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Statement before the House Financial Services Subcommittee on National Security, International Development and Monetary Policy

"The Role of the International Monetary Fund in a Changing Global Landscape"

A Testimony by:

Stephanie Segal

Senior Associate (Non-resident), Economics Program, CSIS

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1616 RHODE ISLAND AVENUE NW
WASHINGTON, DC 20036
TEL. (202) 887.0200
FAX (202) 775.3199

Introduction

Chairman Himes, Ranking Member Barr, and distinguished Members of the Subcommittee on National Security, International Development and Monetary Policy, thank you for the opportunity to testify before you on "The Role of the International Monetary Fund in a Changing Global Landscape."

The Subcommittee has asked witnesses to address the IMF's role in "monitoring and preserving the stability of the international financial system" and "examine the shifts and challenges the IMF currently faces, including disruptions brought on by climate change, rising levels of unsustainable sovereign debt, and the potential for an uneven Covid-19 recovery to exacerbate inequality, undermine social cohesion and increase instability across the globe." My testimony will address these topics with respect to the IMF's mandate and principal activities and will conclude with brief thoughts on IMF collaboration.

IMF Mandate and Principal Activities

The IMF's Articles of Agreement list six purposes that are intended to guide the institution "in all its policies and decisions."[1] They include the promotion of international monetary cooperation "through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems;" facilitation of "the expansion and balanced growth of international trade," thereby contributing to high levels of employment and income; as well as the temporary provision of financial resources, under adequate safeguards, to provide IMF members the "opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity."

Translating purpose into practice, the IMF focuses on three principal activities:

- Monitoring economic and financial developments and policies at the country, regional and global levels to foster growth and promote stability through **IMF Surveillance**
- Providing financial support to IMF members for external (balance of payments) needs to facilitate adjustment and shorten economic crises through **IMF Lending**
- Building capacity through training and technical assistance to IMF members through **Capacity Development**

Over the years, these activities have evolved along with the international system. That evolution is often prompted by crisis and the recognition that the existing tools are inadequate to address current economic conditions and challenges. For example, the advent of larger programs in the 1990s, driven by capital account crises, led to formalized "exceptional access" criteria; an intensified focus on financial sector issues and coverage of potential spillovers in IMF surveillance came in response to the Global Financial Crisis; while the introduction of "realism tools" to scrutinize projections for purposes of debt sustainability analyses came in the wake of the Eurozone sovereign debt crises.

Today, much of the world remains in the grip of Covid-19, and the global economy still struggles to deal with the economic fallout. Given the unprecedented needs and policy response of the past

[1] https://www.imf.org/external/pubs/ft/aa/index.htm

two years, it's not surprising that we once again are witnessing a further evolution of IMF activities. On the one hand, policymakers have a greater appreciation of the potential risks to growth and macroeconomic stability, including those posed by global threats such as climate change and public health emergencies. On the other hand, there is concern that an overly expansive list of items deemed "macro-critical" will dilute the IMF's effectiveness and steer the institution away from its founding purpose and into the domain of development institutions.[2] The IMF and its members need to strike a balance between these competing considerations, bearing in mind the financing, capacity, and political constraints of the membership.

"Shifts and Challenges"

The Subcommittee has asked witnesses to evaluate the IMF's role in meeting the challenges facing the global economy as we emerge from the pandemic, and specifically climate change, unsustainable debt, and inequality.

Climate Change. The climate's impact on macroeconomic outcomes is well-established and concerns both the economic impacts of a changing climate as well as the impacts of policies designed in response to climate change. A recent presentation from one of the world's largest insurers calls climate change "the biggest long-term threat to the global economy,"[3] while a July 2021 report from the Financial Stability Board highlights that "physical risks as well as a disorderly transition to a low-carbon economy could have de-stabilizing effects on the financial system, including through a rise in risk premia and falling asset prices in the relatively short-term." Failure to engage on climate issues would be at odds with the IMF's mandate, but that leaves open the question of how the Fund should engage and whether its tools are up to the task.

