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Rebalancing, Growth, and Development in a Multipolar Global Economy

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Reduction of large and persistent external imbalances is currently a key focus of G-20 discussions. The paper argues that in a progressively multipolar world economy, the goals of global rebalancing, growth, and development are increasingly inter-linked. Growth-oriented rebalancing calls for emphasizing structural reforms and leveraging the role of developing countries in supporting strong and balanced global growth.

Since its launch at the Pittsburgh summit in 2009, the G-20 Framework for Strong, Sustainable, and Balanced Growth and related Mutual Assessment Process (MAP) has rapidly emerged as the main instrument for economic policy coordination in the G-20. Members engage in a mutual assessment of the consistency of their national policies and plans with the group's shared growth and development objectives. The IMF and the World Bank assist in this process by providing technical inputs, working with other international institutions as needed, such as the OECD, ILO, WTO, and UNCTAD. The World Bank's contributions to the MAP provide a focus on emerging markets and other developing countries and highlight links between development and the global growth and stability agenda. Through its participation in this process, the Bank also endeavors to bring into the G-20 discussions the perspective of those developing countries, including low-income countries, that are not G-20 members.

Currently, a central focus of the MAP is the development of a framework to address excessive external imbalances. At last month's G-20 ministerial meetings, agreement was reached on a set of indicators and guidelines to identify large and persistent imbalances that may require corrective action. More conten-

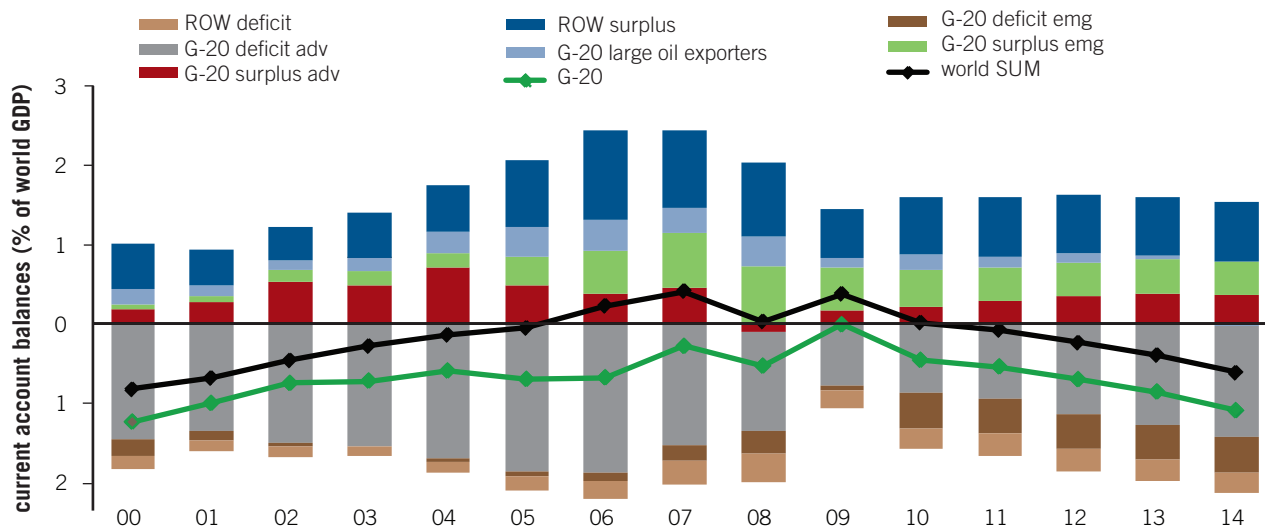
tious discussions lie ahead in the next stage when these imbalances are subjected to more detailed scrutiny and needed policy adjustments are discussed. In this work on imbalances, the World Bank is drawing attention to the links between rebalancing external positions and growth and development.

Rebalancing with Growth

External current account imbalances that grew appreciably in the run-up to the global financial crisis narrowed during the ensuing recession. IMF analysis and projections show that part of the narrowing was cyclical and that, absent policy adjustments, the imbalances could widen again as the world economy recovers (figure 1). There is concern that large and widening imbalances could threaten economic stability and the sustainability of growth.

