FIJI TIMES

. Saturday, February 26, 2011

The Wolf and the Lamb: G 20 on Global Imbalances

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In the famous Aesop's fable, "The Wolf and the Lamb", the wild wolf standing upstream terrorizes the humble lamb drinking water downstream, by growling that it is muddying the waters. The lamb argues: "How can I muddy the stream up there, when I am here at the bottom of the stream?" The wolf does not care and pounces on the lamb.

That is an old story. In modern times, the lamb would dictate!

Ever since the American financial crisis started in mid 2007 with failure of financial sector institutions, which spread to Europe and engulfed the world with recession, the rich nations began to cover up their faults of excess lending and overspending and general greed, by claiming that recession was due to global imbalances.

China was accused of keeping the value of its currency deliberately low and accumulating trillions of dollars.

China's trade surplus is the eyesore.

Twin Deficits

The rich nations wanted China to up-value its currency and start shedding surpluses. That is correcting its "imbalance"!

The advanced countries knew that their ever increasing appetite for cheap overseas goods, fuelled by credit card oriented spending sprees and governments' own fiscal deficits landed them in a soup.

Trade imbalances are due to negative savings at both household levels and government level. Budget deficit and household deficits (in each case, current revenue or income is insufficient to cover expenditure or consumption), always led to trade imbalance.

Budget deficit and trade deficit are known as twin deficits.

One medicine for all ills

The so-called "Washington consensus", is the medicine for poor countries' ills. The International Monetary Fund (IMF)'s remedy is: "Keep the budget balanced; save more to reduce imports; and tighten your belt".

In our region, Samoa and Solomon Islands had undergone the IMF treatment under structural adjustment loan assistance. International aid agencies and bilateral governments never hesitate to dole out this medicine to Fiji as well.

Who will bell the cat? This medicine was never administered to USA. Currently IMF has forced this down the throat of smaller economies in Europe.

The placard carried by an Irish demonstrator in Dublin at a protest march had these words for IMF: IMPOSING MISERY FOREVER!

China has been financing US government deficits by investing its trade in US Treasuries and long term bonds.

The story is not different in the Euro zone.

Germany amassed trade surplus by exporting its goods to other members of the Euro zone. Aside from incurring trade deficits, budget deficits and government borrowing from overseas by the countries known as PIIGS (Portugal, Ireland, Italy, Greece and Spain) landed them in trouble.

When the rest of the world came to know that the PIIGS could not afford financing debt service charges, let alone pay back in euros, or in simple terms, when the rest of the world came to know that Emperor does not wear clothes", euro plunged!

Self-inflicted wounds

Can you blame others for your imbalances?

Last week in Paris, Government leaders of 20 nations (G20) reached a deal on indicators to detect economic imbalances.

A few years ago, it was G8, which used to meet and decide the future of the world economy.

After the recession, rich nations recognized the existence of other nations including emerging economies, led by China, the world's second largest economy. The club was enlarged.

Indicators of Imbalance

The G 20 leaders agreed on indicators. They include public debt, budget deficits, private debt, and savings rates.

These indicators are not new. Time and again we have been hearing about them,

The Maastricht Treaty of 1991 gave a concrete shape, when prescribing the indicators, as pre-requisites for joining the euro zone: (i) budget deficit should be below 3% of its GDP; (ii) public debt be less than 60% of GDP; (iii) an inflation rate within 1.5% of the three European Union countries with the lowest rate; and (iv) interest rates must be within 2% of the three lowest interest rates in EU;

Looking at decade old history of euro, these conditions were observed more in breach.

Tough Compromise

The French Finance Minister called it a tough compromise after "frank, sometimes tense" negotiations.

The G-20 had to go soft on China with regard to current account (trade in goods and services plus factor earnings) surplus. Current account will be an indicator but it will exclude the interest payments.

As China objected again two other measures were dropped: real effective exchange rate and the total value of a country's foreign reserves.

Now having agreed upon indicators, the next April 20 Meeting of G20 will determine the levels of indicators.

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