

VIEWPOINT

The global economy needs to become less reliant on Chinese exports and American consumers – but as Erik Jones argues, addressing the imbalances within the eurozone itself is an equally pressing and difficult challenge

TILTING THE BALANCE

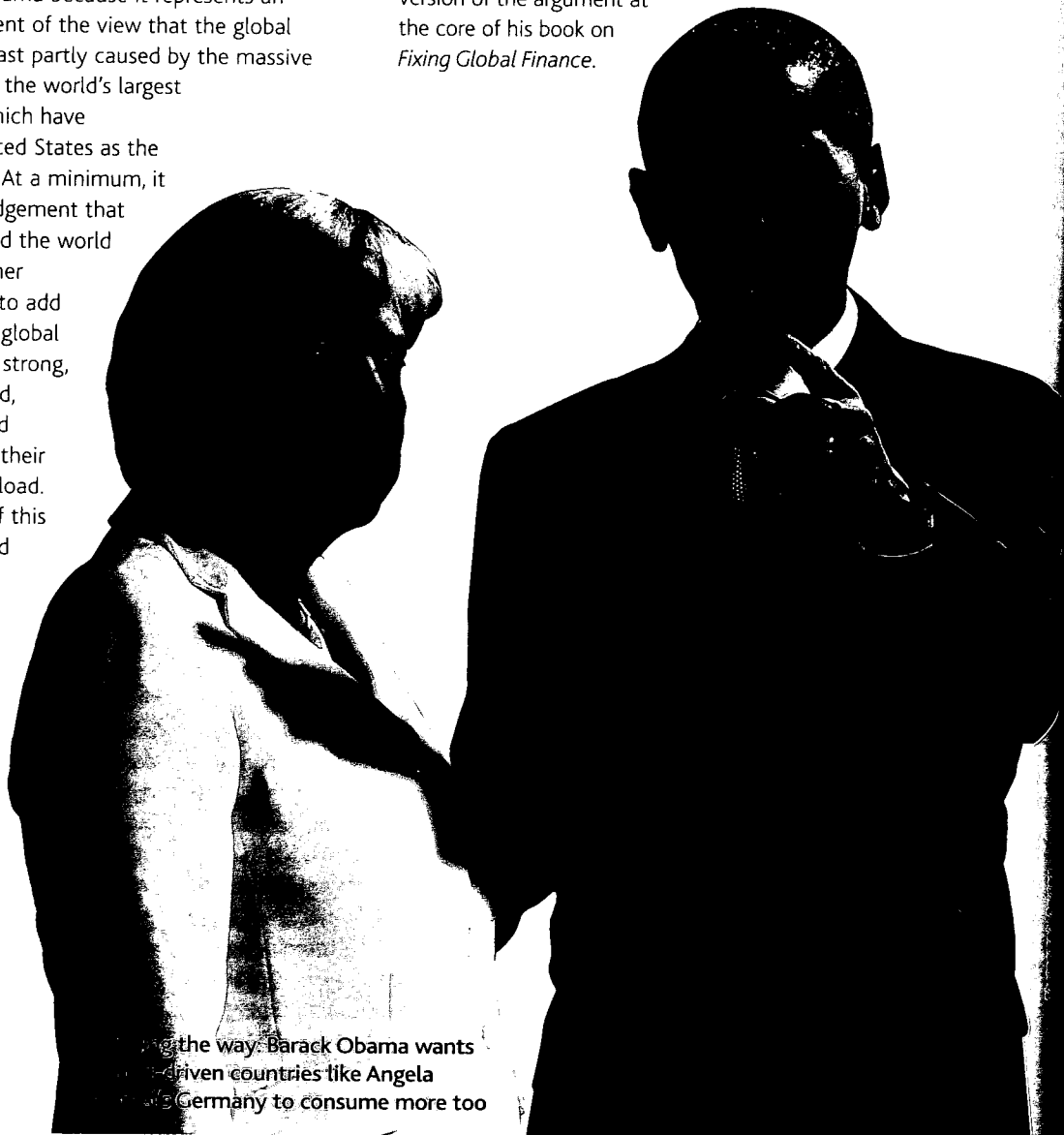
The commitment by the G20 to promote "a framework for strong, sustainable, and balanced growth" is both a victory for the administration of US President Barack Obama and a mixed blessing for Europe.

It is a victory for Obama because it represents an international endorsement of the view that the global financial crisis was at least partly caused by the massive outflow of savings from the world's largest net-export countries, which have depended upon the United States as the consumer of last resort. At a minimum, it represents an acknowledgement that the US alone cannot lead the world to recovery and that other countries will also have to add their weight to increase global demand. Growth will be strong, sustainable, and balanced, because China, Japan and Germany will be pulling their respective shares of the load.

Global acceptance of this commitment to balanced growth was not easily won, for the bias that says net exports are good and net imports are bad is strongly rooted. Before the crisis, it went without saying that the US was to blame for what were then called "global macroeconomic imbalances" as the insatiable demand of American consumers fuelled their country's ever larger current account deficits.

