Global Shift

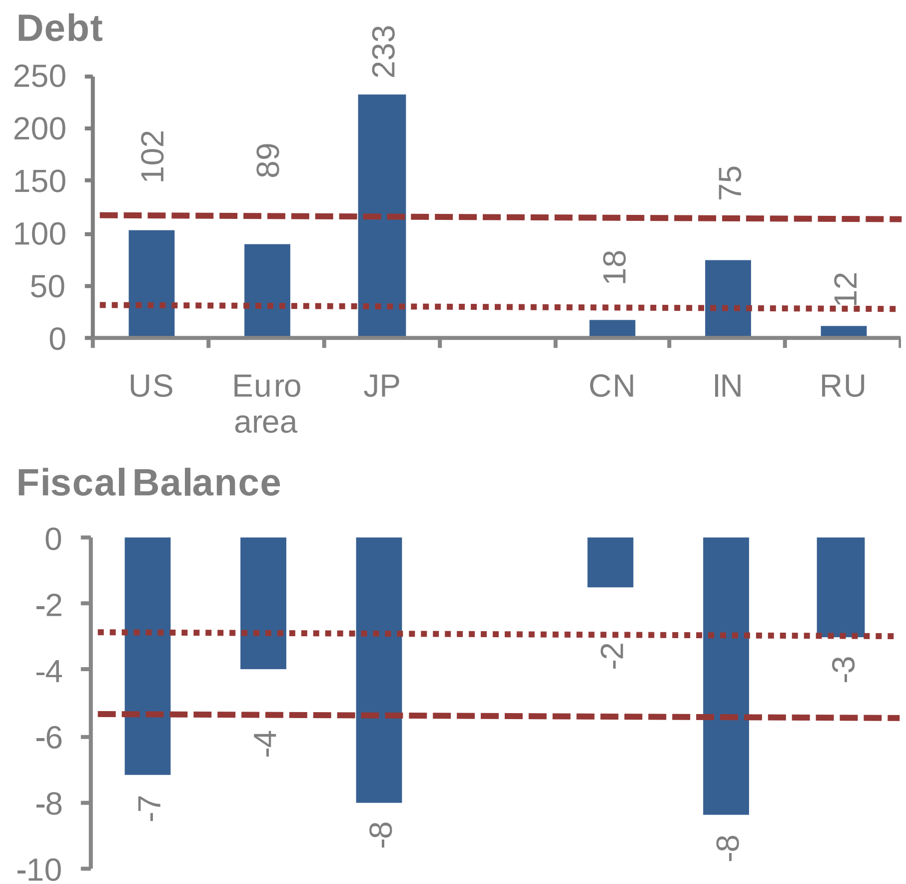
How the West Should Respond to the Rise of China

Transatlantic Academy | Monte dei Paschi di Siena | Instituto Affari Internazionali
Rome
May 18, 2011

Transatlantic Debt Crisis

- Unprecedented surge in public debt in U.S. and EU
- Serious implications
  - Limited fiscal room for manoeuvre
  - Dependence on foreign funding, esp. from EMs
  - Continued disagreement over right policy balance
- Policy options
  - Reduce indebtedness decisively
  - Better transatlantic policy coordination...
  - ... and with EMs

