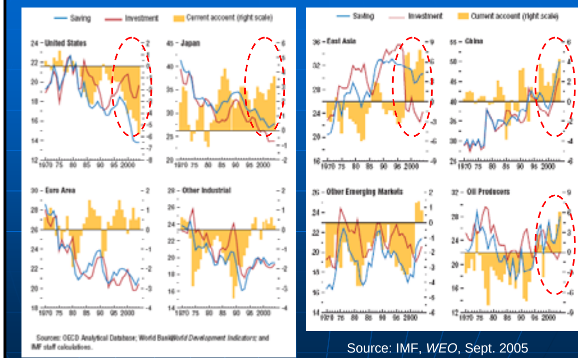
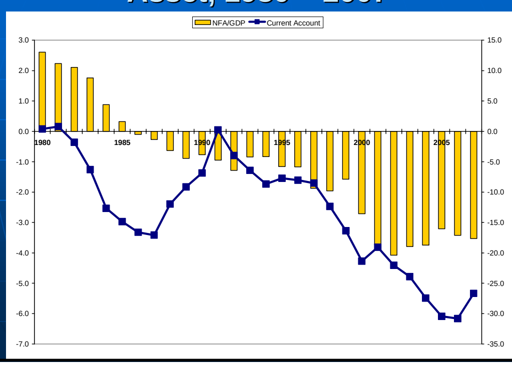
“Global Imbalances”



Source: IMF, *WEO*, Sept. 2005

orange bar – CA balance; blue line – nat’l saving; red line – investment

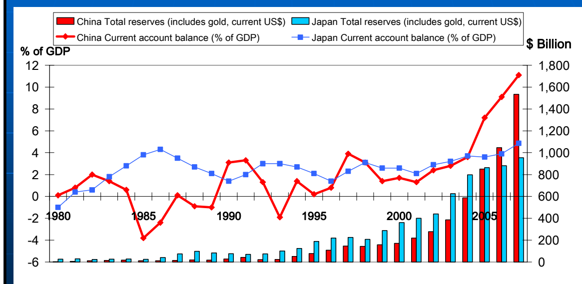
U.S. CAB and Net External Foreign Asset, 1980 – 2007



The debates on the sustainability of the global imbalances

- U.S. CAD is massive
  - $738.6 billion, 5.4% of US GDP (2007)
  - $2.4 trillion (17.6% of GDP, 2006) of net foreign debt
  - Raising questions of the sustainability
    - US$ depreciation, commodity inflation, oil shocks
    - K-flight from US capital markets?
    - U.S. protectionism?

CAB and IR Holdings of China and Japan, 1980 - 2007



The debates on the sustainability of the global imbalances

- CAS of emerging market countries is massive
  - China: $811 billion (est.), 11.1% of GDP (2007)
  - $1.8 trillion (as of the end of June '08; >50% of GDP) of international reserves
    - Growing at a rate of US$100m per hour
    - Could pay for about a year and half's worth of the country's imports
    - Five times of the country's foreign debt (as of end-2007)
  - Raising the question of the sustainability
    - Incomplete intervention creates excessive liquidity, high inflation
    - Low real interest rates feeding asset bubble?

Striking similarities b/w Japan during the early 1980s and China now

Japan in the early 1980s

- Japan's CA Surplus grew rapidly 0% in 1981 to 4% in 1985
- US CA deficit → 0% in 1981 to 3% in 1985
- Japan contributed 45% of US TBD in 1985

China in the 2000s

- Since 2000, China's exports quintupled
- In 2000, China became the largest contributor to the U.S. trade deficit
- CA Surplus grew rapidly after 2001
- In 2007, the U.S. trade deficit with China is $256 billion (32% of total), about triple of Japan's figure ($83 billion)

Similarities b/w Japan during the early 1980s and China now

U.S. reactions in the early 1980s and 2000s

- The White House – hesitant to appear protectionist
  - Initiatives taken to be a counterforce against Congress
    - Yen-dollar committee / Yuan-dollar committee
    - Structural Impediments Initiative / Strategic Economic Dialogue
- Congress – unhesitant to threaten protectionist measures

  <1980s>
  - A number of protectionist measures were implemented against Japanese exports
    - Gephardt resolution (1984) – 20% tariff on **Japanese** imports unless it corrects its "unfair trade practices"

Similarities b/w Japan during the early 1980s and China now

U.S. reactions in the early 1980s and 2000s

<2000s> – resurgence of protectionism in U.S. Congress

- Since 2003, about *three dozens* of bills have been created to challenge Chinese commercial practices
  - Schumer-Graham bill – 27.5% tariff on **Chinese** imports unless it corrects its "manipulative currency policy" → later withdrawn
  - Grassley-Baucus bill – require Treasury to work w/ IMF to fix the Yuan value → later withdrawn
  - Ryan-Hunter (House, 2007); Schumer-Grassley-Graham-Baucus (Senate, 2007); Dodd-Shelby (Senate, 2007); Davis-English (House, 2008)

Arguments against China in the 2000s

- China is the *biggest contributor* to U.S. CA deficit
- China *manipulates its currency value* and maintain it at *undervalued* values, so that it can keep *dumping exports* to U.S. markets
- China *needs to change its currency policy* and *revalue* the currency. Otherwise, it deserves some trade sanctions. Also,
- China's *financial markets are underdeveloped and closed. Therefore,* its enormous saving is not *recycled within the country (or the region), but keeps flowing to the U.S.* Therefore,
- China *needs to liberalize its financial markets*, so that
- China's *excessively high levels of saving* will come down and be effectively used locally.

