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GLOBAL IMBALANCES AND THEIR EVOLUTION DURING THE CURRENT CRISIS

The current crisis has further revealed a systemic problem of the contemporary global economy that lies in imbalances between savings and investment in the major world economies reflected in large and growing current account imbalances. Even though global imbalances are not a new phenomenon, their new features since the early 2000's have induced many debates about their role in triggering the current crisis and their impact on global economic governance. The aim of this paper is to explain global imbalances as an outcome of trade and financial globalization combined with long-standing policy challenges that were not reflected enough before the current crisis and to analyze their evolution during the crisis. The paper suggests that policy failures that fuelled the current crisis cannot be fixed without facing the causes of global imbalances from a more coordinated perspective than so far. Since the risk of further widening of global imbalances prevails, global financial governance must strengthen surveillance in order to enable such a coordinated approach.

KEYWORDS: GLOBAL IMBALANCES, CURRENT ACCOUNT, INTERNATIONAL MONETARY SYSTEM

JEL: F32, F02, F13, F21

1. INTRODUCTION

The current crisis has further revealed a systemic problem of contemporary global economy that lies in "imbalances between savings and investment in the major world economies reflected in large and growing current account imbalances" (Dunaway, 2009, p. 3). Even though global imbalances are not a new phenomenon, their new features since the early 2000's have induced many debates about their role in triggering the current crisis and their impact on global economic governance. Obviously, global imbalances are based on both trade and financial globalization and thus offer an opportunity to discover some systemic features of the globalized world economy. From global political economy (e.g. Phillips, 2005 or Watson, 2005) perspective, they are also largely connected with policy and governance failures and thus offer the field to study the quality of economic governance

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of the current world. The aim of this paper is to explain global imbalances as an outcome of trade and financial globalization combined with longstanding policy challenges that were not reflected enough before the current crisis and to analyze their evolution during the current crisis.

In its first part, the paper explores trade related issues that have contributed to the build-up of global imbalances since the mid 1990's and during the early 2000's. Even though the imbalances were fuelled by the same trends as the current crisis, this paper will suggest that real causes of both imbalances and crisis lie in economic policies of global economic actors. These policy failures cannot be fixed without facing the causes of global imbalances from a more coordinated perspective than so far. In its second section, the paper focuses on capital account developments by addressing monetary and financial developments during the same period of the global economy development. The final part explores policy changes that are needed to resolve the imbalances and explores their recent developments and perspectives.

From the perspective of global political economy the global imbalances are seen as a major problem even though economic theory broadly sees them as a normal outcome of global investment-savings allocation. This paper builds upon a perspective that escalated size of global imbalances during the pre-crisis period was caused by major economic policy failures in global macro-regions. These failures keep building political tensions between global actors and thus influence outcome of their potential agreement on global matters, including the climate change.

2. TRADE-RELATED CAUSES OF GLOBAL IMBALANCES

Global imbalances are usually understood as large current account deficits and surpluses that reflect trade and financial flows in global scale, namely between United States and East Asia being largest trade deficit and surplus regions respectively. This definition however does not reflect an important feature of global imbalances and thus the systemic risk and deviation from equilibrium (i.e. namely the policy interventions including policy failures into global trade and financial mechanism) they include. More precise definition thus explains global imbalances as "external positions of systemically important economies that reflect distortions or entail risks for the global economy" (ECB, 2008, p. 12). They are based upon both trade (current account) and financial (current account and financial position) concerns that are understood more than just a mirror of each other (i.e. trade and financial globalization are both taken into account in this paper).

Regional view on global imbalances is offered by Table 1. It shows the composition of trade surplus and deficit countries groups. As far as the deficit side is occupied predominantly by the United States and their huge current account deficit, surplus side consists of a variety of countries and regions (oil exporters, China and Japan being the most important part). ECB (2008, p. 20) easily suggests that today, the surpluses that mirror the US deficit are in a larger number of countries than before: "in 2005, five countries accounted for 50% of world surpluses (Japan,

China, Germany[1], Saudi Arabia and Russia); in 1985, three countries only accounted for 50% of world surpluses (Japan, Germany and the Netherlands). A rising number of countries accounting for world surpluses has the advantage of spreading risks across a larger number of players; however, it may also make the resolution of global imbalances more difficult" – which will be reflected in the part analyzing the IMF's capacity to challenge global imbalances. On the other hand, the systemic importance of the United States – as almost the only deficit country – is also an unprecedented feature with a marked impact on possible global solutions.

