

Global Imbalances and the Global Financial Crisis : An Examination of Unbalanced Globalization and Future Prospects

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Abstract

This paper examines the developments and interactions of global imbalances and the current global financial crisis from the perspective of unbalanced globalization. Neoliberal globalization resulted in higher income inequality in both the US and East Asia and exacerbated global imbalances. The rising current account deficit in the US and foreign capital inflows to the US aggravated the asset market bubble and its burst caused the global financial crisis. Global imbalances have been shrinking after the crisis, however it is still limited and future prospects are uncertain. This paper argues that structural reforms of the US and East Asia are necessary in correcting global imbalances. A reduction in excessive spending in the US and a change of the growth strategy are necessary for more balanced globalization.

Key Words : The Global Financial Crisis, Global Imbalances, Globalization, Neoliberalism
JEL Classification : F30, F32, E20

I. Introduction

Starting from mid-2007, the global financial crisis has engulfed the global economy. The crisis occurred at the heart of the core countries, that is the US, and spread into other countries very fast thanks to the development of financial globalization. It hit hard almost all of advanced countries and developing countries as well after Lehman's bankruptcy in September of 2008. Already many explanations were presented about the cause of the crisis. They emphasize the problems of financial deregulation, too much risk-taking of financial institutions based on wrong theoretical models, lax monetary policy leading to the real estate market bubble, and so on. The crisis was indeed a highly complex event and the full analysis of it is beyond the scope of this paper. However, it is clear that the strong belief in the free market and benefits of financial deregulation and globalization waned, while the Keynesian argument for the stronger role of the government became much more popular.

Given the critic against neoliberal financial globalization, this paper examines the so-called global imbalances as an important background of the current financial crisis. We attempt to

analyze how imbalances in the global economy grew serious between the US and East Asia and how this contributed to the US financial crisis. After the beginning of the new millennium, the current account deficit of the US economy kept increasing and international capital kept flowing from East Asian surplus countries to the US. This provided excessive liquidity and stimulated domestic consumption and bubbles in the US overly. Along with the crisis and the deep recession of the US, the global imbalances appear to have been reduced. However, there should be concerted efforts of the US and East Asia to bring about a rebalance of the global economy. We present future prospects and underscore the change of the growth strategy in East Asia as an essential factor to this global rebalancing.

This paper is organized as follows. Section II investigates the current global financial crisis, focusing on its causes and the effects on the global economy. Section III critically evaluates the development of globalization and demonstrates the problem of global imbalances. It also discusses the political economy of global imbalances by indicating how different the effects of similar neoliberalism were on the US and East Asia. Section IV examines the current changes of global imbalances after the crisis and presents future prospects. We underscore the important role of East Asia in the rebalancing process.

II. The Global Financial Crisis after 2007

1. The US Financial Crisis and Its Causes

The financial crisis in the US was a collapse of the new financial architecture that was established by several measures of financial deregulation against the backdrop of neoliberalism after the 1980s (Crotty, 2009). The idea that the free financial market is always efficient grew predominant and brought about institutional changes in the US financial markets. For example, in 1999, the U. S. government repealed the Glass-Steagall Act that separated operations of commercial banks and investment banks. Also, an act called the Commodity Futures Modernization Act to introduce deregulation for all transactions including financial derivatives was passed in the US congress in 2000.

Along with these rounds of deregulation, financial innovation encouraged the growth of securitization of debts and financial derivatives markets. Financial institutions started to operate the business dealing with MBS (Mortgage based securities) very actively given the bubble of the real estate market in the early 2000s. Many institutions introduced an aggressive business strategy to sell mortgage to subprime borrowers by providing teaser rates and so on. They went far to develop the more complex securitization scheme called a CDO (Collateralized Debt Obligation) that divided debts into several groups, called tranche, and then repacked them to sell in the financial markets. Thanks to these measures, credit rating companies, closely related to those investment banks banks, evaluated these assets very credible, which did not reflect risk in reality. The amount of global CDO issuance rose from \$157.4 billion in 2004 to \$520.6 billion in 2006, and its market size grew more than 4 times between 2002 and 2006, when the amount was estimated about \$2 trillion. The progress of

derivatives market made the process much more complicated. A CDS (Credit Default Swap) was newly introduced and provided insurance service for financial institutions that dealt with CDOs to some extent. The size of the CDS market skyrocketed from less than \$ 1 trillion in 2001 to more than \$ 60 trillion in 2007 in the whole world. Investment banks such as Lehman Brothers actively utilized SIVs (Special Investment Vehicles) that did business in this sector in a huge scale, freer from financial regulation. It was called the 'shadow banking system' and was indeed highly risk-taking and profitable before the collapse.

