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An African Perspective: Comments on Yoshitomi, Liu and Thorbecke

Brian Kahn

Some of the arguments and prescriptions that came out of the chapter by Professor Yoshitomi *et al.* were similar to what came out of the discussions on the papers by Eichengreen and Park, and D'Arista and Griffith-Jones. In line with these and other papers included in the previous volume,[1] the prescription by Yoshitomi *et al.* is that the United States should be increasing domestic savings primarily through fiscal consolidation as well as by implementing policies to reduce consumption to raise the household savings rate. To prevent a recession in the US, a depreciation of the dollar is required to bring about expenditure-switching to stimulate net exports. If a decline in absorption is not achieved, the depreciation would be substantial and inflationary. At the same time, the Asian countries should allow their currencies to appreciate in the context of some form of concerted action in order to prevent a recession through increased absorption.

1 The Investment-Savings Balance and Exchange Rate Policies

Let me raise a number of points on the chapter by Yoshitomi *et al.* First, I agree with the emphasis on the investment-savings balance as well as exchange rate issues. It is not just one or the other, and I think this focus

[1] *Global Imbalances and the US Debt Problem: Should Developing Countries Continue to Support the US Dollar?*, edited by Jan Joost Teunissen and Age Akkerman, FONDAD, The Hague, 2006.

makes it clear that it is not simply a US problem or an Asian problem, but a combined problem. But what I feel is missing is how Europe fits into the picture. Obviously, the focus of the chapter is on East Asia and the US, but I think, following the earlier discussion of the paper by Jan Kregel, that Europe plays an important part in the adjustment process. Furthermore, Japan is also missing from the discussion. Japan is important in Asia and it would be important to explain Japan's role in the adjustment process. It would also have been interesting to have seen some differentiation between the different countries in Asia and the respective policies that they should follow. The prescription for Asia assumes that all countries are more or less in the same situation, but as was pointed out in the earlier discussions, China has a high investment rate, whereas a number of the other Asian countries suffered a collapse of investment in the wake of the Asian crisis. It would have been useful to see some differentiation in policy prescriptions to understand exactly what policy should be followed. In particular, I would like to ask whether all countries need to expand their fiscal policies and to what extent some of them are constrained in this respect. We saw in the paper by Eichengreen and Park, that the room for manoeuvre with fiscal policies was constrained in certain countries, for example Indonesia and Philippines, and in some countries it is more difficult than others. What would seem to be a very sensible solution for China isn't necessarily the same for a number of these other countries.

The second issue that I wish to raise relates to the exchange rate. Firstly, it is asserted by Yoshitomi *et al.* that although the United States current account deficit remains high, the dollar is not overvalued. This is on the basis that the dollar is more or less at its long-run average and therefore not misaligned. It is always difficult to calculate the equilibrium real exchange rate. As we know, the equilibrium level can change in response to changes in the fundamental determinants such as productivity changes and other structural changes, both in the United States and Asia. I would have thought that some notion of the sustainable current account deficit would also be relevant. If the underlying assumption in the chapter is that the current account deficit in the US is not sustainable, I would have thought that this would imply that the US dollar is currently overvalued or misaligned. Furthermore Yoshitomi *et al.* argue that a 30 percent depreciation on an effective basis is required, which suggests that the dollar is in fact currently misaligned.

With respect to the East Asian exchange rates, even though China did not devalue in the wake of the Asian crisis and the other countries have not gone back to pre-crisis levels, there nevertheless appears to be a strong case for arguing that there is an undervaluation of the Chinese yuan. We saw, for example, in the paper by Fan Gang (in the previous volume) that unit labour costs in China were in fact falling as wage gains have not kept pace with productivity increases. Similarly, the idea that real exchange rate adjustment would take place through relative inflation changes has also not materialised. Inflation in China has remained low.

