

Rebalancing: China's Perspective

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- I. Global imbalance: assessments and flaws
- II. Policy choices: deficit countries vs. surplus countries
- III. China's perspectives

Background

- In the Seoul Summit, G20 leaders committed to “enhance the Mutual Assessment Process (MAP) to promote external sustainability and pursue the full range of policies conducive to reducing excessive imbalances and maintaining current account imbalances at sustainable levels”.
- The Framework Working Group asked the following questions:
 - (1) What economic/policy indicators could be used to facilitate the identification of large imbalances that require preventive and corrective actions (for example, current account imbalances, fiscal deficits etc.)?
 - (2) How would these indicators be assessed (e.g. against specific benchmark levels, such as fiscal deficits less than 3% of GDP, or against estimates of historical norms)?

Current account imbalance

- Current account balance is the most widely used indicator to identify trade and financial flows imbalances.
- Measured by Current account balance / GDP ratio, In 2009, countries with large current account imbalance include: Saudi Arab(6.2%),China (6.1%) ,Korea (5.1%), Germany(5.0%) and Russia(4.0%). In Q1 2010, countries still have large current account imbalances include: Russia(10.2%), Germany (5.2%), Italy (-4.8%)and Turkey (-6.3%) . From 2002-2008, the CA balance/ GDP ratio in the U.S was more than -4%, in 2009 it was -2.7% and in Q1 2010 -2.6%. EU as a whole do not have large CA imbalance, but Germany has large CA surplus and Italy has large CA deficit.
- After the American financial crisis, most G20 member countries lowered their CA balance/ GDP ratio.

Trade imbalance

- By definition, the current account balance is composed of the balance of trade, factor income and net transfers.
- If calculated by trade balance/GDP ratio, in 2009, countries with large trade imbalance include: Saudi Arab (11.2%), Russia (7.4%), Argentina (5.8%), Germany(4.9%), Korea(4.7%) and China (4.5%). No country has trade deficit/ GDP ratio exceed 4%. In Q1 2010, countries still had high trade imbalance include: Russia (12.8%), Germany (5.5%), and Turkey (-5.0%). In 2002-2008, U.S had a trade deficit/ GDP ratio exceed 4% and in 2009 it was -2.7%.
- Looking at the main components of the current account, great differences emerged among G20 member countries. For Germany, China and the US, trade balance is the major component in the evolution of their CA balances; but in Japan, Australia and Brazil, net factor income is more important.

National foreign trade imbalance

- The traditional international trade statistics system fails to capture the new change in international trade. In the MNC dominant world trading system with booming intra-industrial and intra-product trade, the traditional statistics may be misleading.
- UNCTAD proposed a new statistics system based on ownership of the companies. The National trade balance include one country's cross boundary trade flow, net direct investment income and net worker's income.
- From the perspective of national trade balance, the net asset the developed countries gained from international trade increased while the net asset the developing countries gained from trade decreased.
- Calculated by national trade balance/GDP ratio, in 2009 countries has large imbalance include: Saudi Arab (9.1%), Germany (5.4%), Russia (4.6%) and Korea (4.5%). China's national trade balance/GDP ratio (3.7%) is lower than its trade balance/GDP ratio and CA balance/GDP ratio.

Symptom or cause?

- It's difficult to identify the symptoms of global imbalance, and even more difficult to find the causes.
- The mainstream framework for analyzing current account balance is the intertemporal optimal model. Current account balance is the result of the optimal choice of one country's consumer and producer. For example, a country heading to the aged society tend to accumulate more foreign exchange reserve through trade surplus.
- Factors influencing consumption and investment behavior is quite complicated. And the importance of individual factor differs in each country.
- New international division of labor, international monetary system, exchange rate policy and monetary policy are also responsible for the mounting global imbalances.

Good imbalance and bad imbalance

- A useful framework to discuss the global imbalance is to divide it to “good” imbalance and “bad” imbalance (Balnchard and Milesi-Ferretti). Good imbalance reflects the differences in levels of development, demographic patterns, and other underlying economic fundamentals. Bad imbalance results from distortions, externalities, and risks, at the national and international level.
- The reason why we care about global imbalance is not trade surplus or deficits per se, but the policy distortions behinds the global imbalances. Eliminating these distortions will improve resource allocation and facilitating the functioning of international trade and financial system.
- A realistic goal for the MAP of G20 should be to avoid trade war and currency war, indentifying the potential risks in the world economy, and create consensus for policy coordination.

Policy options for deficit countries

- Strengthen the fiscal discipline of deficit countries. Some deficit countries adopted extremely expansionary fiscal policy after the financial crisis. It may help to stimulate the economy in the short term but with soaring fiscal deficits and mounting debt pressures, this is an unsustainable path. Huge fiscal deficits force these countries to implement loose monetary policy and lower interest rates, fostering capital volatility and contribute to the growth of international reserves.
- Reduce export restrictions. For reasons of hostile ideology or vested interest group, some deficit countries adopt a complicated system of export restrictions. For example, the Bureau of Industry and Security of Ministry of Commerce in the US listed 10 categories of regulated export products. A thorough assessment of these export restriction policy and a specific proposal on how to reduce these restrictions should be one major component of policies dealing with global imbalance.
- Strengthen the discipline of monetary policy, especially for countries issuing reserve currencies. The lax monetary policy of major developed countries has significant spill over effect on other countries, especially emerging markets. Without an effective monitoring of the monetary policy and international capital flows, financial crisis in emerging markets may suddenly erupt.

Policy options for surplus countries

- Exchange rate policy for surplus countries. If the exchange rate of surplus countries is kept undervalued for a long period of time, it will lead to distortion of resource allocation and cause welfare loss. The exchange rate of surplus countries should move towards the equilibrium level which reflects the demand and supply on the foreign exchange market.
- More radical structure reform in surplus countries. Establishing social safety network helps to reduce the precautionary saving. Further liberalizing service sector may increase domestic investment, and also improve the welfare of households. More competition should be encouraged in the service sector.

Smooth transformation

- Short term pain and long term gain. Solving the problem of global imbalance requires painstaking efforts and take a long period of time. G20 member countries will have to face up with the economic and social tensions when going through the transformation. A carefully designed policy package is key to successful structure reform. Supplementary policies like subsidies to the loser and disadvantage groups need also be considered.
- Autonomy and innovation of individual countries. A one size fit all proposal is not good for solving global imbalance. The situation in each countries differs, the economic development level, social safety network, policy measures and the effectiveness of policies varies. Developing countries need more time and room for maneuver.

China in the future

- China already announced the outline of the 12th Five Year Plan. The main theme of the new Five Year Plan is rebalancing.
- Rebalancing on the supply side: upgrading of the manufacturing sector; fostering new strategic industries; further developing the service sector.
- Rebalancing on the demand side: increasing the income of workers; strengthening social safety network; urbanization and the development of the middle and west areas.
- Backed to the normal track: China basically relies on domestic demand rather than external demand. Strong growth can be maintained for another 5-10 years.
- More tolerable on exchange rate reform. But slow progress on the reform of SOEs and liberalization of service sectors.