Of course, all of these developments happened together with the growing bubble in the real estate market. In the US the price of real estate soared from 2000 to 2005 by almost 50 %, after when it started to fall sharply. The lax monetary policy by the Fed after the 2001 recession was associated with this at least in part though it must have been hard for it to stop the bubble growing in advance. Financial institutions that dealt in mortgage-based CDOs expected that this trend would continue without a significant drop of the real estate price. However, similar to all asset market bubbles, the real estate market bubble in the US finally began to burst starting from 2005. This made the investment bank model of American financial institutions deeply wrong, and brought about a sudden financial collapse along with the default of CDOs and then that of related CDS. No financial institutions were willing to purchase sour mortgage-based securities any longer and serious credit crunch happened in the US financial markets from mid-2007. The US government was not so prompt in response to the initial burst of the crisis, and the crisis peaked in September of 2008 when Lehman Brothers, No. 4 investment bank, went bankrupt. After then, large financial institutions such as Merrill Lynch, AIG, and Citigroup received bailout finance or sold to other institutions faced with the situation a bankruptcy.¹⁾

The crisis, though it appears complicated, demonstrated a typical cycle of a financial crisis from the perspective of the growth of bubbles, overlending by financial institutions with irrational exuberance and its collapse in the end (Reinhart and Rogoff, 2009). It became only more serious this time, which is not different from others, due to measures of financial deregulation, the development of financial innovation and lax monetary policy. Thus, the US financial crisis could be understood as an institutional failure of the US financial system and incapability of the government to monitor it. Ideological contention such as neoliberalism and the efficient market theory to argue for the retreat of the government did play a crucial role. The collapse of the US financial system finally ushered in a serious reflection in economic thoughts and a new consensus that financial markets are not efficient inherently and proper government regulation is crucial.

2. Effects on the Global Economy and Future Prospects

The effects of the financial crisis in the US were felt by other countries gravely because the financial markets in the world are already globalized to a great extent. There are several channels through which the US financial crisis influenced other countries. First, foreign financial institutions also exposed themselves to problematic assets such as CDOs hugely as European financial institutions reported a great loss because of the crisis. Second, the breakup

of the US financial market resulted in a global drop of asset market prices including the real estate market and the stock market in most of countries. This significantly shrank the asset base of financial institutions in foreign countries and again brought about credit crunch and turmoil in the financial markets. Third, foreign investment, particularly short-term bank lending and portfolio investment, to emerging market countries declined sharply by 'deleveraging' of financial institutions in advanced countries in the midst of the crisis. This dealt a hard blow to countries that relied highly on foreign capital including Iceland, Ireland and others. Finally, the crisis naturally resulted in a deep global recession and reduced exports demand in the world largely. Many expect that the world export will fall by about 10% in 2009 because of the crisis. Countries that depended on exports including East Asian countries would be greatly damaged by this naturally. For example, Japan is expected to record the largest fall of GDP in 2009, as much as 6%, in the OECD since the export decline is a huge shock to Japan even though the loss of Japanese financial institutions because of the crisis was limited. Recently, the IMF report estimates that the loss due to this financial crisis in all advanced countries would be as large as \$ 4.1 trillion and that in the US would be \$ 2.7 trillion (IMF, 2009a). However, some estimate the loss to be even more than that.

The policy response to the crisis was a tremendous expansion of liquidity by introducing zero-percent interest policy and direct spending of public money to prop up the economy in many countries. The US government decided to spend as much as \$787 billion in early 2009 in total to avert an economic collapse by enacting the American Recovery and Reinvestment Act of 2009 and already spent about \$200 billion this year. The Fed also cut down interest rates aggressively from 5.25% in early 2008 to 0.25% in mid-2009 and provided credit directly for financial institutions in trouble through several support programs. Other advanced countries quickly followed the US, and all G20 nations are in collaboration to boost the global economy. Thanks to these efforts, it is likely that the worst is now over although many are worried that the current crisis is the biggest one next to the Great Depression. However, it is commonly expected that the economic recovery would be very slow and take a long time despite international cooperation of many developed countries. The most recent estimation for the growth rate of the global economy in 2010 is 3.1% by the IMF and 2.4% by UN. These were higher than former estimates reflecting stabilization of the global economy, but were still much lower than 5.2% in 2007. There are indeed a lot of problems in the global economy including the growing fiscal deficit and government debts in many countries and disorder of the global financial system.

One thing very clear about this crisis is that the current financial crisis became truly global due to the progress of financial globalization. It is also ironical that the march toward a total financial integration of the world economy with more economic liberalization, deregulation and opening may be deterred by the current crisis. With respect to the current financial crisis, we should pay attention to the other global aspect of the crisis, that is, the global imbalances problem, another important background of the current financial meltdown. The globalization process up to now was involved with serious contradictions including global imbalances, and the financial crisis starting from 2007 had much to do with them. The next section will

discuss globalization and imbalances of the global economy and how these were associated with the occurrence of the current financial crisis.

