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"Global Economic Imbalances"

- A need for Global Governance beyond the G-8? –

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Background: The German G-8 Presidency had planned to bring back the G-8 meeting to its original focus: discussing and possibly solving global economic imbalances. In February 2007, the Friedrich-Ebert-Stiftung (FES), the Initiative of Policy Dialogue and erlassjahr.de invited scholars and practitioners to a "Shadow G-8" meeting in New York. The findings and recommendations of the "Shadow G-8" were published as FES Occasional Paper in May 2007. Against this background, the FES organized a symposium parallel to the official G-8 summit discussing key issues of the "Shadow G-8" and contrasting these issues to the official agenda. This report summarizes the main discussion of the symposium. While there was consensus about the growing risks of global economic imbalances, different viewpoints about reasons and policy responses were offered. Most participants agreed that the global economic governance architecture needs to be reshaped. However, no first-best solution was found by the symposium In February 2007, the Friedrich-Ebert-Stiftung (FES), the Initiative of Policy Dialogue and erlassjahr.de invited scholars and practitioners to a "Shadow G-8" meeting in New York. The findings and recommendations of the "Shadow G-8" were published as FES Occasional Paper No. 31 in May 2007. Professors Joseph Stiglitz and Stephany Griffith-Jones summarize the identified major issues facing the world today, i.e. global economic imbalances, climate change and promoting development. Participants of the "Shadow G-8" agreed that the G-8 is no longer the appropriate forum to tackle all these problems effectively.

Against this background, the FES organized a follow-up symposium in Berlin parallel to the official G-8 summit to discuss key issues of the "Shadow G-8". The symposium centred around the question of how to rebalance global economic imbalances and provide prospects for a reform of global economic governance structures. In view, three sessions offered perspectives from the North and the South First, causes and consequences of global economic imbalances were mapped. Second, appropriate policy responses by the G-8 were identified, and third, proposals for reshaping the global economic governance architecture were discussed. The following report summarizes the main discussion and contrasts it with the official G-8 Summit Declaration.

1 Global Economic Imbalances as a Threat to Global Stability

In contrast to some policy-oriented workshops, where like-minded people come together to discuss ideas they already share, this symposium gathered scholars and policy makers from different geographic, academic and ideological backgrounds. Consequently, a diversity of opinions prevailed during the symposium and a general consensus was reached on a few issues only. All participants, however, agreed upon a starting point for the symposium: the rapid growth of the world economy rests on global macroeconomic imbalances. The threat to global stability was identified in the first panel by describing the well-known current account imbalances and the corresponding capital flows: The current account deficit of the US reached $857 billion in 2006 (6.5% of GDP), while China's surplus was estimated at $184 billion (7.2% of GDP). The rest of the world, especially Asian and oil exporting countries are financing the high consumption levels in the US, which is not efficient given the fact that the return on investment should be higher in capital-scarce developing countries. Moreover, the destabilizing effects of volatile financial flows, commanded by hedge funds and similar institutions, were regarded by several participants as a reason for concern. Hedge fund assets grew fivefold between 1999 and 2007 and are estimated at $1.6 trillion today. Overall, most participants agreed with the assessment of the current situation offered by Joseph Stiglitz: "There is a non-insignificant probability that there will, in the foreseeable future, be a disorderly and costly global economic adjustment."

However, there was no consensus about the concrete degree of the "non-insignificant probability of an adjustment", about the ones to blame for the imbalances, and about the prime losers following a disorderly adjustment. It is, of course, dangerous for scholars to come up with clear predictions in an unclear situation. Therefore, it was not surprising that participants did not offer probabilities about the sustainability of the global economic imbalances. The US current account deficit, for example, is by no means a new phenomenon and in so far not necessarily an indicator for a dooming crisis. Although the huge accumulation of foreign reserves by Asian countries, especially by China, is a rather recent consequence of the Asian financial crisis of 1997/98, it is difficult to predict how far the reserves will effectively bolster a possible adjustment in the future. Participants agreed that numerous actors are responsible for the imbalances. But while some stressed the United States is primarily responsible, others clearly hinted at China for its aggressive export promotion supported by a supposedly undervalued Renminbi. Some participants called for a stronger differentiation between economic actors within the countries. This political economy perspective would be necessary to analyze the incentives for policy makers to take measures for a "soft adjustment". Some participants formulated the idea that important economic interests work against policy adjustments: consumers in the US want to maintain high consumption levels thus resisting a fiscal policy change which would increase taxes; exporters in Asian countries want to secure profits and employment opportunities thus resisting an appreciation of their currencies; the finance industry lobbies their home governments (especially the US and the UK) to resist any further regulation of highly leveraged institutions. In case of a disorderly adjustment of the world economy, however, it was feared by many participants that the poor in developing countries will have to bear the lion's share of the adjustment costs.