In our discussions, we have been concentrating on the implications of these developments for global imbalances with a focus on the US, the euro area and Asia. However, there are also important implications for African countries, which generally tend to be forgotten about. I think that the point that is raised by Yoshitomi *et al.* about intra-industry vertical trade is very insightful. However, from an African perspective, what is of concern is the area where China competes directly with Africa in third markets and in African home markets. These are generally the wage goods markets. So it is not the intra-industry, highly sophisticated goods that are the problem, but rather those goods that are highly labour-intensive, in particular clothing, textiles and footwear. These industries have been negatively affected in many African countries. Although some would argue that perhaps African wages should be reduced, it is difficult to reduce wages that are already extremely low. We have experienced this in South Africa as well.

A further issue relating to the exchange rate is the prescription of what countries should do with respect to concerted movements of the exchange rate. There are a number of good reasons to argue for a coordinated response. From what we heard in the discussions, it appears to me that there are a lot of potential problems relating to exchange-rate stability and coordination which have been glossed over. From what I understand, Japan would not want to be part of this because the yen is already floating, but there are likely to be political economy problems that may be extremely difficult to coordinate.

2 Systemic Crises and Concerted Action

A further comment relates to the issue of how long imbalances can persist. It is argued in the chapter that the resolution could be very quick, that it could be benign or that it could go on for some years depending on a whole range of assumptions. This uncertainty creates a potential problem for the whole adjustment process and undermines the chances of achieving concerted reforms of the international global architecture. There is a strongly held view that capital markets are now broader and deeper than ever, and are therefore likely to be far more resilient in the face of adjustments to global imbalances. The belief is that ultimately things will work themselves out in the adjustment process. So although there may be a recognition of the problem, the sense of urgency is not there. I think we have seen from experience that concerted global action usually only comes when we are already in a crisis. Very often things do work themselves out before any major reforms can be agreed upon. It is only when we find ourselves in a real systemic crisis that we tend to move towards global solutions. This implies that the longer the global imbalances continue in a benign way, the more complacent we are likely to be.

3 Accumulation of Foreign Reserves

The final point that I want to pick up on is the question of reserve accumulation. Yoshitomi *et al.* have made it quite clear that reserve accumulation has gone beyond what is required for precautionary motives. The other issue they emphasised is the need to maintain a competitive exchange rate. In terms of foreign reserves, there is no doubt that China has more reserves than necessary for maintaining a competitive exchange rate. There are other interpretations of why the Chinese have pegged to the dollar. There is the Dooley, Folkerts-Landau and Garber[2] argument that China's foreign reserves act as a collateral that reduces political risks. I think what is interesting in the Dooley *et al.* study is the focus on how long reserve accumulation can persist. In the opposite case, when a country is losing reserves, we know that a crisis will come about, that there will be a depreciation of the currency and there has to be some adjustment. What they found is that in all instances of reserve accumulation there has never been a speculative attack that has caused an appreciation and a need for adjustment. The Chinese have been able to control inflation and there doesn't seem to be any particular

[2] Michael P. Dooley, David Folkerts-Landau and Peter M. Garber (2004), "The US Current Account Deficit and Economic Development: Collateral for a Total Return Swap", NBER Working Paper No. 10727, National Bureau of Economic Research, Washington D.C., September.

pressure for the whole process to end. I am a little bit concerned that the issue can last for quite some time, so that the pressures to end this reserve accumulation are not necessarily there, unless there is something that forces China to move on that front.

4 Concluding Remarks

The chapter by Professor Yoshitomi *et al.* has highlighted the need for adjustment in both China and the United States, and the need for concerted action on exchange rates. Unfortunately, the pressures on surplus countries are not symmetrical to those of deficit countries, and in this instance the major deficit country, the United States, can sustain its deficit as long as the surplus dollars in Asia are recycled back to the US. I am therefore pessimistic that an orderly exchange rate adjustment will take place in the near future. In the meantime peripheral countries, including those in Africa, will continue to suffer the consequences.