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Global Imbalances and Latin America: A Comment on Eichengreen and Park

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In "Global Imbalances and Emerging Markets", Barry Eichengreen and Yung Chul Park make a number of important contributions to the discussion of the current international monetary and financial situation. First, they analyse the debate on the large US current account deficit and the likely denouement. Their view is that a correction will be required; how disorderly depends on when it begins. Second, they consider the possible impact on emerging markets of a disorderly correction and argue that it will be much more benign than in previous periods. Interestingly, the benign story is based on financial channels, while trade channels are considered more problematic – returning to the approach of earlier periods before the recent financial crises. According to this approach, negative implications vary with countries' openness and their degree of trade concentration with the heavily indebted US. Third, they disaggregate their analysis somewhat and look at five countries or groups of countries: the United States, China, Japan, the emerging East Asian economies excluding China, and Latin America. In each case, they make policy recommendations for how international imbalances could be reduced.

The most interesting – and controversial – aspect of the chapter is the argument that the emerging market economies will be relatively shielded from a negative financial impact, even in the event of a disorderly correction. The treatment of the trade channel is also important but less controversial; it also needs to be integrated into the financial analysis. Finally, the policy recommendations are sensible, but their feasibility needs to be considered more extensively. While I agree with much of

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what is said in the chapter, I believe that the optimistic conclusions are based too heavily on the East Asian experiences and do not necessarily hold for other developing regions. Moreover, if political considerations mean the policy recommendations are not followed, these other regions may well suffer the consequences.

This comment begins by discussing what could be called the "upbeat model" embodied in the chapter and then looks at what has happened outside of East Asia. I focus particularly on Latin America, but the points are likely to hold for emerging market economies in other non-Asian regions as well. In addition, I discuss the politics behind the Eichengreen-Park policy recommendations and then draw some (less optimistic) conclusions.

1 The "Upbeat Model"

The core of the optimistic model that Eichengreen and Park put forward is based on two factors. On the one hand, in the event of a disorderly correction, they say that a fall of the dollar and a rise in US interest rates will likely be offset by the reaction in other industrial economies. Thus, emerging market economies will not face a generalised negative environment. On the other hand, they suggest that emerging economies have reduced their own vulnerability by running current account surpluses, building up reserves, pre-financing their borrowing requirements, and following macroeconomic policies that give investors more confidence. The authors do, however, acknowledge that emerging economies may face dangers from a slowdown in US growth rates and thus a decline in import demand. With respect to the trade channel, they disaggregate more than they do in the more generalised discussion of the financial channel. Not only will countries' relationship with the United States matter, but type of exports may also be relevant for determining impact.

In examining the situation in individual countries and regions, the authors again tend toward the optimistic. In each case, they make policy recommendations that would undoubtedly reduce the possibility of a disorderly correction in the current international imbalances. For example, they say that the United States should lower its budget deficits, while Asian countries should move to reduce their current account surpluses and negotiate a simultaneous appreciation of their currencies. Nonetheless, despite occasional admissions that troublesome politics can

Table 1 Current Account Balances in East Asia and Latin America, 2005
(in billions of dollars and percentages of GDP)

	amount	percentage of GDP		amount	percentage of GDP
East Asia	*224*	*5.7*	*Latin America*	*31*	*1.4*
China	128	5.7	Mexico	-8	-1.0
Taiwan	9	4.7	Brazil	13	1.8
Korea	16	2.2	Argentina	4	2.2
Hong Kong	21	11.8	Venezuela	22	15.8
Singapore	30	29.1	Chile	0	-0.2
Malaysia	19	14.6	Colombia	-2	-1.6
Thailand	-4	-2.3	Peru	1	1.3

Source: Calculated from *The Economist,* February 11, 2006 (current account); World Bank, *World Economic Indicator 2006*, World Bank, Washington D.C., 2006, (GDP except for Taiwan); CEPD, *Taiwan Statistical Data Book 2006,* Council for Economic Planning and Development, Taipei City, 2006 (GDP for Taiwan).

undermine good economics, they fail to elaborate on the political problems or to acknowledge the consequences if their policy recommendations are not followed. In particular, the consequences – a disorderly and costly correction of the international imbalances – would be highly problematic if their hypothesis of reduced vulnerability holds for only one group of emerging market economies.

2 Non-Asian Emerging Market Countries

My analysis of non-Asian developing countries centres on four tables, which provide data on several indicators of the decreased vulnerability that Eichengreen and Park see for the emerging market economies. The tables compare East Asia with Latin America for the year 2005, focusing on the seven largest economies in each region or the region as a whole.