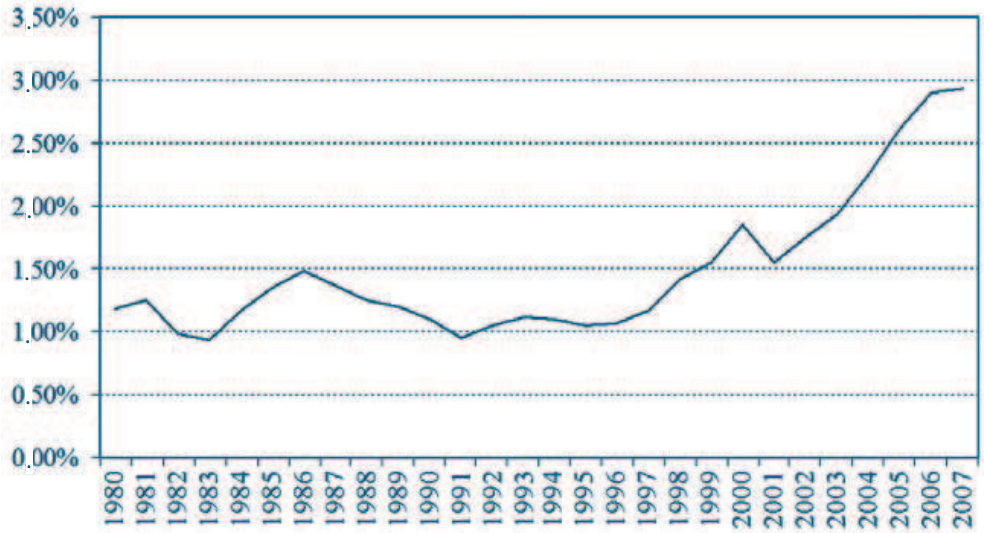
The current episode of global imbalances started in 1996 when the sum of current account imbalances started to grow from between 1 and 1.5% of world GDP.[2] Within this period, the sum of global imbalances doubled quickly to reach almost 3% of world GDP in 2007. On the deficit side it was obviously pulled namely by the US current account deficit but also deficit countries in Europe contributed to this trend after the start of euro – *see table 1.* Several episodes must be however distinguished in the 1996–2007 period, as the current account imbalances must fulfil all the criteria for global imbalances defined above. Namely, they must entail distortions for global economy as current account imbalance on its own can easily correspond to an equilibrium position of an individual economy or the world. Even though there are certain long term trends (which will be developed further) driving *US current account deficit*, its increase between 1996 and 2000 was caused namely by differences in perceived profitability of assets in the United States and other world (specifically East Asia). "US investment increased, linked to high tech boom and expectations of higher productivity growth", while "East Asia's investment decreased due to Japan's recession and Asian Crisis" (IMF, 2009, p. 8). Even though the perception of high tech boom turned to be overoptimistic, "reallocation of capital in response to perceived differences in profitability" must be seen as a unique feature of global financial system and thus is broadly seen as a "good" imbalance (IMF, 2009, p. 9).

The US position changes significantly after the recession in 2001 both in pace of the US current account deficit increase and in its causes. "The dominant factor became a decline in US saving, reflecting a very significant deterioration in public saving" as well as in "household saving, reflecting borrowing against increasing house and other assets values" (IMF, 2009, p. 9). Two important features of global imbalances must be stated here: Firstly, "current account deficits may be unsustainable" and thus lead to global imbalances "if they reflect excessive spending by either the private and the public sector" (Mongelli, Wyplosz, 2008, p. 20); both probably happened in the United States as public saving expected in light of pop-

1 It is important to note that Germany that runs huge current account surplus is depicted as a part of euro area the overall balance of which is slightly negative (as seen in Figure 1). Germany's surplus is mirrored by major deficits namely in the southern tear of the euro zone, which reflects namely competitiveness differences within the EU that can be easily labelled as European imbalances with similar risks as their global counterparts.

2 This is a standard measure of global imbalances calculated as the sum of absolute values of net current account positions divided by two in order to avoid double counting (as both surpluses and deficits are included in absolute values). It indicates "not only an increase in global imbalances over time, but also an acceleration in recent years" ECB (2008, p. 17).

ulation aging and households bids on too buoyant asset prices imposed a risk for near future. Secondly, monetary policy after the dot-com crisis started to be an important factor for global financial system evolutions – financial globalization will be explored in the next section.



Source: UNCTAD (2009) and author's own calculations

Figure 1. Sum of current account imbalances as a percentage of world GDP

On the surplus side, *East Asia including China* continued in accumulating surpluses, which was even supported by the reserves accumulation after the Asian Crisis, which found East Asian countries unprepared and too dependent on external crisis management. "The increase in external surpluses reflected a decline in investment (following the excesses that occurred in the build up to the Asian Financial Crisis) as well as policy decisions in many of these countries to rebuild official reserves, which had been decimated during the financial crisis" (Dunaway, 2009, p. 14). "External surpluses put upward pressure on exchange rates, but this pressure was mitigated by substantial sterilized currency intervention, delaying adjustment" (Dunaway, 2009, p. 16).