III. Globalization, Global Imbalances and the Financial Crisis

1. Globalization and Its Contradictions

Globalization means a development of global integration of economic activities across borders of countries. It could be demonstrated by the growth of international trade and international capital movements. Along with more economic opening and liberalization, especially in capital accounts, globalization developed rapidly since the 1980s in developed countries. After then, developing countries also joined this march toward globalization together with structural adjustment programs recommended by international organizations, frequently after financial crises.

Though many economists and policymakers still believe that globalization would produce more benefits than costs, its evidence is not clear. It is argued that international trade should encourage economic growth by increasing the size of markets and productivity. Foreign investment is also expected to enhance economic efficiency and growth by providing deficient capital in developing countries and through spillover effects. However, empirical evidences for these arguments are still weak. There is a question about growth effects of trade liberalization policy although majority of studies support the growth effects of de facto international trade (Rodriguez and Rodrik, 2001). In particular, it is never evident that financial globalization promotes economic growth in empirical studies as even the IMF study admits it (Kose et al., 2006). There are many reasons why capital account liberalization and international investment fail to stimulate growth. For example, financial globalization may aggravate instability of the economy and more foreign capital inflows may appreciate domestic currency, thereby hampering economic growth (Rodrik and Subramanian, 2009).

Recently, more people are concerned about how globalization affects income distribution within countries because income inequality rose after the 1980s in most countries. A large number of studies point to technology as its cause, which increased the premium related to skill and education, and wage inequality in developed countries. However, it is argued that the role of international trade with developing countries and foreign investment out of developed countries could play a considerable role too. Developing countries also experienced worsening of income distribution, opposite to the standard international trade theory. Many argue that it is because the export sector with their comparative advantage uses semi-skilled labor that is relatively rich in developing countries, while the poor are farmers and non-skilled labor. It is also related with the fact that globalization deteriorated economic instability, leading to financial crises, which is bad to income distribution as always.

Therefore, current globalization has several inner contradictions in its process. The first contradiction is an increasing gap between rich and poor countries. The income gap among countries became larger and what we have seen was not 'convergence' but 'divergence' along

with globalization. Because the growth effects of globalization are not clear, it is understandable that most developing countries, except a few East Asian ones, failed to catch up with developed countries after the 1980s. Now developing countries demand fairer international economic order as they recognized the problems of economic opening and liberalization. The second contradiction is worsening income distribution within countries. For the reason we mentioned above, many studies confirm that distribution effects of globalization may be negative. If income distribution becomes so worsened along with globalization it cannot have domestic political support and will face more anti-globalization arguments. This may deter the current course of globalization significantly.

The third contradiction is rapidly growing financial instability and imbalances of the global economy. Because of the ongoing rise in the current account deficit in the US and continuing capital flows into the US to finance the deficit, the global economy became very unbalanced. The current global financial crisis is related exactly with this feature because the asset market bubble in the US was stimulated by foreign investment into the US considerably. The global imbalances indeed reflect many structural problems of the current global economy and have several explanations as we discuss in the next section. But without the development of globalization as such, we would not have this huge imbalances in the global scale because it is globalization that made domestic imbalances global. Furthermore, we saw so many financial crises in developing countries due to mismanaged financial opening and contagion effects in the globalized financial market. International capital flows, especially short-term ones, were greatly pro-cyclical and volatile, and hence contributed to the increase in instability in the current global financial system. This financial instability became more and more global due to the close linkage of the countries in the world economy through trade and finance as the current crisis illustrates.

If these conflicts of globalization were not addressed successfully, the future of globalization is uncertain because political support for it could be weakened in the future. If we take into account of these problematic aspects of globalization, it is understandable why even prominent economists frequently talk about 'discontents of globalization' (Stiglitz, 2002).

2. Global Imbalances and International Capital Flows to the U. S.

The global imbalances demonstrate the precarious and unsustainable situation of the world economy evidently. As Figure 1 shows, the current account deficit kept rising after early 2000s before the current financial crisis and so did foreign capital inflows into the US economy accordingly.

The main reasons for the imbalances are excessive consumption in the U.S and the recent fiscal deficit under the Bush administration, that is, overspending of both the private and public sector. Figure 2 demonstrates the gap between domestic private investment and saving, and net government saving. We can see that lower saving than investment due to overconsumption and the large government deficit contributed to the current account deficit after the 2000s, while the 1980s saw the fiscal deficit as a main cause of the current account deficit, offset by the private saving-investment gap in part.³⁾ These new twin deficits of the US lied at

Figure 1. The Current Account Deficit / GDP in the US (%)

