
An Indian Perspective on Global Imbalances and Potential Policy Responses

Shankar Acharya

I will confine my remarks to two areas. First, I will try to give you an Indian perspective on this issue of global imbalances. (I want to emphasize the article *an*, since we have lots of perspectives on this matter). Second, I will emphasize three or four of the key ideas and assessments that I am taking with me following these two days of stimulating sessions, which, using Brad DeLong's phrase, may have led at times to "higher levels of confusion."

An Indian Perspective

It is flattering to find India clubbed with China under the rubric of "Emerging Giants." However, honesty compels me to admit that I have to agree with Richard Cooper's point from yesterday that lumping India and China together may not be quite appropriate, at least at the present time, and certainly not as far as the scale of engagement with the global economy is concerned.

Let me give you a few rather obvious indicators and dimensions by way of comparison. If you take merchandise trade (or even if you include services), India's share in global trade is about 1 percent. China's share is, I believe, around 7 percent. If you take inward foreign direct investment, China has received more than U.S. \$60 billion annually in recent years. India, on the other hand, gets about U.S. \$5–6 billion a year. Even if one adds about U.S. \$8–10 billion of portfolio investment, annual inflows of foreign investment into India are running at only about a fifth of the flows into China. A third dimension or indicator, which (surprisingly) we

haven't talked much about during this conference, is energy. This surely is a subject with close linkages to the topic of global imbalances. Now, I just happened to look at some numbers recently in *The Wall Street Journal*. The paper was quoting the International Energy Agency (IEA), according to which the incremental increase in oil demand between 2000 and 2005 was as follows: for India it was 300,000 barrels per day, while for China it was 2.1 million barrels a day. So China's demand is about seven times higher than India's. By way of benchmarking, for the United States the incremental increase in oil demand during this same period was 1.1 million barrels per day.

Turning to issues of labor supply and demand, which we discussed yesterday, let me recall the point made by Abhijit Banerjee about weaknesses in the supply chain of India's higher education system. He mentioned that some 15 to 17 professorships were vacant at the elite Delhi School of Economics—this example may be a special case. But there is plenty of other evidence showing major weaknesses at all levels of India's education system, from primary schools upward. Demand for education is not an issue in India. Supply is the problem. We have not got our act together on this. Unfortunately, this problem is likely to have serious long-term effects on skill development in India and the future supply of skilled labor coming into both Indian and global labor markets. In contrast, my impression is that China has had much greater success in getting its higher education system really to forge ahead, providing the kind of numbers that we saw yesterday in Richard Freeman's presentation.

Let me point to one last indicator of differences in achievement between India and China; namely, employment in the organized (as distinct from informal or small-scale) manufacturing sector. That number (if the official data is correct) for a recent year in India was only about 6 million out of a total labor force of over 400 million. This low figure reflects a long history of all sorts of dysfunctional labor laws, among many other factors, but it certainly is an indication of significant labor market problems. Of course this is very different from the numbers that I have seen on China's factory employment in manufacturing, which, depending on the source, varies from somewhere between 50 or 60 to 150 million. If you take all this together and refer back to some of the very interesting discussions

we had yesterday during Richard Freeman's session, it's probably not two "typhoons" (to use Surjit Bhalla's colorful phrase) that are on their way to disrupt global labor markets. It is probably one typhoon from China, and perhaps only a gale force 2 storm from India, which may not gather much strength in the foreseeable future.

The second dimension of difference that I want to emphasize between India and China relates to some of the policy issues that typically come up in international forums like the International Monetary Fund (IMF) and G7 when one is discussing the issue of global imbalances. Let me touch on a few aspects. First, if imbalance is a problem (and one of the things I have learned at this conference is that there is a very weighty and respectable intellectual view that suggests it may not be such a big problem), India doesn't seem to be contributing to this problem through a structural current account surplus. In the last 17 years there are only three—2001, 2002, and 2003—in which India had a very modest current account surplus. In every other year it has run a deficit. And in the last couple of years the deficit has been mounting. In 2006–2007 it is probably going to be about 2 percent of GDP. In billions of dollars that's only a modest \$15 billion or so. The point is India is not part of the "structural surplus" depicted in one of those diagrams of surpluses and deficits that one commonly sees in papers on global imbalances.

Second, another distinguishing feature between India and China is that the main drivers of aggregate demand in the Indian economy remain domestic consumption plus domestic investment. Exports certainly play a very important supplementary role, especially from an efficiency point of view. But in terms of the macro aggregate demand, India is really a home market-driven economy, which is not what is usually said about recent Chinese experience. Third, with gross domestic savings rate around 29–30 percent of GDP, and gross domestic investment just a shade higher, India is clearly not contributing to any global "savings glut." And finally, I would contend that India's exchange rate policy has been more flexible and variable (in both nominal and real terms) than China's. The variability may not be huge and I'm certainly not arguing that the Reserve Bank does not intervene. Nevertheless, both India's exchange rate policy and outcomes indicate greater flexibility than in China. These are

significant differences from a policy perspective, which I hope you find interesting.

