

Pettis, Michael – The Great Rebalancing*Princeton University Press, 2013 [Economics] Grade* ★★★★★

World trade doesn't work as most pundits think it does. At least the author argues that the effects on national current account balances, savings ratios, investments etc. are too often poorly understood. The author Michael Pettis - formerly a banker at Bear Stearns and a trader at today's JP Morgan - is a professor of finance at the Peking University and a well-read, prolific blogger, discussing topics like global trade and the Chinese economy. In this book Pettis tries to set the record straight and explain why trade policies, in a broad sense, was one of the major factors behind the 2009 financial crisis and what this says about the future for the Chinese economic growth model etc.

Apart from an introductory chapter and a concluding one (including some predictions about the future) the book is structured to try to explain three "confusions" in the trade debate. The first confusion has to do with the causes of trade imbalances and how these generally are the result of distorted economic policies in one or more countries (chapters 2 to 4), the second is related to the relationship between trade, the savings rate and international capital flows (chapters 5 to 7) and the final confusion is that the role of the USD as the global reserve currency is an advantage for the US (chapter 8). As I read the 2014 printing of the book it also contains an appendix with an explanation to why the imbalances discussed in the book emerged to start with. If your copy of the book contains this appendix I would advice you to start your reading with this as it provides background and further details the macro economic accounting identities that are frequently used in the book. Although several countries and regions are discussed, the symbiotic relationship between the US and China is really the key topic of the book.

You get the feel that *The Great Rebalancing* is written out of frustration that so few understand global trade economics. The big advantage of the book is that it looks at the economic causes and effects of trade as an interconnected international system where every country is affected by every other one

through the capital and current accounts. Hence, where many economics textbooks look at theoretical examples containing only two countries Pettis discusses the real-world, complex web of relationships. Still, the book also very much feels like sitting in on a slightly repetitive academic economics course in trade theory, but instead of equations and arrows that point to chains of events everything is described in text only. It would have been more enlightening if the author had added some occasional pictures with the described equations. Hence, the best advice for getting the full benefit of this book and making reading it a valuable learning experience is to write down the equations that Pettis uses on a piece of paper and have it handy while reading the book.

Pettis views imbalances between production and consumption – or rather "underconsumption" as once discussed by Karl Marx – to be the primary source of economic instabilities and from this argues that the economic growth model of China has actually been tried several times before and as it is imbalanced it will have to reverse. In the case of Japan it reversed through a crisis while in Brazil it did so by a lost growth decade. It is this later fate the author sees for China in the end. The growth model builds on financial repression (in China's case through low regulated interest rates), currency manipulation and a wage growth that is slower than the productivity growth. The author claims that there are only three ways that China realistically can rebalance and this is through higher unemployment, increasing debt or through wealth transfers. The best way would be to shift the economic model in a way that shifts means from the state and the corporate sector to consumers. Although this would be relatively painless the GDP-growth will have to slow substantially and it is also a policy that threatens many vested economic interests.

I'm not a good enough economist to know if Pettis is right but despite the somewhat dry writing this is an important book to have read.

Mats Larsson, December 26, 2018