

GLOBAL IMBALANCES, CRISIS AND THE LACK OF GLOBAL GOVERNANCE

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Abstract:

While briefly shrinking during the global crisis, global imbalances in trade and financial flows and their underlying systemic causes have not gone away. The current monetary non-order causes developing countries to adopt defensive strategies against fickle markets and allows developed countries to engage in beggar-thy-neighbour strategies, with a reliance on exports serving to offset their failure to manage domestic demand. Global imbalances are a symptom of existing systemic governance shortcomings. They can only be properly addressed by global governance reform and proper international policy coordination.

Key word: global imbalances, global crisis,. Gross domestic product (GDP)

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Since the Second World War, global merchandise trade has generally grown faster than global income, but the global crisis has left its mark on trade dynamics: Recovery in global trade remains unfinished and uneven, while the trend toward greater trade openness of economies came to a halt. The global crisis and uneven trade recovery have reinforced the ongoing shift in balance in the world economy, featuring the relative decline of developed countries and rise of developing countries. The shifting global balance is also visible in the changing distribution of exports by destination, marked by the rising importance of trade among developing countries.

Vast disparities in per capita income levels continue to exist around the world. The catching-up process of the developing world, which has broadened since 2003, received a boost since the global crisis as key developed countries have struggled to recover from it. These post-crisis developments are not fully benign, since the hesitant and fragile recovery in developed countries risks holding back or even undermining income growth in developing countries. The fast shifting balance in the world economy is reflected in the decline in the share of developed countries in global gross domestic product (GDP).

The gross domestic product (GDP) per capita level provides a rough summary indicator of the average living standard. Vast disparities in GDP per capital levels persist around the world. Average per capita incomes in developed countries exceed average per capita incomes in developing countries by a factor of nearly 11, and disparities are much starker still between the richest and poorest countries. While the income gap between developed and developing countries has declined in relative terms, it continues to widen in absolute terms, reaching \$35,700 in current dollars in 2010.

Convergence of living standards around the world requires that per capita incomes grow faster in poor countries than in rich ones. A comparison of the evolution of growth trends of real GDP thus indicates whether the poor are catching up with the rich or not. The global boom of 2003–2007 generally reversed trends in place in the prior two decades that saw per capita incomes in the developing countries of Africa, the Americas, Western Asia and Oceania (and transition economies the second half of this period) grow at very low or even negative rates.

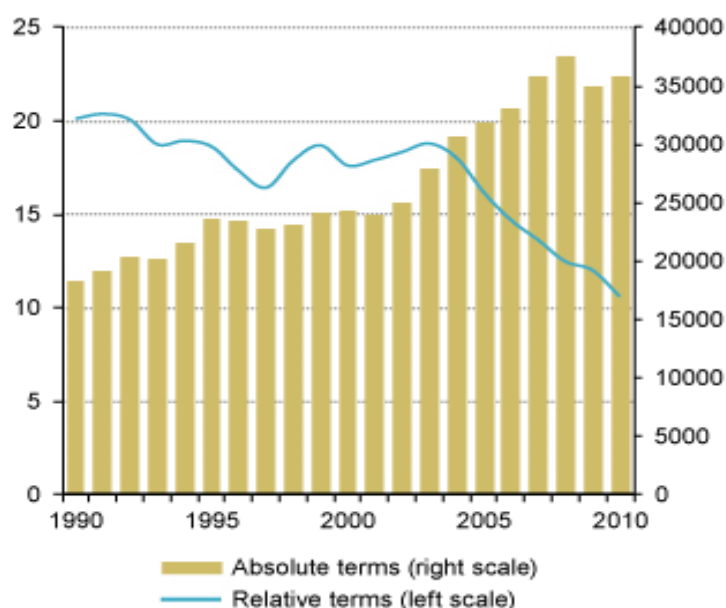


Figure 1 - Gap of gross domestic product per capita between developed and developing economies in absolute and relative terms 1990-2010 (Ratio and \$ per capita)

Source: www.unctad.org

In the last 20 years of the twentieth century only Eastern, Southern, and South-Eastern Asia had experienced catching up, and at a fast rate in their cases. Catching up has broadened since 2003 and may have accelerated further since the global crisis, albeit in a less benign way, since it is owing to a falling off in growth in developed countries that also risks holding back income growth in developing countries.

Table 1 Gross domestic product per capita by region, 1992-2010 (Percentage and \$)

Region	Real growth (%)		Nominal
	1992-2000	2000-2010	2010
World	1,7	1,67	9,178
Developing economies	3.0	4.6	3,703
Africa	0.7	2.7	1,676
America	1.4	2.3	8,558
Asia	4.3	5.9	3,508
Oceania	0.4	0.7	3,313
LDCs	1.8	4.8	0,737
Transition economies	1.7	5.8	6,989
Developed economies	2.3	1.0	39,445

Source: UNCTAD secretariat calculations, based on UNCTADstat

The global crisis severely affected economies around the globe. Its impact has proved more lasting in the case of key developed countries, however. Led by East Asia, developing countries at large have rebounded more vigorously from the global calamity. To begin with, not all developing countries had experienced the crisis as an absolute decline in income levels but as a slowdown in their rate of growth. Furthermore, only a small group of transition economies concentrated in Eastern Europe suffered grave declines in absolute income levels.