Oil prices started to grow rapidly driven both by increasing demand of emerging giants and by new financial evolution facing too low interest rates (another monetary policy implication). As a result, *Oil Exporting Countries* started to represent significant current account surpluses: Russia's current account surplus reached some USD 47 billion in 2000, Saudi Arabia, Kuwait, United Arab Emirates, Iran and Venezuela each accounted for other more than USD 11 billion surplus (UNCTAD, 2009). "Widening surpluses by oil exporters was reasonable, in light of uncertainty about future oil price dynamics" (IMF, 2009), however the question remains to what extent financial globalization and low interest rates contributed to oil prices. Moreover long-term global imbalances among oil exporting countries are caused by limited ability to perform institutional and structural reform to spur financial effectiveness, investment and human development.

Table 1. Systemically important current account positions, 2007

Country	Net current account position (USD million)	GDP (USD million)	Current account/GDP
Deficit			
United States	–731,209	13,869,955	–0.05
Spain	–145,355	1,436,893	–0.10
United Kingdom	–78,765	2,767,982	–0.03
Australia	–57,682	945,674	–0.06
Italy	–51,032	2,095,141	–0.02
Greece	–44,587	313,355	–0.14
Turkey	–37,697	487,552	–0.08
France	–25,839	2,547,007	–0.01
Romania	–23,136	161,279	–0.14
Portugal	–21,418	222,982	–0.10
South Africa	–20,631	283,008	–0.07
Poland	–18,595	419,205	–0.04
Surplus			
Venezuela	20,001	236,720	0.08
Qatar	21,374	63,870	0.33
Nigeria	21,972	173,184	0.13
China, Hong Kong	25,746	206,706	0.12
Libya	28,454	62,060	0.46
Malaysia	28,931	186,720	0.15
Algeria	30,600	132,452	0.23
Taiwan	32,975	383,280	0.09
Iran	34,081	289,933	0.12
Sweden	38,416	454,792	0.08
Singapore	39,062	161,349	0.24
United Arab Emirates	39,113	191,465	0.20
Switzerland	43,946	427,594	0.10
Kuwait	47,471	109,981	0.43
Netherlands	59,586	766,251	0.08
Norway	60,459	387,427	0.16
Russian Federation	76,241	1,289,582	0.06
Saudi Arabia	95,080	377,318	0.25
Japan	210,490	4,379,624	0.05
Germany	252,929	3,317,377	0.08
China	371,833	3,400,351	0.11

Note: Only those deficits/surpluses that represent more than 1% of global deficit/surplus are included.
Source: UNCTAD (2009) and author's own calculations

All in all, "the substantial saving by East Asian emerging economies and Middle East oil-exporting countries were reflected in large net capital outflows, which made their way to the United States. With the desired level of saving in the world exceeding desired investment and the interest rates prevailing at that time, the glut of global savings drove down real rates of interest and set off boom in asset prices"

(Dunaway, 2009, p. 16). "*Asset booms*, associated with lower saving and higher investment, became an increasingly important factor" for global imbalances issue (IMF, 2009, p. 10).

The first years of the euro mean significant changes in Europe too. "Core European Countries increased their current account surpluses sharply, reflecting for the most part declining investment and investment reallocation to new member states" (IMF, 2009, p. 10). Germany's current account turned into surplus in 2001, became world's second largest surplus (after Japan) in 2002, and was world's second largest (after China) in 2007 too (UNCTAD, 2009). Together with Germany some other core European countries run surpluses, namely the Netherlands and Sweden from the EU, and Switzerland and Norway from EFTA. From the global point of view, "consumption-fuelled growth in the United States fostered economic recoveries in *Japan and high-exporting parts of Europe*. Particularly in Europe, corporate profits rose. But problems in structures of these countries' economies – especially rigidities in product and labor markets – limited investment opportunities. The combination of high corporate savings and sluggish investment led to rising national savings and external surpluses" (Dunaway, 2009, p. 14).

As a mirror of rising surpluses in core Europe, deficits started to grow in Europe's periphery[3] both as far as Southern EU members (Spain had the second largest deficit after the United Stats amounting to USD 145 billion in 2007, Italy, Greece and Portugal) and new members or candidates (Turkey, Romania, Poland) are concerned. The story of *European current account imbalances* is very complex. On one hand, Germany's and other namely Nordic countries' surpluses are seen as a very advisable thing in view of population ageing and other costly reforms needed in Europe. On the other hand, current crisis made some deficit countries jealous about Germany's surplus accusing Germany from prioritizing national interest. Obviously, euro zone differences in current accounts are connected with the common currency project at least as "unexpected challenge" as Mongelli and Wyplosz (2008, p. 16) put it. "Since its creation, relative unit costs have diverged within euro zone," while "countries like Germany have gained competitiveness trough wage moderation, productivity gains, or both" (Wyplosz, 2010). EU's Southern members' loosing competitiveness was even escalated by this fact and common currency has limited the option of currency devaluations in order to boost external competitiveness – even though only temporarily, as it was proved that "depreciations breed inflation and lessen incentives to seek competitiveness by tying wages and productivity". Without wage moderation, Southern Countries also let inflation grow, which reflects itself in different monetary policy outcomes, even though it is common and single for the whole euro zone. "The effects of monetary policy are more expansionary in countries with high inflation rates and more contractionary in countries with low ones. As a result, growing disequilibria may occur" within euro zone (Mongelli, Wyplosz, 2008, p. 15). As "international competition can explain why inflation rates did not actually diverged" across euro zone, competitiveness changes must have been reflected in the real