The official G-8 declaration deviates from the diagnosis made by the Shadow G-8. Obviously, the G-8 place less weight on problems of global growth and stability as had originally been planned by the German presidency: only 6 out of 97 paragraphs deal with this issue. Nevertheless, the G-8 acknowledge the existing risks of global economic imbalances and see a need to tackle this. "We have agreed on a policy agenda to promote a smooth adjustment of global imbalances" [para 1]. However, the G-8 seem to be quite optimistic that a disorderly adjustment can be avoided. "Global imbalances have been showing some signs of stabilization more recently and deficits have been relatively easily financed" [para 5]. "The economic environment has developed in a direction which favors the adjustment of global imbalances" [para 3]. Probably, most participants of the Shadow G-8 are more sceptical in this regard. Moreover, the G-8 did not agree in regard to recent developments in global financial markets, especially hedge funds, as a major reason for concern. The heads of state simply "reaffirm the need to be vigilant" [para 7] but do not link the systemic questions of financial markets with global economic imbalances. In contrast, quite a few participants of the Shadow G-8 see the danger that a crisis of highly leveraged institutions will impact strongly on the real economy and possibly precipitate a crisis.

2 Appropriate Policy Responses for Stabilizing the World Economy

The second panel turned its attention to policies preventing global economic crisis and mitigating the effects for developing countries in case a crisis cannot be avoided. With regard to the first aspect, two well-known policy responses found widespread support: the US has to decrease its current account deficit, mainly by increasing savings and lowering consumption; Europe has to accelerate its growth. Both proposals are included in the official G-8 declaration as well. Other policy options were more controversial: While some participants agreed with the G-8 (and with mainstream economic thinking) that China (and Japan) should appreciate their currencies, others cautioned that this could make US deficits more difficult to fund and that a freely floating Renminbi could actually weaken. A Chinese participant argued in favour of different policy measures to increase domestic demand in China and announced that wages were increased significantly in May 2007. Neither was there a consensus about adequate policies in Europe to spur growth: Some argued for structural reforms, others favoured a loosening of monetary policy. In general, the question was raised if we need a new international financial system that does not rely exclusively on the dollar for providing liquidity and that prevents the equity problem that developing countries finance high consumption in the US. More discussions on this issue would be desirable.

The panel argued that transparency of hedge funds is essential. Speakers commented positively on the transparency initiative of the German government, following recommendations of the Financial Stability Forum. Only regulation could reduce the systemic risks and avoid speculation impacts on macroeconomic variables not linked to fundamentals. But while some optimists on the panel thought that a comprehensive regulation would be possible regardless of technical and political hurdles, several participants were quite sceptical about the political will of key players, especially the US and the UK. These governments are under pressure from their financial industries. At least in the short-run the sceptics have won. In the official G-8 agenda the German transparency initiative was watered down to two paragraphs that do not include any recommendations for binding rules to increase transparency.

Regarding the second aspect of policy actions, innovative financial instruments which could mitigate the effects of a possible crisis for developing countries were propagated. Developing countries should be supported to borrow in local currencies. With this end in view, international financial institutions like the World Bank or Regional Development Banks could guarantee local currency bonds or take other measures to deepen local capital markets. This proposal is shared by the G-8 and is explicitly mentioned in the Summit declaration [para 18]. Another attractive instrument could be GDP-related bonds since debt service would be linked to economic performance. Finally, the IMF should expand its contingent lending against external shocks without any further conditionalities.

In the discussion it was criticized that all policy options that had been proposed were geared towards macroeconomics. However, some of the most pressing problems of globalization were related to microeconomic issues, for example, distribution (winners and losers of globalization) and employment issues.

The question was raised if it was not naïve to assume that the heads of state and government have enough power to regulate the private sector in today's world. If the regulators are paid by the private sector, the politicians, even the G-8, do not have the necessary power to influence the private sector. In view of this, well-meaning policy proposals laid on the table of the G-8 are fruitless.

The role of foreign direct investment was discussed from different angles. It was suggested that developing countries should play an active role. He proposed that developing countries make themselves as attractive as possible for foreign capital to be ready for the moment when investors would like to redirect their investments from the US to other countries. On the other hand, it was mentioned that sovereign wealth funds from China and other Asian countries play an increasingly important role as vehicle for outward foreign direct investment. This tendency has repercussions in industrialized countries since some politicians have voiced their concern about a sale of core industries to the newly industrializing powers. Notwithstanding this populist debate, the G-8 commit themselves to "work together to strengthen open and transparent investment regimes and to fight against tendencies to restrict them" [para 10]. It remains to be seen if policy makers in the G-8 will really fight against investment restrictions for sovereign wealth funds from Asia.

3 How to Reshape the Global Economic Governance Architecture

T Debates were even more controversial with respect to the third subject of the symposium: Which institutional consequences can be drawn from the analysis of the global economic imbalances? Most contributions concentrated on the future role and about possible reform options of the G-8. However, several participants warned not to overestimate the importance of the G-8 in the global governance system. A participant from the German government stressed the informal character of the G-8 which prevents members to take binding decisions. The G-8 primarily serves as a forum where industrialized countries can form a common position on certain subjects of relevance to them.