Table 1 looks at the current account balance, both in terms of absolute dollar amounts and percent of GDP. As can be seen, the current account surplus is far larger in East Asia than in Latin America, both in absolute terms as well as share of GDP. Even if China is omitted, this pattern holds although the difference is less striking. Including China, the seven East Asian countries' total surplus is $224 billion (5.7 percent of GDP), while in Latin America the comparable figures are $31 billion (1.4 percent of GDP). Without China, the Asian numbers

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Table 2 International Reserves in East Asia and Latin America, 2005

(in billions of dollars and percentages of GDP)

	amount	percentage of GDP		amount	percentage of GDP
East Asia	*1,642*	*41.5*	*Latin America*	*221*	*10.1*
China	819	36.7	Mexico	73	9.5
Taiwan	253	74.8	Brazil	53	6.7
Korea	210	26.6	Argentina	26	14.2
Hong Kong	124	69.7	Venezuela	24	17.3
Singapore	117	100.0	Chile	17	14.8
Malaysia	70	53.8	Colombia	15	12.3
Thailand	49	27.7	Peru	13	16.7

Source: Calculated from *The Economist,* February 11, 2006 (current account); World Bank, *World Economic Indicators 2006,* World Bank, Washington D.C., 2006, (GDP except for Taiwan); CEPD, *Taiwan Statistical Data Book 2006,* Council for Economic Planning and Development, Taipei City, 2006 (GDP for Taiwan).

are $96 billion (5.6 percent of GDP). Looking beyond the regional averages, the ranges are also significant. In East Asia, these run from a -2.3 percent (Thailand) to 29.1 percent (Singapore), while in Latin America they go from -1.6 percent (Colombia) to 15.8 percent (Venezuela).

Table 2 shows reserves, where a similar picture emerges. Even if China is left out, the Asian countries have nearly four times the absolute volume of reserves ($823 billion versus $221 billion in Latin America); an even larger order of magnitude holds for reserves as a percent of GDP (47.6 percent versus 10.1 percent). Ironically, despite the much larger current account surpluses in Asia, projections by the Institute for International Finance suggest that capital inflows are and will continue to be much higher there as well, meaning that the reserve build-up can be expected to continue apace.[1] In summary, there are current account surpluses and large volumes of reserves in both regions, a fact that represents a vast change for Latin America in comparison to much of the post-war period. Nonetheless, a significant difference in favour of East Asia remains when the two regions are compared.

A third comparison, as seen in Table 3, focuses on debt outstanding. For developing Asia and Latin America, external debt in absolute dollar

[1] Institute for International Finance, "Capital Flows to Emerging Market Economies", Washington, D.C., January 19, 2006.

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Table 3 International Debt in Developing Asia and Latin America, 2005

Debt category	Developing Asia	Latin America
Billions of dollars		
External debt	834	842
Debt service	105	144
Share of exports		
External debt	56	154
Debt service	7	26

Source: IMF, *World Economic Outlook 2005,* International Monetary Fund, Washington D.C., September 2005, Table 37.

terms is just about the same in the two regions.[2] Looking at debt service, however, a differentiation already begins to appear such that Latin America faces more difficult problems in obtaining the foreign exchange necessary to service its debt. If we look at debt as a share of exports, the difference becomes much more dramatic. External debt as a share of exports is about three times as high in Latin America as in the developing Asian countries and nearly four times as high in terms of debt service. This is the same pattern that was present in the 1980s, and it led to the decade-long debt crisis in Latin America compared to much lesser problems in East Asia.

Overall, these three tables suggest a much more favourable financial situation for Asian countries than for other developing countries, proxied here by Latin America. Latin American countries have smaller current account surpluses, a lower volume of reserves, and higher debt ratios, especially as a share of exports. The comparison suggests that Latin America may, indeed, be subject to a financial crunch if/when international monetary conditions turn negative. "Sudden stops" have not ended, and financial vulnerability remains a problem, despite the more positive situation at the moment.[3]

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[2] The Asian countries included in the discussion of debt are different than in the tables on current account and reserves. The World Bank, the original source of data on debt, excludes the so-called newly industrialising countries (NIEs) of East Asia (Korea, Taiwan, Hong Kong and Singapore), since they are considered to have "graduated" out of the developing country status. Also smaller Asian and Latin American countries are included.

[3] On sudden stops, see Guillermo Calvo, "Capital Flows and Capital-Market Crises:

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Table 4 Changes in Terms of Trade for Asia and Latin America, 1987-2006

	NIEs	Developing Asia	Latin America
1987-1996	0.3	0.2	-0.5
1997-2006	-1.3	-0.8	0.9
2003	-1.6	-0.2	3.7
2004	-2.0	0.2	3.1
2005	-2.4	0	7.0

Source: IMF, *World Economic Outlook 2005*, International Monetary Fund, Washington D.C., September 2005, Tables 22-23.

To better understand the possibilities for negative outcomes, we need to discuss the links between finance and trade channels. Eichengreen and Park emphasise the latter as more important than the former in creating potential problems for emerging market economies, and indicate that Latin American countries are quite vulnerable to a slowdown in US and international growth rates and thus the demand for their exports. Strangely, however, they do not mention terms of trade patterns.

