

**High-level Regional Policy Dialogue on
"Asia-Pacific economies after the global financial crisis: Lessons learnt,
challenges for building resilience, and issues for global reform"**

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Current Regional Challenges 3: Rebalancing Growth

Presentation

Current Regional Challenges: Rebalancing Growth

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CURRENT REGIONAL CHALLENGES:

REBALANCING GROWTH

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ESCAP High-Level Regional Policy Dialogue:
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Global Financial Crisis

Manila
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OUTLINE

- I – Structural Causes of Crisis
- II – Imbalance btw Finance and Real Sector
- III – Income Imbalance and Financial Crisis
- IV – Rebalancing Growth

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Three Levels of Causes of Crisis

- ❑ Theoretical and Methodological Flaws of Macro Economics and Market Efficiency Theory
- ❑ Deregulation, Practices and Malpractices of Financial Industry
- ❑ Macro-economic structural causes

Macro-economic Structural Causes of Crisis – 3 imbalances

- ❑ Current account imbalances
- ❑ Imbalance between financial sector and real economy – financialization
- ❑ Income and wealth imbalance

Structural Changes in US Economy since 1960s

- ❑ Secular decline in average growth rate
 - ❑ Growth supported by economy taking on more debt > debt driven economy
 - ❑ Financial debt grew fastest, followed by household debt
 - ❑ Finance now dominates the real economy
 - ❑ Finance has captured regulatory institutions
 - ❑ Finance now master rather than servant of the real economy
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Secular decline in avg real GDP growth fr 4.4% to 2.6% (1960-2006)

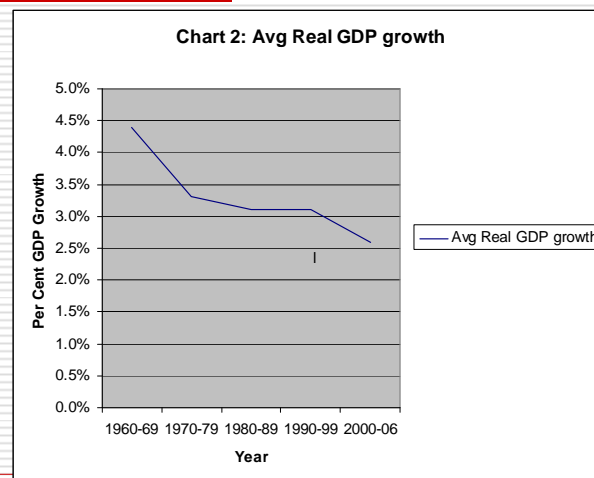
1960-69 - 4.4%

1970-79 - 3.3%

1980-89 - 3.1%

1990-99 - 3.1%

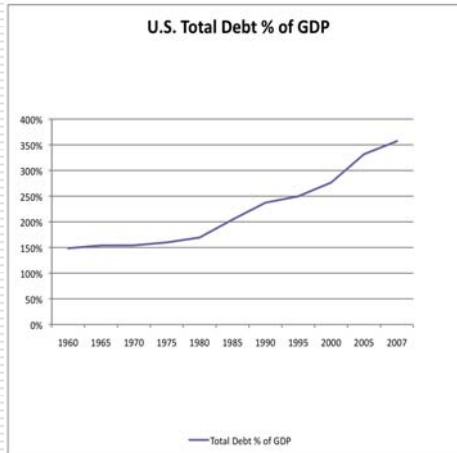
2000-06 - 2.6%



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Debt Driven Economy 1960-2007

□ US total debt rose from 150% to 350% of GDP



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Composition of USD total debt