3 The Core-Periphery issue will be examined further with respect to monetary system features.

exchange rate changes. And as there is "a strong link between real exchange rate change and current account", real exchange rate changes can at least partly explain current account divergences and connect them with policy reforms needed, specifically at the supply-side (Wyplosz, 2010, http://www.voxeu.org/) and in labor markets.

"Another important source of divergence in euro zone can be (as seen at the case of United States) excessive domestic spending;" private, public or both (Mongelli, Wyplosz, 2008, p. 23). That is again supported by financial globalization as well as by the existence of euro zone, as "easy external financing, allowed by monetary integration and absence of exchange rate risk, could make it possible for a country to sustain large current account deficits for a significant amount of time, making the eventual correction more painful (significant fall in demand)". Moreover, also here, lower than optimal "real interest rates can contribute to excessive demand" (i.e. spending), which will be studied in the following section.

Table 2 shows gross external debt positions of the United States, Japan and those European countries that are systemically important for global imbalances. Obviously, the level of external debt is much higher in Europe if compared by the ratio to GDP percentage. Due to financial integration, other European countries, as suggested above, hold most European debts. Similar assumptions apply to external governments' debts, too. Greece's current extraordinary dependence on financial markets is revealed by a very high external government debt financing (amounting to almost 87% of GDP).

Table 2. Gross External Debt Position, Q4 2009

Country	Total external debt		General government external debt	
	USD million	% of GDP	USD million	% of GDP
Japan	2,127,591	43.32	671,529	13.67
United States	13,767,867	97.69	3,700,886	26.26
Italy	2,594,951	112.67	1,138,829	49.45
Germany	5,131,055	140.60	1,297,345	35.55
Spain	2,546,038	158.71	430,405	26.83
Greece	581,685	163.45	309,301	86.91
France	5,234,257	183.24	1,324,692	46.37
Sweden	881,506	184.05	69,000	14.41
Portugal	548,454	225.24	140,751	57.80
Netherlands	2,466,456	283.17	362,709	41.64
United Kingdom	9,153,419	342.30	401,121	15.00

Source: Quarterly External Debt Database and author's own calculations

Combining all these factors, on the deficit side, the USA, with continued low saving, was now joined by countries such as Ireland, Spain, the United Kingdom, and CEE countries (peripheral Europe), with asset price booms and high investment" (IMF, 2009, p. 10). Within the asset boom, construction played the main role in European countries; countries also encountered real exchange rate apprecia-

tion. Declining private saving was offset by higher public saving (easy external financing allowed public spending even in countries with very high deficit (IMF, 2009, p. 20).

"At this point, the cycle began to feed on itself. With expand availability of credit and lower interest rates, US households used debt to sustain consumption and fuel a housing boom. Raising US demand stimulated additional growth in the rest of the world, adding to current account surpluses especially in East Asian emerging market economies. Among these countries, China's current account surplus skyrocketed and official reserves rose to record levels." *China* and its "competition pressure further prevented East Asian countries from appreciation of their currencies against the US dollar, boosting external surpluses and reserves accumulation in these countries." "In turn, trough the net capital flows, developing countries' surpluses were funneled back to the United States, where they helped fund a continuation of consumption and housing boom and a steady rise in asset prices" (Dunaway, 2009, p. 16–17). It is furthermore evident, that also other aspects of global imbalance are intertwined and feed on each other; "for example sharp rise in oil prices is related to very rapid growth in China and other emerging markets, and global growth more generally. And, in turn, the large transfer to oil exporters, that have a high propensity to save, helped widen imbalances, drive down world interest rates, and fuel the boom" (IMF, 2009, p. 11). As such, global imbalances represent a complex feature of current global economy that also requires complex (and if possible coordinated) policy actions in different regions of the world. This chapter suggests namely actions in field of labor and product markets reform, fiscal austerity as well as financial efficiency and sophistication in respective regions.

3. MONETARY FOUNDATIONS OF GLOBAL IMBALANCES

Current financial crisis started huge disputes about the role of monetary policies and financial markets quality as well. Even though previous chapter mentioned several aspects of these issues too, the broader context was largely neglected. Yet, financial globalization markedly influences global imbalances as well as their effects on global economy and economic policy outcomes. "Normally, a current account imbalance triggers forces that encourage adjustment and maintain the imbalance at sustainable level. Countries with deficits face increasing pressures in obtaining financing. This fosters adjustment trough upward pressure on domestic interest rates, downward pressure on the real exchange rate, and slowing economic activity" (Dunaway, 2009, p. 7). After 2001, such adjustment was obviously delayed, which points at other features of global financial system that must be at play.

