

Summary of the report

A European Perspective on External Imbalances

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This report provides a European perspective on external imbalances.

At a world level, Europe has not been a major contributor to global imbalances. However, its aggregate net position did decline in the years immediately prior to the global crisis, such that the rising surpluses in emerging Asia were partly allocated to growing deficits in the European periphery. Global imbalances remain a significant distortion in the world economy and Europe would benefit if the G20 reform agenda were implemented, including international monetary reform to reduce the financial vulnerabilities of emerging economies and domestic reforms in the advanced economies that will act to increase spending levels in surplus countries and reduce spending levels in deficit countries.

Turning to intra-European imbalances, the current crisis has underlined the costs of excessive imbalances. While the success of Europe in promoting net capital flows from higher-income to lower-income countries has had

many benefits, the years immediately prior to the crisis saw an excessive widening of these imbalances, which contributed to asset bubbles and distorted spending patterns in the European periphery. The deficit countries now face an extended and difficult adjustment process, while the surplus countries must design policies to redirect production towards domestic types of spending.

Looking to the future, the high costs of the current crisis requires a re-examination of macroeconomic policy design. The list of reforms is by now well known. A macro-prudential approach to financial regulation is required to ensure banking systems do not take on excessive systemic risk, while national macroeconomic policies must lean against the wind in order to reduce the risk that sectoral or external imbalances result in severe economic and financial disruption. The cross-border spillovers from national disasters are such that enhanced European-level surveillance and policy coordination are required. Accordingly, the current push to strengthen EU-level economic governance is very important.

The full report is available at www.sieps.se