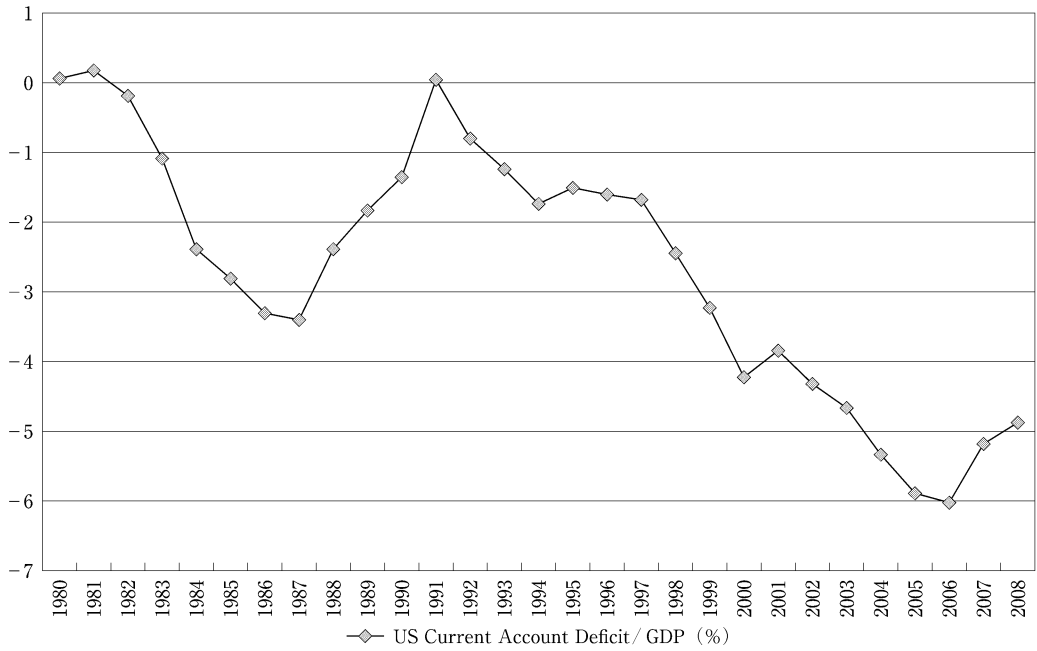
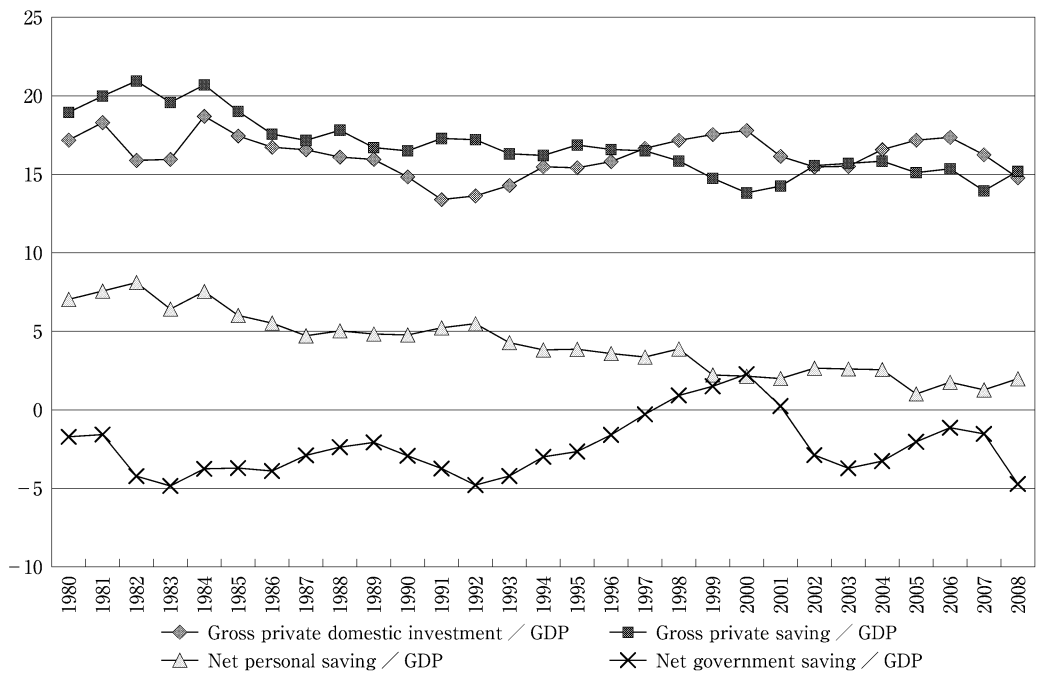


Figure 2. Investment and Saving in the US (%)



the core of the global imbalances.

The surplus countries are mainly East Asian ones such as China and some oil producers in this recent period. These countries have pursued the export-dependent growth strategy rather than domestic demand after the East Asian crisis in 1997. They accumulated the gigantic amount of trade surpluses and foreign reserves, and they recycled these dollars to the U.S. economy by purchasing the U.S. treasury bonds. For instance, the foreign reserves of China jumped from \$212 billion to more than \$1 trillion in 2006 and even more than \$2 trillion in 2009.