"Since the breakdown of the Breton Woods monetary system, there has been greater exchange rate variability combined with phenomenal growth in the volume of international capital flows. There has been major transformation of the world economy, mainly as a result of accelerated economic growth in Asia. The restructuring of the world economy over recent decades was primarily due to mobilization of labor to produce cheap manufactures and policy initiatives that

encouraged increased output in emerging Asian economies. The major supply-side boost had implications for price levels and inflation worldwide (at least until mid-2000's). Financial liberalization has enhanced international capital mobility and thereby facilitated the delinking of domestic savings and investment rates. Matching the increased capital flows around the world, the counterpart to global imbalances has been marked changes in nations' external liability positions" (Makin, 2010, pp. 8–10). Yet, basic features of the monetary system remained probably the same.[4]

The basic feature of today's monetary system that is both connected to the problem of global imbalances and to the main features of previous monetary systems is its asymmetry – the monetary system comprises of *core and periphery countries* (see e.g. Bordo, Flandreau, 2003, pp. 417–468) the policy priorities and tools of which substantially differ: generally speaking "the periphery countries choose a development strategy of undervalued currencies, controls on capital flows and trade, reserve accumulation, and the use of the centre region as a financial intermediary that lent credibility to their own financial systems" (Dooley; Folkerts–Landau; Gerber, 2003, p. 3).[5] United States are the centre country today, too and "the US dollar is the dominant world currency with a large number of countries pegging their currencies more or less tightly to the dollar. The most important regions which maintain common dollar pegs (and therefore informal dollar standards) are East Asia, the Middle East, (Latin) America and the Commonwealth of Independent States including Russia" (ECB, 2010, pp. 7–8). Moreover, "the euro is the second (regional) international currency with a flexible rate against the dollar. In the backyard of the euro area an increasing number of countries are pegging their currencies to the euro. This implies flexible exchange rates between the euro periphery and the dollar periphery".

Periphery countries, for which a development strategy based on export-led growth was the dominant objective for economic policy (today notably China), exchange rate regimes and policies explain important part of global imbalances. "With the discrediting of the socialist model in the 1980s and then the collapse of communism in 1989–91, a new periphery was melded to the US-Europe-Japan centre. These countries were newly willing to open their economies to trade and their capital markets to foreign capital. These countries all were emerging from decades of being closed systems with decrepit capital stocks, repressed financial systems, and a quality of goods production that was not marketable in the centre.

4 Some even argue that they remained the same throughout time: "We used to have a view that (1) there was a system (Bretton Woods) that evaporated thirty years ago into no system at all and (2) now a semi-system has emerged anew (Bretton Woods II.). But, in fact, the system has been the same throughout, just manifesting itself in different forms because the original emerging markets (Europe and Japan) developed and did not need the centre's intermediation any more" (Dooley; Folkerts–Landau; Gerber, 2003, p. 10).

5 In the Bretton Woods system of the 1950s, the United States was the centre region with essentially uncontrolled capital and goods markets. Europe and Japan, whose capital had been destroyed by the war, constituted the emerging periphery. Once the capital of these zones had been rebuilt and their institutions restored, the periphery graduated to the centre (Dooley; Folkerts–Landau; Gerber, 2003, p. 3).

The Washington Consensus encouraged them in a development strategy of joining the centre directly by throwing open their capital markets immediately. Others, mainly in Asia, chose the same periphery strategy as immediate post-war Europe and Japan, *undervaluing the exchange rate, managing sizable foreign exchange interventions, imposing controls, accumulating reserves, and encouraging export-led growth by sending goods to the competitive centre countries*" (Dooley; Folkerts–Landau; Gerber, 2003, p. 6). Moreover, especially "countries with balance-of-payments surpluses that manage their exchange rates can resist upward pressure on their currencies for an extended period. They must however attempt to "sterilize" their exchange market intervention through domestic monetary policy actions in order to avoid a rise in inflation that would otherwise induce a real appreciation of their currencies. Sterilized intervention can be further supported by capital controls and administrative controls over domestic financial markets. Maintaining an undervalued exchange rate however imposes large costs on the real economy. The distortion in the value of the exchange rate will create serious misallocations of resources in the export- and import-substituting sectors of the economy. The longer an undervaluation of the currency is maintained, the greater the misallocations created and the more difficult the readjustment the economy must undergo to unwind the distortion" (Dunaway, 2009, p. 10).[6]

China's success in this respect is also connected to limited efficiency of its banking sector and limited ability to perform vital reforms, which was already noted as a factor underlying global imbalances in emerging countries of Asia and oil exporting countries. Yet, "numerous economic benefits arise from retaining a pegged exchange rate" (Makin, 2010, pp. 17–18) too: faster export growth, limiting trading partners' growth, currency protecting supply of international reserves, stability for underdeveloped financial sector. Financial market reform is also needed to improve the intermediation of savings in China. "Lifting the cap on deposit rates would not only help push up the cost of capital, it would also increase competition in the banking sector and provide incentives for banks to expand credit to new customers. Greater access to credit would reduce the incentives of both firms and households to hold large savings. Bond and equity markets must be developed to provide alternative sources of financing for firms and a much broader array of assets for households to invest in. Better credit access and higher-yielding assets to invest in would reduce household savings and raise household incomes over time, boosting consumption" (Dunaway, 2009, p. 23).

