

General Discussion: Overview

Chair: Erkki Liikanen

Mr. Rajan: Mr. Feldstein, you offered an explanation for our paper. I didn't know if you thought there was a difference between your explanation and ours. I thought they were the same. We are suggesting that one explanation is that savings are endogenous to growth. Therefore, you could get a situation where you have countries that are successful not relying on foreign capital. That does still leave the question, Why aren't they investing more when they have this growth spurt? That is where we related it to the possibility that they can't absorb so much because the financial systems are not adequate. But in no way did that suggest that foreign capital is a bad thing. It was just that it didn't accompany growth in that situation. So, your point is absolutely well-taken.

In that vein, it also would suggest why industrial countries seem to be able to grow while absorbing foreign savings, while poorer countries don't seem to. It may be a difference in the institutional structures that is causing that difference.

Mr. Redrado: Following Arminio Fraga's comments, I would like to point out that one of the critical elements in Latin America and in emerging markets is the lack of structural reforms in the financial system. In particular, let me bring up two key areas. One is the exposure of the financial system to the public sector. There are no specific

limits on its exposure to the government. And the second one is the currency mismatches faced by many dollarized economies. Let me dwell very briefly upon these two subjects.

First, in order to build a monetary and financial system that is independent from public sector needs, specific and explicit caps must be set up. In addition, increasing minimum capital requirements for the holding of sovereign bonds of emerging markets based upon the jurisdiction of the public sector (federal, state, local) to properly reflect the associated risks is a critical element. And these are significant regulatory changes that we have recently introduced in my own country. As a consequence, the exposure of the financial system to public sector assets as a share of total assets was cut in half, and has therefore allowed for a crowding-in of the private sector. This kind of policy tool that curtails the ability of governments to utilize the central bank or the financial sector as a financing source is quite meaningful in terms of achieving additional degrees of freedom for both monetary and financial policy. This factor is crucial in Latin America, where excessive financing to the government has historically crowded out credit to the private sector.

Second, currency mismatches in highly dollarized economies have always been a risk factor for the financial system in Latin America. Therefore, a fundamental challenge is how to reduce the asset-liability gap. In Argentina, prudential regulation is now in place to provide incentives for banks to lend in domestic currency to firms and households that generate income in pesos and to have foreign exchange deposits only applied to financing those who are able to generate income in foreign currency. Many countries in Latin America have started to pursue these kinds of policies, which not only are sound, but also provide resilience to external vulnerabilities.

Mr. Crockett: If the organizers of this conference had uncharacteristically invited Al Gore to participate, I am sure he would have found some way to relate some of the themes to his “Inconvenient Truths.” I wanted to ask whether the panel thinks he would have had some justification in doing so or whether it would be irrelevant.

We have talked about the very rapid growth in the past and projected growth for the next 30 years in countries that represent a very large part of the world population. That is going to result in enormous competition for natural resources. It is going to result in more pollution? And it is going to result, as he would point out, I am sure, in global warming?

What is the relationship between that and economic geography? What problems does that create for the sustainability of the kind of policies and trends that we are talking about now? Is this an issue perhaps for a future conference that economic policy ought to be interested in, or is it something that we should regard as being dealt with by others who have to look at these issues and not particularly relevant for either economic or monetary policy?

Mr. Berner: For the panel, and for Marty Feldstein in particular, two questions on imbalances. The first is, Could you envision other scenarios for the adjustment of global imbalances, for example, somewhat faster growth in the rest of the world, resulting in a contribution to U.S. growth from net exports? It might have a more benign outcome than the two you described.

The second question is for the panel more broadly: Are there possible changes in multilateral institutions and their architecture that could conceivably speed the process or make the adjustment process move more smoothly to reduce global imbalances and the effect on exchange rates?

Mr. Srinivasan: This is a question to Marty, drawing upon what Rakesh Mohan said in his remarks. In most of the discussion and your discussion also, the focus had been on a global imbalance adjustment that is on the gross domestic product (GDP) side, consumption savings side, interest rates, or exchange rates. It seems to me you have to break down the demand side, not only with consumption and investment, but also within investment. What is the composition of investment? Within consumption, what is going to be the impact on

composition of consumption, particularly between tradable goods and nontradable goods? That is point number one.

