



**SESSION 2: SYSTEMIC RISK AND THE GLOBAL DRIVERS OF DEVELOPING
COUNTRY FINANCIAL VULNERABILITIES: REFORM NEEDS AND POLICY
OPTIONS**

**IMPLICATIONS OF THE NEW
INTERNATIONAL TRADE ENVIRONMENT
FOR INTERNATIONAL FINANCIAL FLOWS**

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First Principles: Integrated treatment of trade, debt and financial flows

- Current Account = Goods and Services Balance + Factor Services Balance
- Trade is the External Constraint
- Capital Account = Development Finance (External Debt)
- QUESTION: Does Trade Drive Finance or Vice Versa
 - Does Capital Account Simply Offset Current Account?
 - Does Current Account Simply Offset Capital Account?
 - Link: Factor services balance (Debt service)
- Globalisation: Finance Drives Trade Patterns
- Nationalism: Trade Dominates?
- What does this mean for Capital Account Flows
- Given Stocks of Outstanding Debt

Sustainability

- Meeting debt service
- Borrowing: growth must be greater than interest on debt to avoid rising current account deficit and share of debt to GDP and risk of capital reversal
- non-market Concessional financing
- Net export earnings grow at interest rate on debt stock which requires current account surplus
- No development finance, export- led development
- Domestic financing

Global Accounting

- Capital Account = Net Foreign Borrowing (DEBT)
- Private Sector + Government Sector Financial Balance = Current Account
- Private Sector + Government Sector Financial Balance = Capital Account (Foreign Debt/Foreign Investment)
- $(S-I) + (T-G) = \text{Foreign Debt/Foreign Lending}$
- Domestic Saving = Foreign Lending
- Domestic Dis-saving = Foreign Borrowing (Debt)
- Reducing Foreign Debt Requires Increasing Domestic Saving and Current account Surplus
- Increasing Domestic Saving and/or Government Saving
- Reduces Domestic Demand. (Deleveraging)
- BUT Global Net Current Accounts = 0
- Successful Deleveraging Requires Current Account Deficits RoW

Debt Sustainability requires borrowers and lenders domestic policy compatibility

- Debt sustainability is never only a problem of domestic policy
- Prebisch Report to UNCTAD I
- Developed country preferences for Developing country exports supports sustainability of debt
- Earn our way to Development
- Cannot borrow your way to Development
- Is in the interest of Developed countries: Akamatsu - Flying Geese
- Supports Global Growth
- Stop searching for more/new sources of development finance
- Find direct methods to support growth of manufacturing exports (increase value added retention of Global production chains)
- Support Domestic Financial System Development
- South-South preferential trading and financial systems

What if US eliminates Current Account Deficit?

- Capital flows to US
- Developing country debt becomes unsustainable
- Global growth declines
- Is this likely?
- $CA > 0$ means $S > I$ for US
- Rising household saving or US fiscal surplus
- Or household saving greater than government dissaving
- Can Tariff policy do this?

What can Tariffs do?

- Tariffs have no direct impact on domestic behavioural consumption conditions – propensity to save
- Tariffs have no direct impact on domestic financial conditions - interest rates
- Tariffs have no direct impact on capital flows
- Tariffs have no direct impact on exchange rates
- They do disrupt established production and financing conditions and thus increase uncertainty and adjustment costs



THANK YOU

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