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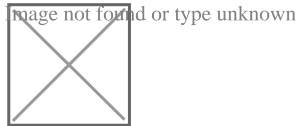
How to restore current account imbalances in a symmetric way

Ξένες γλώσσες / In English



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The sovereign debt crisis in Southern Europe is a reminder that increasing indebtedness can become unsustainable, whether that indebtedness accrues to the government or to the private sector. But when this busts, the danger and fragility of the capital flow from the surplus country also becomes exposed.

The focus of discussion in the eurozone has been on the need to limit the build-up of indebtedness in the deficit countries. A problem is that the focus just on the indebted countries imparts a deflationary bias for the eurozone as a whole, because the expenditures in the deficit countries then have to be reduced while this is often not matched by any equivalent increase in expenditures in the surplus countries.

It is always harder to introduce symmetrical obligations on surplus countries than on deficit countriessince the latter sooner or later become subjectto market

pressures. There is, however, a window of opportunity to do so now. The suggestion here is that the focus should be on capital flows, rather than on current accounts. It should take the form of a tax to be paid on capital flows. Thus, if surplus country A should have a current account surplus of x per cent of its GDP, it should pay a tax on its net capital outflow, irrespective of the destination of the outflow. That would be the same as the tax paid on the inflow of capital,irrespective of source, by deficit country B with a deficit of the same percentage of its GDP. So if country A lent directly to country B, the tax would be paid twice, while if country A lent to country C, with a flat current account. the tax would be paid once.

The basic idea is that markets are generally not able to appreciate the build-up of potentially unsustainable capital flows, until it is too late, and then they overreact. The tax would act as a gradual disincentive to the emergence of unsustainable increases in surpluses/deficits; the greater the disequilibrium in the form of surplus/deficit, the greater the tax; and it would be symmetrical. It would be possible to make the tax progressive, rather than proportional, to the surplus or deficit.

There are, of course, many problems with such a proposal. Indeed if an improvement to the international financial architecture had been easy, it would have been done by now. The first and most obvious is that surplus countries will claim that there is no need for a tax on their capital outflow, and try to veto the proposal. This objection might be met on two grounds.

First, the potential losses from such capital outflows are now only too clear. Second, one can make the political point that the alternative to the capital outflow would be investment at home, which would be more immediately beneficial to the domestic electorate.

The second objection is that not all capital flows, by any means, are unsustainable, even when they are relatively huge. The Old World, notably France and the UK, transferred sizeable percentages of their GDP throughout the 19th century to the New World, and, since much of the latter was invested in enterprises that would generate net exports, were capable of being repaid to the benefit of everybody. One way of dealing with this valid objection is that one could adjust the tax on capital flows into deficit countries downwards to the extent that fixed investment in business investment was above its long-term trend.

Alternatively one could try to apply some kind of macro-risk-weighting to the nature of the capital flow, though such risk could not be measured accurately, and

would therefore be extremely contentious.

The next objection is that the technicalities of imposing a tax on capital flows would be horrific. The measurement of the current account is far from accurate. Errors and omissions are frequently huge. Moreover, gross capital flows are a multiple of net capital flows, and the tax would have to be imposed on gross, rather than net, flows, and would include flows from the public sector as well as flows from the private sector. On the other hand, of course, the tax rate on gross flows could be rather lower, in order to offset the development of an unsustainable surge of such flows. No doubt such a tax could be avoided/evaded in part, but it could be difficult for large intermediaries or coporates to do so.

And to whom would the tax receipts flow? Obviously they would have to flow to an international institution, the IMF in the case of the world, and an EU institution in the case of the eurozone.

Trying to work out the details of any such system would be difficult and might eventually prove impossible. Nevertheless, if we seriously want to reform the international financial architecture, this strikes us as being the most preferable way to try to proceed.

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