Imbalances and the Global System: A Long, Tropical View

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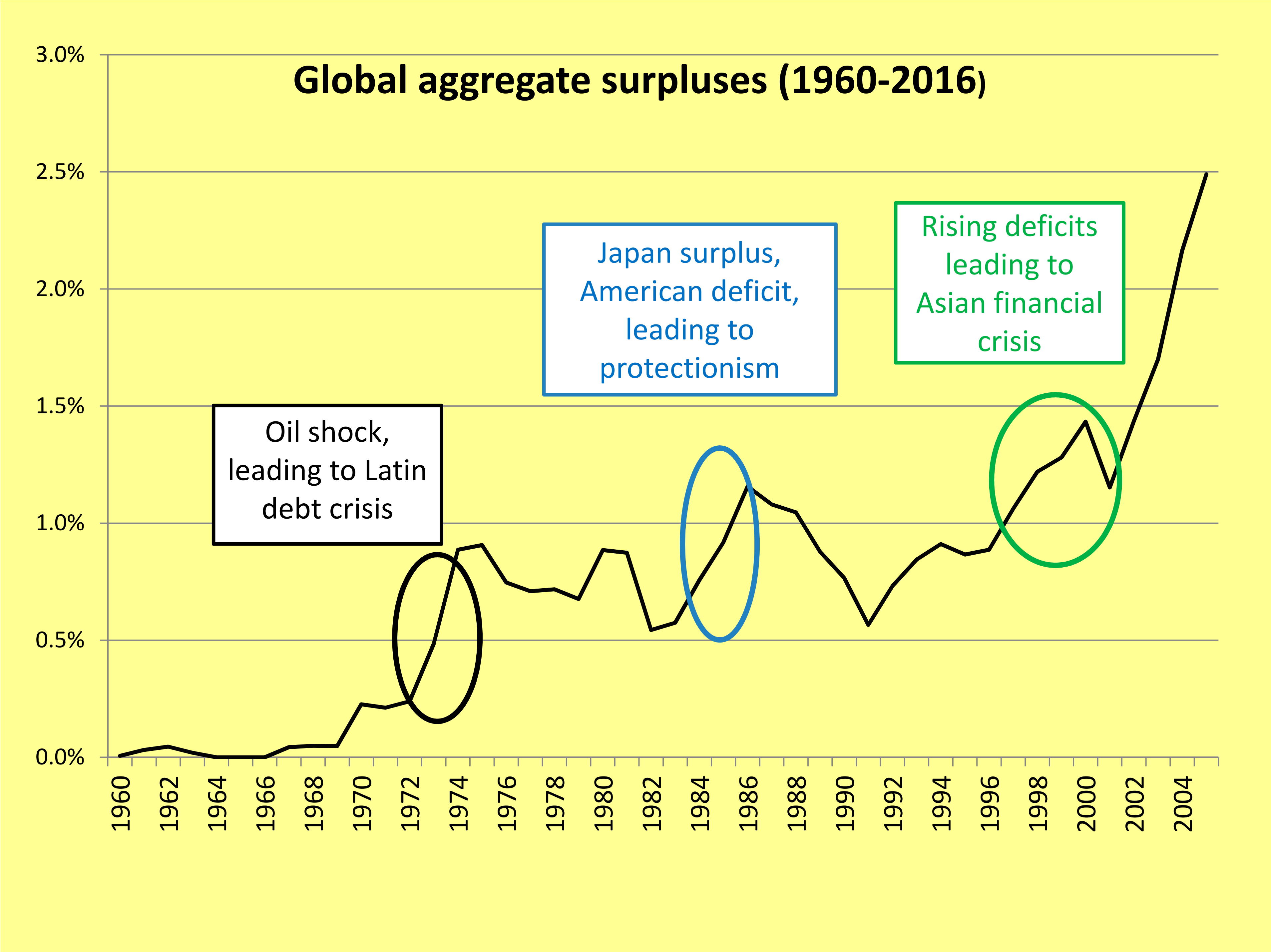

