Global Trade Imbalances: Are They Sustainable?
Traditional and New Remedies

Mordechai E. Kreinin, Michigan State University
Michael G. Plummer, The Johns Hopkins Univ. SAIS-Bologna

Presentation to Doshisha University, March 2008

Problem

- There has been much debate regarding the sustainability of global commercial imbalances.
- It is intuitively clear that they are been revealed to be sustainable in the very short run but cannot be run forever.
- What are the risks that they cannot be sustained in medium term?
- And what can be done about it?

Contribution of Paper

- We consider the degree of the imbalance problem and how it might be resolved.
- Any solution will require both expenditure changing and switching policies.
- We argue that to facilitate adjustment, creditor countries (mainly in Asia) must agree to bear part of the burden.
- We show that exchange-rate cooperation in Asia must be an essential part of the solution.

Outline of Presentation

- I. Global Imbalances and the “Traditional”Approach”
- II. The “Ideal Solution”
- III. The Case for Exchange-rate Cooperation in Asia
- IV. Concluding Remarks

I. Global Imbalances and the “Traditional”Approach”

Global Imbalances and the “Traditional”Approach”

- Ever since the Keynes-Ohlin “transfer problem” debate, economists have grasped with difficulties of adjustments to payments imbalances.
- Today, the chief concern regards massive US current account deficits in the range of 5-6% of GDP in recent years.
- Other OECD countries have even higher deficits at present (e.g., Spain and Greece at almost 9% of GDP).

Global Imbalances and the "Traditional" Approach"

- But the sheer size of the US economy and its role in the global system have generated great concern in recent years. Massive swings in the dollar vis a vis key currencies have been described as a worrisome omen.
- On the creditor side, Germany has had a trade surplus on par with China over the past few years, but its surplus is offset within the EU, which has balanced trade.
- Oil-exporting countries have also been important creditors.

Global Imbalances and the "Traditional" Approach"

- However, by far the largest creditors have been in Asia, whose current account surpluses have been historically unprecedented (%GDP):
- Singapore (24 percent), Malaysia (14.3 percent), Hong Kong, China (10.9 percent), Taiwan (5.8 percent), and Japan (4.4 percent).
- The flip-side of these surpluses has been a massive build-up in reserves in Asia, beyond what is necessary or even healthy for these economies.

Global Imbalances and the "Traditional" Approach"

- The macroeconomics of sterilizing these interventions, coupled with major exchange rate swings and a delicate state of the global economy, point to a strong incentive for these countries to help engineer a "soft landing".

Global Imbalances and the "Traditional" Approach"

- Moreover, independent of the economics of current account imbalances, there is the question of *political* sustainability.
- While the US CA deficit is being financed, the politics of the deficits have bred protectionist sentiments in the US.
- Asia has bore the brunt of this tide (e.g., anti-dumping, accusations of ex-rate manipulation)...the Middle East does not present the same "bashing" opportunities as dynamic export economies like Asia.

Table 1:

US Trade Balances with Selected Partners, Years
(US$ Billions)

Country/ Region	1997	2000	2006	2007/10*
EU	-17.0	-58.7	-116.5	-89.2
NAFTA	-30.0	-76.5	-136.1	-114.9
China	-49.7	-83.8	-232.6	-213.5
Japan	-56.1	-81.6	-88.6	-69.1
OPEC	-18.5	-48.0	-105.3	-100.1
ASEAN**	-22.6	-39.4	-51.3	-40.3

Global Imbalances and the "Traditional" Approach"

- Are these imbalances sustainable?
- Literature does not reach a consensus on medium term:
- McKinsey Global Institute (2007): yes. Suggest it could even finance a deficit of $2.1 trillion by 2012 (!).
  a. But not sustainable forever.
  b. To bring down to 3% of GDP, need a 23 percent devaluation from Jan. 2007 levels.

Global Imbalances and the "Traditional"Approach

- Cline (2005) suggests a 28 percent REER depreciation for same result.
- Mckinnon and Schnabl (2006): more pessimistic; if foreign changes in absorption, inflation, and corresponding macro policies are taken into consideration, adjustment will be much more difficult.
- Obstfeld and Rogoff (2005): need 20 percent REER depreciation, depending on real-income effects.

II. The "Ideal Solution"

The "Ideal Solution"

- Because of the US$'s role as main reserve and intervention currency, one cannot envision the US engineering a depreciation without other countries allowing their currencies to appreciate.
- They can choose to run-reserves, which is costly in terms of higher domestic interest-rates, potential inflation, and the opportunity cost of holding reserves.

The "Ideal Solution"

- Or they can allow their currencies to appreciate. But in this case, they risk losing export markets, a key consideration given the Asian development "model".
- While the euro, British pound, and other non-Asian currencies currencies have risen significantly against the dollar (despite lack of significant CA surpluses), most Asian currencies have changed little; they appreciated over 2007 but only by 5 percent (til Nov).
- The Chinese yuan rose by 7 percent, despite heavy lobbying, threats, and forex reserves that reached $1.44 trillion end-2007 (almost double 3 years ago).

The "Ideal Solution"

- The paper stresses that the ideal arrangement would be a combination of expenditure switching and changing policies.
- This will require a *global* approach to managing the imbalances.
- Hence, Asian countries need to cooperate:

a. An incremental resolution to correcting imbalances is in their respective interests.

b. However, to reach such a solution, *regional* cooperation will be required (next section).