Most participants agreed that the G-8 is a like-minded club and that it is legitimate for G-8 members to meet each other (just like any other group of countries can enjoy the freedom of association). However, different viewpoints persisted about the criteria which make up this like-minded group. Historically, the members have been the seven economic heavyweights of the world (a rich man's club). Today, defenders of the G-8 add another common feature by stating that the G-8 share the same values, i.e. democracy, respect for human rights, freedom of the press and rule of law. Moreover, the G-8 were said to be interested in global welfare. These criteria would prevent some of the new economic powerhouses of the world to enter the club. This assessment was countered by the perception of Southern participants who questioned the high moral ground of the G-8. One participant regarded the dominant common "value" of the G-8 the imperialist past, which still impacts the policies of the G-8 towards Africa today.

But even if one excludes the controversial issue of shared values, tectonic changes in the global economic landscape show a need for reform. Today, China, Brazil and India rank among the ten largest economies in the world (the concrete rank depends on measurement issues, i.e. if one uses official exchange rates or purchasing power parities). In fact, it is quite obvious that for solving problems of global economic relevance, the current G-8 forum is not adequate. Most, if not all participants, saw the need for changes in the global economic architecture, though not necessarily in the G-8.

During the Shadow G-8 it became evident that most G-8 members oppose expanding the G-8, and it is even far from clear if emerging economies would like to be part of the G-8. A Chinese participant made his view clear that the Chinese government is not interested in joining the G-8: "If China can make a deal with the US, it does not need the G-8." But China does not only qualify the importance of the G-8, it sees trade-offs of a possible membership: "China is reluctant to join the G-8 because it would lose 100 friends all over the world." Similar points were raised by Brazilian and Indian participants.

A reform perspective for the G-8 has to answer the question which function a reformed G-8 would perform. If the G-8 should refrain itself to formulate a common position on certain global issues, then there is no great need for reform. But if one wants the G-8 to be able to take action on global issues, then legitimacy and efficiency problems arise. Legitimacy requires some sort of representativeness and inclusiveness which is not easy to achieve in a polarized and pluralistic world as long as one wants to restrict the forum to a maximum number of members. This, on the other hand, was widely regarded as necessary since experience has shown that only smaller groups are manageable and efficient. Participants proposed different options for a reformed G-8 ranging from G-8 plus 5 to G-29. All proposals had their advantages and disadvantages, therefore, the participants agreed that there is no first-best solution for a reformed G-8.

There was consensus at the Shadow G-8 that the world needs a legitimate and efficient forum to deal with global economic imbalances. Moreover, there was broad agreement that the existing G-8 will not be able to deal effectively with important global problems simply because important players are not on board. "No reform at all" is therefore not a viable option. However, it remained an open question which forum is best positioned to fulfil the function of dealing with global problems: an incrementally reformed G-8, reformed existing multilateral organizations (especially the IMF) or new institutions that still have to be created.

Several participants took the view that Europe does not really play a very constructive role in the reform process. Europe was regarded by some as "complacent", as if it does not hear the ring of the bell. It is clearly overrepresented in the existing institutions that deal with global economic issues and still defends this position regardless of its declining economic weight in the world. A single European chair in multilateral institutions was favored by some participants, although others countered that this will not happen in the foreseeable future since every single European country wants to maintain its status.

The official G-8 summit included meetings with African heads of state and government to deal with development issues and with the so-called "Outreach-Countries" (China, India, Brazil, Mexico, South Africa – "O-5") to discuss global problems, particularly climate change. With the latter group the G-8 agreed upon the "Heiligendamm Process" which is a form of structured dialogue between G-8 and O-5 member countries. The Heiligendamm process will consist of a "topic-driven Dialogue in a structured manner based on this new partnership" [para 96]. Four topics will be addressed: innovation, investment (including corporate social responsibility), development with special regard to Africa, and energy efficiency. The OECD will provide a platform for the Heiligendamm process.

In the light of the viewpoints offered during the Shadow G-8, the Heiligendamm process is only a minor step in the right direction. It follows the logic of incrementally integrating major emerging economies into a framework which is based on the principles of "the old world". Nevertheless, given the problems to find common ground for a reform perspective during the Shadow G-8, it has to be admitted that it was not easy to find an institutional solution to the problem of dealing with global economic problems. Or, as one participant stated during the symposium: "If not even we, who do not have any economic interests, can agree upon the most important issues and questions, how can we expect politicians to achieve this?".

4 Outlook

The symposium ended without consensus on most issues. Nevertheless, participants shared a sense of urgency. Policy reforms and institutional amendments need to happen sooner than later. It is therefore important to organize more discussions on these topics and to maintain the momentum for reform which the public debate around the G-8 summit has created.

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