Imbalances, when they are unsustainable, must be addressed, and the World Bank (with the IMF) is supporting the current G-20 work on this issue. But, as the Bank has emphasized in its contributions to the discussions, in this work we must keep in clear view the bigger picture—the main objective of the MAP—which is growth. The focus ought to be on reforms that maximize sustainable growth, not on external imbalances

Figure 1. After Narrowing During the Recession, External Imbalances Could Widen Again



Source: IMF—WEO data/MAP projections.

in and of themselves. Rebalancing should not be a zero-sum game, rotating demand from one to another: the objective is to lift growth, not just shift growth. Imbalances and how they are addressed must be placed in the context of a broader G-20 agenda on how to ensure strong and sustainable growth in the postcrisis global economy. The concern with external imbalances, while warranted, must not divert attention from what is really needed—and that is reforms at home. A growth-oriented approach to rebalancing would have two important elements:

- A strong focus on structural reforms that address the underlying, fundamental drivers of the imbalances, and
- Leveraging of the role of developing countries in supporting strong and balanced global growth.

Structural Drivers of Imbalances

All imbalances are not bad: some reflect the normal workings of globalization, market-driven differences in saving and investment performance and competitiveness, and differences in stages of development that may not be a threat to global stability. Some reflect economies’ fundamental structural characteristics, such as if they are major commodity producers. It is the large and unsustainable imbalances that arise from policy distortions and structural deficiencies that should be the focus of attention, such as domestic product and factor market distortions, financial market failures, structural issues in tax and expenditure policies, deficiencies in social policies, distortions in external sector (trade, investment, exchange rate) policies, and inadequate international financial safety nets that affect economies’ saving and investment incentives/performance and competitiveness. Adjustment time frames need to be flexible because structural reforms in many cases take time.

Many of the policy distortions that give rise to unsustainably large imbalances also impede long-run sustainable growth.

Much of the rebalancing agenda in fact comprises long-standing domestic structural reforms brought into sharper focus by the recent financial crisis. The variety of factors that can cause imbalances, and the differences in specific country circumstances, caution against approaches to address imbalances that may be overly simplistic or that aim for quick fixes.

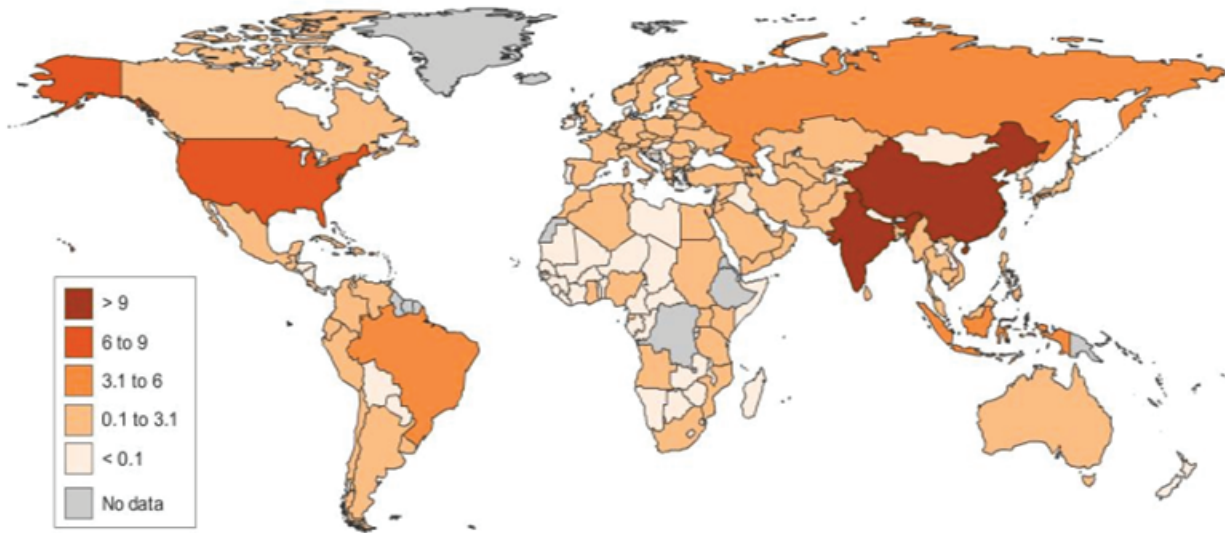
The Role of Developing Country Growth

Rebalancing must be considered in a truly global context that factors in and leverages the role of developing countries in supporting strong and more balanced global growth. In a progressively multipolar world economy, the goals of global growth, rebalancing, and development are increasingly interlinked. With stronger growth, developing countries’ contribution to global growth has increased appreciably over the last two decades. The map in figure 2 depicting countries’ contribution to global growth shows the multipolar pattern of recent global growth.

