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The Transfer Paradox
Rethinking Global Imbalances

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Key Takeaways

- A current account surplus can be interpreted as a transfer of resources to partners. The fact that the latter complain is a paradox for standard economic analysis.
- A dynamic perspective explains the paradox: by using global markets to leverage scale and learning effects, surpluses create and consolidate competitive advantage and technological dominance, to the detriment of deficit countries.
- We call this the "transfer paradox": receiving real resources becomes a disadvantage.
- Beyond insufficient coordination, global imbalances reflect conflicting strategies. Acknowledging this objective antagonism is a prerequisite for devising cooperative policy responses.

Introduction

Global imbalances have come back to the top of the policy agenda. Many analyses and reports have been produced over recent months.[1] The standard prescription involves better coordination of macroeconomic policies, with three familiar recommendations: higher consumption in China, higher investment in Europe, and fiscal consolidation in the United States.

In this view, sectoral balances are irrelevant. Since the current account is, by identity, equal to national saving minus domestic investment, sectoral policies cannot by themselves correct external imbalances. Tariffs, subsidies, industrial policies and exchange-rate movements may alter the composition of trade, but unless they affect aggregate saving or investment, they do not change the overall current account.[2] The International Monetary Fund (IMF) recently introduced the concept of "macro-industrial policies" that act directly on saving and investment behavior. However, because of their cost for domestic consumption and welfare, they were described as second-order determinants of the current account.[3]

We argue that these analyses and recommendations are model-dependent and therefore fragile. The analytical tools leading to these conclusions have existed for decades. Yet, they have not sufficiently informed mainstream analysis. This gap has direct consequences for policy prescriptions, as well as the nature and objectives of international cooperation

Dynamic comparative advantage and the current account

The starting point is that sectors differ. Some sectors generate externalities by diffusing knowledge, inducing complementary investments, and generating new technological capabilities. The result is sector-wide economies of scale and learning-by-doing. Manufacturing has historically been regarded as special for precisely this reason.

Together, scale and learning effects generate strong and complex dynamics. Typically, protection and subsidies would initially help some industries to achieve scale. The pattern of comparative advantages is altered as a result. The initial improvement may be reinforced further through learning. Comparative advantage is therefore "created", rather than simply arising from underlying national characteristics, as Krugman

1. C.-E. Bai, G. Gopinath, H. Rey, and A. Weber, "G7 Economists Memo on Global Imbalances", 2026; H. Rey, B. Weder di Mauro, and J. Zettelmeyer (eds), *Paris Report 4: The New Global Imbalances*, CEPR Press, 2026; "Understanding Global Imbalances", *IMF Policy Paper*, International Monetary Fund, 2026.

2. M. Obstfeld, "The US Trade Deficit: Myths and Realities", Brookings Papers on Economic Activity, Brookings Institution, Spring 2025.

3. P.-O. Gourinchas, G. Kindberg-Hanlon, M. Patnam, L. Rotunno, and M. Ruta, "Global Imbalances, Industrial Policy and Tariffs", *IMF Working Paper WP/26/67,* International Monetary Fund, 2026.

emphasized[4] as early as 1987. Empirical evidence over recent years confirms that domestic subsidies significantly boosted net exports in China's targeted sectors.[5]

A theory of trade and policy that remains largely static in its treatment of comparative advantage has difficulty capturing these phenomena and their consequences. Once comparative advantage is allowed to evolve over time, a different picture emerges. The striking feature of China's spectacular success in sectors such as electric vehicles, batteries, solar panels and other advanced manufactures is not the existence of ex-ante comparative advantages in such sectors; it is the cumulative interaction of scale (magnified by trade surpluses), learning, industrial policy, and global market penetration. As China gains scale, its productivity increases. Meanwhile, its partners cumulatively lose both scale and competitiveness, even when they initially possessed more favorable endowments. This technological dominance becomes entrenched, and learning acts as a powerful barrier to entry

The transfer paradox

The balance of payments identity tells us that a current account surplus is necessarily associated with a net export of capital, which is a financial transfer to the rest of the world. It is also a transfer of real resources: surplus countries consume and invest fewer resources than they produce, making it possible for deficit countries to do the opposite. The key is that the two transfers, the financial and the real, are inseparable: they are two faces of the same reality. The deficit country can import more goods than it exports because it also "imports" capital from abroad. The surplus country transfers capital abroad.