There were hot debates about this global imbalances problem a few years ago (Eichengreen, 2006). Optimists underscored that American consumption had driven the rapid growth of the whole world, providing markets for other exporter countries. According to them, global imbalances were features of the Bretton Woods System II that could be stable because it was on the basis of supports from both surplus and deficit countries. Others insisted that the global imbalances problem was owing to a 'saving glut' of East Asian countries that tried to hold a lot of foreign reserve. These arguments tended to overemphasize the strength of the U.S. economy and the problems outside America. They assumed that global imbalances could continue somehow without a serious instability. However, a large number of rational economists presented concerns that the global imbalances were not sustainable since the burden of external debts in the U.S. economy and the risk of depreciation of the dollar to surplus countries was too high. Many scholars acknowledged that the U.S. economy should reduce their spending and dollars should be depreciated to a large extent. Of course, the other pillar of global imbalances, East Asia, should not be neglected. Concerning East Asia, there has been an 'investment draught', not just a 'saving glut' (Lee and McKibbin, 2006). In fact, most East Asian countries including Korea and the ASEAN experienced a significant decline of the investment rate after the 1997 East Asian crisis, in part due to structural changes of the economy together with neoliberal restructuring. China had a rise in the investment rate but that of the saving rate was faster because domestic consumption was depressed and exports were promoted actively.

Another aspect of global imbalances is that foreign capital has moved from poorer countries including emerging markets to the US, opposite to theoretical expectation, called the 'Lucas Paradox'. Neoclassical theory states that international capital should move into poorer countries where the return to capital is relatively higher with lower physical capital per worker. Of course, many factors including institutions, risk and financial development affect the level of return and hence capital may not move to poorer countries. However, it is true that countries that are really in need of capital for development do not have benefits from capital inflows currently. Even African countries became net creditors because they should pay back their original debts with interests. This is unfair as well as inefficient in view of the balanced growth of the world economy.

The more serious problem is that foreign capital flows into the US had not been utilized by productive purposes. They financed the serious trade and fiscal deficit of the U.S. economy, and stimulated Americans' consumption beyond their income. They also encouraged the growth of recent bubbles in the real estate market and the stock market at least in part.

The debt level of the US economy rose rapidly after early 2000s, which had much to do with continuous capital flows into the US economy. Thus, distorted international capital flows in the global economy aggravated a debt-driven spending binge in the U.S. and asset market bubbles. This suggests that the current global crisis stemmed from the imbalances of the global economy and problematic international capital flows partly.

3. The Political Economy of Global Imbalances in the US and East Asia

It should be noted that institutional and political changes both in the US and East Asia played an interesting role in worsening global imbalances. Neoliberalism became dominant in both the US after the 1980s and East Asia after the 1990s but its effects on external balances were quite different. In the US, conservative economic policy after the Reagan administration resulted in more unequal income distribution on one hand and more financial deregulation on the other hand. Consequentially, poor Americans turned to more and more debts even though they did not earn income enough, provided by financial institutions in the deregulated financial markets. Thus, they kept excessive consumption and this enlarged the current account deficit because the saving rate went lower continuously. After the early 2000s, even poor households such as subprime lenders became able to get mortgage loans to buy houses easily. Financial institutions introduced financial innovation in this market such as securitization and derivatives, that is, CDO and CDS, under weak regulation using the wrong model seized by the strong belief that the financial market is always efficient. This encouraged the excessive growth of sub-prime lending in the mortgage market and increased system risk highly, making the whole financial system very vulnerable.

Furthermore, cheap imports from China were necessary to the US economy as these could check the growth of real wages, which had been in depression for long after the early 1970s. International trade contributed to weakening workers' power and strengthening the neoliberal accumulation regime. Foreign direct investment and the potential threats of transfer of factories out of the US, called the 'threat effects', also led to this result. In this globalized neoliberal accumulation regime, the US consumption was crucial because the US economy was the biggest market for exports from other countries, where US multinational companies are producing export goods. This suggests that neoliberalism, globalization and global imbalances interacted closely in the US. Neoliberal changes were intensified by globalization and they provided backgrounds for rising global imbalances, while global imbalances reinforced neoliberalism in the US at the same time.

On the contrary, neoliberalism in East Asian countries went hand in hand with the export-dependent growth strategy as they struggled to increase exports to make use of globalization for maximum growth. Most East Asian countries observed that income distribution became worse after introducing more liberalization, opening and economic reforms following neoliberalism, same to the US. China suffered from a widening income gap between the rich and the poor for long after the 1980s, and Japan saw income distribution worsening after the late 1990s with neoliberal reforms. Crisis-hit countries including Korea and Thai also went through worse distribution because of neoliberal economic restructuring such as labor market

flexibilization, pushed by the IMF, after the 1997 crisis. These countries strove to globalize more and increase exports for economic growth and they had increasing trade surpluses after 1998 with currency depreciation and structural changes in the economy.