GDP rose - 27x

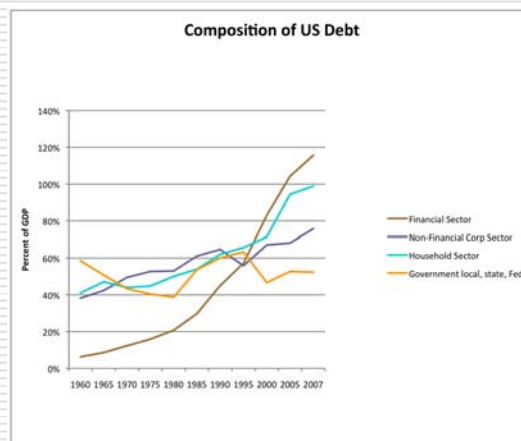
Total Debt - 64x

Financial - 490x

Household- 64x

Non Financial Corp - 53x

Govt- 24x



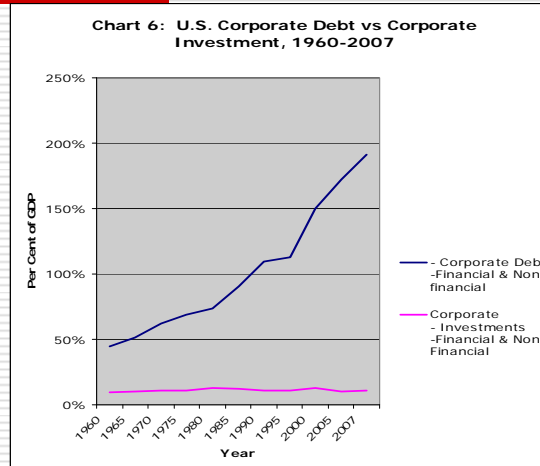
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Use of Debt - for financial engineering rather than investment

➤ Corporate debt rose from 44% GDP to 191%

➤ Gross Corporate Investment stable around 10%

➤ Debt to inflate financial asset prices



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Second Structural Imbalance

□ Financialization of the Economy > Imbalance between Financial Sector and the Real Economy in the U.S.

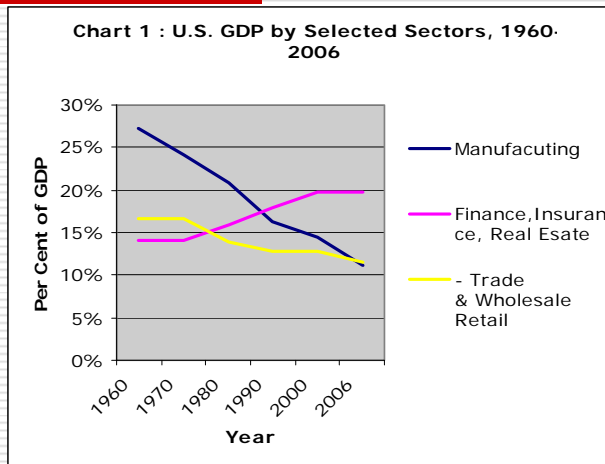
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Financial Sector Twice as Large as the Next Sector

Finance rose to 20% fr 14%

Manufacture fell to 11% from 27%

Finance twice as large as next sector (trade)



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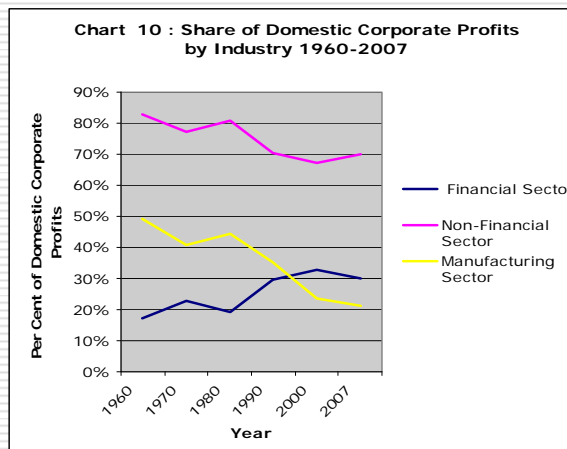
Share of Financial Sector Profits vs Manufacturing Profits, 1960-2007

Finance – rose to 30% fr 17%

Mfg – dropped to 21% from 49%

Non-fin – dropped to 70% fr 83%

\$1 trillion mean reversion for financial profits



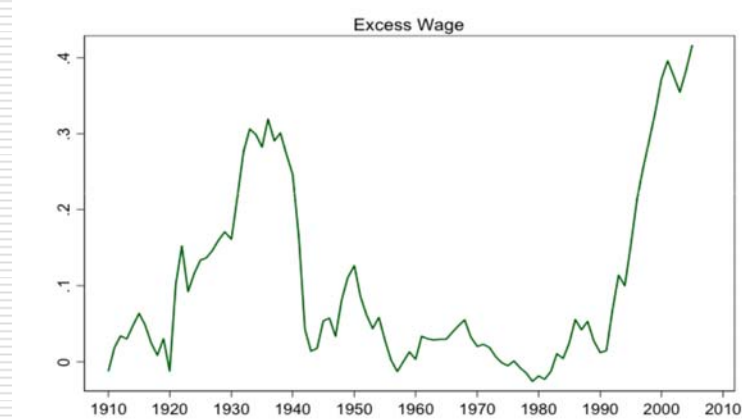
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Banks Have Become Non-Lending Banks