Periphery and other countries' (notably Japan) demand for *reserve assets* is another important feature of the system, to which United States is the main provider of reserve assets; as such they were able to delay adjustment of its exter-

6 Among the emerging economies in East Asia, China most exploited this flaw in the international financial system during the 2000s and also influenced those of other East Asian countries in that they sought to limit appreciation of their currencies in response to competitive pressure from China, and these countries probably built official reserves to levels higher than they ever intended. (Dunaway, 2009, p. 10).

nal position.[7] This explains why the United States was able to finance its external debt so easily: throughout the 2005–2008 period "capital flows increased dramatically with debt flows still playing key role – see Table 3. Official investors (notably China, Japan, and the oil exporters in Middle East) continued to buy significant amounts of US treasury and agency bonds" (IMF, 2009, p. 10), which explains financing of a part of the US's growing imbalances and government debt. "As long as dollars purchased in foreign exchange markets were used to by US securities they registered as capital inflow to the US, without any net effect on liquidity in US financial markets and the US money supply" (Makin, 2010, p. 22). "Funds routinely invested in US and other government bonds, moreover, helped to keep world interest rates low[8]" (Makin, 2010, p. 189) – with some consequences outlined above (low US saving, low mortgage rates, high housing prices etc.).

Table 3. Major Non-OECD Holders of US Treasury Securities, 2009

Holder	Total external debt	
	USD million	% of GDP
China	895	24.3
Oil exporters	207	5.6
Caribbean banking centres	128	3.5
Brazil	169	4.6
Hong Kong, China	149	4.0
Russian Federation	142	3.8
Non-OECD Total	2,143	57.8

Source: OECD (2010, p. 62.)

Yet, "foreign purchases of US corporate bonds – particularly from European financial institutions – also rose sharply" (IMF, 2009, p.10). The fact that the "international financial system is dominated by private – not public – actors and their balance sheets" (Truman, 2010, p. 4) today somehow decreases the importance of reserve asset demand as an explanation of global imbalances (still it can explain their financing as current account deficit must be balanced by capital account surplus (see e.g. Makin, 2010, pp. 93–111)). Indeed, "assets in today's international

7 The United States, which is the primary provider of reserve assets to the system, has been able to finance current account deficits for long periods. The cost to the United States for this financing was relatively low because of the premium foreign governments were willing to pay to obtain presumably risk-free U.S. government securities. One distinct advantage the United States has is the breadth and liquidity of its government securities markets. This is a particularly important consideration for investments by countries in official reserve assets. (US government debt doubled between 1990 and 2006 to amount some 5 trillion US dollars with yields on ten-year US Treasury Bond decreasing from more than 8% to less than 5) (Dunaway, 2009, pp. 8–9).

8 "The fact that low long-term interest rates have coincided with the large US external deficit, sizeable fiscal deficits and high public debt levels has been termed a conundrum" (Makin, 2010, p. 20) (by former Federal Reserve Chairman Mr. Alan Greenspan). The situation largely limited possibilities of US monetary policy action and was connected with the global savings glut issue by Ben Bernanke in 2005.

financial system are predominantly held by private sector, which was not always the case. In the case of international holdings of dollar assets, official holdings as of the end of 2008 were less than 15 percent of total by conservative estimate. By extension, total international assets in all currencies are six times the size of official foreign exchange reserves in all currencies" (Truman, 2010, p. 4). The issue is also connected with global imbalances since "market imposed limits on extensive borrowing formerly limited the size and duration of external imbalances" in form of higher risk rates; "while today, financial globalization makes it possible to borrow and lend internationally on a large scale" (Mongelli, Wyplosz, 2008, p. 20).

Nevertheless, the whole cycle obviously has its limits: Makin (2010, p. 189) firstly points at Sovereign Wealth Funds, with establishment of which "exchange market intervention by external surplus economies has become more diversified" owing namely to depreciating US dollar[9] and raising doubts about US financial market and debt after 2007. "Once toxic US mortgage-related securities found their way into foreign government sponsored portfolios, the US dollars that central banks were taking form America stopped coming back in". Similarly, "excess spending on housing and by federal government had proved insufficiently productive, foreigners decided not to fund it any longer". An important feature here, that moreover "artificially sustains the imbalances, is many governments' borrowing directly in international markets rather than via foreign private investors voluntarily purchasing assets issued in domestic markets" (Truman, 2010, p. 4), which makes them even more vulnerable.

