The Global Rebalancing and Growth Strategy Debate

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Introduction: Major Issues

The run-up to the Seoul G-20 Summit in November last year brought into full light the challenges of forging a global strategy for economic recovery and growth. In Korea, the effort to advance a G-20 framework for "strong, sustainable, and balanced growth" through efforts to engage in global economic adjustment of major imbalances between external surplus and external deficit countries also encountered more frictions than convergence with the specter of U.S.-China currency wars gaining attention. Currency disputes were further fueled by the untimely decision by the U.S. Federal Reserve to engage in quantitative easing to spur U.S. credit expansion and domestic growth which looked to China as being currency manipulation.

There is a mind-set among summit observers, which used to include myself, that anticipates visible "grand bargain" outcomes from leaders' level summits. Born in the G-8 era, this is a kind of maximalist international cooperation outlook that overemphasizes memories of the Plaza Accord and the Louvre agreement, which were really the exceptions rather than the rule. In the G-20 era, we need a new mindset that accepts policy conflicts and more modest progress in resolving them because the G-20 embodies global diversity rather than the "like mindedness" of the G-8.

The intensity of the G-20 debate on strategies for global growth and rebalancing led to a pledge in Seoul to come up with a set of indicators and try again for agreement at the next G-20 summit in France in November this year. The world economy has moved on through several phases since the triggering of the great recession in 2008. So now, we might ask several questions: is a G-20 strategy for global growth desirable or even necessary? And is it feasible? Is global rebalancing crucial to global growth? Is the lens of external deficit and external surplus countries useful in generating a G-20 global growth strategy? And finally, what are the implications for the G-20 economic agenda if the answers to these questions are negative? Does the G-20 need to either change the subject or shift its focus, as some have argued?

A G-20 Coalition for Global Growth: Facts and Feasibility

First, it seems useful to examine the structure of the world economy and the weight of G-20 economies in it in order to determine whether there are indeed clusters of G-20 countries which have enough weight to constitute a feasible coalition for global growth—what Gordon Brown called developing a "plan for global growth". This gives us an understanding of the skeleton of the world economy, if not its muscle and direction.

Broadly speaking, we can divide the G-20 into four groupings:

1. Three advanced G-20 countries with significant current account deficits (excluding the United States), who therefore feel a need to adjust;

2. Four advanced G-20 economies, who could potentially be more aggressive with expansionary macroeconomic policies;

3. Ten emerging market economies (including Russia but excluding China) that are experiencing rapid growth and receiving considerable capital inflows from abroad; and

4. The U.S. and China, who essentially feel they are in a position to take whatever action they deem necessary for their own growth. The U.S. has the special "privilege" of being the issuer of the global reserve currency, while China has the advantage of $3 trillion in foreign exchange reserves.

The three advanced current account deficit countries are the United Kingdom, Australia and Italy. Together they account for 8.9 percent of the world economy.

The four non-deficit advanced economies that might provide more global stimulus are Japan and Germany, two surplus countries, and France and Canada, two countries in a relatively strong position. Together they account for 20.7 percent of world GDP. But Japan with 8 percent of global GDP is likely to slow in the short term due to the recent earthquake, tsunami and nuclear crisis. Continental Europe, including the European Central Bank, seems filled more with caution than ambition. Germany has resisted pressure to engage in expansionary policies and France is now moving toward fiscal consolidation despite possible social unrest. So, the core group of four non-deficit advanced economies of the G-20 coalition for growth is not really in a potentially expansionary stance.

The 10 emerging market economy members of the G-20, other than China, have a weight of 15 percent of global GDP. But this group is quite diverse and fragmented so building a lasting coalition is hard. The top five members—Brazil, Russia, India, Mexico and Korea—are together 11.2 percent of global GDP. They are too small to play a pivotal role alone even if their efforts are amplified by the other five emerging market economies, who account for 3.6 percent of GDP; this larger emerging markets group would only account for 15 percent of global GDP. It is also unrealistic to expect all countries in this group to be at a similar business cycle stage. Several of these emerging market economies are running significantly large current account deficits. Brazil and India are looking at current account deficits as a percentage of GDP of 3 percent and Turkey and South Africa in the range of 5-6 percent, making it difficult for them to be more expansionary. In fact, their fears are of overheating, not of deficient demand.

This implies that the pace of the global recovery will still depend heavily on the United States and China, who together make up 31 percent of global GDP. The U.S. will have to try to combine fiscal consolidation with monetary easing to boost employment growth through credit expansion fueled by quantitative easing while shrinking budget deficits and public debt. China is trying to slow growth to avoid budding inflationary pressures. In both cases, the balance will be hard to strike, but together it suggests neither will be able to sustain very rapid growth at the rate of the pre-crisis boom years.