To East Asia, workers' low wages were requisite to export market competition that grew intensive with more and more countries integrating into the world economy. Worse distribution also repressed consumption and domestic demand, thereby increasing trade surpluses. Furthermore, financial restructuring toward the more liberalized and open financial markets, from the old East Asian style relationship-based financial system, lowered corporate investment considerably. Therefore, neoliberalism and worse income distribution in East Asia caused a draught of investment and consumption and the consequent rise in the trade surpluses. This suggests that similar changes in the political economy created opposite results in the external balance across the Pacific, depending on the different economic growth strategy. The development of neoliberalism along with globalization deteriorated global imbalances.

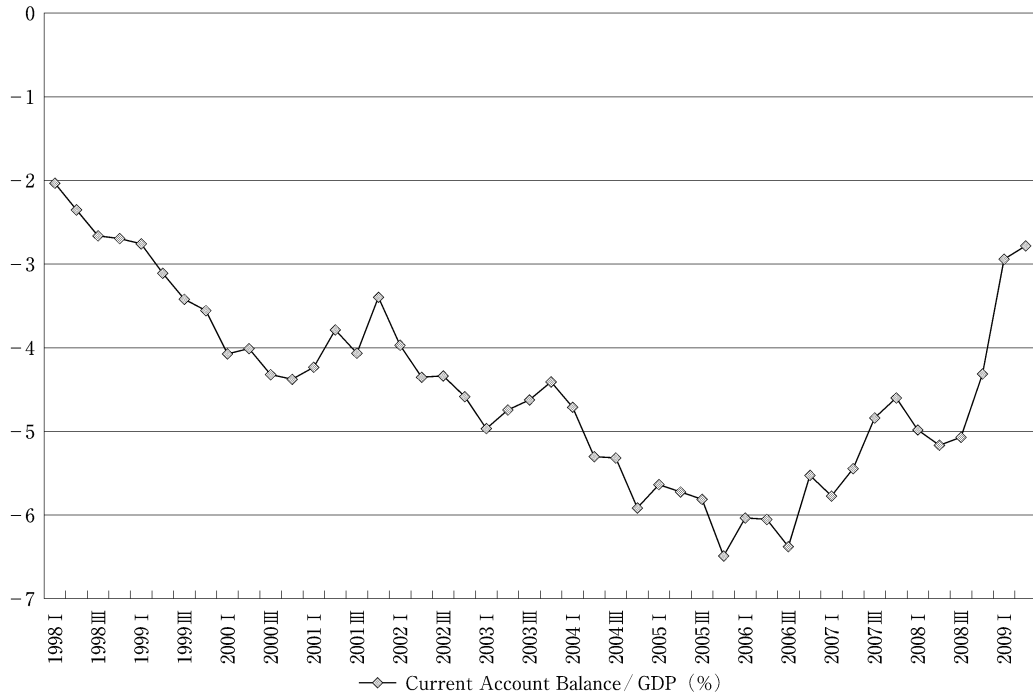
IV. Global Rebalancing and East Asia

1. Changes in Global Imbalances and the US

After the crisis breaking out in late 2007, it appears that the serious global imbalances started to be corrected to some extent along with the decrease in imports of the US economy because of the serious economic recession. Figure 3 demonstrates the quarterly changes of the US current account deficit. It started to shrink from 2006 and there was a significant decrease after late 2008. Its level in 2009 by the second quarter is the lowest in 2000s.

The change after the global financial crisis is related with the fact that the saving rate of the US economy rose while the investment rate fell after the beginning of 2008. The household saving rate out of disposable income continued to rise from 1.2% in the first quarter of 2008 to 4.9% in the second quarter of 2009. The domestic private saving rate recorded 15.2% higher than that of the domestic investment rate, 14.8% in 2008. This contributed to the reduction of the trade deficit significantly. This is closely associated with the sharp fall of net asset value due to the financial crisis and the still high level of household debts.

However, this change was offset by the rise in government net saving that rose up to -4.7% in 2008 from -1.5% in 2007. The government balance worsened even more after 2008 owing to expansive government spending in response to the financial crisis. The official fiscal deficit also went up to 3.2% of GDP in 2008 due to the stimulus package from 1.2% in 2007. Furthermore, the US government announced that the fiscal deficit in 2009 fiscal year amounted to \$1.4 trillion, three times larger than that in 2008, as high as 9.9% of GDP. Household saving out of their disposable income was still mere 2.7% in 2008, lower than the level in 2004, which enforced debt-dependent consumption. The share of domestic consumption out of GDP in the US was still about 70%, not changing at all from 2003, higher than about 67% in 1998. In 2009, the estimate of the total domestic saving rate including the government sector was still 4% point lower than the total investment rate, although it was

Figure 3. The Recent Changes in the Current Account Deficit in the US (%)Source : *ibid.*

lower than the level in all years after 2003. Thus, the US should rely on foreign saving continuously in 2009 because of the rise in the deficit of the government balance in spite of the surplus of the private balance (IMF, 2009b).

