Without China, economic rebalancing won't work

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By Lesley Wroughton and Emily Kaiser - Analysis

WASHINGTON (Reuters) - If the United States is going to succeed in its push for more balanced global economic growth, it must convince China, Germany and other big exporters there is no going back to the pre-crisis boom times.

In calling for the Group of 20 to back its framework for global rebalancing at the Pittsburgh leaders summit this week, the United States is asking its big trading partners to abandon a strategy which paid off handsomely for years -- namely making goods for export to seemingly insatiable U.S. consumers.

Now that the financial crisis has shown that even Americans have their spending limits, the United States is hoping the time is ripe to finally make some progress on an issue which has generated much talk but virtually no action.

It is not a risk-free tactic for U.S. President Barack Obama. If he expects the big exporters to change their ways, he will have to make good on pledges to address the worsening U.S. fiscal position, which means making politically unpopular choices about spending and taxes.

"The key question here is whether the rest of the world believes the United States is really going to stop being the consumer of last resort," said Fred Bergsten, director of the Peterson Institute for International Economics in Washington.

Bergsten said the financial crisis gave China and other big exporters a taste of the down side of relying on exports for growth. When trade collapsed, China's economy weakened even though its banks had largely avoided the bad assets that triggered the global recession.

The U.S. plan seeks to deliver a framework by November for rebalancing the world economy under which G20 nations would assess each others policies to see if they were bringing about better balance in the global economy.

The process would put the International Monetary Fund at the center of the effort. Under the plan, the IMF would forecast the impact of policies and report back to the G20 twice a year with suggested policy adjustments.

BLAME GAME

The imbalances built up at the height of the credit boom, when U.S. consumers freely tapped rising home equity and credit cards to support their spending, have long been cause for consternation among economists.

As the U.S. trade deficit swelled, correspondingly large reserves piled up in China and elsewhere. Many economists argue that while these imbalances did not cause the crisis, they contributed to low interest rates that in turn encouraged investors to chase riskier assets in hopes of fatter returns.

But Beijing rejects that argument and thinks lax regulatory oversight in rich nations was largely to blame for the financial crisis.

That is one reason why Eswar Prasad, an economics professor at Cornell University, thinks the United States will have a tough time convincing China to go along with the rebalancing effort.

"They see this as an underhanded attempt by the U.S. to bring this issue back to the table in a roundabout way," said Prasad, who travels to Asia regularly for talks with Chinese officials.

Past IMF attempts to tackle decades of U.S. over-consumption and excessive savings elsewhere failed, mostly because the IMF lacked the influence to wield the stick over the world's most important economies.

CARROTS AND STICKS

Washington is hoping carrots work better, and it hopes that elevating an issue that had been handled by finance ministers to the leaders level will prove more effective.

The Obama administration has struck a conciliatory tone in its dealings with Beijing, and has been fairly quiet over the thorny issue of China's currency policy. For years, Washington has pressed Beijing to let its yuan currency rise in value to move China's economy away from its reliance on exports.

The IMF launched a multilateral consultation process with the United States, Japan, China, Saudi Arabia and the euro area in 2006 to try and address the distortions of economic growth in the world but got little further than a pledge by countries to tackle trade and investment imbalances.

To strengthen the IMF's hand this time, the United States is pushing for an agreement at this week's G20 meeting to increase the voting power of large emerging market countries to give them more say in IMF decisions.

Domenico Lombardi, president of the Oxford Institute for Economic Policy, said by giving emerging economies more power at the IMF, countries like China would be recognized for their input in the world economy.

"The U.S. is pursuing a multi-pronged strategy whereby on the one hand they're asking China to become a more responsible player in the international monetary system by assuming commitments."

"On the other hand, the U.S. is willing to support any move in the reform of the IMF that would give China a higher role," said Lombardi, who is also a senior fellow at the Bookings Institute in Washington.