

19 A commercial policy package for rebalancing the global economy?

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This chapter suggests that while macroeconomic policies have undoubtedly played a key role in the build up of global imbalances, policymakers should understand the contribution of commercial policies. It argues that the right commercial policies can cut or even eliminate the current account imbalances – at the same time as supporting the global recovery.

While global imbalances are not always harmful from an economic perspective, world leaders recently committed to reducing large current account imbalances and supporting open trade and investment regimes.¹ But if imbalances are not necessarily detrimental, why did world leaders make this pledge? For one, global imbalances do not always build up in a way that is consistent with the intertemporal trade hypothesis,² possibly because of underlying economic distortions. Second, excessive imbalances can have pernicious effects on economies, particularly if they are financed in unsustainable ways. Given that the global economy is increasingly interconnected, a balance of payments crisis in one country can ripple across the globe. And third, from a political perspective, large bilateral imbalances can breed political pressures to raise tariffs and impose other forms of protection on the trading partners with which large imbalances have accumulated.

It is perhaps because of the polarising nature of the debate on bilateral trade imbalances (particularly in the US-China context) and fears of protectionism that much of the attention in the rebalancing debate has centred on how shifts in monetary and fiscal policies may affect national saving-investment imbalances (i.e. on one side of the national net savings-current account identity).³ This may have created the impression that rebalancing is solely an internal macroeconomic policy issue in countries with particularly large surpluses or deficits. While macroeconomic policies have undoubtedly been a key contributor to the build-

1 See the leadership statement from the G-20 Summit in Pittsburgh, 2009.

2 A country may be running a current account deficit today and in return will run a current account surplus in the future. For example, in a capital-poor developing country the investment potential may exceed national savings and this gap can be matched by foreign investment, which is reflected in a current account deficit and capital inflows, see e.g. Ghosh and Ramakrishnan (2006) or Deardorff (2010).

3 $(S-I)+(T-G)=X-M$, where (S) = the amount of disposable income consumers are willing to save, (I) = private investment, (T) = taxes, (G) = government consumption, (X) = exports and (M) = imports.

up of imbalances prior to the economic crisis, policymakers must understand the role that commercial policies can play in the global rebalancing process.

Current account imbalances can undoubtedly be reduced or even eliminated with commercial policies. And while significantly restricting international trade and investment represents an extreme response to the rebalancing question, it is not a purely theoretical option, as some prominent economists have called for the imposition of protectionism as a way to force rebalancing.⁴ But protectionism is not the only way commercial policies can play a role in rebalancing the global economy. We argue that if world leaders pursue an integrated strategy for commercial policy reform across goods and services sectors, this could help the rebalancing process and at the same time support the global economic recovery.

Trade policy solutions to the rebalancing problem

Global imbalances could in principle be reduced or even eliminated by restricting trade and investment flows. However, moving toward protectionism or putting off further liberalisation efforts are most likely not the best strategies to pursue. This is simply because such strategies imply a risky and highly uncertain trade-off. First, since some current account imbalances can be desirable, it is hard to know how much imbalances should be reduced in general. Desirability and sustainability might even be hard to assess on a country-by-country basis. In this context, the uncertainty surrounding the benefits of reducing imbalances must be weighed against the benefits of trade and investment, including efficiency gains related to specialisation according to comparative advantage, economies of scale, access to a wide variety of intermediate and final products, and technology transfer associated with international commerce.

But protectionism is not the only way in which commercial policies can play a role in the rebalancing process. Deardorff (2010), for example, demonstrates how comparative advantage theory can be useful in assessing the commercial policy implications of global imbalances. His work points out that implicit or explicit subsidisation can lead to the accumulation of trade surpluses and deficits that work against a country's natural comparative advantage. Removing such subsidies would both enhance welfare and reduce imbalances.