Besides, it is not certain whether the reduction of the current account deficit will continue and overspending the US will finally end. The decline in consumption might be just temporary in the process of deleveraging of households and financial institutions in the crisis. When the economy stabilizes and grows again, another bubble and a bubble-led boom could stimulate consumption of the US economy again as the financial sector may consider that as an opportunity for profit. In fact, the US economy appears to begin to recover as the quarterly growth rate compared with the previous quarter turned positive to 2.8% in the third quarter of 2009 after recording four consecutive negative quarterly growth rates.

The foreign capital inflows also changed to some extent. Foreign investment into the US, called net foreign lending, fell sharply in the recent period due to the drop of the current account deficit after 2007. The negative international investment position of the US economy did not worsen since then. There has been a change in the behavior of foreign central banks that started to be concerned about the future depreciation of dollars. They attempted to reduce dollar assets more in their foreign reserve assets and diversify their reserve holdings by increasing the portion of other currencies, especially in 2007. However, the demand for safe assets such as the US government security became even higher in the middle of the financial crisis and foreign holding of these bonds rose in 2008 significantly. Partly related to

this, the value of dollars remained higher than the common expectation. It is not until late 2009 that the dollar began to depreciate considerably, reflecting the huge increase in money supply of the US and weakening trust in the US economy. The depreciation of dollars might help the US to reduce the current account deficit further, but it should be noted that too abrupt changes may bring about a collapse of the dollar value and a serious disorder of the global economy.

Thus, a change in global imbalances occurred after 2008 along with the financial crisis but it is still limited. Besides, there is high uncertainty about the correction of global imbalances in the future. It would be fair that we may not say that the recent change due to the crisis will finally lead to a resolution of global imbalances because more structural transformation of the US economy is necessary. Regarding the US economy, the interest of financial capital is still powerful and it is highly likely that another bubble-led boom that will induce overconsumption dependent on debt will be stimulated. Finance already became dominant in the operation of the US economy as the share of profits of financial institutions out of profits of all firms in the US rose from 15.3% in 1980 to 33.3% in 2003. The share of value added of the financial sector in GDP is relatively high by so-called the financialization process. Considering that Wall Street that has great influence in US politics shaped the political economy and policy making in the US, a constant check of lending and debts and tight regulation of financial institutions will be very hard. In particular, regulation of a development in new financial products such as complex financial derivatives will be never easy. It should be noted that there is already criticism that measures of the Obama administration to regulate the financial sector are neither comprehensive nor effective although the US government spent huge money to bail out financial institutions in trouble.⁴⁾

2. The Role of East Asia for Balanced Globalization

It is certain that structural changes in both economies across the Pacific, not just the US, are necessary for correcting imbalances in the current global economy. The cause of global imbalances indeed lied in other economies such as China that accumulated huge trade surpluses and recycled dollars into the US. Global imbalances will not disappear unless those surplus countries strongly encourage domestic demand as a source of growth by changing their growth strategy. Although the size of the current account surplus out of GDP in China slightly fell in 2008 because of the crisis, the level is still much higher than that in the early 2000s. The share of exports in total GDP in China was as high as 33% in 2008, much higher than 20.1% in 2001 and even higher than 30.7% in 2004, though it fell from 36.5% in 2006. Meanwhile, the share of domestic consumption out of GDP in China was still 36.8% in 2008, lower than about 45% from the late 1990s to the early 2000s, and much lower than that of other countries, let alone the US.

As we saw, most East Asian countries pursued the export-dependent growth strategy by increasing exports to the US. That required these countries to keep their currency relatively depreciated for export promotion. For example, the Chinese government maintained the effective peg system between the RMB and dollars until mid-2006 after which it introduced more

flexible exchange rate system and allowed appreciation of the RMB. However, it again pegged the exchange rate of the RMB to the US dollar after mid-2008 in order to encourage its exports. This strategy was successful in the past but it would be harder and harder to succeed. It is not likely to be feasible any more due to the collapse of the US economy and the rising pressure from the US.⁵⁾

This is why many call for a fundamental change of the growth strategy of East Asia. These countries should make more efforts to encourage domestic demand and make this an engine of growth instead of exports to the US. They need to stimulate the purchasing power of nation people by enhancing social welfare and improving income distribution, opposite to the strategy up to now. Appreciation of domestic currencies in East Asia could contribute to this process too. To this end, the political economy in this region should change first. It is needed that these countries should end neoliberalism and introduce more progressive and Keynesian economic policy based on a broad political coalition. The recent change of the government in Japan to the Democratic Party that emphasizes better distribution and domestic demand is meaningful in this sense. It will take more time for China to promote domestic demand enough but the Chinese government appears to recognize the serious problems of bad income distribution. The conservative Korean government still adheres to the neoliberal tenet but more opposition can emerge sooner or later taking into account of the reality of bad distribution and poverty.