III. The Case for Exchange-rate Cooperation in Asia

The Case for Exchange-rate Cooperation in Asia

- Trade has been a key engine of growth in Asian economies, and goes a long way in explaining the success of the region.
- Competitiveness in foreign markets is, therefore, considered vital.
- Many of these countries have been losing out due to FTAs from which they are excluded.
- The last thing they want is the additional disadvantage of an uncompetitive exchange rate.

The Case for Exchange-rate Cooperation in Asia

- Empirically, Asian countries have been increasingly competing with each other in key export markets.
- Each willl be hesitant to let its currency appreciate unless the others follow.
- This is due in part to the new role of China in the region.
- ***Hence, to engineer a creditor appreciation, enhancement of monetary cooperation in Asia needs to be a goal.***

The Case for Exchange-rate Cooperation in Asia

- Despite the belief that the dollar's importance in the region has been waning, in fact it continues to play a key role in all exchange-rate regimes in East Asia (Kawai 2007).

Weights Placed on US Dollar in East Asian Exchange-rate Management (Kawai 2007)

	Jan. 1990/June 1991	Jan. 2005/April 2006
HK$	0.99	0.99
Skwon	1.01	0.66
Sing$	0.74	0.59
Tai$	0.89	0.80
Indo rup.	0.96	0.75
Mal$	0.91	0.97
Phil Peso	1.03	0.87
Thai Bt	0.96	0.69
CHN yuan	1.02	0.96
Cam Riel	0.52	0.86
Laos kip	0.40	0.51
VN dong	0.53	0.86

The Case for Exchange-rate Cooperation in Asia

- Two observations:

a. The weight placed on the dollar rose in several countries and more or less stayed the same in the others.

b. The range of weights tightend from 52-.99 pre-Crisis and .66-.99 of late.

The Case for Exchange-rate Cooperation in Asia

- Will strengthening monetary (and financial) cooperation be difficult in Asia?
- The theme has been studied extensively since the Asian Crisis. However, concrete steps in this direction have taken a back seat to movement in the real sector (e.g., FTAs).

The Case for Exchange-rate Cooperation in Asia

- Cooperation initiatives include:

a. Regional Economic Surveillance (ASEAN Surveillance , ASEAN+3 Economic Review and Policy Dialogue, Exec Meet of EA CBs, EMEAP)
b. Regional Reserve Pooling (Chiang Mai Initiative); recent proposals to multilateralize (AMF?)
c. Asian Bond Market Development (ABMI, ABF)

The Case for Exchange-rate Cooperation in Asia

- Studies evaluating the economics of closer monetary cooperation (e.g., Kawai 2007, Kwan 2001, Bayoumi and Eichengreen 2001, McKinnon 2005) based on the usual OCA criteria have been positive.

The Case for Exchange-rate Cooperation in Asia

- What has been missing is the political will to push forward closer cooperation.
- We would suggest that the need to foster smooth adjustment to international imbalances adds another incentive to do so.

The Case for Exchange-rate Cooperation in Asia

- Finally, we note that with closer monetary cooperation, there will be a need for closer macroeconomic cooperation in the region. Is THIS possible?
- Certain regional institutions are deepening in the region that could facilitation this (e.g., AEC).
- Besides, perhaps it would not be too difficult. If, for example, we used the Maastricht criteria for Asia, the countries would generally fare better than the EU did prior to monetary union.

Divergence of ASEAN Macroeconomic Indicators

	Public Sector Debt (% of GDP) 1/	Fiscal Balance of Central Government (% of GDP)	Inflation Rate (%)	Interest Rate (%) 2/
Japan	...	-5,2	-0,3	0,1
People's Republic of China	19,2	-1,6	1,8	2,5
NIEs-3				
Hong Kong, China	...	0,3	1,1	3,2
Republic of Korea	22,0	0,8	2,7	3,7
Taipei,China	30,3	-1,0	2,3	1,5
ASEAN				
Brunei Darussalam	...	...	0.9 3/	...
Cambodia	...	-3,1	5,8	...
Indonesia	58,3	-0,5	10,5	10,3
Lao PDR	...	-6,0	7,2	...
Malaysia	68,9	-3,8	3	2,9
Myanmar	...	-6.0 3/	4.5 3/	...
Philippines	101,3	-2,7	7,6	7,0
Singapore	...	8,0	0,4	2,3
Thailand	49,4	0,1	4,5	3,3
Viet Nam	40,8	-2,3	8,3	...

The Case for Exchange-rate Cooperation in Asia

- Of course, in addition to numerical indicators, Asian countries would also have to have institutional indicators, given the diversity of development in the region.
- Still, doing this based on the principles of best practices is a goal of all Asian countries.

IV. Concluding Remarks

Concluding Remarks

- There is no consensus on the sustainability of US current account imbalances in the short- and even medium run. They cannot be sustained indefinitely, however, so adjustment is in order. Sooner, the better.
- Effective management of the problem will require expenditure-switching and changing policies.
- To do this, there will have to be cooperation from deficit and surplus countries.

Concluding Remarks

- In this paper, we argue that in order to do this, closer macroeconomic/exchange-rate cooperation in Asia may be necessary, or at least will facilitate the process.
- We show that, while there has been arguably little in terms of concrete progress in this regard to date, the economic and, increasingly, political prospects for closer cooperation are good.

Thank You!