Unsustainable public finances

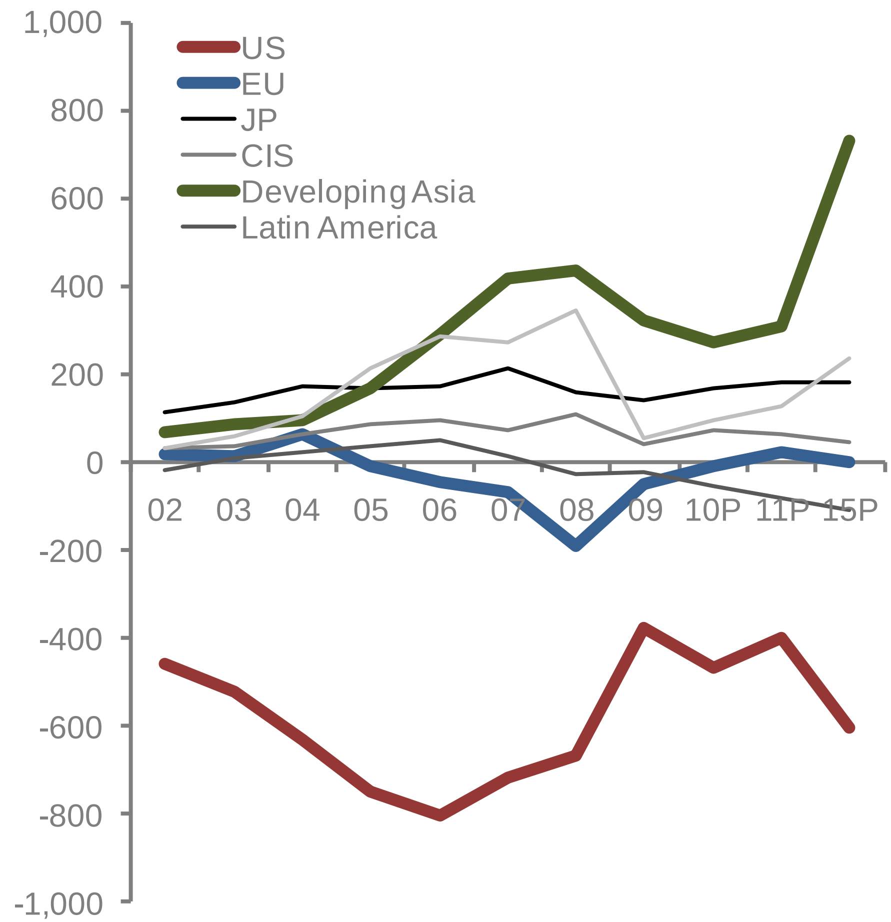


Note: Overall fiscal balances and general government gross debt, % of GDP, estimates for 2012, major G20 economies. Broken line: G20 advanced economies average. Dotted line: G20 emerging economies average.
Sources: IMF, own calculations

Global Imbalances

- Global imbalances, reflected in diverging current account balances, set to continue, if not aggravate
- Substantial risk of shock reversal at times of fragile global economy and financial markets
- Policy options
  - U.S. under pressure to adjust private and public consumption patterns
  - Effective trialogue with CN needed

Imbalances Set to Aggravate

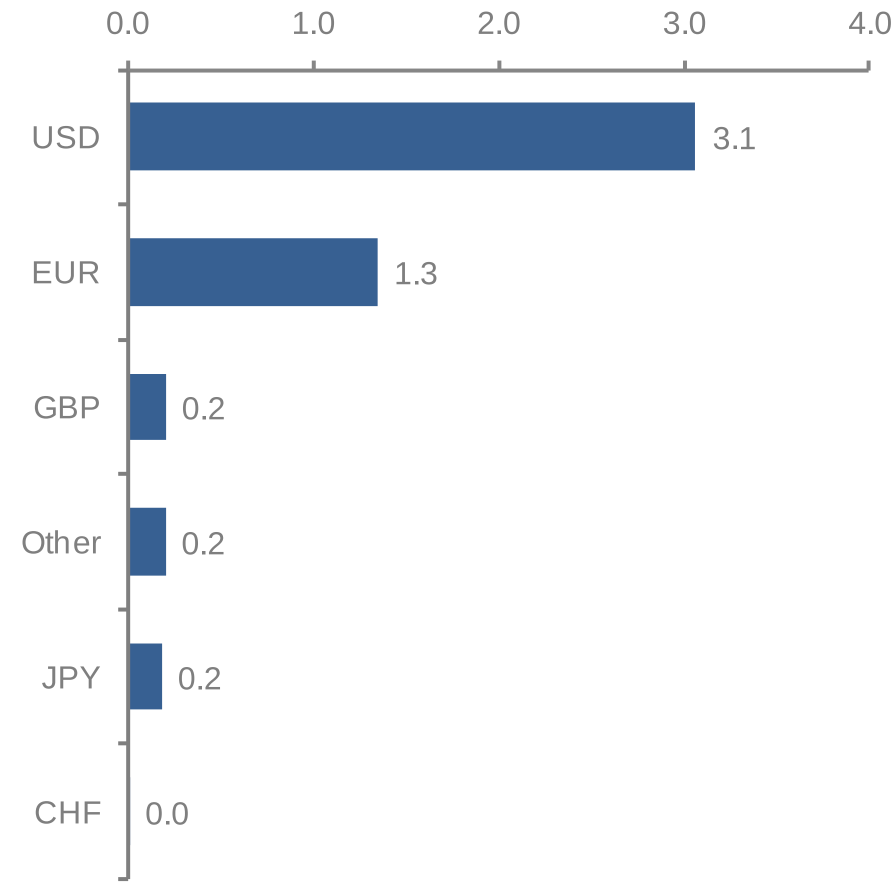


Note: Balances on current account, USD bn, IMF projections for 2010,2011, and 2015
Sources: IMF, own calculations

