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How a little Trump bullying may steer the global economy from another meltdown

By Steven Pearlstein May 18 at 7:14 AM

We interrupt our wall-to-wall coverage of the latest Trump imbroglio to bring you this important news flash:

Remember the global economy, the one that nearly collapsed in 2009? Well, it turns out that although we stabilized it, we never actually fixed it, and there is a very real danger that it is about to unwind all over again.

That's the sobering message delivered by the former governor of the Bank of England to a blue-chip gathering Tuesday evening at the Peterson Institute in Washington. Mervyn King — Lord King to his friends and countrymen — is the closest thing there is to a charter member of the global economic and financial elite, a Cambridge-trained economist who taught at Harvard, MIT and the London School of Economics before settling into a 26-year career at the world's second-oldest central bank. As King sees it, as long as countries such as the United States and Britain continue to run large and persistent trade deficits while countries such as China and Germany continue to run large and persistent trade surpluses, the global economy and the global financial system will remain fundamentally unstable and susceptible to another crisis.

One can hear faint echoes of a Donald Trump stump speech in King's concerns about trade deficits. But although President Trump and his team think the solution is to negotiate better trade deals and bring manufacturing jobs back to the United States, King understands it's more complicated than that.

As long as the United States and other Anglo-Saxon countries continue to consume more than they produce, saving too little, and as long their trading partners in Europe and Asia continue to produce more than they consume, saving too much, the developed world will continue to live with some combination of high unemployment and stagnant incomes. Things won't get better — things can't get better — until the dollar and the pound fall, interest rates rise and the global economy is allowed to find a more balanced and sustainable equilibrium.

Indeed, King warned, the only thing that is standing in the way of a painful day of reckoning is the willingness of the world's major central banks to continue printing vast sums of money — money that has been loaned to investors who use it to bid up the prices of stocks, bonds and real estate well beyond their economic value, and money that has been loaned to consumers and governments, who use it to live beyond their means.

In a world of free trade and floating exchange rates, large trade imbalances should naturally correct themselves and disappear as the currencies of deficit countries fall while those of surplus countries rise. But reality has turned out differently from economic theory. For decades, Asian countries have manipulated their currencies in various ways to prevent that natural rebalancing, while more recently the creation of the euro has effectively done the same for Germany and the other countries in Europe.

In 2007, for example, the Chinese trade surplus was a whopping 10 percent of gross domestic product, which reflected not only a fixed exchange rate with the dollar but also a gross savings rate of 46 percent of GDP. Since then, the trade surplus has fallen to just under 2 percent as the Chinese government has allowed its currency to rise.

Meanwhile, the German trade surplus has risen to more than 8 percent of GDP, while the savings rate is around 28 percent. (The U.S. saving rate, by contrast, is below 20 percent.)

Because of these imbalances, the cumulative trade surpluses of China and Germany came to about $2 trillion over the past five years. Not coincidentally, that was approximately the mirror image of the U.S. trade deficit over the same period.

It is no wonder, then, that over just a single generation the United States has gone from being the world's largest creditor to the world largest debtor. Along the way, the global economy has settled into an unsatisfying and ultimately unsustainable equilibrium characterized by slow growth, low interest rates, rising debt levels and inflated prices for stocks, real estate and other financial assets.

If you are like me, just thinking about the constant interplay among trade flows, investment flows, savings rates, exchange rates, inflation, interest rates and asset prices makes your head hurt. Perhaps that's because it's never exactly clear what is cause and what is effect, or whether the effect is up or down. But you don't have to have a PhD in economics to understand that no country, however rich, can keep borrowing indefinitely.

"The longer this state of affairs persists, the greater the ultimate correction will be," King told his audience Tuesday. At some point interest rates will rise, stock and real estate prices will fall and overly extended households, companies and countries will find themselves unable to service their debts.

The debt crisis in Greece and the banking crisis in Italy are canaries-in-the-coal-mine warnings of a much bigger crisis to come, King said, if governments don't take strong steps to bring exchange rates into better alignment: "Muddling through" — having central banks continue to buy up every bond they can lay their hands on while sending in the International Monetary Fund on an endless rescue mission — is no longer an option.

Which brings us back, in a strange way, to Trump.

For 26 years, King — as the Bank of England's chief economist, a member of its policy committee and then governor — has had a front-row seat at every international economic conference and financial crisis. And despite all the talk of a new world order in which American wealth and power is matched by that of Europe and the Asian tigers, his view is that American leadership is still required to do anything hard or important, just as it was in 1944 at the Bretton Woods conference that set the now-outdated rules for the global financial system.

As King sees it, Trump was right to remind us that trade deficits matter, even if he badly misunderstands what drives them or the best way to fix them. Now is the time for Trump to put his dealmaking instincts to good use by convening a conference among the two biggest deficit countries — the United States and Britain — and those with the biggest surpluses — European countries and China — aimed at rebalancing trade and investment flows and creating a new financial architecture to keep them in balance.

King was vague on what that architecture might look like, other than to suggest it might involve some financial penalty for countries that run surpluses, a default mechanism for overly indebted countries and coordinated interventions in currency exchange markets.

A little Trump-like bullying might be required to get the parties to the table, while the detailed negotiations would have to be left to someone else. My nominee would be Commerce Secretary Wilbur Ross, a savvy practitioner of the art of bankruptcy workouts who knows how to keep his options open and his mouth shut.

As to who would play the crucial role of John Maynard Keynes, the crafty and creative British economist who provided the intellectual foundation for the first Bretton Woods conference, there could be no one better than Mervyn King.

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