Financial innovation – another outcome of financial globalization – certainly plays an important role in the system, too. "Throughout the 2000s, the leverage of the developed economies' financial system rose continually. This rise permitted the 'transformation' of some $4,000 billion of emerging-countries' savings, invested largely risk free, into loans to Western households and firms, risky by nature"[10] (Brender, Pisani, 2010, p. 115). For the first time in history, "we have a global financial system in which the dominant flows are going in the opposite direction" (Summers, 2008, p. 355) – from developing to developed countries.

4. CURRENT TENDENCIES IN THE DEVELOPMENT OF GLOBAL IMBALANCES

With their sources being complexly based in all major global economy actors' economies and policies, global imbalances have represented a truly global challenge for global governance. Namely International Monetary Fund (but also Bank for International Settlements, UNCTAD or European Central Bank have published various studies on global imbalance) tried to address the issue already before the current crisis. In its "multilateral consultations on global imbalances" (conducted

9 The US dollar depreciated between 2002 and 2008 by over 30% in nominal effective terms, one of the largest dollar declines in post-Bretton Woods era. (Makin, 2010, p. 20).

10 The risks attendant on those loans did not of course vanish: they were borne by the risk-takers of the globalised financial system: hedge funds, investment banks, off-balance-sheet vehicles, specialised institutions like Fannie Mae or Freddie Mac, etc. (Brender, Pisani, 2010, p. 2).

in 2006 with China, the Euro area, Japan, Saudi Arabia, and the United States) the IMF promoted a joint approach to reducing global imbalances while sustaining world growth. Each participant put forward its own set of proposed policy adjustments, which were also discussed by their peers (IMF, 2009, p. 11). These plans, presented the spring of 2007, stated generally accepted remedies and reform policies that should have been performed in individual respective countries. No particular steps towards global imbalances unwinding were however undertaken, showing obvious institutional weakness of the IMF mechanism: "the IMF cannot compel member countries to change their economic policies; it can only urge them to make needed changes. The persistence of global imbalances suggests that the IMF has failed in the execution of its surveillance mandate, especially with regard to its larger, systemically important members, which have been the main players in the global imbalances saga" (Dunaway, 2009, p. 25).

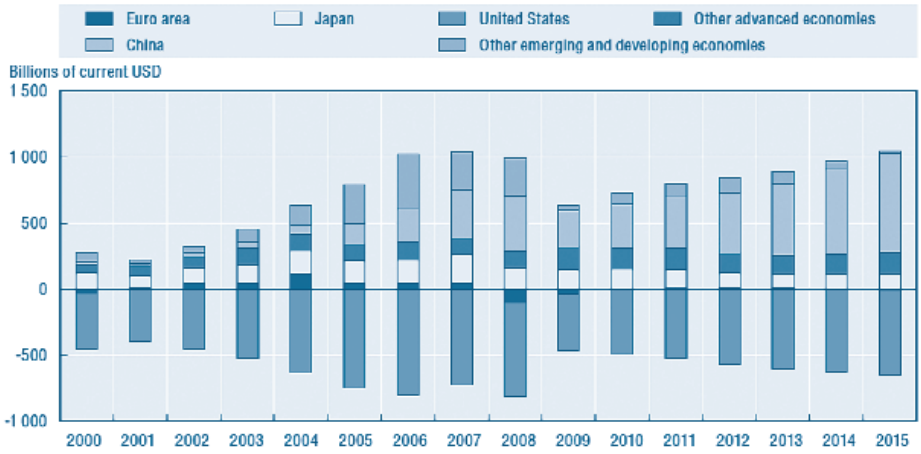
With the break up of the current crisis, global imbalances remained in the centre of policy makers' interests. "The statement of the November 2008 G20 summit hints at the role that imbalances played: "Major underlying factors to the current situation were, among others, inconsistent and insufficiently coordinated macroeconomic policies, inadequate structural reforms, which led to unsustainable global macroeconomic outcomes. These developments, together, contributed to excesses and ultimately resulted in severe market disruptions." The term "unsustainable global macroeconomic outcomes" appears to be a rather oblique reference to global imbalances" (Dunaway, 2009, p. 14). With markedly higher media coverage, the remedies remain unchanged as stated e.g. in IMF (2009, p. 17), with several features that the current crisis healed itself *(see Figure 2)*:[11]