Adjustment of exchange rates, especially between the Chinese RMB and the US dollar must be helpful to the resolution of imbalances directly as it will decrease imports of the US and increase exports of the US. But there is a danger of too fast and disorderly depreciation of US dollars, which may destabilize the global economy. If it occurs, it will incur serious cost to China and other East Asian countries because they hold gigantic amount of dollar assets. In this situation called the dollar trap, an orderly and slow depreciation of dollars would be more desirable.

A more balanced global economy could be realized only when the benefits of international investment spread to poorer countries that did not receive foreign investment. International investment went to the US under the current global imbalances, which worsened the asset market bubble and overconsumption in the US, thereby becoming a background of the current crisis. More desirable form of financial globalization should direct international capital flows much more into developing countries in need of development finance, which may need a reform of the global financial system (Ocampo, 2009).

East Asia can play a key part in this, too. Since this region holds the largest foreign reserves as much as \$4 trillion, East Asian countries should devise a way to make use of reserves more productive way on the basis of more financial cooperation (Lee, 2007). They should not only diversify their reserve holdings from dollars to other currencies, but also think of plans to establish institutions to help finance developing countries as well as stabilize the regional economy. For instance, the Asian Monetary Fund (AMF) may have this function to some extent and they may set up a new regional development bank to encourage development finance. East Asian countries already achieved an agreement upon the plan to

set up a multilateral fund by developing the Chiang Mai Initiative in 2009, but more close regional economic cooperation is called on. If East Asian countries change their course of the economic growth strategy and assist developing countries by utilizing their foreign reserves, it will make great contributions to the correction of global imbalances and more balanced globalization.

V. Conclusions

The global financial crisis after 2007 has shed light on the problematic features of unbalanced globalization that has several contradictions, especially global imbalances. Growing imbalances in the global economy with the huge current account deficit in the US and foreign capital flows into the US exacerbated the asset market bubble and became one cause of the financial crisis. The crisis from the US spread to other developed and emerging market countries rapidly and became truly global because financial instability in the world economy was made highly serious by financial globalization.

This paper has examined the current global financial crisis and global imbalances by critically investigating their developments and relationships under unbalanced globalization. Neoliberalism and globalization have developed after the 1980s in the world economy but they failed to bring about stable economic growth and convergence of countries. Neoliberal globalization led to higher inequality within countries and more global imbalances, which were related with its political economy in both the US and East Asia. The real estate market bubble and finance-led growth in the US were stimulated not only by financial deregulation and lax monetary policy but also by ongoing capital inflows from surplus countries. The burst of the bubble in the end caused a collapse of the financial system in the US that dealt in complex derivatives, seized with of the market fundamentalism.

After the global financial crisis, there has been a correction of global imbalances to a limited extent. The US current account deficit and capital inflows to the US fell rapidly after late 2008, however still their size and China's trade surplus are historically large. Without structural transformation of the US and East Asia, the resolution of global imbalances is hard to be realized. The US economy should reduce excessive spending with debts and reduce the deficit in households, the government and the whole country. East Asian countries should change their export-dependent growth strategy to a domestic-demand-based growth strategy with more equal income distribution and reduce recycling of dollars to the US. Many argue that more effective financial regulation in the national and global level is necessary to prevent future financial crisis. However, what is to be done to stabilize the global economy fundamentally is an effort for more balanced globalization to correct global imbalances.

Notes

- 1) After the bankruptcy of Bear Stearns in March 2008, the fifth largest investment bank in the US, the fourth largest, Lehman Brothers and the third largest investment bank, Merrill Lynch,

- went bankrupt in effect. The first and second largest ones, Goldman Sachs and Morgan Stanley had not so much exposure to problematic subprime assets.
- 2) Fortunately, there was no serious move to protectionism after the global financial crisis. Although some countries introduced measures such as the 'Buy American' clause in the US, there is a consensus that protectionism will ruin the global economy, different from the time of the Great Depression. However, it is highly likely that trade conflicts between the US and China and pressure to appreciate currencies of surplus countries would be seen more frequently.
 - 3) The identity of GDP is $C+S+T=C+I+G+(X-M)$. If we rephrase this equation, $(X-M)=(S-I)+(T-G)$. Therefore, the current account deficit could be decomposed into two parts, the private balance and the government balance. Both balances recorded negative after the early 2000s and aggravated the current account deficit in the US.
 - 4) Nobel laureates in economics and progressive economists such as Krugman and Stiglitz, who criticized the Bush administration harshly and supported Obama, presented a disappointment about the effort for the financial reform by the Obama administration. For instance, see Krugman, Paul. "Stressing the Positive," *New York Times*, May 7, 2009, and "The Joy of Sachs," *New York Times*, July 16, 2009, and Stiglitz, Joseph. "Obama's Ersatz Capitalism," March 31, 2009, *New York Times*.
 - 5) The more countries join export markets, the harder it is for this strategy to be successful. Thus, there is a sort of fallacy of composition in the export-dependent growth strategy of individual countries when it comes to the whole world.

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