The comparative advantage principle can also be a useful guide in thinking about global imbalances in a more traditional, static sense. For example, in a two-country two-product model, a welfare-reducing trade imbalance could arise between two countries if the levels of trade protection are asymmetric. If one country (say China) has a comparative advantage in the production of labour-intensive products (goods), and the other country (say US) has a comparative advantage in the production of human capital - or technology-intensive products (services) - then any asymmetries in the structure of trade barriers could result in

⁴ Krugman (2010), for example, called for import tariffs to be imposed on Chinese imports to solve the problem of the US's bilateral trade deficit with China. In addition, the temporary 1971 US import surcharge has been considered as a viable precedent in the current US-China currency dispute. Others judge a potential protectionist approach as self-defeating and highly destructive. See Evenett (2010a) for a summary of this debate and Evenett (2010b) for an analysis of the 1971 import surcharge.

the build-up of unsustainable (and welfare-reducing) imbalances. This would be the case if import barriers are persistently higher in services than in goods in both countries, or if one of the countries has higher import barriers on both products. A liberalisation scenario that alleviates this asymmetry would result in both the reduction of imbalances as well as welfare gains.

Insights from the Balance of Payments and the structure of trade protection

How does theory fit with reality? First, we look at whether the evolution and structure of global imbalances in the run-up to the economic crisis point to welfare-reducing and imbalances-enhancing distortions. Strikingly, the build-up of global current account balances – measured as the sum of the absolute value of world current account balances divided by world GDP – that began in the mid-1990s was driven by the goods side of the trade account (that is, imbalances related to trade in goods have contributed the most to global imbalances since the mid-1990s) (Figure 1). In fact, the contribution of the goods sector to imbalances doubled from below 3% of world GDP in mid-1990s to above 6% in the late 2000s.

In contrast, the contribution of services trade to global imbalances has remained relatively constant at around 1.5% of world GDP over the period, albeit with a slight upturn in 2007-2008. Of course, the current account does not capture all of the channels through which services are traded,⁵ but this potential bias would not be expected to increase over time. It is also hard to resist comparing the timing of the emergence of this disparity (the mid-1990s) and the conclusion of the Uruguay Round of trade negotiations (1994), especially since the commitments in goods have been reported to deliver more actual trade liberalisation than those in services.⁶ Thus, these trends may be suggestive of a growing divergence in the structure of trade protection for goods and services, especially given the fact that the countries that account for the bulk of the large deficits in goods are specialised in the services sector.

This trend is also evident when analysing the current account balances of the 10 countries with the largest current account surpluses and deficits in 2007 – the year preceding the economic crisis (Figure 2).⁷ Only two of the economies with a current account surplus in 2007 are not high-income – China and Malaysia. But half of the surplus countries are Asian – China, Japan, Singapore, Chinese Taipei and Malaysia. This is a marked contrast from 1996 – the year when current account imbalances began to increase significantly – when only China (no. 9) and Chinese Taipei (no. 8) made it into the top 10. This pattern reveals both the

5 The services category in the current account does not cover two important modes of services delivery (mode 3 services trade (commercial presence) and mode 4 services trade (temporary migration of labour)). These components are captured in the capital (mode 4) and financial (mode 3) accounts of the Balance of Payments.

6 Hoekman (1995), for example, provides an assessment of the Uruguay Round Agreement commitments on services and their failure in terms of generating liberalisation.

7 This ranking excludes large net oil exporters.

shift of economic clout from West to East as well as some of the aftershocks of the East Asian Financial Crisis of 1997-1998, when balance of payments problems induced countries to pursue economic policies aimed at achieving current account surpluses.

On the deficit side, all of the countries are high-income countries (and all OECD members except Romania). The opposite trend appears here, as developing and largely Asian countries⁸ moved out of the top 10 deficit countries in the 11-year period (1996-2007) and more high-income, largely European countries⁹ moved in. Remarkably, in 2007 nine out of the ten countries with the largest current account deficits recorded negative balances on goods trade and, at the same time, positive balances on services trade. All surplus countries recorded a positive balance on goods trade and the three countries with the largest surpluses (China, Germany, Japan) as well as Chinese Taipei and Canada had at the same time a negative services trade balance.

