and urgency of making progress in improving services trade and regulatory policies in high-income and emerging markets alike.

References

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About the Authors

Stijn Claessens is Assistant Director in the Research Department of the International Monetary Fund where he leads the Financial Studies Division. He is also a Professor of International Finance Policy at the University of Amsterdam where he taught for three years (2001-2004). Mr. Claessens, a Dutch national, holds a Ph.D. in business economics from the Wharton School of the University of Pennsylvania (1986) and M.A. from Erasmus University, Rotterdam (1984). He started his career teaching at New York University business school (1987) and then worked earlier for fourteen years at the World Bank in various positions (1987-2001). Prior to his current position, he was Senior Adviser in the Financial and Private Sector Vice-Presidency of the World Bank (from 2004-2006). His policy and research interests are firm finance; corporate governance; internationalization of financial services; and risk management. Over his career, Mr. Claessens has provided policy advice to emerging markets in Latin America and Asia and to transition economies. He is a fellow of the London-based CEPR.

Simon J. Evenett is Professor of International Trade and Economic Development at the University of St. Gallen, Switzerland, and Co-Director of the CEPR Programme in International Trade and Regional Economics. Evenett taught previously at Oxford and Rutgers University, and served twice as a World Bank official. He was a non-resident Senior Fellow of the Brookings Institution in Washington. He is Member of the High Level Group on Globalisation established by the French Trade Minister Christine LaGarde, Member of the Warwick Commission on the Future of the Multilateral Trading System After Doha, and was Member of the the Zedillo Committee on the Global Trade and Financial Architecture. In addition to his research into the determinants of international commercial flows, he is particularly interested in the relationships between international trade policy, national competition law and policy, and economic development. He obtained his Ph.D. in Economics from Yale University.

Bernard Hoekman manages the World Bank's international trade department. Prior positions at the World Bank include Research Manager of the trade and international integration program in the Development Research Group; the manager of the trade capacity building program of the World Bank Institute; and working as a trade economist in the Middle East/North Africa and Europe and Central Asia departments. He has published widely on the multilateral trading system and economic development, trade in services, and preferential trade agreements. Between 1988 and 1993 he worked as a research economist in the GATT Secretariat in Geneva. He is a graduate of the Erasmus University Rotterdam, holds a Ph.D. in economics from the University of Michigan and is a Research Fellow of the London-based Centre for Economic Policy Research.