

Can Multilateralism Tame Mercantilism?

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Bank of Thailand Conference
November 7-8, 2008

Outline

- Situate the issue
- Outline proposal
- Implementation and caveats
- Political economy of realizing proposal

Financial Globalization: Gross and Net

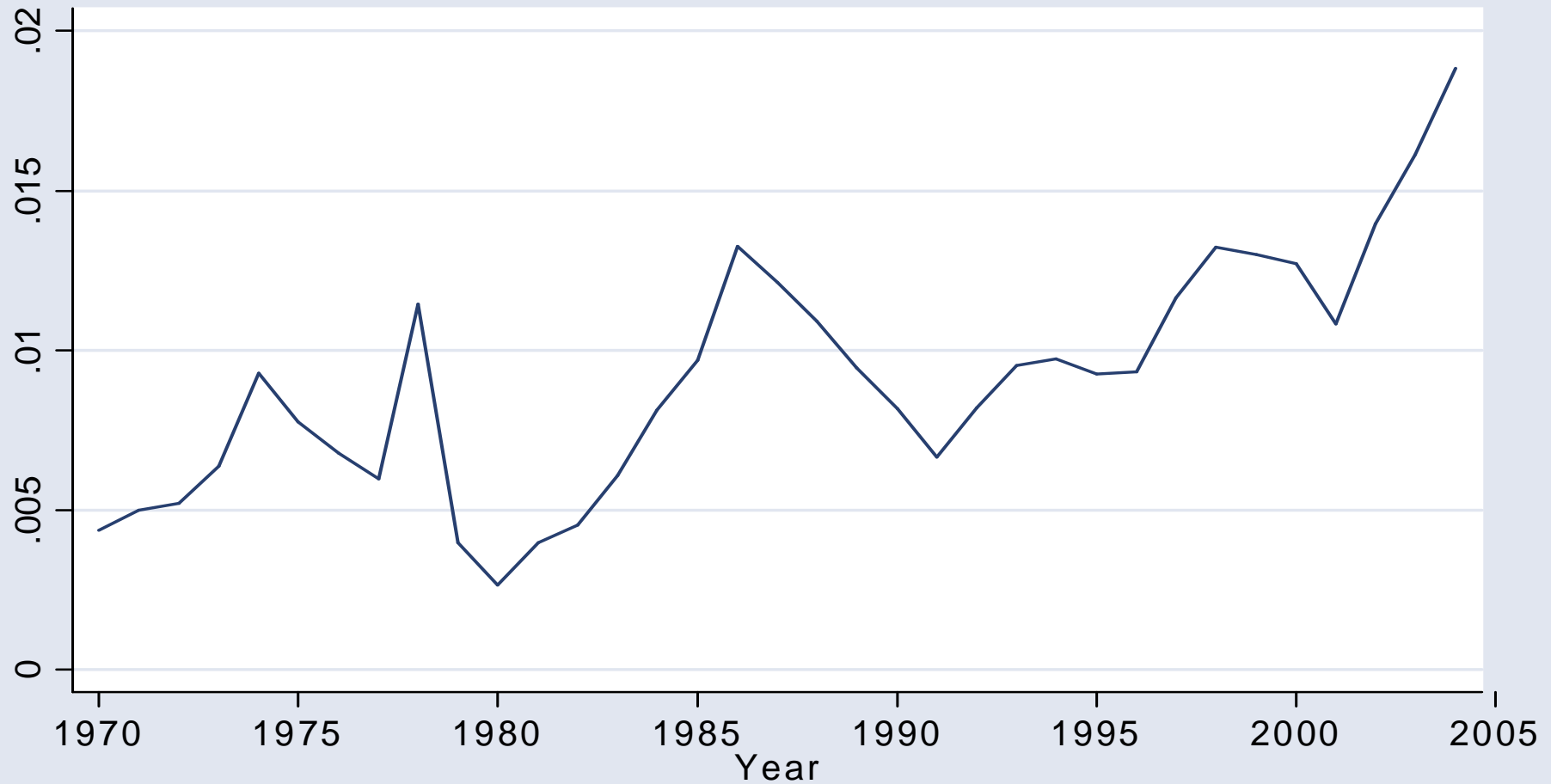
- Financial crisis related to gross and net flows in distinct ways
- Crisis in individual Asian emerging market countries (Korea and India) related to gross flows (“sudden stop”): deleveraging
- Asian self-insurance post-1990s: Net not gross
 - Reserve accumulation reflected Bretton Woods II exchange rates and current account surpluses
 - But this was accompanied by huge increase in gross flows
 - Of course, reserve accumulation helped but did not insulate from reversal of gross flows

Financial Crisis and Financial Globalization

- Rogoff (2003): World needs larger current account deficits and surpluses
 - That is larger NET flows from capital rich to capital poor countries
- Wish fulfilled

Wish Come True

Figure 1. World Current Account Surpluses as a Ratio to World GDP



Note: This plot shows the sum of current account surpluses for countries in our sample that report a surplus in a given period as a ratio of the sum of world nominal GDP in that period.