Global aggregate surpluses (1960-2016)
3.0%
2.5%
2.0%
1.5%
1.0%
0.5%
0.0%
Oil shock, leading to Latin debt crisis
Japan surplus, American deficit, leading to protectionism
Rising deficits leading to Asian financial crisis
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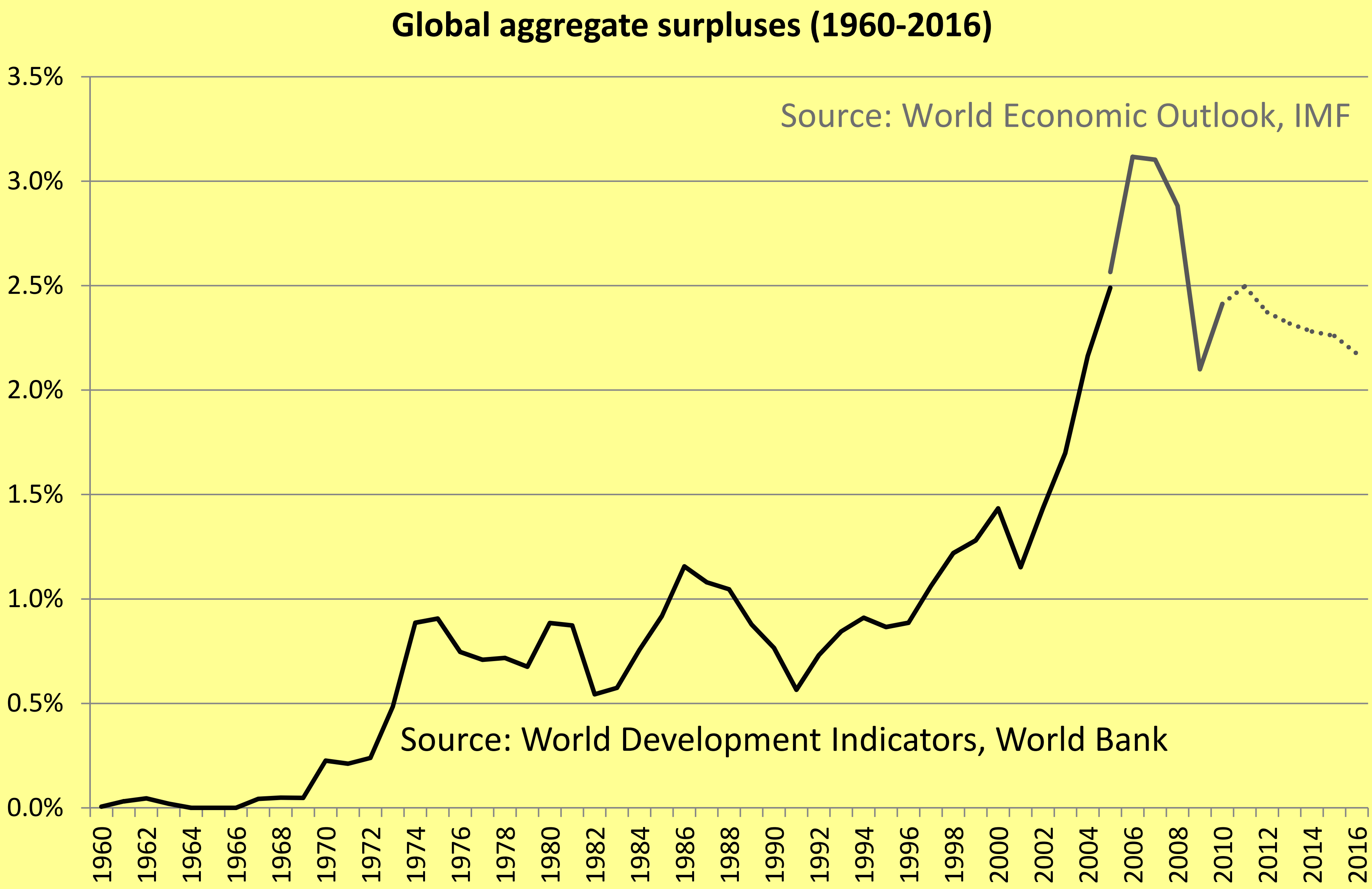
IMF on Imbalances

- "We at the IMF have not been a cheerleader for burgeoning current account imbalances, …But at the same time if we think ahead, it becomes obvious that the real challenge is not to reduce current account imbalances but to find ways to sustain bigger ones, albeit properly directed." *Ken Rogoff in the Economist, 2002*

