KITA PIIE INTERNATIONAL CONFERENCE ON THE NEW GLOBAL TRADING SYSTEM IN THE POST-CRISIS ERA: SEOUL, DECEMBER 7, 2009

CLOSING PANEL COMMENTS

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A conference on trade will inevitably focus on the outlook for exports and policies that either facilitate or retard trade among nations. That trade has been the main driver of economic development for all non-resource rich countries in the post-war period is well understood. What is also well understood is that the 8 years leading up to the recent economic turmoil were remarkable for their growth in world trade and for the continuance of certain shifts in economic power. The former will not return to its former self because the period was characterized by unusually low interest rates, artificially high demand for imports, and capital markets that knew no limits. The latter, the shift in economic fortunes that favors some of the new economic powers (NEPs) is a phenomenon that may dominate coming decades. What is not clear, however, is how the NEPs will exercise their new economic muscle and whether the paradigm that has enabled them and other economic powers, including Korea, to reach their levels of development will be the prevailing one going forward.

Let me preface my comments on the nature of future globalization by saying a few words about the aftermath of the shock and where we may be headed in the next year or two because this will have an impact on the future model of globalization.

Much is written about the shape of recoveries. The reality is that the trajectories will differ considerably. In Korea and Brazil, for instance, we have seen the V shaped recovery that we like to see, with a minimum destruction of wealth and a swift recovery, in Korea led as always by exports and in Brazil by domestic demand. The US is seeing signs of slow recovery although credit is not yet flowing normally as banks try to beautify and strengthen their balance sheets, firms shy away from major investments, and consumers either save if they are employed or dis-save if they are not. The only buoyant part of aggregate demand is government, and that is not sustainable. So what we can expect is a bowl-shaped U recovery. This recovery will be slow unless policy mistakes are made, which is unlikely, but it will also mean major realignments domestically to pay for higher debt. The only place where a double dip is possible but not likely is Europe, where the recovery has been quick, but where the anti-inflationary zeal of the ECB could abort the recovery and combine with an appreciating Euro to create a downturn. Not the likeliest scenario but possible.

That said, what can we expect in the next few years and how will new phenomena affect the globalization model that we have come to consider the norm?

It is fair to say that the golden age of cheap finance and booming demand that relentlessly drove up trade volumes is over.

We know that capital will be more expensive due to lower leverage, stronger capital requirements, and less appetite for risk. Any kind of Tobin tax, which I am not a fan of, will add to the cost of capital.

Capital flows have become less reliable and therefore less desirable. Brazil's attempt to stem capital inflows and the appreciation of the exchange rate illustrate that capital importers, who saw flows reach 8 percent of GDP in 2008 no longer seek that kind of capital dependence. The alternatives include greater tax effort to generate public resources, which I favor, and greater encouragement of public banks, which I do not necessarily favor.

Trade expansion, at least based on access to the OECD markets, will be more difficult, especially when unemployment rates peak in 2010. Whether other markets will remain as robust and as open remains to be seen.

Taken together, these developments lead to an increased questioning of the current model of globalization. Some, like Rodrik and Subramanian, have already begun to question that model. This is not all bad, however. Let me explain why.

A greater reliance on domestic savings in development countries is over-do in many, as seen for example in the stock of savings in Miami compared to Buenos Aires. This places a greater premium on governance issues.

A greater effort to generate taxes is also possible in many emerging markets economies and the average capital inflow to GDP ratio of 1.5% in the past two decades in emerging and developing market economies can be substituted for by take takes. Mexico provides a great example of a missed opportunity.

A somewhat lesser reliance on export-led growth can also be accommodated if domestic infrastructure needs are catered to, say in India or Brazil. What cannot be accommodated are unsustainable surpluses that are fueled by implicitly subsidized exchange rates.

The paradigm can withstand some adjustments of the kind I have referred to but cannot withstand protectionism either at the border or at the exchange rate window or at the safety inspection station. It would be a tragic mistake in my opinion if countries resorted to new forms of protection, in the guise of saving or creating jobs at home or under the pretext of protecting the public from unsafe imports. Statesmanship will be required and the global consequences of unilateral actions must be considered. This is a major challenge to the G-20 nations and to Korea's chairmanship of the G-20. It is precisely in economic downturns and in fragile recoveries that the world's trading system must remain open.

Let me conclude with a few thoughts on other aspects of the future face of globalization that need to be watched with great attention.

I have already alluded to the role of public sector banks, which now seem very attractive as alternatives to imported capital. It must be acknowledged that in India, Brazil, and of course in China and elsewhere, public sector credit did successfully substitute for the freezing up of international capital markets. Nevertheless, this spigot will be hard to turn off. Moreover, the wall between government provision of credit and public views on industrial policy is often paper-thin and this does lead in most cases to efficient credit allocation.

This issue is clearly connected with the role of government more generally in the economy. I for one have been associated in my work with a balanced view of government in development, and my recent work with the Spence Commission on Growth and Development has re-enforced my view that it is not the size of government that matters, but rather its effectiveness. That Commission, with distinguished Commissioners including Dr. Han Duck Soo, former Prime Minister and now Korea's Ambassador to Washington, clearly identified government vision as a critical factor for sustained high growth. Yet there are limits, and government will have to find ways out of the market, hopefully replaced by stronger and better regulation of the " Animal Spirits " that Akerlof and Shiller described in their recent book.

We have to careful in going forward and searching for a newer paradigm not to unlearn the lessons of the past. We have to acknowledge that the economic weights are beginning to shift without ignoring the current reality that without a strong US economy, the net few decades will be much worse for all concerned. We must strive to balance the short-term necessities of dealing with job issues in a way that does not encourage trade barriers to be erected. And we must ensure that the enormous imbalances that helped fuel the pre-conditions of the crisis are not allowed to resurface.

Finally, and most importantly, we must balance the domestic imperatives with a concern for the global good. This tug of war between domestic and global objectives will be played out in the trade arena for sure, but it will also be seen in exchange rate management, in how global competition is encouraged or stifled, and yes it will be played out in conversations of Tobin taxes. We have witnessed a fair amount of wealth destruction in 2009. How that wealth will be restored depends a lot on global confidence and on the rules of the game that can either help re-grow the international economy or can keep it smaller for all. For this reason, it is in all our interests to support global economic statesmanship.