In 2010, developing countries, including emerging markets and other developing countries, contributed close to one-half of global growth (figure 3). While much of this growth contribution comes from some large and dynamic emerging markets, many other developing countries have also improved their growth performance and have the potential to achieve stronger growth. Sub-Saharan Africa achieved annual growth of about 6 percent in the five years preceding the recent financial crisis and is now rebounding quickly.

Developing countries’ share in world trade rose from 20 percent in 1995 to close to 30 percent in 2009 (figure 4). Their share in world trade growth is higher still, because their import demand is rising at twice the rate of import demand in high-income countries. Trade among developing countries, or South–South trade, has risen to 40 percent of total developing

Figure 2. An Increasingly Multipolar Pattern of Global Growth (distribution of global growth shares [%], 2006–8)



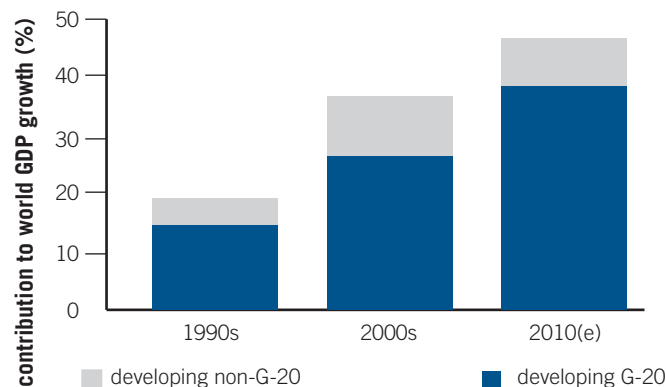
Source: World Bank staff estimates.

country imports. Developing countries have led the recovery in world trade.

Looking ahead, developing countries will likely continue to lead growth in the global economy, with average growth in the medium term twice as high as in high-income countries (figure 5). Also, developing countries' growth, while varying in speed, is likely to range widely across developing regions. These projections are of course contingent on developing countries continuing to pursue the macroeconomic and structural reform policies that have contributed to their growth momentum.

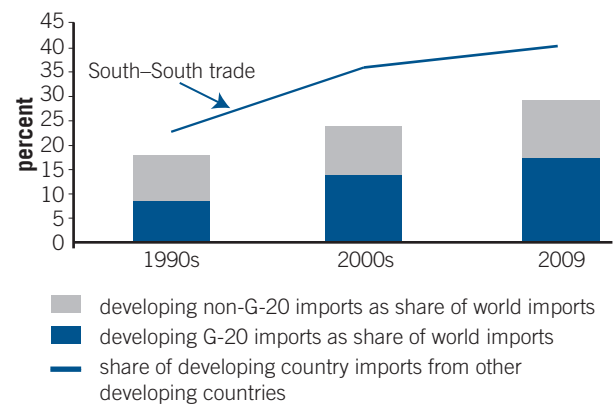
The upshot of these figures on the growing role of developing countries and their improved growth prospects is that developing countries can be an important source of growth in demand to support the desired rebalancing of global growth—and achieve the MAP objective of strong, sustainable, and balanced growth. Developing countries offer abundant opportunities for high-return, growth-enhancing investments, such as in critical infra-

Figure 3. Rising Share of Developing Countries in Global Growth



Source: World Bank staff estimates.

Figure 4. Developing Countries' Rising Share in World Trade and Growing South–South Trade



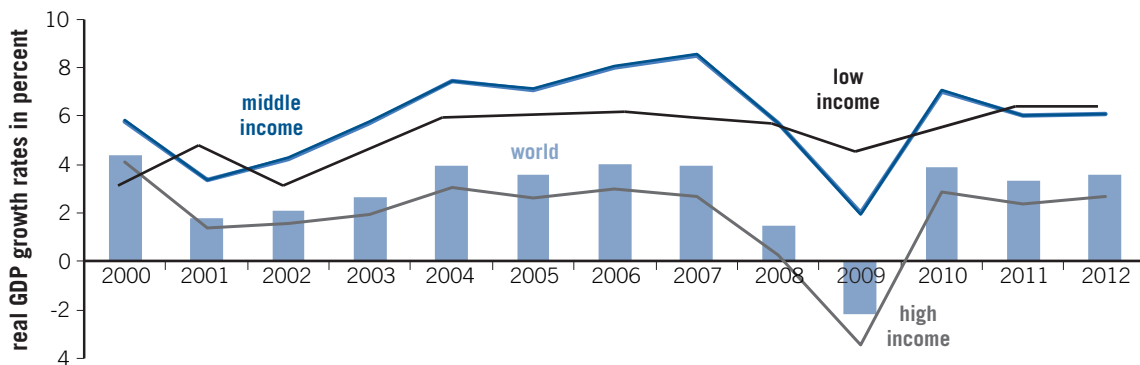
Source: WDI database and UN Comtrade.