Imbalances: a look in the rear mirror

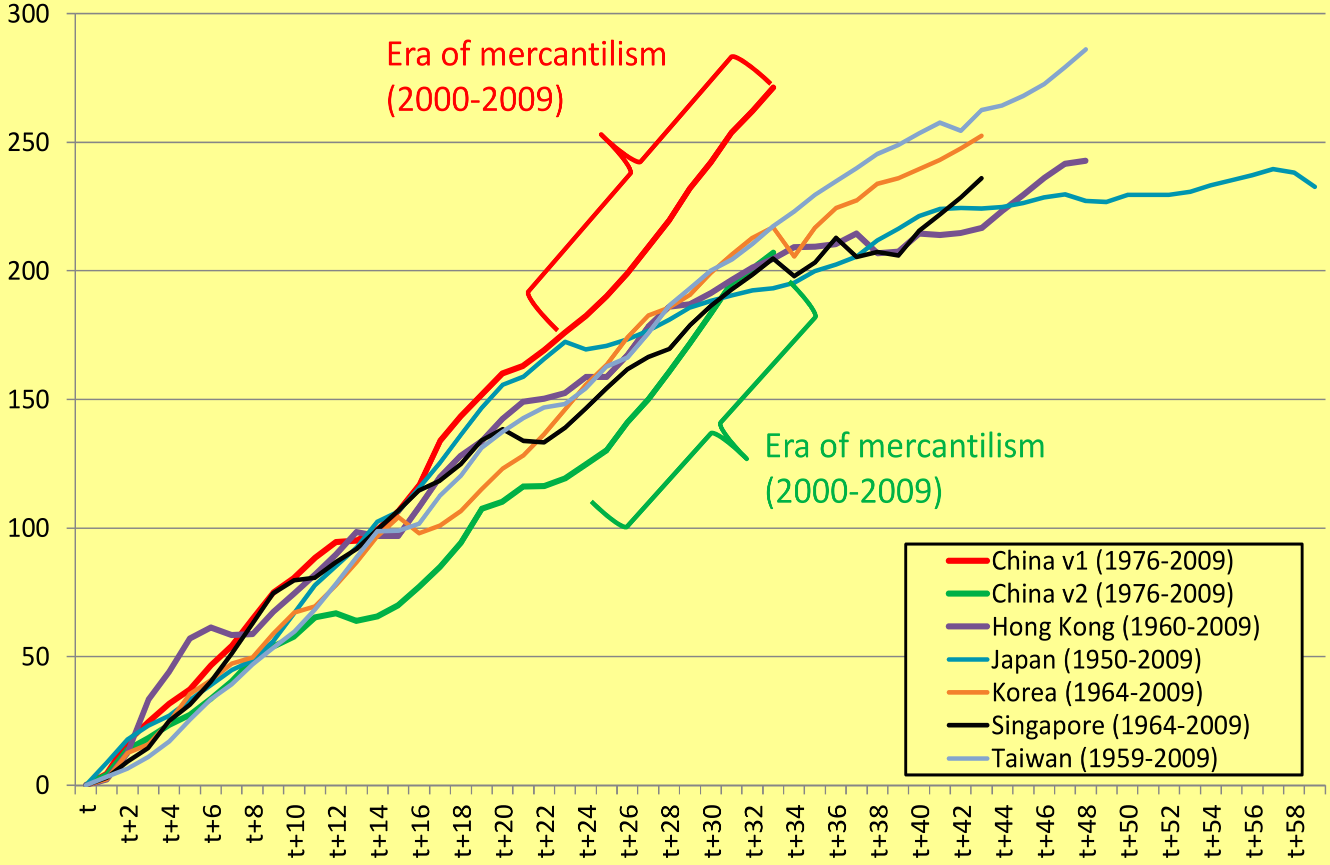


Post-Asian Financial Crisis

- 3 deficit experiences:
  - US
  - Eastern Europe
  - PIIGS

- One surplus experience: China

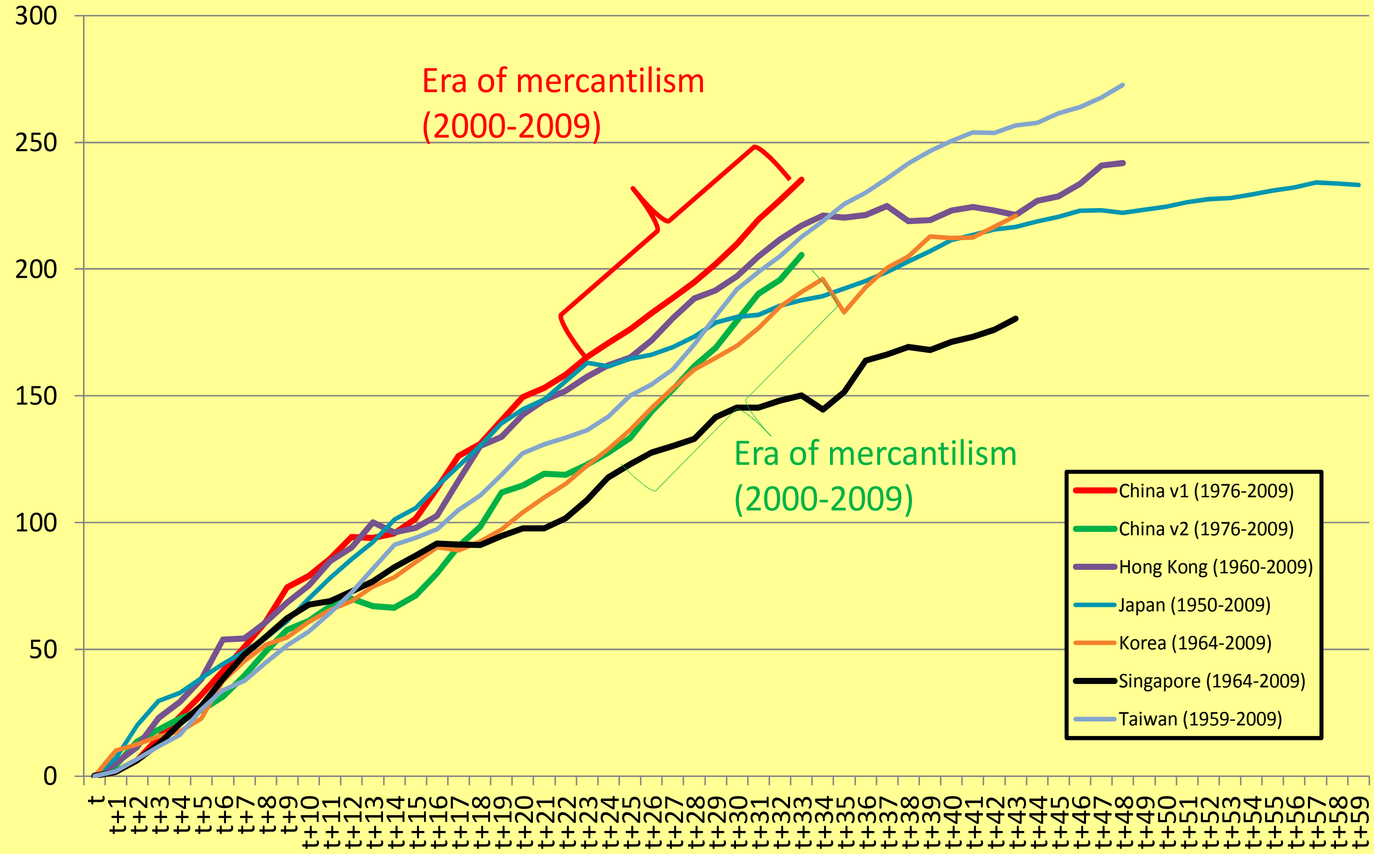
Six take-offs – Growth of GDP (PPP)



Source: Penn World Tables, version 7.0

Note: GDP in PPP dollars, in logarithm, normalized at the year of take-off

Six take-offs – Growth of consumption (PPP)



Source: Penn World Tables, version 7.0

Note: Consumption in PPP dollars, in logarithm, normalized at the year of take-off

Imbalance: Evidence Supporting Surplus

- China: Era of mercantilism has delivered highest rates of growth of GDP per capita, consumption per capita, while reducing vulnerability to external crises

- Consistent with other evidence on growth and current account positions (Jeanne, Subramanian and Williamson, forthcoming)

Tentative Inferences for Emerging Markets

- Global economy “cannot bear” too much imbalance

- Current account deficits are not easily managed and often lead to financial crisis:
  - Latin America (1980s)
  - East Asia (1990s)
  - Europe’s Eastern periphery (2008-)
  - PIIGS (2010-)
  - United States (2000s)

- Current account deficits lead to trade frictions
  - United States versus Japan (1980s)
  - United States versus China (today)

- Mercantilism works as development and insurance strategy, at least for some time

Systemic Implications

- Option 1. Emerging markets should strive for large downhill net flows of capital (Rogoff, 2002)
  - "Import capital and manage them through better institutions/regulations" not very defensible

