Pressure grows to act on global trade imbalances

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Lesley Wroughton and Glenn Somerville - Analysis

WASHINGTON (Reuters) - With just two weeks before a meeting of financial chiefs in Washington, pressure is growing on five major economic players to reveal the outcome of year-long secret talks on global trade imbalances.

Some insiders call the International Monetary Fund-led initiative to wring specific policy actions out of the United States, China, Saudi Arabia, Japan and the euro area a flop.

Others remain hopeful for a last-minute breakthrough before the meetings on April 14-15 and note the discussions were an experiment from the beginning that may serve as a guide for cooperation among a broader group in future.

The so-called multilateral consultations were launched last year by the IMF to persuade the five key players to come to grips with imbalances, primarily big U.S. trade and budget gaps and massive surpluses in Asia and oil producing countries.

"A year ago there was some hope that momentum would build to tackle imbalances," said John Williamson, a senior fellow with Washington's Peterson Institute for International Economics. "It really needs someone to take the lead in talks but no one seems to be doing it, including the IMF."

Failure to take action against imbalances raises the risk of abrupt and excessive changes in exchange rates and asset prices, and hotter trade disputes, economists warn.

Some statement setting out what major participants are trying to do to lessen imbalances will be issued during the IMF meetings but it remains unclear how specific it will be.

NEW PLAYERS WARY

What started as a promising effort to tackle imbalances in a coordinated fashion seemed to suffer because China was distrustful of the process but a change in leadership at the U.S. Treasury Department also brought a shift in emphasis to an intensified bilateral effort to settle U.S.-China issues.

Meanwhile, euro-area countries accused the United States of not cooperating, while Saudi Arabia saw it as an effort to get it to pump more oil.

"Although everyone supports the idea, no one believes there is anything in it for them," said one source. "Everyone has lost interest and, more importantly, at Treasury they don't see it as being the right approach anymore."

But Treasury Undersecretary Tim Adams, who has led U.S. participation in the discussions, denied any loss of U.S. interest in the multilateral talks.

"To offer criticism that there has been a change in U.S. interest is unfair. Our enthusiasm for the topic has not changed," said Adams, who is soon leaving Treasury.
One participant said the dialogue lost steam in part because U.S. Treasury Secretary Henry Paulson, who took over last July, is preoccupied with one-on-one talks with China and "didn't even give the IMF the courtesy of a high-level meeting until February when it narrowly focused on policy."

**BILATERAL FOCUS**

Paulson, who has already made three trips to China since taking over the Treasury, has initiated a "strategic economic dialogue" with the Asian giant to try to find ways to shrink the U.S. trade deficit with China and to persuade it to adopt a more flexible currency policy.

So far, though, Paulson has little to show for his efforts to persuade China to let its yuan currency's value rise more rapidly and he is facing rising discontent among U.S. lawmakers who want stiffer trade action against Beijing.

Four U.S. senators, both Republicans and Democrats, are working on a proposal they say will make China let the yuan increase in value or face penalties and, on Friday, the Commerce Department said it was imposing duties on some imports of paper from China.

In a report this week, leading economists from Europe, Asia and the United States, argue the only way the global imbalances can be tackled is through a global adjustment program induced by policy actions.

Like the IMF, the economists argue that if left untouched the imbalances could unravel in a disorderly way forced by financial markets that could trigger a global recession.

The solution, they say, will require an adjustment in exchange rates, including a 10 percent to 20 percent depreciation in the U.S. dollar, a 30 percent increase in the Chinese yuan, a 25 percent to 30 percent rise in the Japanese yen, and a rise in the euro to $1.45 to $1.50 from about $1.30.

"We view the current stalemate regarding policy actions as dangerous, as financial market participants are likely to change their minds at some stage about the sustainability of imbalances," the report said.

Eswar Prasad, a former IMF economist and now a senior trade policy professor at Cornell University, says a confrontational approach calling for immediate and drastic policy actions is not the way to make progress on China's currency.

In testimony this week before Congress, Prasad argued the U.S. has a crucial role in the Chinese reform process and Washington should rather develop deadlines for achieving specific policy goals.

"These intermediate steps could serve as concrete guideposts for the reform process and help break down internal resistance to the reforms," he said.