The IMF's surveillance activities represent the most immediate and consequential way in which the IMF can engage with members on climate change. The IMF's Executive Board has formally supported coverage of climate-related issues in IMF surveillance, with discussion of the 2021 Comprehensive Surveillance Review (CSR) resulting in broad support for coverage of climate change adaptation and transition risk in Article IV reports wherever macro-critical.[4] The Board also supports including climate in Financial Sector Assessment Programs where climate change may pose financial stability risks.[5]

IMF surveillance activities entail a bilateral component via Article IV consultations, which apply to all 190 IMF members and include direct engagement between IMF staff and country authorities, private sector participants, and civil society, as well as a multilateral component on regional and global economic and financial conditions. This structure enables the Fund to engage on climate at the country level, where relevant policies are typically set, while covering climate issues in

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[2] Some experts have also raised concerns around IMF conditionality and whether IMF lending terms are sufficient to reestablish financial stability (https://www.project-syndicate.org/commentary/imf-acting-like-aid-agency-risks-embarrassment-by-kenneth-rogoff-2022-01.)

[3] https://www.swissre.com/media/news-releases/nr-20210422-economics-of-climate-change-risks.html.

[4] https://www.imf.org/en/Publications/Policy-Papers/Issues/2021/05/18/2021-Comprehensive-Surveillance-Review-Overview-Paper-460270

[5] https://www.imf.org/en/Publications/Policy-Papers/Issues/2021/07/30/IMF-Strategy-to-Help-Members-Address-Climate-Change-Related-Policy-Challenges-Priorities-463093

multilateral surveillance reports to reflect the nature of climate change mitigation as a global public good.

While surveillance obligations apply to all IMF members, IMF lending operations come into play only at the request of an IMF member, require a balance of payments financing need, and entail conditionality designed to achieve needed adjustment. Unlike bilateral surveillance, which applies to all IMF members, IMF lending programs are active in only a subset of IMF members. As a case in point, many of the largest emitters have not had IMF programs in decades, if ever, meaning the IMF's ability to gain traction on climate change issues through its lending is more limited relative to surveillance.

That said, there is a role for IMF engagement on climate-related issues in the context of an IMF lending program. Climate issues can impact budgets and the health of financial systems, issues covered in standard IMF programs. Also, the proposed Resilience and Sustainability Trust or RST provides another template for such engagement. If approved by the IMF's Executive Board, and pending adequate donor financing, the RST would be available to low-income, small island states, and vulnerable middle-income countries for purposes of targeting macro-critical, longer-term structural challenges such as climate change and pandemic preparedness. Financial support for the RST could come from the rechanneling of Special Drawing Rights (SDRs) by members with strong external positions, addressing a common critique of the most recent SDR allocation as not sufficiently benefitting the poorest countries. Qualification for the RST would require a concurrent IMF-supported program and a package of policy measures consistent with the RST's purpose. In this respect, the division of responsibilities between the IMF and development partners is a critical aspect of the RST, which I will address later in my testimony.

Finally, the IMF also engages its membership on climate-related issues through Capacity Development activities and in coordination with other institutions and donors. To date, climate-related capacity development has focused on fiscal issues, but the need for such support as relates to financial sector surveillance is growing.

Debt. The Subcommittee rightly calls out "rising levels of unsustainable sovereign debt" as a challenge facing the IMF, but the debt issue can more precisely be described as challenging the IMF's ability to engage in lending activities with highly indebted, often low-income countries. Unfortunately, high debt burdens were identified as problematic well before Covid-19, and the pandemic has further constrained countries in their ability to respond to the public health crisis and its economic fallout. The strong likelihood of higher global interest rates and withdrawal of central bank support in the very near future is adding fuel to the fire.

The lack of transparency and availability of comprehensive debt statistics challenges the quality of IMF surveillance and policy advice, but the bigger challenge relates to IMF lending activities. Specifically, the IMF is prohibited from lending into situations where a member's debt is judged unsustainable, leaving many countries most in need of IMF financial support unable to access it unless debt is rescheduled or restructured.

To their credit, the leaders of the IMF and World Bank reacted with urgency to the pandemic needs of the Fund's poorest members against a backdrop of excess indebtedness, calling on G-20 countries to temporarily suspend debt service from the poorest countries to official sector creditors and re-direct proceeds to health and other social spending. The resulting Debt Service Suspension Initiative (DSSI), which expired at the end of 2021, provided a rapid response to an unprecedented crisis, but many private sector creditors and official lender China Development Bank failed to provide relief on the same terms. Nor could DSSI provide the deeper debt relief required of a subset of DSSI-eligible countries. To that end, the G-20 introduced the Common Framework as a voluntary mechanism to provide a common approach among G-20 creditors to treat unsustainable debt. Despite its potential, which benefits greatly from the inclusion of China as the largest official bilateral creditor to low-income countries under the Framework, the Common Framework has thus far fallen short, with only three countries applying for relief under the Framework. To-date, only Chad has reached agreement on financing assurances with creditors, while negotiations between Zambia and its creditor committee are ongoing. Ethiopia's negotiations have stalled due to security conflicts.