Can Global Economy Handle Imbalances?

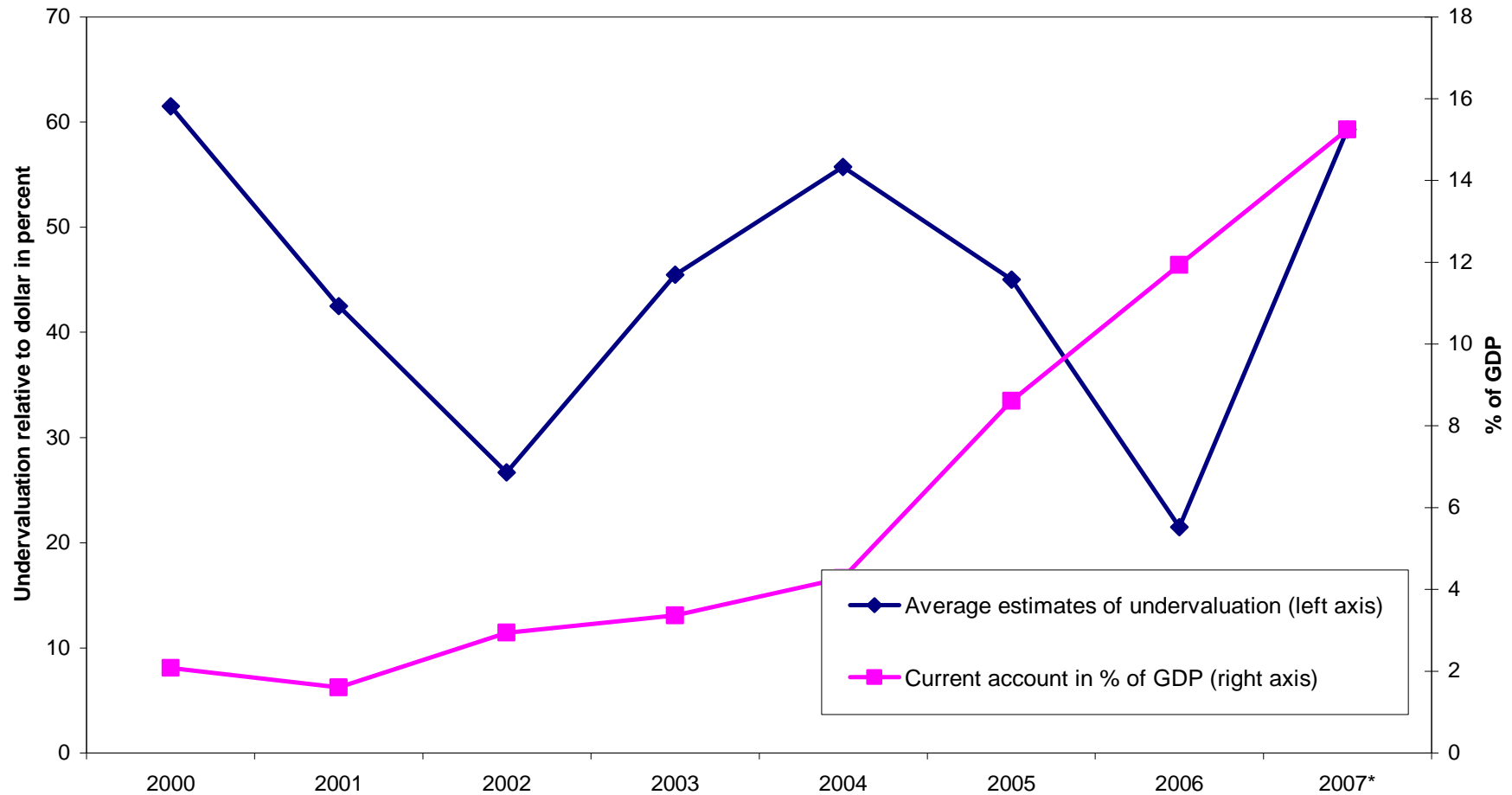
- Limits not just to deficits but apparently to surpluses
- But at global level, 2008 crisis related in part to net flows:
 - global imbalances (savings glut)→ liquidity surfeit→lax lending
- Note also true earlier: Post-1973 surpluses led to Latin American debt crisis (Walter Wriston)
- Tension between surpluses at national level (positive?) versus global surpluses? Need for collective action on macroeconomic grounds
- But there is the same tension from a development/real sector perspective. That is, mercantilism by large countries imposes costs on others