Some Take-Away Themes for Policymakers

To begin with, I found the Meissner and Taylor paper and discussion very illuminating for tracing how imbalances had emerged historically in the 1870 to 1913 period, and how these had been resolved apparently with relatively little distress. Unless, of course, you count the First World War as a consequence of the prior history of global imbalances! Second, I also found very interesting the emphasis placed on balance sheet analysis by Guy Debelle in looking at issues of valuation, dark matter, and so forth. Such valuation issues get bypassed in the standard analyses of balance of payments flows. When one does this kind of balance sheet analysis, it suggests a much more sanguine view of the time profile of U.S. net external liabilities. Third, and perhaps most importantly, I was quite struck by Richard Cooper's analysis of global imbalances in which he appears to view the present pattern of imbalances as pretty much a desirable, perhaps even optimal, outcome. In his view, a number of key countries and regions of the world are presently structural "excess savers" like Japan, "augmented Germany" (to use his term), China, and the oil exporters, which are quite happy (not just now, but perhaps for the foreseeable few years) to put their excess funds into the U.S. financial system, essentially because the U.S. financial system provides far superior financial engineering and intermediation capacities and entrepreneurship than is available at home in the excess saver countries and regions. Hence, a persistent and large current account deficit in the United States is perhaps not a surprising outcome. Indeed, this situation could continue for quite a while.

All three of these take-aways, as well as some of the views expressed this morning by Peter Garber and others, seem to favor the following policy message: don't worry too much about the present pattern of global imbalances. These may well reflect a desirable outcome from the viewpoint of global welfare. And even if these are not an optimal long-term outcome, the imbalances will go away painlessly in due course through the operation of market forces.

However, I am still left with some nagging doubts, which I want to share with you. My first set of nagging doubts relates to the sheer scale of the imbalances, and how quickly these have ballooned in the last or six or seven years. The second set of nagging doubts relates to Laurence Kotlikoff's very worrying assessment of the U.S. government's financial position and his fearsome reference to the \$63 trillion "hole" (in present value terms) in U.S. government finances, which he fears could one day be noticed by financial markets with perhaps very unpleasant consequences. Why the markets haven't noticed it up to now, I have no idea. But it certainly leaves a nagging doubt.

Third, with Larry Summers on this panel, I am reminded of a speech he gave eight or nine years ago in Hong Kong, then in his capacity as Deputy Treasury Secretary of the United States, where I happened to be present. If I recall correctly, he was extolling the virtues of U.S. economic performance, describing it as the "1-2-3-4 economy," referring (I think) to a 1 percent current account deficit, a 2 percent fiscal surplus, 3 percent productivity growth, and 4 percent GDP growth. Now, if I just look at those numbers for 2005, these somehow come out a little bit different. It's now a 7 percent current account deficit, a 2 percent fiscal *deficit*, and the other two good numbers are, somewhat surprisingly, still holding up. I do wonder if the 1-2-3-4 economy was a good state for the United States and the world economy back in 1997, and whether the current situation is quite so hunky-dory given today's very different numbers.

If these nagging concerns have some merit, let me close by commending to you the recommendations outlined by the Massachusetts Institute of Technology's Olivier Blanchard at an IMF conference on global imbalances a couple of months ago. He basically advocated a set of policies that would gradually reduce global imbalances, but were also quite worthwhile in themselves for the key country groupings. What are these policies? First, a reduction in the U.S. budget deficit would improve U.S. macroeconomic balances and help reduce the U.S. current account deficit. Second, a shift in favor of domestic demand in China brought about by some combination of appreciation of the renminbi and higher domestic consumption. Third is the good old IMF recommendation of structural reforms in Europe, which can stimulate higher investment and growth and thereby move the Eurozone into taking some of the responsibility

for shouldering the deficits to match Asian and oil exporter surpluses. And, finally, there was a call for policies to improve financial intermediation in all economic systems outside the United States, particularly in the structural surplus countries. It seems to me that some sort of coordinated move along these policy lines would not be a bad thing, simply as insurance against the future, whether it is filled with dark matter or not.

The Effects of Globalization on Inflation and the Implications for Monetary Policy

Donald L. Kohn

Although my discussion will touch on the important topic of global imbalances, I would like to focus on globalization's potential influence on inflation and the associated implications this may pose for monetary policy. This seems a natural emphasis for a policymaker at a central bank; indeed, several of my colleagues on the Federal Open Market Committee (FOMC) have also addressed this issue in the months leading up to this conference.¹ You would see from reading their various remarks that no consensus has yet emerged about how globalization has been influencing recent inflation developments. Part of my intention today is to illustrate some of the considerable challenges that are involved in attempting to identify the extent to which the recent pickup in the pace of global economic integration has influenced inflation dynamics in the United States.²

Of course, the trend toward greater international integration of product and financial markets has been established for quite a while; the share of U.S. economic activity involved in international trade (measured by nominal exports plus imports as a share of nominal gross domestic product) has been rising since the early 1970s. However, this trend has accelerated markedly since the early 1990s. Over this period the economies of eastern Europe have become more integrated into the global economy, while China, India, and some other East Asian market economies have emerged as important players in the global trading system.

Although inflation is ultimately a monetary phenomenon, it seems natural to expect, as others have argued, that these developments would have exerted some downward pressure on inflation in the United States. In particular, the economic opening of China and India represents a