'Rebalancing' takes contrarian view of world economy

BY GLENN C. ALTSCHULER Special to the Tulsa World
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About a year ago, Dutch academic Helen Mees predicted that "as China's economy continues to mature, it may just be the economic engine that the United States and Europe need to dig themselves out from under their mountain of debt."

According to Michael Pettis, a professor of economics at Peking University and a senior associate at the Carnegie Endowment, Mees' argument "doesn't make sense."

In "The Great Rebalancing," Pettis argues that China's high growth rates - based on transfer of income from households to corporate and state sectors through artificially low interest rates, regulation of cross-border capital movements, tight connections between government, banks and pension funds, and currency manipulation - are not sustainable and that Beijing is "running out of time" to avert a hard landing for itself.

When China narrows the gap between domestic consumption, which now stands at 34 percent of GDP, by far the lowest percentage in the world, and domestic investment, and when it imports capital and exports demand, then - and only then - "will it be a net contributor to growth abroad."

Designed to provoke, "The Great Rebalancing" is full of contrarian, counter-intuitive insights. China's domestic distortions are so deeply entrenched and its political structures are so inflexible, Pettis suggests, that it may be the last major economy to emerge from The Great Recession.

Pettis points to Germany, supposedly "the paragon of thrift and hard work," as being largely responsible for the financial crises of Greece, Italy, Ireland, Spain and Portugal.

Germany now faces the "Hobson's choice" of cutting domestic taxes, boosting spending and accepting slower growth, rising unemployment and debt, or writing off its claims against the GIIPS countries, "in which case government debt levels will surge anyway."

And the "foreign accumulation of dollar assets," Pettis indicates, accentuates - and does not mitigate - the trade deficit, low savings rate, and high levels of public and private debt in the United States, which he believes "may be the first major economy to emerge from the crisis."

Perhaps most surprising of all, Pettis insists that, under current circumstances, "deficit countries hold most of the cards."

Although "economists are not supposed to say this," he writes, "in a world of weak demand growth, demand is the most valuable economic asset."

And China has no real alternative to holding U.S. bonds. Unfortunately, however, because surplus countries do not realize "how vulnerable they are to unilateral action by deficit countries and how limited is their ability to retaliate, it is hard to see how conflict can be avoided." Nonetheless, "one way or the other the world must rebalance, and it will."

As he focuses like a laser on the rebalancing of international accounts, Pettis, at times hyperbolically, discounts the potential impact of other policies on the economies of other nation-states.

He's is making the point, of course, that austerity doesn't work because the principal problem is not a "lack of
liquidity but a lack of competitiveness." But, alas, Pettis doesn't always make clear how the countries who "hold most of the cards" should play them.

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Associated Images:

'THE GREAT REBALANCING: TRADE, CONFLICT, AND THE PERILOUS ROAD AHEAD FOR THE WORLD ECONOMY'
By Michael Pettis
Princeton University Press, $29.95