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RETHINKING EXPORT–LED GROWTH

America, China and Global Imbalance

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The developing and emerging-market economies that have focused their current export-oriented strategies on the markets of the major developed economies for achieving growth and job creation should rethink their policies, the United Nations Conference on Trade and Development (UNCTAD) has advised.

In its *Trade and Development Report* (TDR), UNCTAD said that export-led growth ambitions will meet with increasing constraints now that the debt-financed consumption boom in the US has ended.

The US economy will no longer serve as an engine of growth for the global economy. Neither China nor the Euro area nor Japan is likely to assume this role in the foreseeable future.

Policies for sustainable economic growth, job creation, and reductions in poverty should be based on establishing a balanced mix of domestic and overseas demand, said UNCTAD.

"The shift in focus on domestic-demand-led growth is necessary both in developed and emerging-market economies with large current-account surpluses and under-utilized production potential in order to prevent the recurrence of imbalances similar to those that contributed to the outbreak of the global financial crisis," said UNCTAD Secretary-General Dr Supachai Panitchpakdi in the overview to the report.

"Past experience and theoretical considerations suggest that a sustainable growth strategy requires a greater reliance on domestic demand than has been the case in many countries over the past 30 years... Especially for developing countries, this may call for a rethinking of the paradigm of export-led development based on keeping labour costs low," he added.

According to the report, there is widespread agreement that the persistently large imbalances in the world economy contributed to the outbreak of the current economic and financial crisis and facilitated its global spread.

There is also agreement that a smooth and non-deflationary reduction of these imbalances is indispensable for ensuring that the recent global economic upturn continues.

Although the US accounted for about 50% of the aggregate current-account deficits in the world economy, and China for about 22% of all surpluses in pre-crisis 2007, the global imbalances are far from being just a bilateral problem between the US and China. China began to show a strong current-account surplus only from 2003; prior to that the main counterparts to the US' long-standing current-account deficit were surpluses in Germany and Japan.

However, while so far there is little evidence that adjustments in the two countries would be able to help bring about a global re-balancing, in the US, there appears to be no alternative to adjusting household consumption unless another asset bubble is allowed to occur.

In China, added UNCTAD, the need to embark on major structural transformation from investment-and export-led growth to consumer-led growth has been officially recognized.

The recent growth trajectories of the US and China appear to have moved in opposite directions. Consumption as a share of gross domestic product (GDP) increased in the US but fell in China; investment rose dramatically in China while its importance shrunk in the US.

Thus, the US current-account deficit has been associated with a low national savings rate and a continuously rising share of private consumption in GDP, while along with China's current-account surplus there has been a very high national savings rate and a very low share of household consumption in GDP.

"However, the external position of neither of these two countries is sustainable," says the report.

It is now widely accepted that in order to recreate a favourable external environment for development, the challenge for policy-makers is to achieve a non-deflationary and durable rebalancing of demand in the world economy. Such rebalancing will probably have to include a decline in the share of consumption in aggregate income in the US and an increase in that share in China, adds the report.

"While there are different views on the causes and effects of global imbalances, there can be little doubt that the savings and consumption pattern of United States households have been a key determinant of those imbalances."

The report examines a number of issues relating to re-balancing in the context of the national economies in the US and China.

It says that a decomposition of the national income and product accounts in the savings-investment balance, with the components of net national savings disaggregated, highlights the secular decline in the US household savings rate since the beginning of the 1980s, with a particularly sharp drop around the year 2000.

The decline in the US household savings rate went hand in hand with a rapid expansion of private consumption. Since the late 1990s the share of personal consumption in GDP has considerably exceeded its average long-term trend of about 66%, reaching a peak in early 2009, when it accounted for 71% of GDP.

More importantly, notes the report, the increase in US household consumption was largely debt-financed, facilitated by easy consumer credit, lax lending standards, a proliferation of exotic mortgage products, the growth of a global market for securitized loans and soaring house values.