Today, the "transfer problem" is reversed

That reality was in Keynes' mind when he discussed German reparations after the First World War. He emphasized that, in order to pay reparations—a financial transfer—Germany had to run a current account surplus. In other words, it had to make a real transfer to the rest of the world—to produce more real resources than it absorbed. Keynes thought that a significant depreciation of the German currency would be required to achieve this outcome, meaning that the transfer itself would be too much of a burden on the German people—what he then called the "transfer problem".

Today, the problem is reversed. China's surpluses effect a massive transfer of real resources to other countries. And yet, those countries, while consuming goods they have not produced, are those who complain. This is what we call the "transfer paradox". By standard economic analysis, European consumers should welcome the opportunity to buy electric vehicles or solar panels subsidized, directly or indirectly, by Chinese workers and

4. P. Krugman, "The Narrow Moving Band, the Dutch Disease, and the Competitive Consequences of Mrs. Thatcher: Notes on Trade in the Presence of Dynamic Scale Economies", *Journal of Development Economics*, Vol. 27, No. 1, 1987, pp. 41–55.
5. S. Jean, "Global Imbalances, Industrial Policies, and the Challenge of Surging Chinese Trade Surpluses", in: H. Rey, B. Weder di Mauro, and J. Zettelmeyer, *Paris Report 4: The New Global Imbalances*, op. cit., pp. 263–289.

taxpayers; but they do not. Symmetrically, it seems irrational for the Chinese government to deprive its own people of the benefits of their work by sending resources abroad.

The description of imbalances in terms of investment-saving disequilibrium cannot solve the paradox. But common sense does: it tells people and their representatives that foreign surpluses may end up destroying future industries and activities. This gap between perceptions and some economic prescriptions stems from the difference between the static and dynamic perspectives emphasized above. Describing policy-induced trade surpluses as "neo-mercantilism" is not wrong, but it is incomplete: the surplus is valuable, not because it allows the accumulation of foreign wealth, but because it supports the expansion of sectors with significant externalities.

More precisely, there are three reasons why engineering a transfer may be fully rational for the surplus country:

- Policymakers may not seek to maximize the discounted value of consumption over an infinite horizon, as standard models assume. In the current environment, an alternative objective is plausible: technological dominance, with spillovers into military power and geopolitical influence. In that context, moving rapidly down the learning curve yields major strategic benefits. The transfer may be a small price to pay to set in motion a cumulative process of learning-by-doing, through which comparative advantage and dominance become increasingly irreversible.
- It may make sense to subsidize foreign customers rather than to support domestic producers directly if doing so expands the market scale available to the sector. This reveals the limits of recommending that China simply increase consumption: it amounts to asking to restrict the expansion of its tradable sector, thereby giving up the benefits it draws from oversized production.
- The policymaker may be willing to accept a long period of suppressed consumption if it expects future gains in productivity, autonomy or power. The costs are then borne by current households, while the benefits accrue to firms, future workers, the state, or to the long-run accumulation of national power.

At this stage, it is useful to introduce capital flows. Many Asian countries, China above all, are net capital exporters. They exhibit high domestic net savings and do not depend on foreign capital. They can nevertheless attract gross foreign inflows, because they offer high rates of return; as a result, their real exchange rate tends to appreciate. This benefits consumers through cheaper imports, but it penalizes the tradable sector and impedes the dynamic process of increasing returns. The static gain comes at the cost of a dynamic loss.

Thus, left to market mechanisms, capital inflows may trigger a reallocation of domestic resources from the tradable to the non-tradable sector, which is the opposite of what these countries are trying to achieve. The analogy with the natural resource curse is suggestive: capital inflows can create a "financial resource curse."[6] In both cases, new resources—transferred from abroad or extracted from the ground—crowd out production in the manufacturing sector. In those situations, controlling capital inflows, together with managing the exchange rate, seems a natural policy course in order to protect the tradable sector.

