World Knowledge Forum 2012

October 9th, 2012 – The Global Consequences of Deleveraging

The 13th World Knowledge Forum held in Seoul, South Korea was highlighted by a panel discussion on the global consequences of deleveraging. The panelists focused on major markets, such as the United States, Europe, and Asia, different fiscal strategies that have resulted in varying consequences, and signs of spillover effects of deleveraging between markets.

Jean Pisani-Ferry, Director of Brugel Institute, pointed out the irony of the debt issue the world is facing today. Fifteen years ago, the world "discussed debt in the emerging economy, but now, the world is discussing debt in an advanced economy," Mr. Ferry stated.

The differences of policies to combat the deleveraging issue in U.S and Europe were highlighted by Mr. Ferry. The private sector was the focus of the U.S. while Europe's centered on fiscal policies. U.S strategy to reduce private debt first "has worked, decreasing from 14 percent in 2007 to 11 percent now," he asserted. Meanwhile, Europe's goal to mitigate the private sector through fiscal policy brought down aggregate debt ratio.

Both strategies, comparatively, worked to bring down the overall debt ratio. However, the question now in Europe is whether we are trying to do too much at the same time, referring to deleveraging both the public and private sectors "causing recessionary conditions," Mr. Ferry insisted.

Jean-Louis Beffa, Chairman of Lazard Asia Financial Advisory, shares the somewhat negative sentiment that it is "certainly going to take a long time" to deleverage to a stabilized debt to GDP ratio. He also worries what will happen to growth during this process.

Speaking from the point of view from Asia, Rhee Changyong, Chief Economist of Asian Development Bank, mentioned the spillover effect of U.S. and Europe issues into Asian markets, especially in China and India. Mr. Rhee pointed out that China and India "have already slowed down," since these economies are heavily export-oriented. China's growth has declined to 7.8 percent from 9.3 percent just one year ago, which, according to the International Monetary Fund, was the "largest move downward since 2008."

However, Mr. Rhee asserted that impact on the Asian region is not homogenous because Asian markets other than China, India and East Asia, are projected to grow due to less reliance on exports.

Although the emerging Asian markets are not as gloomy as the current markets in Europe, the latest growth cycle is at an end. "Deleveraging of advanced economies means the era of close to double-digit high growth has come to an end," Mr. Rhee conceded.

Following up on issues in the Asian market, Faculty of Business and Commerce professor from Keio University, Fukao Mitsuhiro, pointed out the difficulty of stabilizing the GDP at the current rate due to "aging of society, increasing pension and cost of medical care."

Mr. Mitsuhiro also mentioned that in order to close the current budget deficit, consumption tax needs to rise to 25 percent from the current 5 percent, which is not an easy solution. He added that Japan probably needs "at least 5 to 10 years to reach stability in gross debt to GDP ratio."

Shifting the focus to Europe, Erik Berglof, Chief Economist of European Bank for Reconstruction and Development, pointed out a case study on "how advanced economies can affect emerging economies and how policy responses can try to mitigate some of those spillovers."

Jorge Sicilia, Director of BBVA Research, stated that "regulatory changes are understandable when you have had a crisis that has generated significant tax money to bailout banks." However, it was at a time when hopes of recovery still existed, and the impact these regulations could potentially have on developing economies and emerging markets are radically different.

The panel concluded by addressing who has the biggest problem between Korea, the U.S., and Europe. The panelists mentioned that different strategies implemented on the very different large public debt in the U.S. and the large private debt in Europe is “a great experiment,” and that it is still in progress, leaving the future uncertain.

Mr. Rhee concluded that what Korea needs to learn is how to do the deleveraging once the country has large assets like those of the U.S and Europe.