Can these differences in the structure of the balance of payments between surplus and deficit countries be related to the prevailing structure of comparative advantage and trade barriers? Possibly yes. Figure 3, Panel A demonstrates that while the levels of protection on imports of goods are comparable across the surplus and deficit countries (Singapore and Malaysia are exceptions with relatively high barriers), barriers on imports of services tend to be higher¹⁰ in surplus countries (Panel B). Deficit countries tend to be more (less) specialised in exports of services (goods) than surplus countries (Panel C), which suggests that their exports could be hampered disproportionately by relatively higher services trade barriers. Interestingly, this line of thinking possibly generalises beyond the top 10 surplus and deficit countries, as a strong tendency can be observed for barriers to services trade to decrease as income levels rise (Panel B, Income Groups), while the share of services in value added and specialisation in exports of services tend to increase with income (Panel C, Income Groups).

In the deficit economies (apart from Turkey), the portfolio and other investments elements – not FDI – contribute the most to the overall financial account balance (Figure 4). This pattern has not changed much over the 11-year period. Given that current account imbalances are more sustainable in the medium-term if they are financed by FDI, which is less subject to sudden reversals, it appears that the largest deficit countries may have difficulties continuing to run deficits with the current structure of their balance of payments. As a result, encouraging FDI (or mode 3 trade in services) is an important element of any policy package designed to help reduce unsustainable imbalances.

If it is essential to encourage FDI, then policymakers must understand how restrictive services policies are in the countries that contribute the most to

8 Brazil (no 2), Korea (no 3), Thailand (no 5), Indonesia (no 8), Argentina (no 9), and India (no 10).

9 Spain, Italy, Greece, Turkey, France, Romania, and Portugal all moved into the top 10 during this time.

10 This is based on the World Bank index of GATS commitments reported in the World Trade Indicators database. This is an imperfect measure of services trade restrictiveness but so far this is the only index that offers a broad sectoral coverage and comparability across countries. Other sources of information on services trade barriers such as Dihel and Shepherd (2007) and Wölfel et al. (2009) confirm the general finding that barriers to services trade tend to be higher in developing and emerging economies, as compared to the OECD area. The OECD is currently developing services restrictiveness indexes at the sector level: <http://www.oecd.org/trade/stri>.

global imbalances. Based on the currently available data, it does not appear that the countries that are on the deficit side have particularly restrictive policies toward trade in services. Using either the FDI component of the OECD's measure of product market regulation or the World Bank's GATS Commitments Restrictiveness Index, it does not appear that the deficit countries (apart from Turkey) have overly restrictive services regimes (Figure 3, Panel B). However, these measures are imperfect and more robust measures covering a wide variety of developed and developing economies are needed.¹¹

These data suggest that surplus countries are not choosing to invest via portfolio and other means in deficit countries because they face overly burdensome restrictions to direct investment. Indeed, their World Bank Doing Business scores all rank quite well (apart from Greece and to some extent Turkey). What we can say is that Asian countries, particularly developing Asian countries, are playing a larger role in financing other countries' deficits, and that this has come in the form of portfolio and other investments, as well as reserve assets in the case of China, which is less sustainable than FDI. These developing countries generally have more restrictive services policies than the high-income countries on the deficit side.

Conclusion

Differences in the structure of current and financial accounts, the pattern of post-Uruguay Round barriers to trade in goods and services, together with broad patterns of trade specialisation, all suggest that a policy package designed to rebalance the global economy can usefully include services trade liberalisation as one important element. Since many of the deficit countries specialise in services, they are at a disadvantage when trying to rebalance their economies because they face higher barriers to exporting in the sectors in which they have a comparative advantage. Similar reasoning may also apply to remaining protection within goods sectors.

It also makes sense to liberalise services from the perspective of the surplus economies, particularly those in developing Asia where barriers are highest. Crucially, services liberalisation would help the surplus countries by providing access to a greater variety and quality of services. The associated services productivity boost would encourage domestic consumption, thus putting these countries on a more sustainable growth trajectory. Moreover, there can be important feedback mechanisms between services liberalisation and productivity in manufacturing, the sector in which many of the surplus economies have a comparative advantage, with positive welfare implications (Leshner and Nordås, 2006).