- Increase private and public U.S. saving. The private part has largely taken place. The public part will have to take place over time. This will be good for the US, and help global rebalancing.
- Increase social insurance, strengthen corporate governance, and implement reforms to increase access to credit for households and SMEs in China. This will be good for the Chinese economy, and help global rebalancing.
- Move from export-led towards more domestic-demand led growth in a number of emerging market countries. This change in the policy mix will likely require exchange rate adjustments to maintain internal and external balance. More generally, a current account surplus is not necessarily a sign of virtue. A number of emerging market economies that have strengthened their external position and macroeconomic policy framework and whose growth prospects are good can afford to rely more on domestic demand and let the current account balance decrease, in line with their higher growth prospects.
- If oil prices remain high, as currently forecast, some oil-exporting countries have room for higher domestic demand, and more spending on social infrastructure needs. This gradual demand rebalancing would be eased by an

11 Especially, the increase in saving is expected to be larger in the United States, where private saving was unusually low before the crisis, and where the crisis has probably durably affected saving behaviour. To the extent that U.S. saving is indeed more affected than in other countries, this implies a reduction in the U.S. current account deficit, and lower global imbalances. (IMF, 2009, p. 13).

adjustment of the real exchange rate to reflect their much-improved terms of trade.

- The crisis has again brought to the fore the need to improve global liquidity provision. Providing such liquidity would decrease the need for reserve accumulation, and could have larger benefits.



Source: OECD 2010, p. 55.

Figure 2 - Current account balances in key economic regions, USD billions

As seen in the Figure 2, global imbalances have significantly decreased during the current crisis. Most of this fact can however be attributed to the overall decrease in international trade: according to UNCTAD (2010), global merchandise exports have fallen from 16 122 million USD in 2008 to 12 511 million USD in 2009 and have not returned to their pre-crisis level in 2010. For US merchandise exports, significant driver of current account imbalance, the decrease is even higher: US merchandise imports decreased from 2 169 million USD in 2008 to 1 605 million USD in 2009 and amounted to 1 968 million USD in 2010. Despite initially favourable expectations of global imbalances decrease, most recent forecast of global imbalances (e.g. the one depicted in Figure 2 based on OECD and IMF data) show their continued widening. Moreover, most of the future global imbalance issue is designated to United States and China, whose mutual relation should continue to cause major part of current account deficit and surplus, respectively. Taking the policy weaknesses identified in previous sections of this paper into account, this outcome is far from being optimal, even though it certainly is an outcome of international monetary system. All in all, policy changes will take time and namely the slowing prospects of the global economy can make them even harder. The international system has allowed governments to build up huge balance-of-payments imbalances; the international system will continue to allow them to do so. But the past year or so of crisis demonstrates the *difference between doing what may be politically expedient and doing what is sound economic policy*" (Dunaway, 2009, p. 29): the United States could have missed the opportunity to increase national savings and namely reduce its cyclically adjusted fiscal deficit and China

was not forced to reform it economic model and policy interventions that created significant imbalances and structural problems nor was it encouraged to reform its banking sector and social security system.[12]

5. CONCLUSIONS

Recent global imbalances were caused by various movements on current s well as financial accounts of systemically important countries. Even though they can be seen as an outcome of global savings-investment allocation, this paper suggests that this allocation was distorted by inadequate economic policies in all concerned regions and thus was not optimal. As such it led to those conditions that contributed to the build-up for the current crisis. "Macroeconomic policies, in particular easy monetary and profligate fiscal policies in a wide range of countries, contributed to a benign economic and financial environment that was too good to be true and to lax lending and credit standards in many countries. In that sense, the crisis and the imbalances were jointly determined by macroeconomic policy mistakes" (Truman, 2010, p. 3). Taking political economy of trade and financial globalization both into account, global imbalances are seen as an outcome of macroeconomic policy interaction (or even policy failures or policy reaction delays) of centre and periphery countries and as such they should be addressed. Addressing national causes in systemically important economies will eventually bring better results that redesigning the monetary or financial system as a whole, namely because it is mostly a private – not public – system today, as was suggested above. In that case also the allocation of investment would be more balanced globally and would contribute to facing global issues in a more sustainable way.

Despite a significant decrease in global imbalances during the current crisis, most recent forecasts suggest that global imbalances will widen again. Their structure is expected to change as well, leaving most responsibility on the United States and China. Policy reactions in both regions (e.g. fiscal consolidation and tax reform in the United States as well as banking, exchange rate, and pension reforms in China) seem to take longer than expected earlier and can thus pose significant tension to agreements on global matters. With the main responsibility lying on individual governments, the question remains, what role can global governance play to make the resolution of global issues smoother. Its vital role must be especially in surveillance and in focusing on global and systemic issues that can be left unnoticed (or neglected) by national economic policies. Ability and willingness of national policy makers to implement and follow multilateral rules however seems

12 Similarly: Labour and product market liberalization should have been stressed by the European Commission and leading nations of Europe in light of many European countries' loosing competitiveness and failing in following the Stability and Growth Pact. And similar assumption can be drawn from the articles above in respect to policy responses in Japan, oil exporting countries with week investment environment, peripheral Europe with growing fiscal instability, or to export oriented East Asia.

almost unchanged by the current crisis, which will make the efforts on multilateral balancing even harder.

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