The persistence of global imbalances

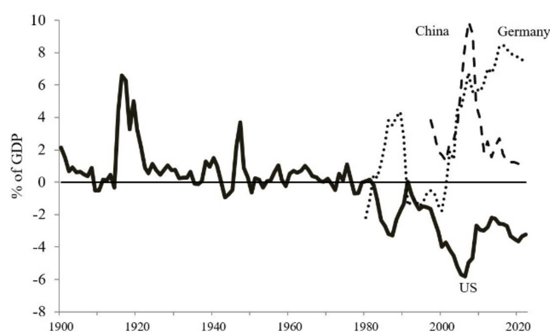
By Carmen Reinhart
August 30, 2017 – *Project Syndicate*

The primary focus of this year's Federal Reserve Bank of Kansas City symposium in Jackson Hole, Wyoming, which convenes the world's leading central bankers, was not explicitly monetary policy. Fed Chair Janet Yellen's opening remarks emphasized the changes in regulatory policy that followed the 2008 global financial crisis, while European Central Bank President Mario Draghi's luncheon address dwelled on the need for continued reforms in Europe to sustain the eurozone's recent economic recovery.

But it was global trade and finance – the key forces shaping the economic outlook and financial market conditions with which central bankers grapple – that took center stage. On the effects of the globalization of trade in goods and services, the discussion emphasized the costs to domestic employment, wages, and inequality. On the finance side, international capital flows and global imbalances were the primary focus.

And here, the old adage applies: the more things change, the more they stay the same. For most of the last four decades, the United States has been a net importer of capital from the rest of the world.

Current Account Balances, Actual and Forecast (2017-2022): US, China, and Germany (% of GDP)



Sources: Historical Statistics of the United States, Economic Report of the President, IMF World Economic Outlook.

From the start of the previous century until the early 1980s, the US seldom recorded a deficit on its external current account (see chart). The current account reflects an economy's saving-investment balance. When saving exceeds investment, the result is a current-account surplus, and the economy becomes a lender to the rest of the world. After it emerged as a world power at the end of World War I, the US became a net supplier of capital to the rest of the world.

In 1987, the economist C. Fred Bergsten was among the first to point out that global imbalances had begun to climb toward uncharted territory. "The United States, the creator of the postwar economic system and home of the world's key currency," he wrote, "has become the largest debtor nation ever known to mankind – and its red ink will continue to flow at least into the 1990s. Japan, widely viewed as a developing country only a generation ago, has become by far the largest creditor – and its massive buildup of foreign assets will continue expanding rapidly as far ahead as one can predict."

Japan was singled out as a particular culprit of the soaring global imbalances, because its current-account surplus topped 4% of its GDP in 1986, while the Bank of Japan amassed record levels of US Treasury securities. Japan adopted "voluntary" caps on some exports to the US and, under the Plaza Accord of late 1985, helped orchestrate yen revaluation relative to the dollar.

At the end of the 1980s, however, the yen strengthened, Japanese asset bubbles in real estate and equities burst, and Japan's growth rate plummeted. At around the same time, South Korea temporarily emerged as a key culprit behind the US trade deficit. In 1987-1988, South Korea's current-account surplus

climbed above 6% of GDP, with currency manipulation often cited for the rise in external saving.

The same charge has dogged China, which, with its spectacular export-led growth, record official purchases of US assets, and fixed (or semi-fixed) exchange rate, today continues to dominate discussion of global imbalances. And, indeed, there is some evidence to support claims that currency manipulation and unfair trading practices have been key drivers, at least over some sub-periods.

But China's current-account surplus has been shrinking faster than the International Monetary Fund and many forecasters had anticipated. After climbing to almost 10% of GDP during 2006-2008, the external surplus currently is oscillating in the 1-2% range. Furthermore, despite some moderation in the first quarter of this year, private capital flight from China continues.

Enter Germany. As China's current-account surplus shrinks, Germany's is climbing to record levels (see chart). US President Donald Trump's suggestion that these surpluses are a byproduct of unfair trade practices rings stridently hollow. As Germany does not have its own currency, it is also a stretch to suggest that it benefits from currency manipulation (though the ECB's quantitative easing policies have been cited in that context).

While Germany is singled out on account of its size, it is by no means unique among the advanced economies in maintaining a sizable external surplus. As of 2017, Austria, Denmark, Ireland, Japan, Luxembourg, Netherlands, Norway, Sweden, and Switzerland have substantial current-account surpluses, relative to their respective GDP. So do other Asian economies.

The US has run chronic current-account deficits for almost two generations. Pointing the finger at surplus countries is getting old. In the discussion at Jackson Hole, someone asked whether international pressure could be exerted on the surplus countries to spend more and save less. When the same question was put to the US in its era of surpluses at the end of World War II, when the concern was a global shortage of dollars, it was dismissed unequivocally.

The US has recorded external surpluses in only three of the 38 years since 1980. Tax policy has favored debt accumulation by households at the expense of saving, and a significant productivity slowdown is affecting US international competitiveness. As Ethan Ilzetzky, Kenneth Rogoff, and I document, because of the absence of alternatives, the dollar's status as the world's major reserve currency remains unchallenged, making it easy for the US to continue to finance current-account deficits. But the fact that it is easy does not make it a good idea.

Carmen Reinhart is Professor of the International Financial System at Harvard University's Kennedy School of Government.