Point number two is to review what is happening in globalization, not simply as a proportion of GDP rising everywhere, but also what were previously nontradable and becoming much more tradable now? The share of nontradable will be strictly defined into the GDP side, and the demand sides are also changing. This is another source of adjustment.

The third thing: It is not very clear, when one is talking about adjustment of global imbalances, whether one is talking about some equilibrium that is out there. Right now, we are not there, and this is a process of adjustment toward that equilibrium. Because of all the exogenous effects of globalization, etc., that are out there, the equilibrium itself is shifting. To what extent does the adjustment have to reflect not only the disequilibrium effect, but also the shift of equilibrium over time? Once you have broadened the means of adjustment, then the impact on a single element in the adjustment—whether it is GDP or whether it is consumption or whether it is an exchange rate—will be to that extent less. Are we exaggerating the exchange rate impact of GDP by ignoring various other elements of adjustment that could also be useful in bringing about the part which is tracking the changing equilibria much better?

Mr. Feldstein: Raghuraj Rajan and I agree. It is really a matter of emphasis on what you said within the paper itself. As you revise it, if there is time, it would be useful to look at the role of FDI coming into countries as a form that doesn't depend on the sophistication of the financial markets.

Andrew Crockett raised the question of what might have been said about pollution in this conference. Obviously many, many things could have been said, especially by somebody more expert about the subject than I am. One distinction that would be worth making is between local pollution—the kind of pollution that we associate with local water supply or other pollution that stays within a country, like SO₂ from

global pollution that comes from CO₂. That is a global problem in the sense that the creation of CO₂ anywhere in the world within a year finds its way into the atmosphere and adds to the global warming problem. Some of those problems can be treated in a strictly local way; others can be treated only by some kind of international coordination.

Dick Berner asked about the potential favorable effects of faster growth in the rest of the world on shrinking the U.S. current account imbalance. It is just too small. Do the arithmetic. Let's imagine adding 1 percentage point to the growth rate and look out five, six, 10 years even to the higher level of GDP that results. Apply to it an import factor. Break that down between the United States and elsewhere, and you don't make a very big dent on the size of the U.S. current account.

Mr. Srinivasan, I think you are absolutely right. There are both the overall question of getting the savings rate up in the United States and the composition. You cannot reduce the trade deficit without increasing saving minus investment, so savings has to rise, but that is not automatically going to convert itself into a reduction in the trade deficit. For that, we require a change in the mix of what American consumers consume, consuming less in the way of imports and more of domestically produced goods and services. We are not going to produce Chinese-style products in the United States. What has to happen is a change in the relative cost of imported products, not just Chinese imports (half of our imports come from high-wage countries), and a change in the relative cost of imported products and in domestic consumption, which includes in large part services. That requires a change in the exchange rate.

Mr. Fraga: There is one question left from Dick on whether changes in multilateral institutions could help deal with imbalances. Perhaps, but as of today, I am skeptical that would be the case. The multilateral institutions are mainly designed to deal with problems in the developing countries. The larger countries don't seem to be willing to give up their independence.

What would probably help were we to have a problem driven by some accident, some war, or exuberantly negative market dynamics of some sort or another—and I am not predicting that (I am leaning toward a softer landing than anything else)—would be that the G-7 would get together and invite China, and maybe they could work something out. My prediction there is that China would play a constructive role, as they seem to playing these days

Mr. Mohan: I want to respond to the question from Andrew Crockett on the sustainability issue. Obviously I can't do it justice in just one minute. There is only one silver lining in the efficiency and usage of both oil and other materials. What is interesting is that between 1970 and now, the oil intensity usage, that is, say, kilograms of oil per real used per input worldwide, has come down from 0.18 to 0.11. The efficacy of the price mechanism goes to show that the United States has come down from 0.19 to 0.09. At the same time, the United Kingdom and Japan have come down to 0.05, that is, the United States is about twice as inefficient as the United Kingdom and Japan, which seem to be on the frontier. But developing countries are four times as inefficient as the United Kingdom and Japan. That is, India and China are around 0.20, compared with 0.05 for the United Kingdom and Japan. In terms of these kinds of numbers, there is a long way for us to go in terms of efficiency with oil usage. Maybe that also applies to other materials. As prices go up, usually these types of changes will take place. The point you brought up still bothers me when I look at these kinds of numbers: Can it really happen that a billion and a half people go marching forward the next 30 years with the kind of development we have seen over the last 50 years?