The increase in private consumption was unsustainable because it was not supported by a similar expansion of labour compensation in the private sector. Compared to previous upswings, the economic expansion that ended with the onset of the current prices has been characterized by a low increase in employment–a phenomenon sometimes referred to as "jobless growth"–and by the relative stagnation of real wages.

As a result, said UNCTAD, private sector labour compensation grew at an unusually sluggish pace and fell short by more than US$800 billion (in real terms) relative to the trajectory of the previous four business cycles.

Buoyant consumer demand in the US was the main driver of global economic growth for many years in the run-up to the current global economic crisis. Household debt to GDP was about 100%, in strong contrast to China where it has been relatively low, at roughly 20%. This means that in the US, consumer demand is likely to shrink–not just grow slower–while in China, it is likely to grow rapidly.

It is unlikely that the sharp decline in US imports of consumer goods could be compensated by an increase in consumer spending and associated imports of consumer goods by China or any other developing country. Given that China's consumption was only about one eighth of US consumption and that its GDP at current exchange rates is only one third that of the US, there is little reason to believe that household consumption in China could supplant US household consumption as a driver of global growth anytime soon.

In order for Chinese consumption to compensate for the reduction in US consumption, the share of consumer spending in GDP in China would need to increase by at least 10 percentage points–an unlikely occurrence in the foreseeable future.

The report finds that the most internationally visible characteristic of China's development path has been its strong export growth. Such emphasis on foreign demand for economic growth inevitably increased China's vulnerability to a downturn in its major export markets. Thus, it is not surprising that China's exports fell sharply with the onset of the global economic crisis. This has led to renewed calls for a rebalancing with less emphasis on investment and exports and more to a greater reliance on domestic consumption.

The report also notes that private consumer spending in China is low by international standards, regardless of whether it is measured in per capita terms or as a share of GDP. In 2008, per capita consumption was only $758 (in real 2000 terms), much lower than that of many other developing countries including in Asia.

However, the report adds, a low and declining share of private consumption in aggregate demand is a characteristic frequently observed in rapidly industrializing economies during their early phase of economic take-off.

There is widespread agreement that measures such as an increase in government spending on social security (including pensions, health and education) and public investment in housing could help reduce household precautionary savings and may help increase consumer spending in China coupled with reform of the financial sector to help boost household consumption.

The report says that the tendency of a falling share of consumption in GDP results mainly from the decline in labour compensation as a share in GDP. The latter development, in turn, is closely related to structural change, involving a shift from activities with a high employment share (particularly agriculture) towards industrial activities with a generally lower employment share, and to an emphasis on capital-intensive production in the manufacturing sector.

However, achieving such structural change–which is a natural process in a country's economic development–without real wages growing more rapidly relative to productivity than in the past may become increasingly difficult.

According to media reports, minimum wages have been rising strongly in several provinces. While this evidence suggests a broad tendency towards rising wages, it must be interpreted with caution, says the report, adding that part of it could be a reaction to more supportive agricultural policies, such as the abolition of the agricultural tax.

All of these factors taken together could be a powerful stimulus to domestic consumption.

The report also examines the implications of the re-balancing processes in the US and China for other countries.

The report suggests that the net effect of the adjustments in the US and China taken together would be deflationary for the world economy, while they would not be sufficient to unwind the large global imbalances.

This is due to the fact that not only the absolute value of the consumer goods bought by Chinese households but also their import content is much smaller than that of goods bought by US households. Moreover, the composition of consumer goods imported by China differs considerably from that of the goods imported by the US.

As a result, there will be a tendency towards a deterioration in the trade balance of many other countries in the world economy, unless the necessary adjustments in the US and the structural changes in China are accompanied by rebalancing efforts in other economies.

Since world exports are set to decline, especially for industrial goods, with the largest declines likely to occur in the most labour-intensive industrial sectors, the net effect of adjustments by China and the US could well have a sizeable adverse impact on employment worldwide with differing impacts across countries. □□□

—Third World Network Features