Nevertheless, an

impressive combination of commentary, analysis, and political pressure won the day. *Financial Times* Chief Economist Martin Wolf has been making the case for rebalancing global demand for much of the past two years and he presents an extended version of the argument at the core of his book on *Fixing Global Finance*.



...ing the way: Barack Obama wants to drive driven countries like Angela Merkel and Germany to consume more too

Four of the past five issues of *Foreign Affairs* include articles making similar claims and Olivier Blanchard, research director at the International Monetary Fund (IMF) lent his own weight to the charge in the September issue of *Finance and Development*. When the G20 finance ministers had their preparatory meeting on September 5, US Treasury Secretary Timothy Geithner insisted that strengthened "domestic demand-led growth" is a "global imperative"; by contrast, issues related to bank executive compensation and financial regulation run "alongside".

This new emphasis on balanced growth is a mixed blessing for Europe because it presents a direct challenge to Germany's reliance on exports and an implicit indictment of Europe's economic and monetary union. The challenge is easy to interpret and widely known: so long as Germany relies on export-led growth, it cannot lead Europe to recovery and will remain reliant on market conditions elsewhere.

For German Chancellor Angela Merkel, this is a necessary dependence; she cannot sustain deficits in the public sector and neither can she get the German consumer to pick up the slack. Export competitiveness is the lifeblood of the German economy and always has been. Hence Merkel ridiculed the notion of rebalanced growth as an *Ersatz*, or secondary issue before the summit and ensured that any commitment would make reference to the need for "structural reforms" after the fact.

The implicit indictment of Europe's single currency can be seen in Merkel's attempts to deflect attention away from German net exports and onto Europe's monetary union as a whole: Germany may run impressive surpluses, but the eurozone does not. At the moment, in fact, the eurozone is slightly in deficit – and so contributing to net demand at the global level. The worrying part is that German surpluses are offset by Greek, Spanish and Portuguese deficits. And since Germany is wealthier than any of its southern neighbours, their deficits are much more impressive as a percentage of income. When Germany ran a surplus worth 6.4 percent of GDP in 2008, Greece, Spain and Portugal ran deficits equal to 14.4, 12.0, and 9.6 percent of GDP respectively.

The implications of these deficits are not immediately obvious. None of the southern countries has its own currency and so none faces the prospect of a currency crisis. Indeed, they would never have been able to sustain such large current account deficits were that not the case; that is why the IMF was called in for Hungary and Latvia but not for Portugal or Greece. The introduction of the euro has released these countries from any short-term current account or balance of payments constraint.

That does not mean, however, that they do not suffer any consequences from their dependence on net imports or from the inflow of capital that comes in their wake. Just as the Obama administration argues that the United States suffered a housing bubble and financial collapse due to the incoming flood of savings from the rest of the world, so persistent current account deficits are likely to have distorted housing markets in the EU's southern members. Indeed, research published in 2008 by Joshua Aizenman and Yothin Jinjarak with the US National Bureau for Economic Research suggests

that "the economic importance of current account variations in accounting for real estate valuation exceeds that of other variables, including the real interest rate and inflation."

More balanced growth would lower German export surpluses as well as Greek, Spanish and Portuguese deficits. This may be a challenge for German policymakers, but it would ease distortions in southern real estate markets that have long complicated monetary policymaking for the eurozone as a whole. Hence it is unsurprising that European Central Bank President Jean-Claude Trichet welcomed the commitment to balanced growth at the G20 summit and went further to acknowledge that macro-economic imbalances "lay at the root of the current difficulties". Monetary policymaking only stands to benefit as a result and if it

should come along with a healthy dose of much-needed structural reform (as Merkel desires), all the better.

The question is: how do we get there from here?

Europe has a mixed message to offer in return. The Obama administration has pushed for the G20 to become the new forum for economic policy coordination, with the IMF restructured to play a substantial supporting and analytic role. The G20 participants will meet twice-yearly until the end of the crisis and annually thereafter to discuss their shared objectives and to ensure that each acts responsibly in working toward a common goal.

This design is not so different from the early incarnation of the EU's multilateral surveillance procedure, albeit without a clear statement of "broad economic policy guidelines". It offers a forum for naming, faming and shaming those who deviate from overall balance but no real mechanism for enforcing the common will. If European experience is any guide, the results will be uneven at best. Those leaders who seek international pressure to pursue unpopular agendas at home will find their scapegoat; those who resent any interference will keep their distance.

The Obama administration won a victory with the international commitment to balanced and sustainable growth, but it is far from self-evident that a new global equilibrium will be the result. China has already demonstrated its reluctance to change tack under US pressure and a newly re-elected Angela Merkel will be sure to reiterate her doubts as well.

Within Europe, the picture remains mixed. Even if it is not wholly welcome, the new emphasis on balanced growth could open an important discussion about the structural vulnerabilities of Europe's single currency and the requirements for successful economic governance. For too long, that discussion has been mired in debates about the EU's Stability and Growth Pact. Fiscal discipline is important, but savings and investment also matter.

As chronic current-account-deficit countries like Spain look ahead to a long and painful adjustment, it is important for those member states running substantial surpluses to begin talking about ways that they can help.

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