structure that removes growth bottlenecks but that often requires large, lumpy investments (also important are complementary investments in human capital). Many countries, however, face a binding financing constraint. Promoting growth in developing countries through more support for investment that removes bottlenecks to stronger growth would be a global win-win. It would support their development and it would contribute to stronger growth at the global level and to the rebalancing of global growth—by creating new markets and investment opportunities and more sources of growth in global demand.

Investing in Developing Country Growth: A Win-Win for Rebalancing and Development

Rebalancing global growth and development financing can be linked in a virtuous circle. Three-quarters of developing countries are net importers of capital. However, in the aggregate, developing countries have in recent years run a surplus, main-

Figure 5. Growth in Developing Countries: More Resilient and with Stronger Prospects Than in Advanced Economies

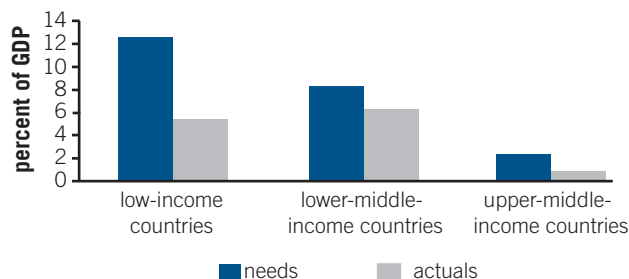


Source: World Bank staff estimates.

ly reflecting the large surpluses of saving over investment in a few countries—notably China and developing oil and mineral exporters. So, considered as a whole, developing countries have recently been net exporters of capital to advanced economies—a phenomenon sometimes referred to as capital flowing uphill. Successful rebalancing in advanced deficit economies, thereby reducing their borrowing needs, would allow more of the surplus global savings to flow to support investment and growth in developing countries, which in turn would generate more import demand to reinforce global rebalancing and growth. The Indian Prime Minister Manmohan Singh made a similar point at the G-20 summit in Seoul when he called for “recycling” more of the surplus global savings to investment in developing countries as part of the global growth and rebalancing agenda.

Infrastructure gaps are large across the developing world (figure 6). Infrastructure investment and maintenance needs in developing countries are estimated at \$900 billion plus annually; actual spending is a little over half that level—about \$500 billion annually. The gaps are especially large in low-income countries. Helping to build financial and institutional capacities for infrastructure investment in these countries—by catalyzing scaled-up and coordinated efforts by governments, international institutions, and the private sector—can be a key area for G-20 collective action to support the shared objectives of growth and development.

Figure 6. Infrastructure: Needs Greatly Exceed Current Investment Levels



Source: Yepes 2008.

