Global Imbalances and Policy Frictions

James Mirrlees
Chinese University of Hong Kong

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The Distribution of Capital

- In our world, national capital is not entirely the result of national saving.
- No reason why it should be. Capital ought to go where the returns are greater, until, adjusting for risk, the returns are the same everywhere.
- Capital importers (low savers, high or secure profits) will have balance of payments deficits.

Optimal Saving and Investment

- Public policy helps to determine national saving. We should consider whether countries have it right.
- Once countries have it right, the rate of return, risk-adjusted, should be the same everywhere. And per-capital consumption should grow at a rate a fixed fraction of that rate of return.
- The fraction reflecting intertemporal tastes.

Imbalance?

- Expect low-wage/skill countries to have most capital relative to output, or even population. A low exchange rate lowers wages.
- China should import capital, unless its citizens want rapidly growing consumption. USA should export capital, unless its citizens prefer slow growing consumption.
- But USA need not complain while it is a capital importer: that was its choice.

Growth.

- Countries where capital investment is high relative to output grow faster, generally. And later starters
- We might expect the countries that import capital to grow faster. But China has saved more than it invests (recently), USA the opposite; and China has grown much faster. The future may be different.

Deficient global demand

- The world economy goes well so long as demand for real investment (and consumption) is equal to full-employment output, globally.
- If demand too high, governments moderate it, as prices rise excessively.
- Good until events reduce demand too quickly for governments to compensate.

Demand deficiencies

- Credit squeeze. If savers and financial intermediaries suffer capital loss, they prefer to lend “safely”, which is generally not real investment, but (some) governments, sometimes land or gold.
- Increased income inequality: oil booms, gambling (e.g. swaps). It seems the rich spend more on financial and fixed assets. N.B.: rising commodity prices reduce real demand.

Taxing hydrocarbons

- Do we want low oil prices?
- To encourage non-carbon technologies and reduce demand for carbon-produced energy, the price to users should be high. To redistribute income from oil-owners to others, the price to oil producers should be low.
- That means tax: think of it as redistributive.

Fiscal expansion

- Government spending seemed to work in China, quickly restoring its version of full employment.
- Not enough in the developed economies? Yes, and not soon enough. And not the real investment that would restore growth and expectations.
- Implausible that public spending would be fully offset by private saving to pay later.

National debt

- But there is a similar problem. Spending financed by debt means that later the government will want to reduce its contribution to net demand to reduce the national debt.
- No guarantee that in time a primary surplus sufficient to eliminate debt would be consistent with full employment.
- Monetary expansion helps. Too much and we get serious inflation, like Weimar, etc.

National debt for ever

- A growing economy can sustain a growing national debt only if the interest rate is less than the growth rate. Japan is the striking example, with a very large debt, domestically financed.
- Economic management is hard when interest rates for the debt becomes high, as in the problem Euro-states.
- Occasional large deficits are manageable.

Global balance

- The problem for the world economy is when nations that could do expansionary spending, without driving rates up, don't: Germany, oil states, and even China.
- Inflation is a concern, even when price rises are really relative-price adjustments. Probably commodity and food prices have that character.

The China case

- China may prove to be an interestingly different example of this problem – without an explicit national debt problem.
- Banks were made to lend, particularly to state-owned enterprises, e.g. for railways.
- Many loans will be "non-performing". State-owned banks will have effective deficits, backed by government.
- There will be a sort of gradual bail-out, as small as possible, not generating the excessive incomes the US and UK ones did.

The emerging economies

- China, India, South America, the Turkic lands, are still doing well. They had the advantage of simple financial systems, not mesmerized by securitization, hedging, complex derivatives, and clever short selling.
- No credit crisis: investment not hit. They easily compensated for reduced exports to the developed economies.
- But inequality is growing: China spending is low.