The question is thus not just to cope with insufficient coordination; it is to discipline conflicting strategies

This perspective helps explain why some countries combine high saving, capital controls on inflows, exchange-rate management and industrial policy. These policies are often analyzed separately: capital controls as financial repression, exchange-rate management as mercantilism, subsidies as trade distortion, and high saving as macroeconomic imbalance. But they may form a coherent strategy, sustainable over the long run. Together, those policies impede normal domestic adjustment by maintaining domestic resources in strategic sectors, preventing premature absorption, preserving competitiveness, and accumulating dynamic comparative advantage.

Implications for international cooperation

Conventional wisdom holds that global imbalances reflect unintended external consequences of domestic imbalances; better macroeconomic coordination is a logical conclusion as a result. We argue that this is only part of the explanation: global imbalances also reflect deliberate strategies whereby trade surpluses are used as industrial policies, leveraging scale in pursuit of technological advantages in manufacturing sectors. This dynamic process of comparative advantage buildup has been allowed to operate largely unchecked for more than a decade, and competitive positions secured through scale and learning are now deeply entrenched.

The question is thus not just to cope with insufficient coordination; it is to discipline conflicting strategies. Acknowledging this objective antagonism is a prerequisite for devising suitable policy responses. This does not mean advocating aggressive tariffs and retaliation, which will not provide more than short-term relief at best—at consumers' expense, without addressing the underlying dynamics. However, it implies that different trade and exchange-rate disciplines will be required to devise a cooperative response to the present situation.

There are two fundamental challenges.

First, in a world of powerful externalities and pronounced asymmetries, large actors may have strong incentives to pursue import substitution and strategic dominance. Such

6. G. Benigno, L. Fornaro, and M. Wolf, "The Global Financial Resource Curse", *American Economic Review*, Vol. 115, No. 1, 2025, pp. 220–262.

strategies would be collectively both very costly and conflict-prone. Only strong, effective disciplines on market access and domestic subsidies could keep them in check.

Second, the main economic powers do not share the same view on international economic relations. When designed after World War II, the multilateral trading system was meant to rest upon a "liberal understanding",[7] encompassing not only cross-border disciplines, but also a broader-ranging set of rules about the functioning of the economy, including property rights, business practices and investment. Its explicit codification was abandoned as a result of the United States' failure to ratify the Havana Charter for the International Trade Organization, which it had signed in 1948, and it has remained largely unachieved ever since. Until recently, it did not matter much. Most of the important trading partners were decentralized market economies, whose functioning was broadly consistent with this liberal understanding. The same cannot be said of China today, given the extent of its industrial policies, its explicit strategy of import substitution, and the management of its macroeconomic imbalances. The result is that rules conceived to organize competition between economies sharing more or less the same economic system are now used to govern trade between economies that do not. Given the dominant role now played by China in world trade and manufacturing, this undermines the coherence of the whole system: the time when the GATT (or now the World Trade Organization) could work satisfactorily alone, without being complemented by a codified understanding of how economies are organized and governed, is over.

Trade disciplines can no longer be meaningfully applied separately from exchange-rate policies and capital controls

Trade disciplines can no longer be meaningfully applied separately from exchange-rate policies and capital controls. Using the terminology of Gourinchas et al.[8]—but not their conclusions—, it does not make sense to set tight constraints on "micro-industrial policies", while leaving "macro-industrial policies" unchecked. Active surveillance of exchange-rate policies should be an immediate priority, in close connection with trade rules and subsidies. As long as the transfer paradox goes unrecognized, discussions on the governance of international economic relations will rest on inadequate foundations.

7. P. Mavroidis and A. Sapir, "China and the WTO: Why Multilateralism Still Matters", Princeton, Princeton University Press, 2021.
8. P.-O. Gourinchas, et al., "Global Imbalances, Industrial Policy and Tariffs", op. cit.

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