The G20 was not a success

The G20 meeting in London last week got a lot of coverage (fine), the IMF came out of it stronger (good), tax havens and hedge funds might be regulated a bit more stringently (probably good), but the critical problem of macro economic imbalances was not tackled (bad, very bad).

Interdependence

The world consists of two groups of countries: those who save and those who do not. The savers run current account surpluses and the non-savers run current account deficits.

The US and UK are the leading low-saving countries in the world. They import huge amounts from the rest of the world.

China, Japan, Germany and the energy exporters (when energy prices are high) are the leading high-saving countries. They earn that by exporting to the others.

The one cannot exist without the other. The export countries sell to the import countries and so generate their surpluses. Then they send some of those surpluses back to the importers so that the latter can balance their books. They do that by buying American financial and real assets.

Thus the Chinese buy lots of American treasury bills, which helps the US cover its budget deficit. The Germans bought a lot of American sub-prime assets, which have now inflicted damage on German banks and insurance companies. Complete interdependence.

The last thing the world needs right now is for the low saving countries to begin to save more, *right now*. That will contract demand, choke off imports, hit the export countries and prolong the global recession. It is what Lord Keynes called the paradox of thrift.

Paying to get out of recession

Against this background of interdependency the world is now in recession. Frantic attempts are being made to get out of it. The favourite tools are very low interest rates, money printing, and deficit spending by governments. Problem is that so far it is mainly the poor savers (US and UK) that have taken on this burden. Germany and Japan have made a minimal contribution to extra spending to resuscitate the economic machine. The Chinese have indeed launched a big stimulation package, but in the eyes of her critics not big enough, considering her size.

A huge exporter like Germany is a reluctant stimulator (partly understandable, given their experience with Weimar inflation and German reunification). Consequently it is now under pressure from its European allies and the G20 to do more.

Selfishly, the Germans state that their economy will pick up *as soon as the other countries' stimulus packages kick in* because German exports to these countries will rise. An American taxpayer must find that a touch ungrateful, considering the interdependency of the global world (as well as Marshall aid).

Enters Politics

Now here is the problem. Why should the taxpayers in the deficit countries (US & UK) take on huge extra debt which they and their children will have to repay if the benefits and jobs from that debt-induced stimulation simply flow to the big export countries? It is not a sustainable position.

Pres Obama clearly understands the relationships and had a gentle warning for the Germans on Friday in Baden-Baden: "It is not the Germans' fault that they make great products that the US wants to buy. But …over all there's probably going to need to be a rebalancing of who is spending and who is saving."

Stuff you…?

And if the export or surplus countries refuse to be part of this rebalancing?

Well, it is quite clear that the Americans are not going to hold back. Their budget deficit is sitting at 12% and rising. They are throwing billions at toxic assets and printing lots of money. Their reputation for tackling problems and throwing money at them is holding fast.

The consequence will be a much lower dollar, as we have already seen. That will help to balance US imports and exports. In due course the US position will improve but at the cost of greatly reduced imports and at the cost of capital losses for those who bought US assets. A low currency is a most effective weapon of import protection. The export countries will feel the pain of that protection.

But that's not the end.

The Chinese currency is pegged to the US dollar so the lower the latter, the lower the former. The Chinese probably have enough reserves to maintain that peg. That will make Chinese exports very competitive worldwide (for example against the textile industry in SA).

And so the Germans will feel the pain of a high euro against the dollar AND the yuan. They may not benefit from higher exports. The citizens will then go to the streets and put pressure on their politicians. That can only lead to full-blown trade protectionism.

The World Bank has already identified 72 protectionist measures that have been introduced world wide since the onset of this crisis. If more follow, we might be on the slippery slope of the 1930s.

A "stuff you" approach is a global zero sum game that takes us nowhere.

The Solution

What one wants, as Pres Obama said in Baden-Baden, is more balanced consumption. That is what keeps the factories busy, the ships steaming, the retailers active, the workers employed – and what justifies investment. No consumption, no investment.

Consumption also determines standard of living. George Soros made the point long ago that as the Chinese workers become more productive (which they are) they will want to share in the higher proceeds of that productivity and increase their living standards, i.e. they will consume more.

Part of this adjustment would be that the Chinese currency would rise against the dollar (either the currency must become fully convertible or it must be pegged at rising levels against the dollar). This is a critical part of global re-balancing. It will also help the Chinese to up consumption and raise their living standards. Whether it will happen….?

So one does not want the US consumer to do all the consumption and the Chinese worker do all the saving. One wants both to consume and save. A major re-balancing is required in the world otherwise protectionist politics could take over. And that is what the G20 failed to address.