International Currency System

- USD set to remain dominant reserves currency
- Challenged by
  - strength of EUR, even at times of PIG debt crisis
  - weight of CN economy, and possibly of RMB
- Tripolar global currency system most like outcome
  - Acceptance of RMB as reserves asset still far away
  - Key conditions unfulfilled (convertibility, floating, current account liberalisation, mature financial system, acceptance by markets)

USD, EUR Dominate Reserves



Note: Currency composition of official foreign exchange reserves, allocated reserves only, value in USD tr, September 2010
Sources: IMF, own calculations

Post-crisis Financial Market Reform

- G20 policy coordination important and welcome, but coherence too low
- Non-syncronised policy agendas in U.S. and EU in way of effective regulation and supervision
- EM financial markets raise pressure on U.S., EU to maintain market and regulatory competitiveness
- Policy options
  - Revive FMRD
  - Strengthen G20 process

G20 principles

Regulatory standards

IMF	IOSCO	FSB

National implementation

USA
- Dodd-Frank Act
- Uncertainty over implemen-tation
- Trans-position of standards (Basel, OTC, AI, systemic FIs)

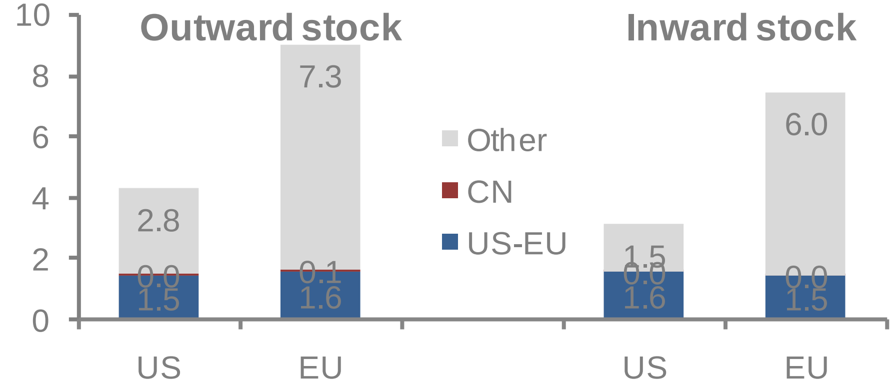
EU
- EU regulatory agenda
- Timely realisation

Others
- Esp. other key financial markets
- CN
- IN
- BR
- SG
- HK

Foreign Direct Investment

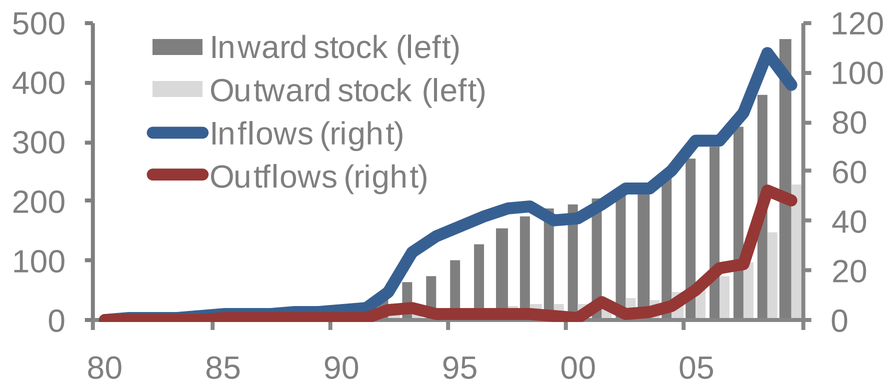
- FDI as reflection of new phase of globalisation – competition for ownership of global assets
- FDI assets from EMs still low, but dramatically rising flows
- Policy options
  - International investment policy
  - Coordinated U.S.-EU third-country policy
  - Single EU investment policy

China With Still Minor Role...



Note: Stocks of foreign direct investments of US and EU, USD tr, end-2009
Sources: Eurostat, U.S. Bureau of Economic Analysis UNCTAD, own calculations

... but Rising Fast



Note: Inward and outward foreign direct investments in China, stocks and flows, USD bn
Sources: UNCTAD, own calculations

Global Economic Governance

Transatlantic Academy

- Policy challenges
  - Historic confluence of serious economic issues (debt, imbalances, looming failure of trade agreement, looming protectionism)
  - Incoherent policy frameworks to meet these challenges (general economic policy, trade, FDI)
  - Institutional weakness of G20 set-up
  - Lack of agreement among key players (U.S., EU, CN)

- Policy options
  - More decisive approach to tackling key economic problems domestically (public finances)
  - Better coordination internationally (G20)
  - Closer alignment of policies among key players (policy trialogue between U.S., EU, CN)
  - In long run, greater institutionalisation of G20