The IMF cannot resolve low-income countries' debt vulnerabilities—such resolution requires agreement between debtor and public and private creditors to reschedule or restructure the debt—but it plays an essential role in developing the macroeconomic framework and financing envelop that serve as the basis for such an agreement. The IMF, with G-20 support, can drive this process and call for more predictable and timebound targets for negotiations under the Common Framework. It could also shed light on why more eligible countries have not sought relief under the Framework. Further, the IMF can bolster its concessional support to low-income members with adequate donor support. Additional donor support to the Poverty Reduction and Growth Trust or PRGT, along with the RST will provide the IMF with resources to assist low-income countries with balance of payments support on concessional terms.

Inequality. The third challenge flagged by the Subcommittee is the potential for an uneven recovery from Covid-19 to exacerbate inequality, and this is precisely what we've seen over the past year. While most advanced economies including the United States are at or above pre-pandemic trend output, many low- and middle-income countries have yet to recover. This two-speed recovery has various causes, starting with disparate access to vaccines and inadequate health systems to get shots in arms. The IMF does not and should not have a role in the acquisition and administration of vaccines, but it was early to identify and publicize the disparity in vaccination rates and the link to economic outcomes; its partnership with the WHO to highlight the issue of vaccine inequity was a creative and appropriate use of the IMF's platform, as was its attention to the issue in its multilateral surveillance.

Uneven recovery is also a function of the massive disparity in countries' policy response to the crisis. Whereas most advanced economies and some emerging market economies provided unprecedented fiscal support and highly accommodative monetary policies to bolster their economies, low- and middle-income countries simply did not have the capacity to provide the same magnitude of support. As a result, their economic rebound has been considerably weaker.

The 2021 Comprehensive Surveillance Review calls for the IMF to focus on inequality in surveillance as an issue with the potential to impact economic sustainability, with bilateral surveillance covering the distributional impacts of macroeconomic policies already featured in

Fund surveillance.[6] Efforts to respond to inequality between countries associated with the pandemic are also found in IMF lending, where the Fund moved to make additional resources available to its members, increasing access levels on emergency financing and allowing for rapid disbursement with very limited conditionality. In IMF program design, the Fund protects priority social spending with floors for education and health, and there is generally a more measured pace allowed for fiscal consolidation in light of the ongoing pandemic and attention to growth impacts of fiscal consolidation. These efforts are important, but they come with trade-offs, including prolonged imbalances leading to heightened vulnerability for longer.

Boosting the IMF's concessional resources through the PRGT and RST can support efforts to address inequality between countries, but to be effective, they must go along with efforts to address the debt overhang in low- and middle-income countries and provide additional concessional financing to low-income countries through the multilateral development banks.

IMF-World Bank Cooperation

Committee members will know the history of the IMF and its creation alongside the World Bank at Bretton Woods in 1944. The two institutions, both integral to the goal of creating a more stable and prosperous global economy, have distinct mandates, with the IMF focused on the stability of the international monetary system and the Bank focused on economic development and poverty reduction. It is critical that the two institutions work together, respecting their distinct roles and responsibilities. As noted in Treasury Secretary Janet Yellen's statement last fall to the International Monetary and Financial Committee, effective IMF and World Bank coordination will be necessary if there is to be a successful and durable recovery.[7]

As the Fund moves increasingly into coverage of issues that have both macro-critical and deep structural aspects, the need for close cooperation between the two institutions will only increase. On the issues we are discussing today—climate, health and debt in particular—there is a track record of coordination between IMF and World Bank staff to build upon, which covers data sharing, transparency initiatives, and assessment letters. The RST, with financing to address long-term structural issues and repayment terms to match, will test the ability of the two institutions to coordinate yet respect the division of labor between them. The IMF's reasoned focus on climate and pandemic preparedness should be a force multiplier and need not morph the IMF into a development agency. But this will require a thoughtful approach, supported by the shared stakeholders and leadership of the two institutions.

I thank the Subcommittee for the opportunity to share my views and I look forward to answering your questions.

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[6] https://www.imf.org/en/Publications/Policy-Papers/Issues/2021/05/18/2021-Comprehensive-Surveillance-Review-Overview-Paper-460270

[7] https://meetings.imf.org/en/2021/Annual/Statements