Bretton Woods II Process

- Avoiding global imbalances, surpluses, seems desirable and craves multilateral cooperation (Keynes' obsession)
- Need to limit absolute value of surpluses/deficits
 - Quantity versus price (i.e. exchange rate)
- Surpluses:
 - undervalued exchange rates (mostly Asia but also elsewhere) but also
 - Oil exporters

Estimates of Chinese Undervaluation

Chart 1: Chinese Undervaluation and Current Account, 2000-2007



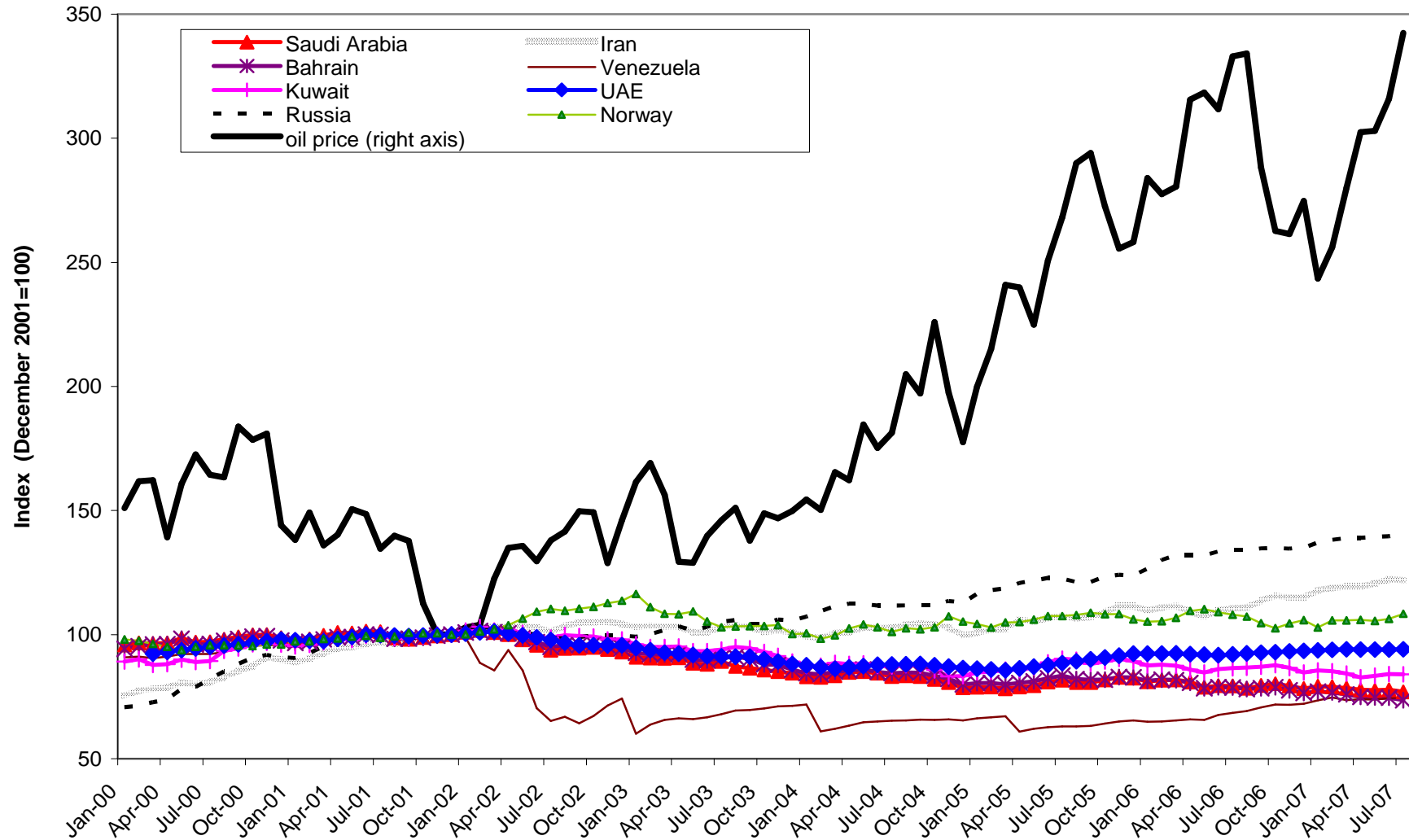
Source: Cline and Williamson, 2007, Table 1