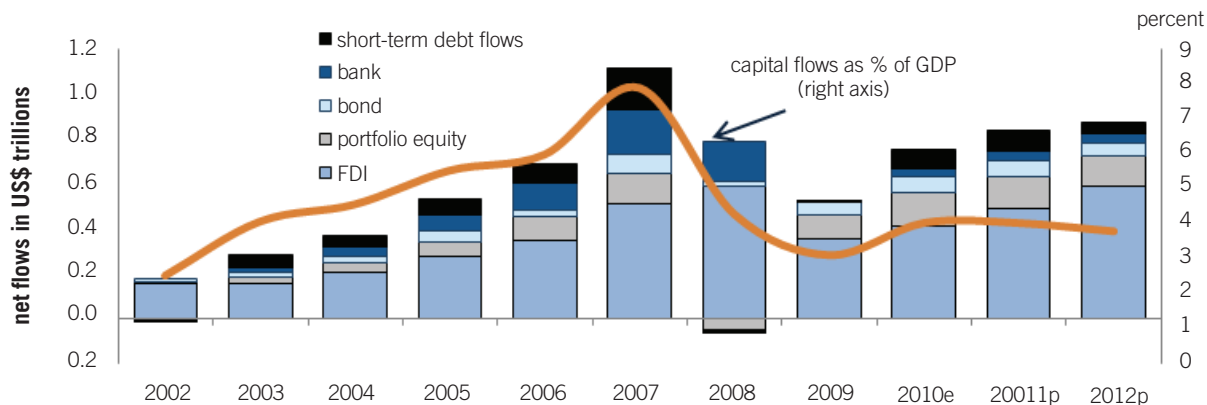
Financing for Investment and Growth

Private capital flows to developing countries have recovered from the sharp fall during the peak of the recent financial crisis, but, in the aggregate, they are likely to remain well below precrisis levels, partly because of persistent weakness in bank financing (figure 7). For the medium term, recent analyses, including a recent study by McKinsey Global Institute (2010), suggest that capital markets will tighten, and interest rates will rise. Factors contributing to that outlook include demographic developments, China’s plans to encourage more domestic consumption, tighter financial sector regulation and banking system consolidation, concerns about elevated sovereign debt levels and potential for crowding-out, and rising investment demand in emerging markets that could combine to reduce the supply of capital while increasing the demand for it.

Several emerging markets have seen a strong surge in capital inflows, especially portfolio inflows, in part driven by very low interest rates in advanced economies (figure 8). Indeed, some countries have taken policy actions to restrain the inflows, concerned about the macroeconomic implications of capital flow volatility and the potential for new bubbles. There is ongoing work in the G-20 on policy responses to capital flow surges. More recently, there have been indications that portfolio (“hot money”) flows to emerging markets are beginning to moderate.

But not all developing countries have been awash with capital inflows. East Asia and Latin America have seen a surge in inflows, but Europe and Central Asia, South Asia, and Africa not as much. The pattern of private capital flows across developing countries is highly concentrated and uneven. Five emerging market economies—Brazil, China, India, Mexico, and Russia—account for more than two-thirds of gross private capital flows to developing countries. The distribution of the flows may have become even more concentrated postcrisis, because the recovery in portfolio flows has been concentrated in a few major emerging markets (figure 9). Many developing countries, especially low-income countries, in contrast, face the prospect of scarcer and costlier capital in the postcrisis pe-

Figure 7. Private Capital Flows to Developing Countries: Recovering, but Likely to Remain below Precrisis Levels



Source: World Bank staff estimates.

riod—especially for capital that supports long-term growth and development.

For developing countries with limited access to private capital markets, official flows (multilateral and bilateral) remain important, or perhaps take on added importance, both in directly providing development finance and in leveraging private capital. Fiscal stress in donor countries heightens the need to supplement traditional financing with innovative forms of finance, including risk-mitigation guarantee and insurance mechanisms for private investment, public-private partnerships, sovereign wealth fund investments, South-South financing, and carbon finance.

Financial Sector Reform

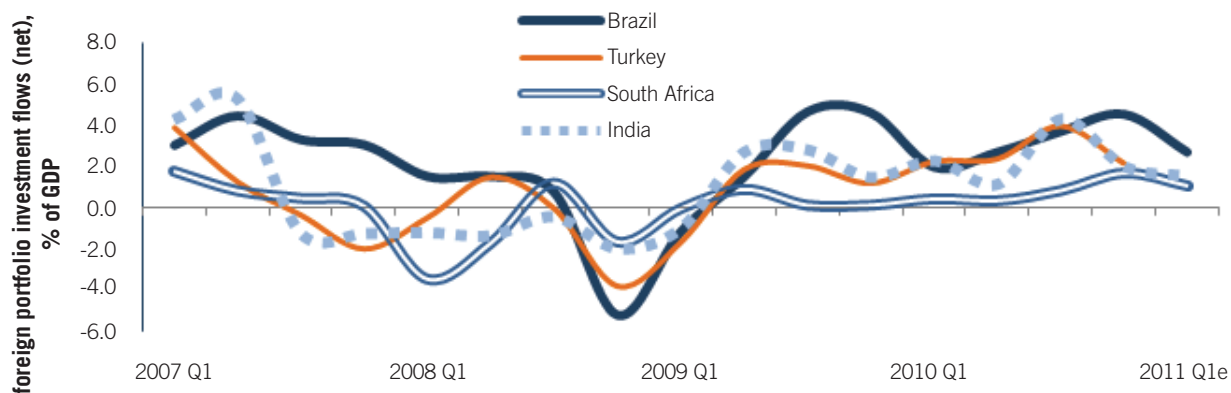
The World Bank has also addressed the role of financial sector reforms in the context of the MAP discussions. Financial regulatory reforms are crucial to global financial system stability. Encouraging progress is being made in this area, including the Basel III reforms. It is important to ensure that these reforms do not have unintended adverse consequences for financial flows to

developing countries, such as trade finance, or for their financial sector management given differences in the level of financial development and in structural and institutional characteristics. Developing countries will need expanded technical and capacity-building assistance to help them implement higher standards, adapted to their specific circumstances. This can be another important area for G-20 support, complementing ongoing efforts in financial inclusion to improve access to financial services by underserved populations and small and medium enterprises. Financial sector development is central to stronger mobilization by developing countries of their own resources.

