

GREEK DEBATE

Germany is unfit for the euro

By: Joerg Bibow
21.04.10

Portents of the Greek Rescue

By: Barry Eichengreen
15.04.10

Finally a deal, but I am still sceptical

By: Wolfgang Münchau
13.04.10

Why Greece will default

By: Wolfgang Münchau
07.04.10

Why an IMF solution is most likely

By: Laurence Boone
24.03.10

The Greek crisis and the future of the Eurozone

By: Paul De Grauwe
11.03.10

Greek Competitiveness Is Not the Issue, Fiscal Discipline Is

By: Erik Jones
04.03.10

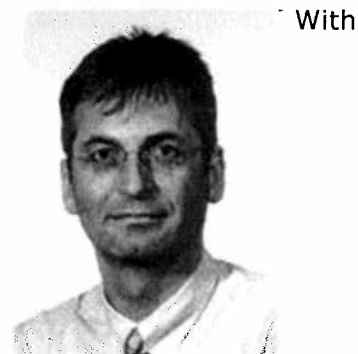
Europe in Dire Straits – don't be Brothers in Arms.

By: Henrik Enderlein
02.03.10

How should the Eurozone handle

23.01.2009
THE NEED FOR CONCERTED ACTION

By: Jörg Bibow



aggregate demand in the U.S. and global economies in free fall it may be time to reconsider the idea of sustainable global imbalances featuring a quasi-permanent U.S. current account deficit, as propagated by Dooley, Folkerts-Landau, and Garber in their influential "Bretton Woods (BW) II" hypothesis in 2003 (and as reconfirmed in Dooley et. al 2008).

According to the proponents of BWII, global current account imbalances reflected a symbiosis of interests among deficit (U.S.) and surplus (developing world) countries. The developing world's interest is to sell its products into the large U.S. market as a way of stimulating employment growth and development. The U.S. economy, on the other

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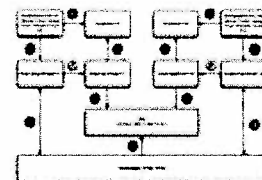
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EUROINTELLIGENCE BRIEFING NOTE



The Flaws of the Central Counter Party Idea

16.03.2011

By: Satyajit Das

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By: Wolfgang Münchau

16.02.10

hand, is flexible enough to tolerate the resulting quasi-permanent drag on U.S. income growth given its comparative advantage in creating safe assets, which provide the collateral for the FDI stock needed in the developing world to complement its vast cheap labor resources in export production.

To begin with, it was always curious that BWII completely neglected factors other than the supposed neo-mercantilist development strategy of prominent emerging-market economies, thereby assigning center stage to China in the BWII interpretation of the build-up of global imbalances. While China's current account surplus has surely reached gigantic dimensions in recent years, in 2003 it was still globally insignificant and of comparable size as Switzerland's at the time. By contrast, the origin of the U.S. current account deficit goes back to the early 1990s; with an earlier episode in the 1980s heralding things to come. As the International Monetary Fund vigilantly observed in 2002: "external imbalances across the main industrial country regions widened steadily during the 1990s, [imbalances being] dominated by the euro area and Japan" (IMF, World Economic Outlook, September 2002). In contrast to BWII, protracted domestic

no option



FINANCIAL
TIMES

16.03.2011

By: Wolfgang
Munchau

There are only two ways to resolve a debt crisis: through bail-out or through default.

GLOBAL ECONOMIC SYMPOSIUM

A repository of solutions to global problems

25.06.2010

For two years now, leading policy makers, academics and businessmen have been meeting for discussions in the Global Economic Symposium to provide concrete solutions for the most pressing global governance issues the world will be facing this century. Here is the result of these discussions: a repository of concrete policy proposals.

demand stagnation in Japan and Germany (spreading in Euroland) ever since the early 1990s may be singled out as a key contributing factor to the built-up of global imbalances during that time. Since 2005 oil-exporting countries provided another such factor ignored by BWII.

The particular point of disagreement with BWII I wish to emphasize is however another one. It concerns those "safe assets" the U.S. is supposedly well-equipped to produce. It is true that the developing world's official sectors have accumulated soaring amounts of U.S. Treasury securities in recent years, with an ever greater share of the outstanding stock of such securities ending up in their coffers. It is also noteworthy that their purchases of these safe assets were actually sourced both from running current account surpluses as well as accepting private net capital inflows. But an important oversight afflicts BWII in this regard that has proved rather critical to the sustainability of these arrangements. The point is that while the developing world may have largely hoarded safe assets, the assets that actually sponsored U.S. spending in excess of income growth are nowadays referred to as "toxic" assets. The vital oversight in BWII was that the domestic counterpart to the U.S.'s external deficit was

based not on (safe) public debts, but on (toxic) private debts, mortgage debt in particular. Skepticism regarding soaring household indebtedness and the implications for the solvency of lenders ended the party when underlying collateral values stopped rising in 2006.

