SOUTH CENTRE

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SOUTH CENTRE PROPOSES POLICIES TOWARDS SUSTAINABLE GLOBAL ECONOMIC RECOVERY

The South Centre has published a paper analysing current weaknesses and imbalances in the global economy and in the major countries. It also makes proposals on what needs to be done to achieve a global economic recovery

The paper **"Global economic prospects: The recession may be over but where next?"** is written by the Centre's Special Economic Advisor Yılmaz Akyüz (formerly Director of UNCTAD's Division on Globalisation and Development Strategies).

The paper throws interesting light on the global economic imbalances, the situation in the major countries, and what needs to be done, especially in terms of these countries' macro-economic policies.

According to the South Centre, the global economy is weak because there is insufficient effective demand globally, and this is a major obstacle to a sustained economic recovery. For the global economy to recover, there has to be a boost to global demand, while at the same time securing financial stability.The paper examines how the major economies – the United States, Germany, Japan and China – are contributing to global demand, what their weakness are and what policies they should take.

The following are among the paper's main points:

US has to adjust

- The US economy (with its problems of high household debt and trade deficit) has to adjust. It has to reduce its consumption while increasing exports while improving financial stability. But this adjustment may cause its own problems for many developing countries as it may result in increased interest rates (which is bad for indebted countries) and a higher dollar (exerting a downward pressure on currencies in developing countries in deficit, and on commodity prices).

Germany and Japan have to play a more positive global role

- In the debate on the global economy, attention has focused on the US-China relation, to the neglect of the role of Germany and Japan. These countries, like China, have been having large current account surpluses (7.5% of GDP in Germany and 4.8% in Japan, before the crisis). They also have large trade surpluses with the US ($50 billion for Germany and $75 billion for Japan).

The overall trade surplus of China (11% of GDP) and its trade surplus with the US ($270 billion) is higher. However the contribution of Japan and Germany to global demand and growth is much smaller than China's and their reliance on exports is much greater.

Firstly, the real domestic value of China's trade surplus with the US is actually lower than the gross figure because there are a lot of imported components in Chinese exports. Thus in 2005, the trade surplus of China with the US was $172 billion in conventional terms, but it was only $40 billion in value-added terms (the amount after deducting the import content of the exports of both counties).

In the same year Japan's surplus with the US was $85 billion. Since the foreign content of Japan's exports is lower than the foreign content of US exports, in value added terms Japan's surplus with the US turns out to be higher than China's surplus with the US.

Secondly, and more importantly, "Japan and particularly Germany have been siphoning global demand without adding much to global growth." During 2002-07, exports grew 25 times faster than domestic demand in Germany and 8.5 times in Japan while the figure is less than 3 for China.

While exports contributed 34% to GDP growth in China, they contributed 50% to Japan's GDP growth and 143% to Germany's growth in 2002-2007. In other words, even if there had been no export growth in China, the GDP would still have enjoyed high growth, but without export growth Germany's GDP would have fallen by about 1% a year during 2002-07.

- Under-consumption as a major problem in Germany and Japan. In Germany, there has been high unemployment and stagnant wages because of an over-focus on price stability. In both countries, the share of wages has fallen, thus suppressing consumption.

These two advanced countries need to increase their contribution to global demand (and thus to the global recovery) by expanding their domestic consumption through faster wage growth. Their increased domestic demand and higher growth is needed to spur more imports and reduce their trade surplus, which would contribute to other countries' exports and GDP growth.

China has to adjust by boosting domestic consumption…

- China, through its high growth and its reliance on both its own domestic demand and exports, has contributed relatively more than the two industrial countries to global growth, the report implies.

However, China obviously also needs to adjust. It cannot rely as much as previously on exports and it thus has to generate domestic demand through significantly increasing its consumption, whose share of GNP fell from 55% in the late 1990s to 36% at present.

Under-consumption is thus a major problem. Consumption has to grow faster than both national income and investment in China in the future. The significant fall in the share of wages would need to be reversed.

The report proposes suggests a combination of policies for China – promoting higher wages, elimination of the gap between wage and productivity growth, increased budgetary transfers especially to rural households, and increased public-sector social spending.

…. But China cannot be expected to be the new global growth engine

- However, even if China maintains its high GDP growth, it cannot be expected to become the locomotive for global growth. This is because there are a lot of imported inputs going into China's exports, whereas imports make up only 8% of China's domestic consumption.

Consequently, a $100 shift in the composition of aggregate demand from exports to domestic consumption would reduce Chinese imports by some $40. This has serious implications especially for South-east Asian countries which supply a lot of the parts and components to China for its exports.

The US-China currency rate is not the most important issue

- The report also comments on currency exchange-rates, an issue made topical by the high level of criticism of China's currency policy by the U.S. administration and Congress members, and the threat to take trade measures such as an import surcharge on Chinese goods.

The paper says that exchange rates is an important issue in the adjusting of global trade imbalances, but currency movements do not create additional demand for the global economy. They alter relative growth rates rather than raising the overall global growth.

Thus, currency movements cannot address the problem of global under-consumption associated with sluggish wages.

A depreciation of the dollar against the Chinese currency could reduce Chinese exports and its trade surplus with the US, but would not increase domestic demand and could even aggravate the under-consumption problem. Thus the exchange rate is not an appropriate instrument to address under-consumption problem and excessive reliance on exports in China.

- Dollar depreciation against the Chinese currency would also not address the root cause of the US problem of over-consumption. It is unlikely to produce significantly faster growth of exports to China. Even if it reduces China's exports to the US, this may be replaced by imports from other developing countries as long as US consumers continue to live beyond their means.

The US has run current account deficits in the past four decades regardless of the strength of the dollar against the currencies of its main trading partners, blaming Germany in the 1970s, Japan in the 1980s and now China. The yen has been rising against the dollar during this period but this had no impact on the surplus of Japan with the US.

- Thus, the paper concludes that: "The solution should be sought primarily in national policies designed to address problems of over-consumption in the US and under-consumption in surplus countries."

NOTE:

The full South Centre paper on "Global economic prospects: The recession may be over but where next?" by the Centre's Special Economic Advisor Yılmaz Akyüz is available at www.southcentre.org or http://www.southcentre.org/index.php?option=com_content&view=article&id=1250%3Aglobal-economic-prospects-the-recession-may-be-over-but-where-next&catid=142%3Aglobal-financial-and-economic-crisis&Itemid=67&lang=en

For more information, contact Vice Yu of South Centre at
Tel: +41 22 791 80 55, E-mail: yu@southcentre.org

The author can be contacted at yilmaz.akyuz@bluewin.ch