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Causes and Consequences of Economic Imbalances

Comparison of US-Asia and Europe

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Abstract

In the past ten years, huge economic imbalances among US-Asia as well as eurozone countries have built up. Since huge economic imbalances have led to numerous crisis situations in the past, the goal of this paper is to find out if economic imbalances are sustainable or if they need to be rebalanced? And what role do distinct national policies play?

The author is going to compare the imbalances of US-China with the intra-euro imbalances of Germany, Spain and Italy. In the first chapter, the historical development of the economic imbalances is presented in order to point out the unprecedented height of the mentioned imbalances. Not only the current account is being analyzed, but also the debt structure of the mentioned countries is presented since it shows how vulnerable a country is towards economic changes. Prior to the crisis, debt was mainly composed of private debt whereas afterwards it was partly turned into public debt. In the third chapter, the author is analyzing the causes of imbalances by presenting the development of the competitiveness, the saving-/investment rates, the financial markets as well as the different national policies. It is shown that distinct national policies were the underlying causes for the development of such high economic imbalances.

After having seen the historical development as well as the causes, the author describes the possible costs and benefits of having imbalances as well as the implications of the global financial crisis and the current European crisis. Due to the increasing globalization, the financial crisis spread fast and led to huge losses and decreasing investor's trust in European countries. This resulted in the European crisis which subsequently could also endanger the global economy.

Because of the huge crisis' impact, traditional and alternative balancing channels are discussed in the following chapter. Despite supporting measures such as restrictive fiscal policies and financial assistance, Europe is still suffering from an economic downturn whereas the US returned to a slow economic recovery. At the end, the author concludes that global imbalances need to be rebalanced in order not to avoid reaching an unsustainable level. The occurring as well as rebalancing of economic imbalances highly depend on distinct national policies. Unless the international coordination and cooperation increases, economic imbalances will continue to occur and will lead to economic crises when reaching an unsustainable level.

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CA	Current Account
CPI	Consumer Price Index
ECB	European Central Bank
EFSF	European Financial Stability Facility
EFSM	European Financial Stability Mechanism
ESM	European Stability Mechanism
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GNI	Gross National Income
G-7	Group of 7 – International Finance Group
IMF	International Monetary Fund
LTRO	Long-term Refinancing Operations
NCU	National Currency Unit
OECD	Organization for Economic Co-operation and Development
PIIGS	Portugal, Ireland, Italy, Greece, Spain
UK	United Kingdom
UNCTAD	United Nations Conference on Trade and Development
US	United States
USA	United States of America

1. Introduction

1.1 Problem and Objective

"The economic health of every country is a proper matter of concern to all its neighbors, near and far."
-Franklin D. Roosevelt[1]

This quotation reflects the importance of economic imbalances for the global economic environment. As seen in the past, huge economic imbalances of emerging countries have resulted in a number of crises such as the Mexican *tequila* crisis, Asian crisis or the Argentine crisis. In the past ten years, major economic imbalances have been concentrating among a small number of countries. The main deficit countries such as USA and Spain have been mirrored by current account surplus countries in Asia, Middle East as well as in Europe. Already in 2004, the persistency and growing size of the global imbalances have led to the speculation about a disorderly unwinding in the future. In 2007, the global financial crisis started in USA and rapidly spread across major economies due to the high financial integration. Out of the financial crisis, the current eurozone crisis developed which is posing a major threat to the global economy.[2]

"Global imbalances can be defined as widening external positions of systemically important economies that reflect distortions or entail risks for the global economy."[3] External positions are shown in the current accounts which show huge deficits or surpluses caused by distortions or/and pose a risk for the global economy. Distortions can arise due to policy decisions taken by the public or private sector. The current account development of a single European country does not fit the definition, but a country's possible contagion effect in case of a crisis and the overall European development is systemically important and poses a significant risk to the global economy. Hence, in the author's point-of-view the current account development from US-Asia as well as the intra-euro economic imbalances can be considered as global imbalances.

According to Blanchard and Milesi-Ferretti (2011), global imbalances can be considered as good or bad for the global economy. In the <u>optimistic point-of-view</u>, it may be desirable to hold economic imbalances in a globalized world, e.g. to counteract inefficiencies in the national economy. In contrast to that, in the <u>pessimistic view</u> imbalances

[1] Kerry 2012, p.1
[2] Dullien et al. 2010
[3] Bracke et al. 2008, p.5