Some existing commentary suggests that this policy prescription could indeed be a viable option for the two countries with the largest current account

¹¹ The OECD is currently developing a comparable services trade restrictiveness index, though the first stages of this work have concentrated on current OECD members and a limited number of sectors (see: <http://www.oecd.org/trade/stri>)

imbalances – China and the US. Greene et al. (2006), for example, describe the duality in China's economy where the opening up of trade and FDI in goods coexists with a high level of public ownership and important regulatory barriers in the services sectors.¹² Indeed, this is independently acknowledged in internal discussions on China's 11th Five-Year Plan (2006-2010) which for the first time emphasises development of services as a means of improving the overall structure of industry, job opportunities and comprehensive competitiveness.¹³ More recently, Godement (2010) argues that greater access to China's capital market and services sector and public procurement ("second opening") would be a better solution to the US-China currency dispute than currency revaluation.

Evidence presented in this note provides support for these arguments but, by showing potentially harmful asymmetries in the levels of protection across the goods and services sectors and countries at different levels of economic development, it also advocates for a wider and a more transparent services liberalisation agenda (e.g. in the context of the DDA negotiations in the WTO or through free trade agreements). Commercial policies can usefully contribute to global rebalancing and support the global economic recovery, and policymakers would be well-served to incorporate them in their policy agenda.

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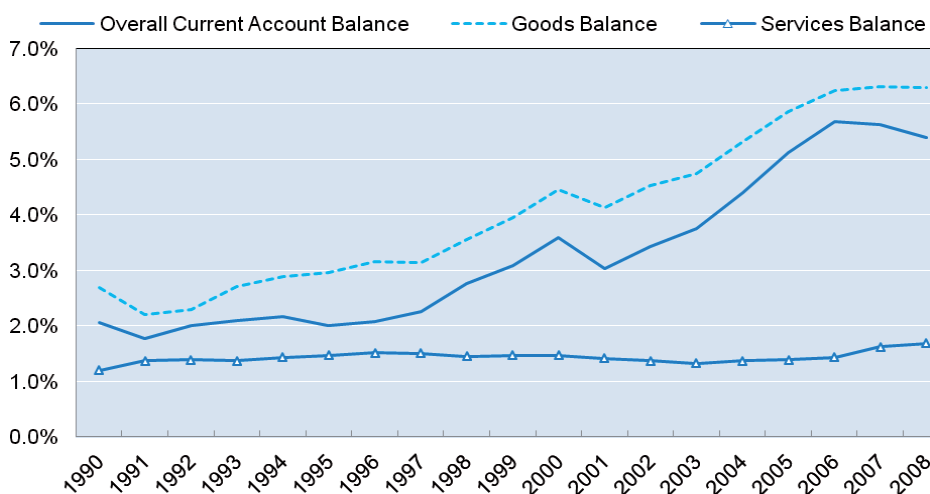
¹² High entry barriers, excessive state involvement, opaque regulatory process and overly burdensome licensing and operating requirements.

¹³ See e.g. <http://www.china.org.cn/english/2006/Mar/160397.htm>.

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Figure 1. Composition of Current Account Balances, 1990-2008

Absolute values of respective imbalances divided by world GDP



Source: Authors' calculations based on IMF Balance of Payments data. For presentational purposes, net income and transfers, the other two components of the Current Account, are omitted.

