

Michael Pettis The Great  
Rebalancing PUP 2013

He focuses on the national income identity in a closed global system to show the interrelationships among  $I-S + G-T + X-M$  at home and abroad to argue that much policy and analysis is misguided because it fails to take into account the mutual determination of imbalances. For example he faults those who see trade policies as the major cause of trade imbalances and Germany for not acknowledging how its trade surplus contributed to the euro crisis and ~~it~~ is making adjustments more difficult for the deficit countries. He refers to the German view as "the vanity of moralizing" and argues that the euro crisis cannot be solved as long as Germany continues to run a large trade surplus.

He argues that the current under consumption and over investment in China isn't due to Confucian values which in earlier days were considered lazy rather than hard working, but to government created distortions that put a heavy effective tax on households.

To rebalance he argues the rate of accumulation of state assets must fall by around 10% of GDP to allow consumption to substantially increase its share of spending which has fallen from around 50% in the 1980s to around 40% <sup>and to 34%</sup> today, likely the lowest ever recorded across the globe for a sustained period.

This compares with around 50 to 60% <sup>most</sup> in other Asian countries. Consumption share for Europe and most other developing run in the 60 to 70% range. Consumption in the US is around 70%.

The low consumption is heavily influenced by the low share of household income which has fallen from the 64 to 72% range between 1990 and 2002 to below 50% now.

China has been using "a souped-up version of the Asian development model ~~also used~~ used by Germany in the 1930s, Japan in the 1960s, Brazil in the 1960s and 70s and Russia in the 1950s and 60s. All were based on huge effective subsidies from the household sector and can generate high growth for a number of years but cannot be sustained.

He argues that in China repressed interest rates generate a subsidy from households of 4 to 9% of GDP.

To increase consumption from 34 to 50% of GDP over 10 years at 6 to 7% GDP growth the consumption growth rate would need to increase

(P3)

from 7 to 8% to 17 to 19%

He expects China's growth to fall to 3-4% over the next decade but rebalancing would allow a continued high rate of increase of household income. This would help social stability

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While Pettis' global perspective of mutual interdependence is extremely valuable he sometimes makes arguments and criticisms based on implicit assumptions about the key causal factors in particular episodes. For example he argues "domestic policies by the German government can explain not only high German savings but also high Spanish consumption before the 2007-8 crisis" (p 127) while not discussing that by the logic he frequently uses Spanish policies would have also had an influence.

One of his strongest over readers is his argument that the US fiscal deficits were the result of foreign purchase of US bonds. (pp 161-62) (P4)