- ❑ Banks losing function as financial intermediaries
- ❑ More into trading of securities, foreign exchange, commodities, derivatives, advisory services
- ❑ Ratio of net interest income to non interest income declined from 75% to 25%

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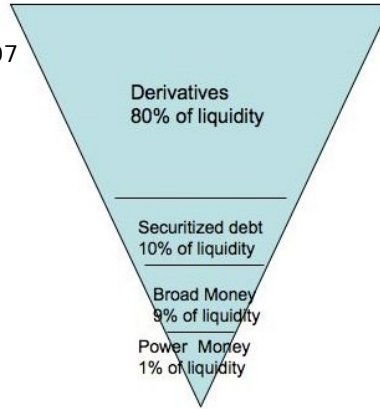
Average wage (controlling for education, skills, employment risks)



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Financial derivatives & transactions multiple of real ecy

Inverted Liquidity Pyramid - \$607 trillion - 13 x world GDP

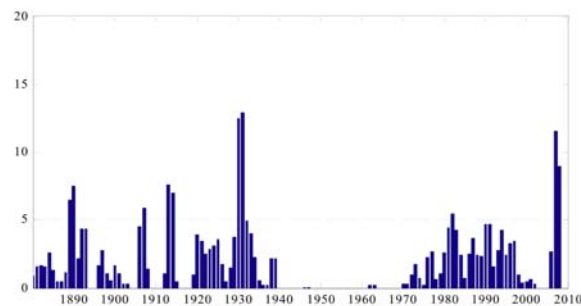


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Banking Crises 1880 - 2010

□ Note few banking crises 1940s -

Figure 1: Weighted 2-period Moving Sum of Banking Crisis Frequencies: 1880-2009



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Regulatory Capture(R Posner)

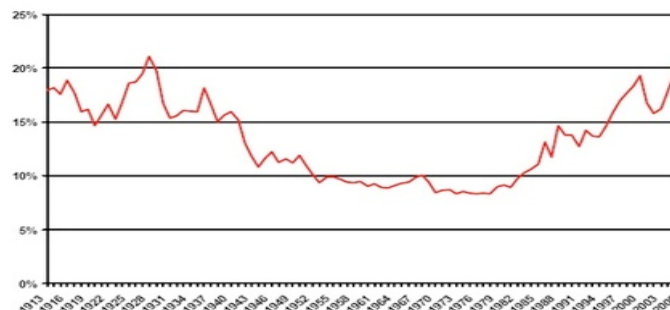
- Financial sector spent \$5b last 10 yrs
- \$1.7b on political contribution, \$3.4b on over 3000 lobbyists in Capitol
- Goldman Sachs - \$46m; Citi -\$108m
- Robert Reich – political democracy hijacked by corporate rich
- Revolving door- Wall St and Penn Ave

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Inequality Preceded Great Depression and GFC

Income Share of Highest Income Households At Highest Level Since 1928

Share of Total Pre-Tax Income Flowing to Top 1 Percent



Source: Thomas Piketty and Emmanuel Saez, based on IRS data

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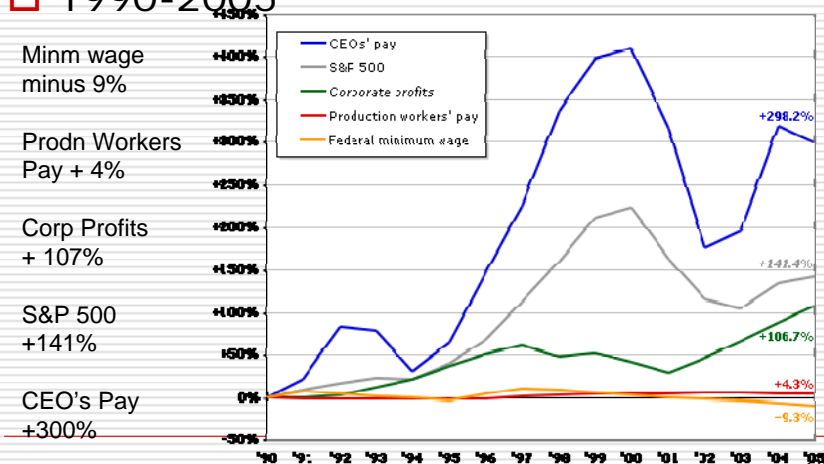
Third Imbalance – Inequality and Financial Crises