Be that as it may, circumstances have surely changed fundamentally since then and one may contemplate here what the emerging global arrangements might look like even as the global economy is still struggling to overcome the current crisis. Arguably, the most important change concerns U.S. fiscal policy. Fiscal policy also played an important role in the 2001 recession, with a six-percent-of-GDP budgetary swing offsetting corporate retrenchment following the "dot-com" bust. But the conspicuous fact during that time was that private consumption held up so well. And that had a lot to do with the Federal Reserve's aggressive easing in the face of deflationary pressures in U.S. product and labor markets. Today critics blame these policies for creating the property market bubble and later bust. What these critics tend to overlook is that the Fed followed its dual mandate, which required it to stimulate domestic demand sufficiently, even as the rest

of the world was getting ever keener to export to the U.S. and accumulate U.S. dollar reserves with no end. Monetary policy stimulates domestic demand through interest rates and asset prices, supported - in normal circumstances - by credit institutions that thrive in an environment of rising asset prices. The so-called global saving glut was only a consequence of the Fed's successful following of its mandate. In case of failure the outcome would have been a global deflation.

And that is again a possible outcome today, only that traditional monetary policy has by now lost much of its effectiveness. Therefore fiscal policy is all the more important. The challenge is that in contrast to the 2001 slump this time round U.S. fiscal policy will have to offset a massive and simultaneous retrenchment of both U.S. households and corporations. The order of magnitude of this challenge may well exceed the mind-boggling numbers currently discussed for the coming fiscal stimulus package.

What are the global implications? Can a U.S. fiscal expansion reflate the global economy in a sustainable way? One implication is that the U.S. will enter a true "twin deficit" situation - very much in contrast to the 1990s. The U.S. budget

deficit is set to break all post-war records (perhaps reaching double-digit territory as a percent of GDP). At the same time the recent trend in the current account balance will likely reverse again and the deficit not shrink further. On the positive side, thanks to the slump in oil prices at least one of the above-mentioned contributing factors to soaring global imbalances is unlikely to reemerge any time soon. More relevant is the future evolution of the other two contributing factors, which will depend on the policy reactions in the developing world at large on the one hand, China in particular, and in the non-U.S. industrialized world on the other, Germany and Japan in particular.

As to the former, exchange rate trends up to this point have once again underlined how unsafe global finance is for developing countries, with a general flight for safety benefitting the U.S. dollar despite the fact that the U.S. is at the center of the global financial turmoil. These new experiences may well further strengthen the developing world's desire for "self-insurance" through reserve hoarding and reliance on export-led growth through competitive exchange rates ("neomercantilism"). As such this tendency would seem to make for a re-emergence of BWII-like arrangements, with

one important difference: the safe assets (i.e. U.S. Treasuries) accumulated by the developing world's official sectors would also be the very assets that actually sponsor U.S. spending in excess of income. To emphasize this vital point the new prospective global arrangements might be dubbed "BWIII".

In principle, BWIII might prove more sustainable than BWII as long as the credit standing of the U.S. Treasury is not in doubt and U.S. interest rates stay very low. Best of all interest on U.S. debts accumulated by foreigners should be zero, as in the case of dollar bills. For as long as foreigners are willing to hold barren pieces of paper with a dollar sign on them forever there is no sustainability issue at all. The question is whether this would really be a desirable outcome for all sides involved, a new symbiosis of interests as presumed by the proponents of BWII. Let me emphasize, then, that my outline of a new BWIII is not meant as a proposal, but to illustrate the conditions that need to be met for sustainability and to highlight the deficiencies in today's global monetary and financial order. Surely alternative, more efficient and equitable global arrangements are conceivable. (See my "Insuring against private capital flows: Is it worth the

premium? What are the alternatives?", Levy Economics Institute, Working Paper no. 553 (http://www.levy.org/pubs/wp_553.pdf).

The other requirements for the workability of BWIII are that U.S. fiscal expansion will actually succeed in largely offsetting the falloff in private U.S. spending and that other industrialized countries, foremost Germany and Japan, will get off their long-time habit of freeloading on export-led growth and finally stimulate domestic demand in their economies sufficiently. In contrast to China, which has announced a sizeable fiscal stimulus package that would make a real contribution to sustaining global growth, Japan and Germany (and Euroland at large) have so far proved reluctant in undertaking anything decisive. Nothing at all seems to come out of Japan. And what Germany has to offer, while surely welcome, is "too little, too late" (the recently agreed fiscal stimulus package of 50bn euros over this year and next amounts to merely one percent of German GDP per year).

In the absence of truly concerted action, the need for which is highlighted in the Levy Institute's latest Strategic Analysis of December 2008 ("Prospects for the U.S. and the world: a

crisis that conventional remedies cannot resolve" http://www.levy.org/pubs/sa_dec_08.pdf), freeloading by Japan and Germany (and Euroland at large) may be contained through exchange rate movements, but any global recovery under BWIII would be muted and global growth not re-attain the temporary briskness enjoyed under the unsustainable BWII any time soon.

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