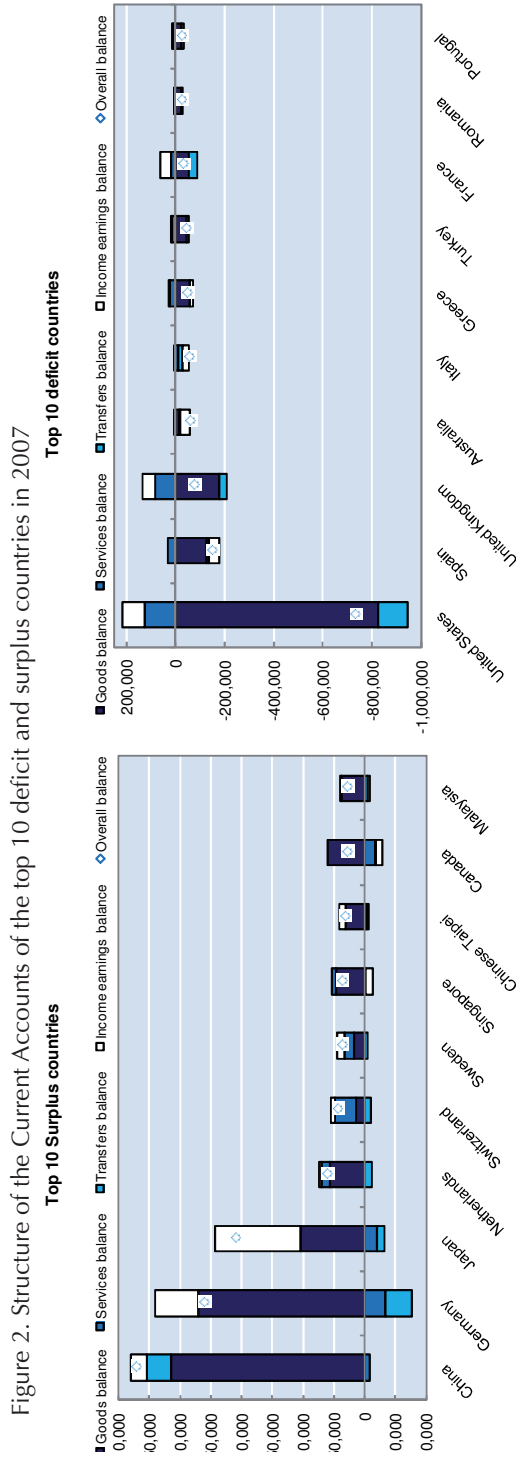
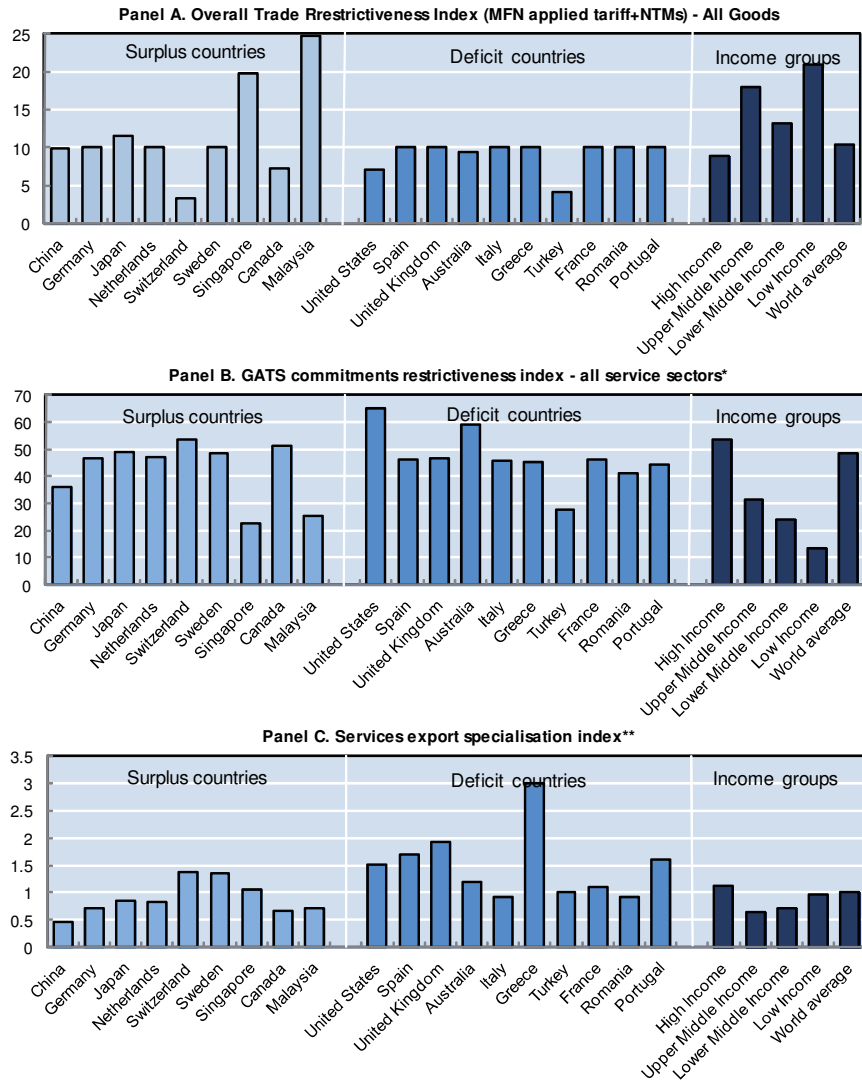