Open Trade and Investment

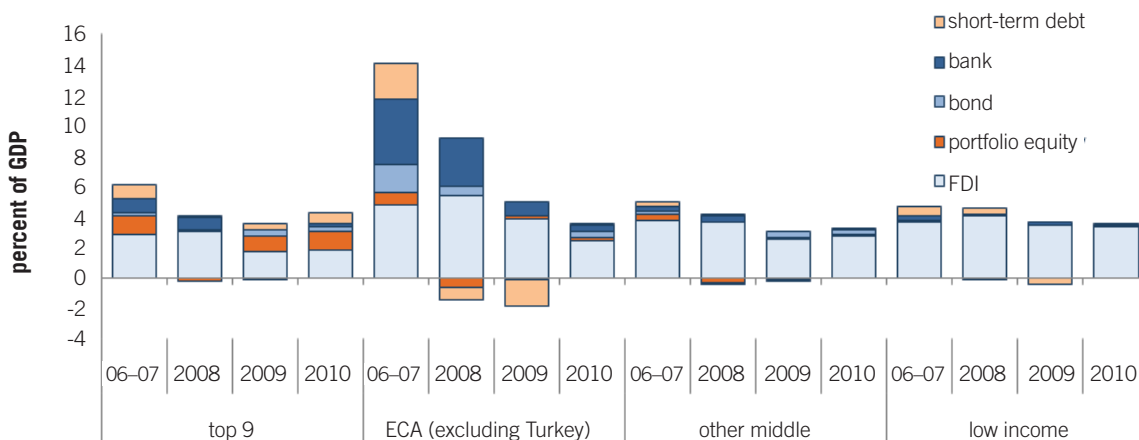
Finally, the World Bank has underscored the role of open trade and investment in growth and rebalancing. While open protectionism has been resisted relatively well since the global financial crisis, there is concern that opaque protectionism might be on the rise. Measures such as antidumping actions, safeguards, preferential treatment of domestic firms in bailout packages, and discriminatory procurement have increased. G-20 mem-

Figure 8. Strong Surge in Capital Flows Complicating Macroeconomic Management in Some Emerging Markets



Source: Central Bank data and World Bank staff estimates.

Figure 9. Capital Flows to Developing Countries: A Tale of Contrasts



Source: World Bank staff estimates.

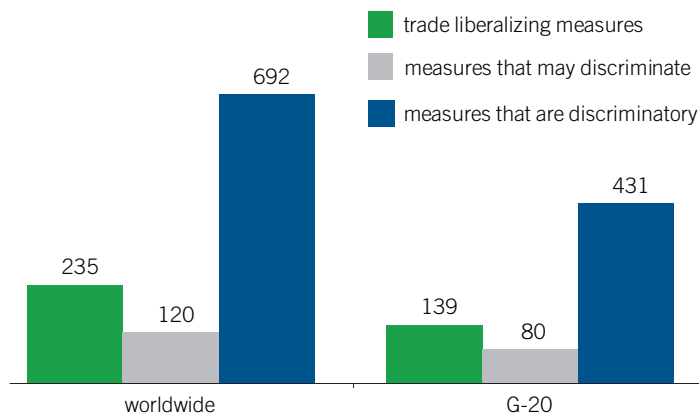
bers account for close to two-thirds of the trade-distorting measures implemented by governments worldwide in the postcrisis period between November 2008 and November 2010 (figure 10). Strengthening multilateral trade disciplines and moving ahead with the Doha Round are important areas for action and merit a more forceful commitment from the G-20. For less developed countries, improved market access needs to be complemented with stronger trade facilitation and aid-for-trade programs to enhance their trade capacity.

About the Author

Zia Qureshi is Senior Adviser in the Office of Senior Vice President and Chief Economist at the World Bank. This paper draws on

Figure 10. Open Protectionism Resisted, But Opaque Protectionism on the Rise

(Trade measures implemented worldwide and by G-20, November 2008–November 2010)



Source: GTA database.

ongoing World Bank work on global economic prospects and G-20 issues. Contributions from several colleagues are gratefully acknowledged.

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