The conclusion has to be that the feasibility of a G-20 coalition to actually accelerate global growth that combines economic weight with national policy thrusts is not there. That is not necessarily a major problem given that global GDP growth for 2011 is expected to surpass 4 percent. This diminishes the urgency for the type of expansionary action that G-20 leaders felt necessary in London in 2009 and Toronto in 2010. Therefore, we have to probe more deeply into the current context and what it really means for macroeconomic policy coordination.

The Current Context and Debate

The current context is one where the real engines of global growth now are the United States and the big emerging market economies. The dynamics of current patterns of growth follow from the quantitative easing policy of the U.S. Federal Reserve in the fall of 2010, which not only has lifted U.S. growth but also has encouraged massive capital flows to the larger emerging market economies, increasing their growth but also posing some risks of volatility. If anything, this creates some pressure in the big emerging market economies toward more contractionary policies to cool down overheating, dampen inflationary expectations and control capital flows. The problems in Greece, Ireland, Italy and Portugal have increased sensitivity in international financial markets.

All of this brings the focus back to the U.S. and China as the main sources of growth. But part of the value of the G-20 for these countries has been the opportunity to try to pluralize and multilateralize the global growth strategy to spread the heavy lifting around rather than relying on the two giants. A renewed focus on the G-2 tends to conflate again the challenges of global growth and global rebalancing in a single conundrum, reducing the possibility of separating them.

For both G-2 countries, the central issue is not external imbalances but domestic economic policy adjustments to correct internal imbalances. Correction of the U.S. fiscal deficit and low domestic savings and stimulating greater domestic consumption in China should be the central focus. These internal adjustments would automatically help correct the external imbalances even without global coordination. So perhaps U.S. and Chinese policymakers should shift their focus from global external imbalances in trade and capital accounts to internal shifts which will in turn rebalance the world economy.

Looking back over recent decades, it certainly seems as if the concentration of huge external deficits and surpluses in a very select few of the world's largest economies has contributed to patterns of global instability. In the 1980s, massive U.S. fiscal, trade and capital account deficits were mirrored by Japanese internal savings, trade and capital account surpluses. In the 1990s, as the Clinton administration gradually restored fiscal and trade balance to the U.S., a select few then-creditworthy Asian developing countries (Thailand, Indonesia, Korea and Malaysia) attracted capital from the Japanese surpluses, triggering the Asian financial crisis in 1997. In the 2000s, the booming Chinese economy ran huge savings, trade and capital surpluses which financed the continuing U.S. deficits, allowing the U.S. to postpone necessary internal adjustments. While these imbalances did not directly trigger the 2008 global financial crisis, they revealed some underlying weaknesses in the global financial system.

The concentration of massive global imbalances in a very few countries for three decades is clearly not conducive to global stability. When capital is attracted by big power deficits and surpluses, it may not be spread around the world to finance investment in an efficient manner that would diversify risk, reap higher and more stable returns, and be more conducive to financial stability. Hence, even though domestic imbalances are central, one cannot conclude that external imbalances are irrelevant for global policymaking.

Conclusions and Implications

The conclusion for the G-20 in 2011 is that, although domestic and external balances need to be focused on and dealt with, there may not be any "grand bargains" to be negotiated which could effectively deal with the diverging economic contexts of each G-20 country. We have to put aside the old G-8 mindset and accept a more complex, conflicted and diverse world in which G-20 policy differences and tensions are part of the game and not just obstacles to it. As much as the G-20 could be a possible vehicle for pluralizing and multilateralizing global growth and rebalancing, the current context does not yield a clear cut scenario for addressing these two problems.

Therefore, the pathway forward would be to put some distance between the technical track of what needs to be done to improve the economic functioning of the global economy from the political track of forming bargains or coalitions to implement policy. The technical work needs to proceed through the G-20 finance ministers' and central bank presidents' process to address global growth and rebalancing in workmanlike fashion during

2011, delving deeper into sources of disequilibria and disturbance in macroeconomic policy conduct. This should remain a technical and policy discussion among senior economic policy officials from G-20 countries with technical support from the International Monetary Fund through the Mutual Assessment Process (MAP).

But it would seem to make sense not to put this policy work center stage into the French G-20 summit this fall unless there appears to be new convergent views on a feasible concerted political deal among G-20 countries. In 2010, the G-20 finance ministers' meeting in Gyeongju in late October spilled over into continuing discord in the G-20 leaders' summit in Seoul in mid-November, making G-20 leaders look as if they were not able to resolve matters and achieve consensus even though some technical progress was indeed made. There seems to be no point in repeating that scenario again. The situation is still more complex today and margins for incremental expansionary policies are thin. As a result, there is every reason to lower expectations on macroeconomic policy coordination for now and to perhaps bring other issues, including development, to the forefront of the leaders' summit in November. Finance ministers and central bank governors, with support from the IMF, may need another year or more before the MAP really yields results. Recognizing this reality should not imply abandoning the effort. In the longer run, macroeconomic policy coordination can indeed be a key benefit of the G-20 process but it is not the whole show, especially not continuously at the leaders' level.

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