Figure 2. Structure of the Current Accounts of the top 10 deficit and surplus countries in 2007

Source: Authors' calculations based on IMF Balance of Payments data.

Figure 3. Structure of protection in goods and services markets and services export specialisation



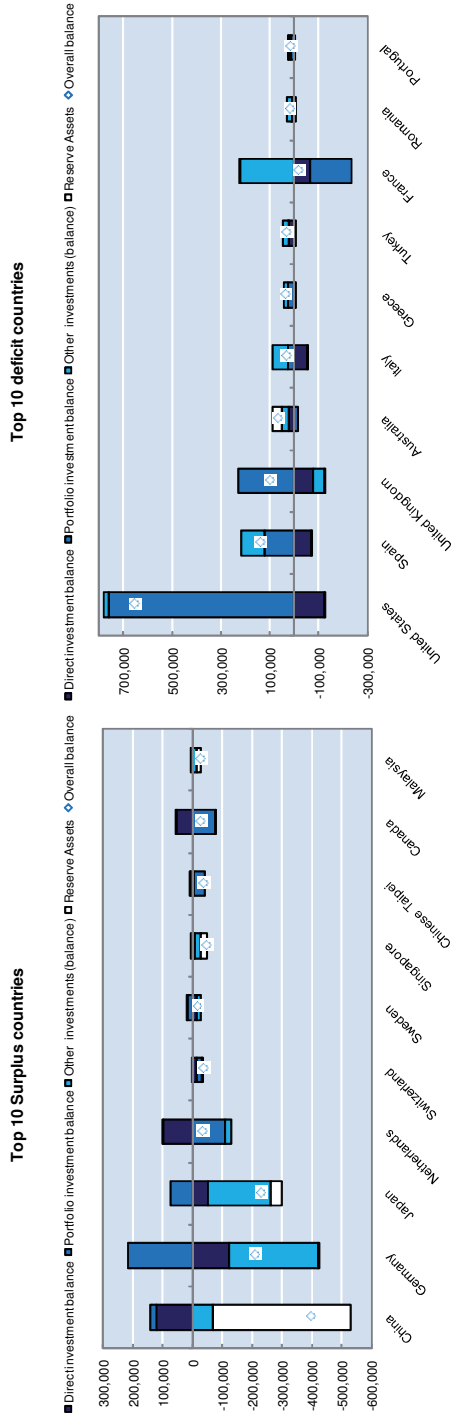
Notes:

* The GATS Index score for these countries is on a scale of 0-100, with 100 meaning fully liberal.

**This is ratio of a share of a country in world service exports (current US\$) and a share of a country in world exports of goods and services (current US\$).

Source: Authors' calculations based on World Trade Indicators and World Development Indicators data.

Figure 4. Structure of the Financial Accounts of the top 10 deficit and surplus countries in 2007



Source: Authors' calculations based on IMF Balance of Payments data.

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