- Key to understanding long term structural causes of Global Financial Crisis is to examine the link between:
- growth, debt, financialization and inequality

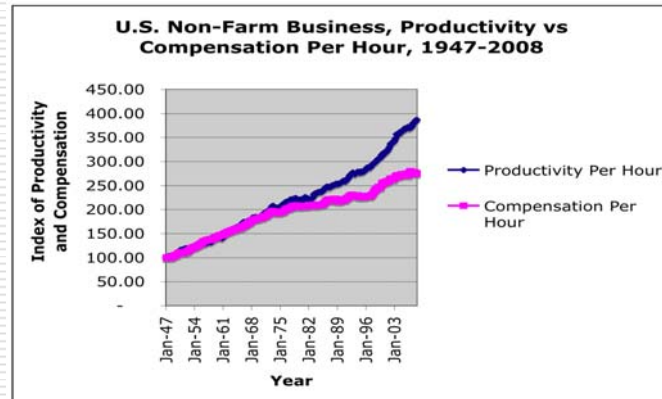
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Wages stagnated, CEOs' pay ballooned

□ 1990-2005



Wages lagged behind productivity



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U.S.- Inequality, Under-consumption & Financial Crisis

- ❑ U.S. wage stagnation and growing inequality > underconsumption
- ❑ Under-consumption "solved" by over consumption thru rising household debt
- ❑ Excess savings of rich recycled thru financial system to finance HH debt > **DEBT BUBBLE**
- ❑ Excess savings > high risk appetite > invest in risky assets > **ASSET BUBBLE**

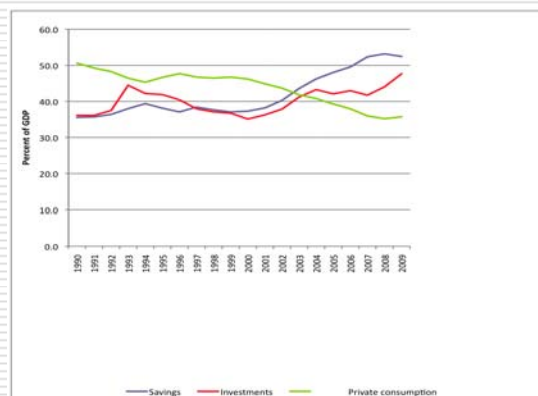
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China = inequality, under-consumption, Current Acct Surplus

- Share of GDP to labor fell from 57% to 37% over last 20 years
 - Share of personal consumption to GDP fell fr 55% to 35%
 - High savings rate of 50% due to precautionary savings and high corporate savings and investments for exports > **current account surplus**
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China's Savings, Consumption, Investments 1990 - 2007



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What does global current account imbalance mean?

- ❑ Asia and Emerging Markets (EM) over-saving and U.S. overspending
- ❑ Irony - poor countries are financing consumption of rich countries
- ❑ Bernanke blames Asian savings glut but ignores U.S. overconsumption glut

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Rebalance Growth – Reduce export dependence and income imbalance

- ❑ Reduce dependence on exports and diversify export destination
- ❑ Look to domestic consumption & intra-regional trade/investments
- ❑ Domestic mkts constrained by income imbalance & lack of social safety net
- ❑ Need to reduce inequality, have wage increase rise with productivity

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Rebalance by Reinvesting Savings in the Region

- ❑ Part of huge foreign reserves invest within the region rather than sent to West and recycled at higher costs
- ❑ SWFs instead of chasing after high yields in Wall Street funds and contributing to instability, invest part of funds in regional projects **with socially acceptable rate of return**
- ❑ Promote regional long term credit/development banks

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Asia should not follow Anglo American model of finance

- ❑ Bring back finance to serve real economy, not casino economy
- ❑ Strengthen traditional lending to support production especially SMEs
- ❑ Regulate speculative finance
- ❑ Raise capital gains tax to increase costs for speculative fin transactions
- ❑ Central banks to lean against the wind, not pick up debris approach

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□ THANK YOU