

Testimony to the House Financial Services Committee: Sub-Committee on National Security
On “The Role of the International Monetary Fund in a Changing Global Landscape”

Kenneth Rogoff, Thomas D Cabot Professor of Public Policy, Harvard University

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As the only truly global multilateral financial institution, the International Monetary Fund has played a critical role in helping to preserve global financial stability, thereby supporting global growth. And it is needed today as much as ever.

The Fund’s activities have multiple facets. These include its essential surveillance activities, where it aggregates, synthesizes and curates information from a wide variety of public and private sources to provide macroeconomic forecasts and policy assessments for all its members, and the world as a whole. Unlike private sector forecasts, the Fund’s work is distributed for free, and is highly valued, especially in poorer countries where there are few alternatives.

The Fund is also a reservoir of global macroeconomic and financial data, with again, most of the work made widely available. A major step forward has been in its work in debt reporting transparency, which had been weakness in the runup to 2008, and is now a growing strength. Transparency is essential in reducing vulnerability to debt crises, and in resolving them. This includes transparency about the massive but often opaque lending activities of China.

The Fund also provides technical assistance to countries in a variety of areas, from tax systems to financial regulation, and provides a forum for sharing best practice.

I will concentrate my remarks today, however, on the Fund’s single most important and unique activity, which is its role in lending to debt distressed countries. Although best known for its role in emerging markets and lower-income countries, the Fund played a large role in the European debt crisis last decade. This was not as new as one might think: Many forget that the United Kingdom alone had 11 IMF programs from the 1950s to 70s. Today, the focus is shifting again, as the search for yield has allowed many lower middle-income countries and developing economies, that once relied almost exclusively on official lending, to access private markets. Non-Paris club official lenders such as China, Saudi Arabia and India have also become more prominent in these debtor countries .

Especially since the pandemic, the situation has become dire for these newer borrowers, with over 60% of low-income countries in debt distress. A handful of emerging markets (e.g., Argentina, Lebanon) is already in default, and there is a risk that a greater than expected rise in world interest rates could cause problems in larger emerging markets. Turkey, thanks to unorthodox monetary policies, faces problems regardless.

Fortunately, a number of larger emerging markets have become resilient thanks to two critical changes. First, many have large reserves of foreign currency, providing a cushion before needing to call on the IMF. Second, and even more importantly, the global low inflation environment that prevailed until recently has allowed many countries to deepen their local domestic markets. This allows them not only to borrow in their own currencies, which is safer, but even more importantly, to borrow more frequently under local court jurisdiction, which gives governments considerably more agency over debt workouts should they be needed, even with

foreign creditors. I have been arguing for this change in my academic writings for over three decades. Nevertheless, a sufficient rise in global interest rates will place stress even on many of these borrowers as well, in part because even if government debt is increasingly domestic, emerging market corporate borrowing from abroad is almost exclusively in dollars (or euro), and governed under New York or London law.

Let me conclude with five points

- (1) The Fund is built as a revolving credit agency; with loans that typically need to repaid within two to four years. It can certainly forgive loans, but only if its main hard-currency shareholders stand ready to replenish its resources.
- (2) The two emergency SDR issuances during the global financial crisis (183 billion SDR) and again during the pandemic (650 billion dollars), on balance, made sense. Plans to reallocate a larger share to poor countries, if successful, are welcome. But the SDR is not designed as an aid instrument any more than the Fund was designed as an aid agency, and a better plan for more efficient and transparent aid is needed, bigtime.
- (3) The Fund is at its best when it plays the role of the honest broker, when in its routine forecasts and policy advice, or the design of its bailout programs.
- (4) There are many cases where the most realistic advice to a country is that it needs to restructure its private debts, but the Fund is not legally allowed to make that a stipulation of its programs. It can only say that it will not lend into unsustainable programs, but unfortunately all too often it gets gamed into giving overly optimistic projections about growth and compliance. This happened (yet again) in Argentina and is a serious risk going forward in trying to exit the pandemic-era loans.
- (5) It would be a mistake to try to twist the Fund into being an aid agency, which is a role better suited for the World Bank. In general, advanced countries must be prepared to make vastly larger aid programs (outright grants not loans) than currently envisioned. Risks to the environment and the experience of the pandemic underscore that we cannot ignore how economic and human progress evolves in the rest of the world.
- (6) The problem of helping developing countries control their carbon footprint as they (hopefully) grow is beyond the scale and expertise of either the IMF or the World Bank. There is a case to be made for creating and funding a World Carbon Bank to help countries, for example, phase out coal plants, and to help facilitate transfer of technology. In a changing world, this is a problem that may need a dedicated solution.

Thank you.