Drawing on data from the World Economic Outlook, Table 4 shows changes in the terms of trade during the two decades, 1986-96 and 1996-2006, and individual years during the most recent period, for the four newly-industrialised economies (NIEs), other developing countries in Asia (excluding China and India), and Latin America. Some interesting patterns can be seen. For the NIEs, the terms of trade were clearly more favourable in the earlier decade than in the more recent one. For developing Asia, the picture is similar if more muted. For Latin America, by contrast, the current decade has been much better than the previous one. If we look at the three most recent years, a negative movement in the terms of trade appears for the four NIE economies, not much movement at all for developing Asia, but an extraordinarily successful period for Latin America – which cannot be expected to continue in the longer run. Since the Asian pattern has been negative in the most recent period, it is less likely to suffer when a reversion toward the historical mean occurs.

The Simple Economics of Sudden Stops", In: *Journal of Applied Economics*, Vol. 1, 1998. For a discussion of financial vulnerability in emerging market economies, see Ricardo Ffrench-Davis and Stephany Griffith-Jones (eds.), *From Capital Surges to Droughts: Seeking Stability for Emerging Economies*, Palgrave Macmillan, 2004.

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The boom-bust cycle, which has been so typical of Latin America over the years, arises from a combination of trade and financial factors. Negative terms of trade lead to current account deficits, which obviously require financing. Private lenders are more hesitant to provide finance under these circumstances, and the conditionality accompanying public-sector loans often lead to complicated political situations that can further a downward cycle. On the upswing, private capital pours in, but it can leave as quickly as it entered in the presence of a political or economic shock. In financial terms alone, even in the absence of trade issues, flight to quality has been a greater problem in boom-bust Latin America than in the more stable economies of East Asia.

3 Politics of Policy Recommendations

I agree with most of the policy recommendations made by Eichengreen and Park. My concern is that more discussion is needed about the political prerequisites for their recommendations to be carried out and the implications if they cannot be implemented. Are there alternatives that would make a positive outcome more likely? What are these?

The main recommendation with respect to the United States is to lower the current account deficit through increased savings. This, in turn, should come about by allowing tax credits to expire so as to reduce the budget deficit. It is certain that the Bush Administration will not follow this advice. Moreover, the Democrats, even if they were to take control of the House or the Senate in the mid-term elections of 2006, are unlikely to cut the deficit in a serious way either. So what do we do? Just wait for a crisis, or is there perhaps an international bargain to be struck? Is there a political bargain that would help to lessen the international crisis that would result if a disorderly unwinding of the US deficit would occur?

For China, Japan, and the rest of Asia, the main recommendation is to cut surpluses through a coordinated appreciation together with fiscal expansion. While there is a caveat that not all countries in the region could engage in this process, it is argued that an important number could and should. Here we get into a collective action problem or a prisoner's dilemma in that all countries want to maintain their competitiveness. What can be done? This is a topic we talked about in a previous Fondad conference at De Nederlandsche Bank, where Eisuke Sakakibara gave a

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paper on financial cooperation in the Asian region.[4] The same problems exist with respect to trade cooperation: Japan and China do not have a very cooperative relationship, and this relationship has only gotten worse in the intervening period. What are the political elements that might bring about regional cooperation? We need to look at those rather than the political advantages that would come about by greater cooperation.

Finally, the chapter includes a very short section on policy recommendations for Latin America. The basic message is to cut current account surpluses by raising investment rates. Certainly Latin America – unlike East Asia – needs higher investment rates. But it also needs higher savings rates, which some theoretical approaches say would reduce growth and undermine investment. Moreover, it seems questionable to argue that Latin America needs to lower its current account surpluses: they are not very large, and they will become smaller when the terms of trade deteriorate. In addition, the current political climate in Latin America is extremely delicate, with increasing polarisation between left and right in many countries. In this climate, the debate is favouring greater consumption rather than investment, with negative implications for future growth.

4 Conclusions

In summary, I would argue that it is misleading – and perhaps even dangerous – to make projections about emerging market economies as a whole. At a minimum, we need to distinguish the successful East Asian economies from others. Here the focus was on Latin America, but other regions suffer similar problems. Since structural conditions and historical experiences have diverged so substantially, the same policies are unlikely to be appropriate for all. In addition, the political prerequisites of sound policy prescriptions need more attention. Otherwise, the most sensible recommendations may well fail with serious consequences for at least some of the developing countries that were the focus of the Eichengreen and Park analysis.

[4] Eisuke Sakakibara, "Asian Cooperation and the End of Pax Americana", In: Jan Joost Teunissen and Mark Teunissen (eds.), *Financial Stability and Growth in Emerging Economies: The Role of the Financial Sector,* FONDAD, The Hague, 2003.

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