PART 4: What would rebalancing entail? Which policies must change? Is collective action needed?

10 Does the rise of the BRICs and the credit crisis make it easier to rebalance the world economy? Yes!

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The global credit crisis, by halting the growth in imbalances, may actually be quite useful for leading us to a more balanced world. As Chinese consumption could be growing by 15% in real terms and US savings starting to pick up, this chapter argues that G20 leaders should encourage this process to continue by supporting a world where the US consumer has adjusted to at most 15% of the world's consumption, and China somewhere close to 10%.

Since early 2009, I have been of the rather unfashionable opinion that perhaps, the global credit crisis, especially at its worst in late 2008, is actually quite useful for leading us to a more balanced world, and certainly a world of lesser imbalances. What would be helpful, as we approach the middle of 2010, is if G20 leaders encouraged this process to continue.

At the core of this rationale, is that the credit crisis itself was influenced to some degree -possibly substantially – by the growth in imbalances. If correct, their reversal would presumably help reduce the likelihood of such a repeat in the future. At the core of the imbalance problem, was the seemingly never ending shift of US personal household savings towards zero, and the possibly not directly related strength of personal savings elsewhere, especially in the biggest of the BRICs, China. A world in which, financial intermediaries (and governments) dreamed up increasingly exotic ways for the US weak savings position to be supplemented by foreign savings seemingly suited many. US consumers could continue to over consume and Chinese consumers under consume. Many other countries had "bit part" in this global pattern (Germany and Japan, excess savers, the UK, some parts of Club Med Eurozone, excess spenders, other BRIC and important developing countries mixed roles too), but at the core of it, has been this dilemma. The US, with a population of around 300 million people, less than 5% of the world's population –up until the crisis-was consuming more than 20% of the world's output. China, with about 20% of the world's population was consuming somewhere between 2-3%.

The prime goal of G20 policymakers should be to help, cajole, support a world in the future, where the US consumer has adjusted to at most 15% of the world's consumption, maybe beyond this decade, less, and China somewhere close to

10%, and beyond this decade more. If this can be achieved, then no doubt there will be some other form of global imbalances, but this one, that has dogged the world for the past decade (and in the US's case for the previous two decades), will be behind us.

There are some signs that key G20 policymakers are starting to recognise that steps along these paths have occurred, and if so, it might be easier for them to create an environment in which it continues. US Treasury Secretary Tim Geithner, speaking in China recently, publicly acknowledged the evidence that Chinese consumption was becoming a larger share of their GDP, and with it, the balance of payments current account surplus much smaller. According to the data we track, in fact, Chinese consumption could be growing by somewhere close to 15% in real terms, which if so, must indeed, mean that it is starting to increase from its- probably underreported- low share of around 35% of GDP. Similarly, the data for the first 4 months of 2010 show that the annualized trade balance is currently in surplus of somewhere between 1-2% of GDP, nearly five times less than its peak before the crisis. Indeed, one of the most impressive things in data so far this year, is that China's imports year to date have risen by around $500 billion on an annualized basis compared to the same period in 2009. This amount incidentally is equal to about 1.4 times the size of Greece's total economy, i.e. China's has been importing the equivalent of another Greece every 8 months.

At the core of this, is a realisation amongst Chinese policymakers that they cannot rely on the export machine for future economic growth. At one stage before the worst of the crisis, China had around 12% of its GDP equivalent in exports to the US. Those days are behind us. Chinese policies designed initially to boost domestic demand, and increasingly to focus on domestic consumption are, increasingly in vogue in China, and this is to be highly welcomed.

While other BRIC countries don't have the same degree of need for change, awareness that it is dangerous to be over reliant on exporting as a means of growth is no bad thing for them all. According to our projections for the next decade up to 2020, the possible increase in the aggregate GDP of the four BRIC countries will be about $11 trillion, about three times more than the 3 trillion that the US is likely to grow by. In fact, if this occurs, the dollar size of the BRIC economies will match that of the US sometime before the end of the decade, both being around $18 trillion. China will be about 2/3 of this, at 12 trillion, with the other BRIC countries, Brazil, India and Russia making up the rest. Of that 11 trillion increase, it is vital for the US, and other over levered economies who will be raising savings, reducing their budget and external deficits, that the lion's share of it will be in domestic consumption, much of which can be satisfied through imports.

Whether it is sensible for G20 policymakers to directly "target " these possible numbers as deliberate policy goals, I suppose is a debatable point, but this is the sort of underlying goals they should have.

From the US side, some of the evidence for a changing world post crisis, is also pretty clear. The trend of the balance of payments current account is better, currently around 3% of GDP on a 12 month annualized basis. Domestic personal savings have increased notably, albeit from pitiful levels, but it is a start. Probably something in the vicinity of 8% of total income, a bit more than double where they currently are, will be necessary for the US to do its "bit" to help improve global imbalances, and support a world in which its own consumer will be less important. The related international part, i.e. dramatically boosting exports, is already a stated target of policy. In February, President Obama announced a goal of trying to double exports over the next 5 years, something which sounds ambitious but is exactly the sort of step the US, and world needs.

Other countries, including those within the developed G20 need to understand, and contribute to this broader world. This includes Japan and Germany, for whom contributing might be more of a challenge than the US or China. Germany in particular has some need from both a global and Eurozone perspective, in my opinion. Recent data shows a quite incredible trend involving German trade. A detailed breakdown of regional German export destinations shows a staggering degree of growth in exports to both China and India. To China in particular, things are so buoyant that if the current pace remained for the next 12 months, by this time in 2011, German trade with China could be as large as their trade with France. I have found myself thinking recently, that what goes on in China might be more important for the city of Munich- home to both BMW and Siemens- than anything going on in other Eurozonecountries. Indeed, it might even be more important than anything going on elsewhere in Germany. While all of this speaks to the marvel of German exports, it is actually also a major problem, as Germany needs more domestic consumption, less personal savings. The rest of the Eurozone, especially those with US /UK style, need to raise domestic savings, and Germany to save less and spend and import more from them. The US, both in terms of its markets, and in terms of competition, probably needs Germany-and Japan- to spend more, import more and save less.

So should the G20 have a definite plan for targeting lower imbalances? It should certainly form part of the heightened multilateral, IMF led, surveillance of each G20 member country's view of the future. As the post crisis imbalance world is moving in this direction, as Mr. Geithner has observed, why not only consolidate these gains, but ensure that moving further in this helpful direction is at the heart of what the G20 sets itself as tasks when it meets in near future.

About the Author

Jim O'Neill is Head of Global Economics, Commodities and Strategy Research for Goldman Sachs which he became in 2008. He received his Ph.D. in 1982 from the University of Surrey after graduating in Economics from Sheffield University in 1978. Jim is the creator of the acronym BRICs and, together with his colleagues, he has published much research about BRICs, which has become synonymous with the emergence of Brazil, Russia, India and China as the growth opportunities of the future. Jim is a member of the board of the Royal Economic Society in the UK, of the European think-tank Bruegel, and Itinera, a Belgium think-tank. He is a member of the UK-India Round Table, and the UKIBC. Jim is one of the founding trustees, as well as the current Chairman, of the London-based charity SHINE. In 2009, Jim received an honorary doctorate from the Institute of Education, University of London, for his educational philanthropy. He also served as a non-executive director of Manchester United before it returned to private ownership in 2005.