Il Sole 24 ORE

10 November 2013

Keynes and the chimera of symmetrical adjustment

By Alessandro Leipold

Here we go again: the international economic debate is once more focused on an issue that remained unresolved at the Bretton Woods conference, now almost 80 years ago. The issue is how to secure a symmetric adjustment of global payments imbalances. How to ensure, in other words, that the needed correction does not fall exclusively on deficit countries (pushed by market pressures and the hemorrhaging of reserves), but is correspondingly shared by countries in surplus as well. The latest installment of this endless debate is focused on Germany, triggered by the U.S. Treasury's accusations of a deflationary bias, taken up by the IMF, and promptly rejected by Berlin. At the same time, the EU Commission came out with figures that would subject Germany to the new "excessive imbalances" procedure. The latest data on the country's trade surplus – at a record level in September – has further fueled the controversy.

Those who hope that all this attention will shift German policy to a less restrictive stance are due for a disappointment. Not because of any particular German stubbornness, but simply because international pressure has never succeeded in imposing adjustment on creditor countries. Consider, in recent times, the cases of Japan or China, or – at the height of the oil crisis – that of the OPEC producers. Corrections, when they happen, are driven by exchange rate appreciation (where the rate is not manipulated) or by the domestic realization that a change of course is ultimately in the country's own self-interest.

The issue of global imbalances gripped John Maynard Keynes when shaping the post-war international monetary system. He called it "the secular international problem," acknowledging its intractability. His fear was that the international trade system could degenerate into a dangerous mercantilist game designed to export unemployment – precisely the accusation leveled today at Berlin. In the absence of an international adjustment mechanism, and as long as surplus countries resist deploying their greater purchasing power, adjustment inevitably occurs via a contraction in debtor countries, thus imparting a deflationary bias on the world economy. The solution proposed by Keynes foresaw penalties not only for deficit countries but, in a symmetrical manner, also for those in surplus – including mandatory revaluations for surplus accumulation beyond a certain threshold. But Keynes himself was well aware of the political resistance to his proposal, calling it "an ideal scheme ... complicated and novel and perhaps utopian." And indeed it turned out to be so: to date, the IMF has not succeeded in ensuring that the exercise of its surveillance be truly evenhanded and balanced, despite many proposals to this end.

Such success is even less likely for EU surveillance, whose design is lopsided to begin with. Indeed, whereas an "excessive imbalance" is triggered by a current account deficit in excess of 4% of GDP, the threshold for a surplus is set at 6% of GDP. Such congenital asymmetry weakens the mechanism from its very start. No fundamental changes can realistically be expected from this procedure.

So, what is to be done? In the first place, Mario Draghi did well to induce a divided ECB Council to approve a rate cut by majority vote last Thursday. Although the effect on the euro's exchange rate, initially in the desired direction, may turn out to be short-lived (as it was on the occasion of the last rate cut, in May), the anti-deflationary intent is certainly appropriate. The ECB still retains in its arsenal a possible new long-term liquidity injection (LTRO) and a negative deposit rate – both measures, however, not devoid of risks. On the fiscal front, one cannot but hope that the EU's new surveillance over 2014 budgets, currently underway, be truly "growth-friendly" as so often proclaimed, and that it downplay any marginal deviations from established nominal targets. Finally, a start to Fed tapering would also help, likely strengthening the U.S. dollar. However, as in the case of Germany, significant U.S. policy changes will occur only when dictated by domestic considerations. In this regard, the latest positive U.S. employment data offer some promise.

To close Italy's competitive gap – estimated by the IMF at about 10 % for its real effective exchange rate – all of the above would help but would not in themselves suffice. One should not expect the current pressures on Germany to lighten Italy's own task, which remains unaltered: to improve productivity and reduce labor costs via a significantly lower tax wedge, a greater role for firm-level bargaining, the removal of widespread insider protections, a more efficient judicial system, and privatization free of taboos. In the meantime we can certainly discuss "symmetrical adjustment." Debates are useful, but let us not expect to succeed today where Keynes failed yesterday; let us focus rather on the real factors underlying Italy's feeble competitiveness.