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World economy

A call to action

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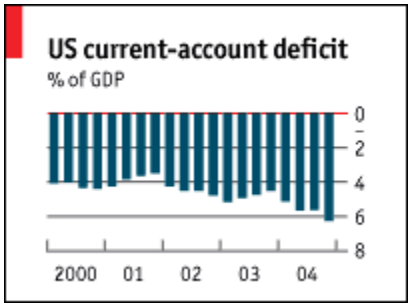
Unless politicians stop talking and start acting, the world economy is heading for trouble



"CIRCUMSTANCES seem to me as dangerous and intractable as any I can remember, and I can remember quite a lot." That sombre assessment of the world economy came from Paul Volcker, chairman of America's Federal Reserve between 1979 and 1987, writing recently in the *Washington Post*. "What really concerns me", he went on, "is that there seems to be so little willingness or capacity to do much about it."

Coming from one of the giants of American economic policy-making, the man who vanquished the high inflation of the late 1970s and helped navigate the global economy through the 1980s debt crises, that is a pointed admonition. The finance ministers and central bankers, who gather this weekend in Washington, DC, for the spring meetings of the International Monetary Fund and World Bank, would do well to take it seriously. For beneath a veneer of resilience, the world economy is becoming increasingly fragile.

Judging by their public statements, many policymakers are worried most about the price of oil (see article). Although prices of crude have eased in recent days, they are still above $50 a barrel, more than 70% higher in real terms than in the summer of 2003. Though substantially smaller than the "oil shocks" of the 1970s, that is still a big jump.

Thus far, however, there seems little reason to panic. Indeed, in 2004 global output grew at over 5%, its fastest pace in a generation. In its latest World Economic Outlook, released on April 13th, the IMF forecasts growth of 4.3% in world output for 2005, slower than last year but still above trend. The new oil shock has neither had a dramatic effect on inflation expectations nor precipitated a dangerous wage-price spiral, even though global monetary conditions remain extraordinarily loose. All this could change if the oil price stays at its current levels for long or rises yet further. At some point, higher oil prices will bite hard. But, for now, the oil price is not the world's most pressing economic problem.

That distinction goes to the imbalanced nature of the global economy. The world as a whole may

be growing pretty robustly, but the aggregate growth rates mask a big and growing divergence between places that are booming and those that are lagging behind. America and China lead the boomers: in both cases growth has consistently been stronger than expected. Continental Europe and Japan, in contrast, are falling ever further back. Japan's recovery stalled in the second half of 2004 and there are only modest signs of a turnaround. The IMF's economists expect Japan's GDP growth to be a mere 0.8% in 2005. The outlook for the euro zone's big economies is similarly bleak, with unemployment high and domestic demand low. Like most other economists, the IMF's number crunchers have scaled back their euro-zone growth projections to a mere 1.6% for this year.

The result of this increasingly lopsided growth is that the imbalances in the global economy—in particular, America's huge external deficits—are growing ever bigger. In the last three months of 2004, the country's current-account deficit was running at 6.3% of GDP. Judging by the latest monthly trade figures—a $61 billion deficit for February—it is heading higher fast. Serious observers are now talking about a current-account deficit of well over 7% of GDP by the end of 2005.

High oil prices have aggravated and complicated these imbalances. They have dampened already weak domestic demand in Europe. They have added to America's import bill. And they have created a new class of big surplus countries: thanks to the oil boom, last year's external surpluses in oil-producing countries were about the same size as those of Asia's emerging economies. But oil prices are not the cause of global imbalances. That remains the world's over-reliance on American consumers as an engine for growth.

Every finance minister in Washington this weekend knows this very well. Equally well-known is the route to more balanced global growth. At each of their recent gatherings, the world's economic policymakers have repeated a “to-do” list: raise savings in America, particularly by cutting the budget deficit; boost Europe's growth potential through structural reforms; and shift East Asia away from its addiction to exports through exchange-rate adjustment, particularly in China.

Words into actions

The problem, as Mr Volcker puts it, is that no one seems willing to act. For all the talk, China has shown no inclination to adjust its currency peg. In the euro-zone, momentum seems to be shifting away from economic reform. For instance, this week Germany's government was proposing the introduction of a particularly pernicious type of minimum wage, despite jobless rates not seen since the 1940s. In America, meanwhile, fiscal discipline is a farce. Far from thinking hard about how to cut deficits, the House of Representatives on April 13th passed a bill eliminating inheritance taxes.

The world's finance ministers should stop this drift and start serious efforts to unwind the lopsided global economy. They are much more likely to wring their hands about the oil price and leave it at that. Such a response just will not do.