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# The Gross Inequities of Global Imbalances

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**The huge size** of current global economic imbalances is unprecedented. Such imbalances are both unsustainable and inequitable (see the IPC webpage on the State of the World Economy, e.g., Working Papers #12 and #23).

A few rich countries are running large current account deficits. One in particular, the US, is running a deficit about 3.5 times larger than the deficits of all other OECD countries combined.

At the same time, a few rich and middle-income countries (Japan, Germany, China, Saudi Arabia and Russia) are running large current account surpluses. Prominent among these are big oil exporters and Asian exporters of low-cost manufactures, which deposit their surpluses in rich countries.

Why are these trends troubling? Do not all global surpluses and deficits balance out? Yes, in an accounting sense. While countries running large deficits have to borrow abroad to finance them, countries running large surpluses have correspondingly extra money to invest abroad. But in practical terms, the deficit countries can have problems in borrowing enough money abroad; and the surplus countries can have problems in obtaining a high enough rate of return on their investments.

The unhealthy US economy poses grave global risks: either the US dollar has to dramatically depreciate in order to reduce the country's trade deficit or US interest rates have to substantially rise to ensure attracting foreign investment. Or both.

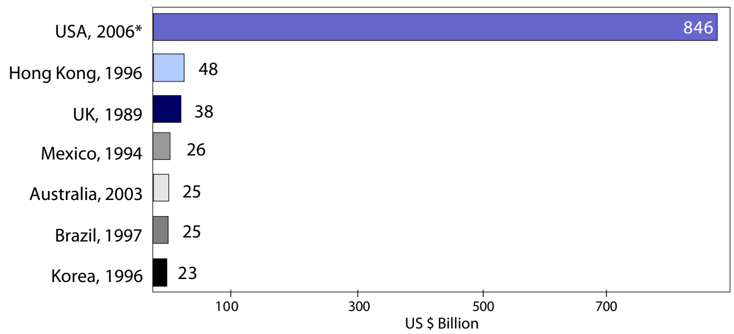
Normal exchange-rate and interest-rate movements might, under circumstances of small deficits and surpluses, be sufficient to correct global imbalances. But much more drastic movements, likely to destabilize global capital markets, would be needed to reduce the US current-account deficit—namely, about US$ 850 billion projected for 2006. This deficit is, by far, the largest ever recorded (see figure).

A positive solution to the US deficit will require international policy coordination. 'Market forces' will not solve the problem—unless they force an abrupt, devastating adjustment for all. The US's voracious demand for global goods and services is currently driving, for better or worse, the growth of many other economies. But this demand has to be slowed—preferably gradually—in order to rectify global imbalances. Absent a coordinated international response, the US economy could plunge into recession, destabilising the rest of the world.

Current global imbalances not only pose huge dangers; they also cause a grossly inequitable distribution of global resources. Capital is 'flowing uphill' to rich countries—overwhelmingly to one rich country, the US. A stark illustration of this inequity: the average US current account deficit in recent years has been one third *higher* than the total Gross Domestic Product of sub-Saharan Africa.

The money that many middle-income countries are now investing in the US could make a major contribution to development if it were redirected to poorer countries, or even kept within these middle-income countries. Because more goods and services would become available domestically, the population in such countries would enjoy a higher standard of living.

**World's Largest Current Account Deficits since 1970**




* USA deficit for 2006 is an extrapolation of known figures over the first ten months of the year.

Currently, the US population is indulging in a standard of living that is six per cent higher than its own income, thanks to the mammoth and continuous inflow of capital from other countries. In global terms, the US is becoming a 'heavily indebted' country.

When a country runs an external deficit, major sectors of its economy must be spending more income than they receive. In the US, the most notable is the personal sector. Seduced by real estate appreciation and rising stock prices and encouraged by low interest rates, US households have hiked their net borrowing to over six per cent of national income in recent years. This profligacy cannot be sustained indefinitely.

Based, in effect, on borrowing money from other countries, US households have monopolized goods and services that could have a greater impact on global human welfare if they were consumed in poorer countries. Also, the US economy is enjoying a gargantuan inflow of financial resources that could be invested at a higher social rate of return by low-income and middle-income countries in their own development.

Since the US is enjoying the fruits of this inequitable imbalance in resource flows, it has limited motivation to correct it. An impending US economic collapse is probably the main factor that could impel national policymakers into action. An alternative solution, mutually beneficial to all, could be a coordinated effort by both developed and developing countries to stimulate domestic demand in regions other than the US.

Policies to stimulate domestic demand in Europe and Japan would help compensate for a slowdown in US demand. Substantially boosting demand, particularly domestic investment, in developing countries would be a priority for achieving an equitable resolution. For such countries, currently starved of development resources, such as for the MDGs, greater policy coordination is not an unrealistic ideal. It is an urgent necessity.

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