Arguments against Japan in the early 1980s

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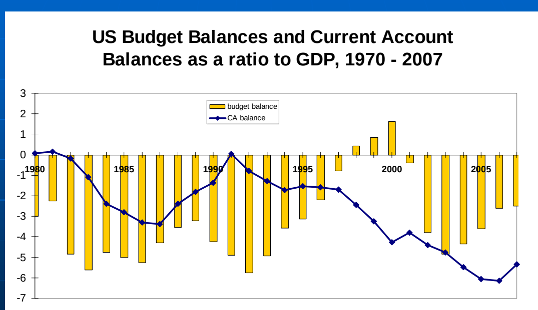
Another commonality



What is the main cause of US current account deficits?

- Saving glut hypothesis
  - Excess saving in China/East Asia (or Japan)
  - China (or Japan) spends too little and needs to invest more (education, infrastructure, etc.)
  - US comparative advantage in financial market development ⇔ Chinese (or Japanese) comparative disadvantage
- Twin deficit hypothesis
  - Public dissaving due to U.S. fiscal policy shift in 2001

Traditional "Twin Deficits" argument

- The main cause is US dissaving
  - i.e., public dissaving = gov't budget deficits since 2002
  - While corporate sector is saving recently, individuals and the public sector are big dissavers
  - Relatively good performance in equity and housing markets → dissaving factors

Those who run CA surpluses are to be blamed!

The "savings glut" argument

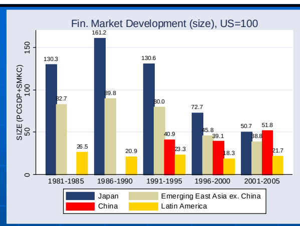
- "Asia, esp. China, saves too much!"
- The Asian region savings lead to CA surplus
- With closed financial markets, CA surplus = IR accumulates
- Heaving FOREX intervention => IR accum. more
- IRs were invested in US gov't bonds, contributing to lower long-term interest rates
- Therefore, the Asian savings fed the housing bubble, and allows the U.S. gov't to run budget deficits less costly

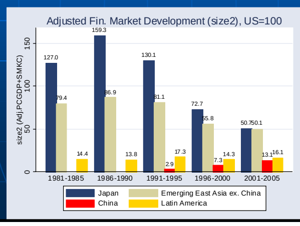
These two economies are so different after all

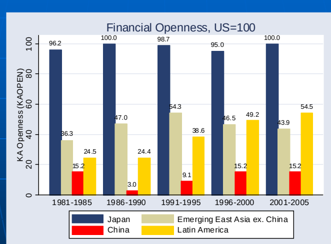
Table 1: Descriptive Statistics – U.S., China, Japan, and Emerging Market East Asian Economies in 1981-85 and

	United States		China		Japan		ex-China emerging Asia	
period	1981-85	2001-06	1981-85	2001-06	1981-85	2001-06	1981-85	2001-06
Per capita GDP in constant 2000 PPP	22,757.3	35,656.9	966.3	5,251.0	16,472.9	24,536.0	6,275.7	13,428.7
Ratio to the U.S.	100.0	100.0	4.2	14.7	72.5	68.8	27.6	37.6
GDP in constant 2000 PPP (billion)	5,322.1	10,428.0	990.6	6,795.1	1,964.6	3,130.9	269.6	819.2
Ratio to the U.S.	100.0	100.0	18.6	65.2	36.9	30.0	5.1	7.9
Output growth rates (%)	3.3	2.5	10.8	9.8	3.1	1.5	5.0	5.1
Current Account Balance (% of GDP)	-1.4	-5.1	0.2	4.5	1.9	3.3	-3.6	6.2
National Saving (% of GDP)	18.3	13.6	34.7	45.6	30.9	26.5	26.8	30.8
Investment (% of GDP)	20.1	18.6	35.0	41.2	29.5	23.4	29.7	23.9
Young dependency ratio (%)	32.8	31.6	51.8	32.4	33.1	21.1	57.7	39.8
Old dependency ratio (%)	17.3	18.4	7.9	10.6	14.4	28.4	6.9	9.9
Budget balance (%)	-4.3	-1.9	-0.4	-2.5	-3.2	-6.2	-2.7	-0.9
Private credit creation (% of GDP)	93.9	179.9	74.5*1	127.9	126.9	110.3	49.7	86.7
Stock Market Capitalization (% of GDP)	47.5	131.5	5.8*2	39.7	42.9	76.7	37.8	121.2
Stock Market Total Value (% of GDP)	19.2	211.0	8.0*2	35.3	19.5	77.8	7.6	77.3
Private Bond Market Cap. (% of GDP)	69.8*3	110.2	4.7*3	8.8	40.3*3	45.5	8.1*3	21.1
Public Bond Market Cap. (% of GDP)	52.1*3	44.0	3.9*3	15.9	45.6*3	121.4	17.4*3	28.4
Financial Openness*4	4.3	4.3	0.7	0.7	4.2	4.2	2.6	2.4
Trade openness (%)	18.2	25.2	23.0	59.1	27.2	24.5	75.3	172.

Notes: *1 – 1986 – 1990; *2 – 1991 – 1995; *3 – 1990. *4 – Financial openness is measured using the index on the openness of capital account







Differences in the Economic Structures

- China lags behind Japan in financial development and openness of financial systems
  - A large portion of financial intermediary is provided by public financial institutions
  - China is equipped w/ dysfunctional financial system, unlike Japan during the 1980s
- China is expected to move toward financial liberalization (esp. on K-outflows)

Empirical investigation

- Twin deficit vs. Saving glut
- What are the effects of financial development and financial opening
- What drives current account imbalances in the two episodes? Is it NS or I?