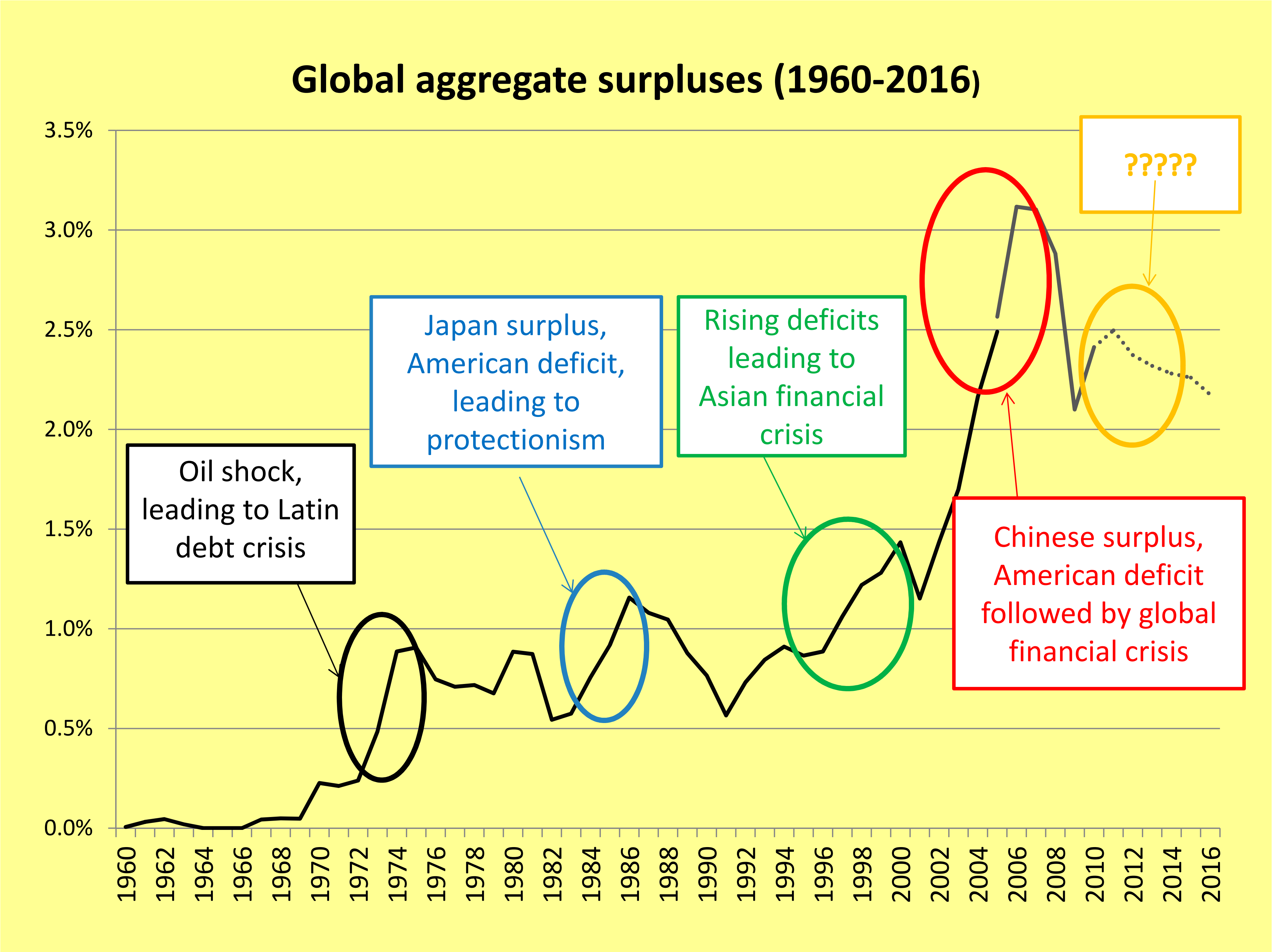
- Option 2: "In general, there are both domestic and multilateral reasons for countries to reduce current account deficits and surpluses." (Blanchard and Milesi-Ferretti, 2011)
  - Polonius Solution: Emerging markets should strive for something close to balance: Small net flows of capital

- Option 3: China writ large: Emerging markets should strive for surpluses a la China and east Asia: system should be geared toward uphill flows of capital
  - More structural impediments to capital flows, especially debt
  - More mercantilist exchange rate policies

Systemic Implications (contd.)

- Adding up problem: Tension between individual and systemic good?
  - Reduced aggregate demand under conditions of unemployed resources and liquidity traps (Blanchard and Milesi-Ferreti, 2011)
  - Beggar-thy-neighbor that affects exports and growth of other developing countries (Mattoo, Mishra and Subramanian, 2012)

- Do we need the exact opposite of staus quo?
  - Countenance if not encourage capital controls
  - Countenance mild mercantilism
  - But complement with tough rules on egregious mercantilism especially on large countries
  - Also tough rules on adjustment for large surplus countries (Germany?)



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Oil shock, leading to Latin debt crisis
Japan surplus, American deficit, leading to protectionism
Rising deficits leading to Asian financial crisis
Chinese surplus, American deficit followed by global financial crisis
?????

Eurozone imbalances