For each year, the average of the estimates across studies is computed. Number of studies per year varies from 1 (2000) to 7 (2007)

*Current account figure for 2007 is an extrapolation

Exchange Rates of Oil Exporters

Chart 2: Real Oil Price and Real Effective Exchange Rates (REER), January 2000-July 2007
(Decline in the REER index denotes depreciation)



Political Context in US

- US bilateral initiatives:
 - Schumer-Graham
 - Baucus-Grassley
- President-Elect Obama supports against recent currency manipulation bill
- If deep recession + if dollar continues to strengthen, pressures will resurface, especially since pre-existing anxieties about globalization
- Effects on immobile versus mobile factors: Democrats (immobile labor) versus Republicans (mobile capital)
 - Reason why currency bills led nowhere

Multilateral Solution: Push

- Recap: Political imperatives combine with underlying need to call for multilateral action
 - Unilateral action unsuccessful and undesirable
- In principle, IMF but ...
- IMF's de facto abdication (Mussa, 2007)
 - Problems of eroding legitimacy
 - Problems of inadequate leverage (when has surveillance ever changed beggar-thy-neighbor policy?)
- In contrast, WTO's effective dispute settlement system:
 - Perceived as less asymmetric
 - Two-way disputes
 - Countries can initiate
 - Enforcement

Exchange rates: Pull

- WTO regulates import taxes and export subsidies but not undervalued exchange rates (which are both)
 - Theory
 - Empirical evidence
- But undervalued exchange rates (especially of large countries) also inflict cost on developing countries
 - Terms of trade shifted away from tradables
 - collective action problem seen from real side
- A lot of unexpressed concern in the developing world on effects of Chinese currency
- Trade effects: If China's undervaluation is about 20-30 percent, likely effects are substantial (Goldstein and Lardy, 2007). Contrast with tariff negotiations in Doha Round

New Rule on Exchange rates

- Current rules do not provide clear obligations
- Subsidy: financial contribution?
- CV and Anti-dumping would not address problem of “import tax” aspect of undervalued exchange rates and competition in third markets
- New rule would say: undervalued exchange rates caused by government action would be deemed to be akin to export subsidies and import tariffs and hence prohibited.
- 2 determinations: Undervaluation and attribution to government action

New Rule: Implementation and Caveats

- IMF would make technical determination of undervaluation a la its BOPs role in Articles XII and XVIII (Korea Beef and India QRs on consumer goods)
 - Distinguish IMF as a political forum and as repository of technical expertise
- Difficulty of determining “undervalued exchange rates?”
 - Prevent frivolous litigation
- Depriving countries of exchange rate as a development tool (Prasad, Rajan and Subramanian, 2007; Rodrik, 2007)
- Trade-off between possible domestic benefits and spillovers to trading partners:
- Hence draw upon subsidies code: Income and trade threshold for exchange rate disciplines: KEY to reconciling national from systemic implications

Doubts about Proposal

- Overloading the WTO (Bhagwati and Martin Wolf)
- Turf battles within countries: trade versus central banks versus finance ministries. True but...
- Responsibility for exchange rate management unaffected: small tail of outcomes (undervaluation) subject to trade action
- Precedent for reconciling turf issues: Financial services agreement in GATS.
- Too big to litigate: Yes and no
 - Key question is whether rules agreed as part of a fair bargain

Historical Digression

- Problem of getting countries with current account surpluses to adjust
- Keynes and Scarce Currency Clause of the IMF
- Right idea but wrong institution
- Our proposal tries to rehabilitate by drawing upon comparative advantage of WTO (enforcement) and IMF (technical expertise)

International Politics of Exchange Rate

- There will have to be a new rule which has to be negotiated. But how?
- There is a potential coalition of the affected, the disaffected
- US tried bilaterally and failed
 - Administration--Paulson
 - Congressional legislation mostly abandoned (ambivalence of mobile capital)
- Until recent crisis, significant unexpressed concern in developing countries (Brazil, Mexico, Korea, Turkey, Africa). Also immobile labor in US and EU—potential ally

Politics of Exchange Rate

- Coalition cannot form in an IMF/finance context
- More likely in a trade context because exporters and domestic producers affected in a variety of countries
- But China is China. Need carrots as well
- Possible carrots (Bretton Woods II process)
 - Prospect of market economy status in the WTO
 - Quota reform in the Fund

Conclusion

- Two facets of the collective action problem
- Macroeconomic: reducing net flows and hence global imbalances necessary
- Real/development: costs on others (incentives for tradables specialization) of mercantilism
- Need coordinated action that reconciles this tension
- Need to combine comparative advantage of IMF and WTO