These economies also seem to find it similarly hard to recoup lost ground, as do the developed countries that were at the heart of the global crisis. Meanwhile, developing countries at large have not only regained and exceeded pre-crisis GDP levels, but also returned to their pre-crisis growth path. This contrasts with the situation in developed countries. Barely regaining their pre-crisis income levels, as a group, developed countries continue to operate well below their pre-crisis growth trajectory. The situation is most critical today in those European countries that share the euro.

The crisis has not changed the fact that the bulk of global income, as expressed by world GDP, remains in the hands of the developed countries, but their share has shrunk sharply from 70 per cent in 1980 to 64 per cent in 2010. The balance in the global economy is shifting fast.

While briefly shrinking during the global crisis, global imbalances in trade and financial flows and their underlying systemic causes have not gone away. The current monetary non-order causes developing countries to adopt defensive strategies against fickle markets and allows developed countries to engage in beggar-thy-neighbor strategies, with a reliance on exports serving to offset their failure to manage domestic demand. Global imbalances are a symptom of existing systemic governance shortcomings. They can only be properly addressed by global governance reform and proper international policy coordination. At the peak of the global crisis, G20 members managed to see eye to eye on the need for coordinated measures to generate a strong demand stimulus. Policymakers mostly agreed that deflation presented the greatest threat. That moment of unanimity in policy views has since passed. However, nothing is gained if cooperating countries agree on strategies for their respective countries that do not represent any departure from the policies that had led to the global imbalances in the first place. Significant policy adjustments have been made in developing countries, to the extent that some have again been pushed into precarious positions by speculative capital flows. Major obstacles to global rebalancing and sustained recovery reside in key developed countries or regions.

Persisting global imbalances indicate a failure of the G20 process of international cooperation. So far that process has fallen short of launching serious reforms of the international monetary and financial system.

Essentially, the world is missing an international monetary order allowing for both reasonable exchange rate stability as well as symmetric adjustment pressures on creditor and debtor countries alike. The lack of coherence between the multilateral trading system and the international monetary system has led to persistent current account imbalances. Combined with far-reaching financial deregulation and unfettered global finance, a highly unstable and hazardous global economic environment is nourished, in which democratic national governments are subject to market whim. Given systemic asymmetries in economic and political power, developing countries are particularly vulnerable.

UNCTAD's proposal of a multilateral agreement centered on a constant real exchange rate rule would directly address the systemic causes behind global imbalances. The proposed multilateral system of rules-based managed floating exchange rates aims at stabilizing real exchange rates at sustainable levels, so as to facilitate international trade and decision-making on fixed investment in the tradable sector, while forestalling destabilizing currency speculation. The proposed system requires symmetric obligations for currency market interventions by members and amounts to a dynamic version of the earlier Bretton Woods system of pegged but adjustable exchange rates. Instead of allowing discrete adjustments in the face of fundamental balance-of-payments disequilibrium, this alternative system aims at avoiding such disequilibria from arising in the first place, namely through continuous rules-based adjustments.

Rules-based adjustments of nominal exchange rates could follow either of two principles: adjustment according to changes in purchasing power parity; or adjustment according to uncovered interest parity. The first principle addresses more directly the need to avoid imbalances in trade flows, while the second is more directly related to avoiding imbalances in financial flows (i.e. destabilizing carry trade speculation). To the extent that differentials in official interest rates reflect differences in national inflation rates, which is largely the case (while inflation differentials, in turn, very closely correlated with trends in unit-labor costs), the two approaches lead to the same result.

It may seem paradoxical at first that the proposed monetary system should take the traditional theories of purchasing power parity and uncovered interest parity as its key guiding rules, given that these theories were found contradicted by the facts in the era of non-orderly floating exchange rates. Unfettered markets cannot be trusted to determine exchange rates that reflect fundamentals and allow balanced trade. Left to their own devices, currency markets lack an anchor, and exchange rates are rendered inherently restless, inviting destabilizing speculation. Policy intervention following the proposed rule would provide the needed anchor. Intervention by governments and central banks should not be seen as an exception to the rule of free markets, but rather, as a means of making the market function more efficiently.

Establishing a multilateral system of rules-based managed floating exchange rates should go hand in hand with re-regulating global finance, including financed commodities markets, with a view of safety and stability. Lack of coherence between the multilateral trading system and the international monetary system has led to persistent current account imbalances;

- International monetary non-order, financial deregulation and unfettered global finance make for an unstable and hazardous global economy – highly asymmetric for its lack of proper global governance;
- Crisis has accelerated the shift in economic balance toward emerging market economies while global rebalancing remains unresolved;
- Global financial reform and national re-regulatory initiatives remain unfinished business;
- The G20 process of international policy cooperation has failed to produce satisfactory results;
- UNCTAD's proposal of a multilateral agreement on exchange rates provides a solution to a pressing lack of global governance.

The global financial crisis provided a dramatic illustration of the risks of the global market. For developing countries it underlined their vulnerability not only to natural disasters and terms of trade shocks but also to a sudden economic collapse of the advanced industrial economies. The crisis will not induce developing countries to give up the opportunities for growth the global market provides; after all globalization and market capitalism were working well for them before the crisis and they recovered more quickly than the rich countries did from it.

The crisis may also mark an important watershed in whether and how the international community manages global challenges to its common welfare. In the new multi-polar world, there is less likelihood of the kind of change wrought after World War II, when, with the United States the unrivaled lead in the Western world, came the creation of the United Nations, the World Bank, the International Monetary Fund, and what became the World Trade Organization. The current crisis will be remembered as marking the end of Western economic dominance. With the creation of the G-20 replacing the G-8, China and other emerging markets now sit at the table of global collective action.

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