The Critical Role of the IMF and How to Make it More Effective in the Post-Pandemic World

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It is a pleasure to be here to address you on an issue that is critical to the United States and to the world.

We all know the importance of global financial stability. We cannot have a robust American economy and a strong global economy in a world of financial instability.[2] The 2008 global financial crisis illustrated how easily global instabilities can move from one country to another, and how grave the consequences can be. These are issues that can best—and in some cases can only—be addressed multilaterally, in particular through the IMF. And it is appropriate that they be addressed multilaterally because global financial stability is a global public good that needs to be tackled through global collective action.

This is especially important now, as the world faces a multiplicity of risks: the pandemic and its economic aftermath; the climate crisis; and the inequality crisis[3]. Let me make clear that all these crises touch directly on the core mission of the IMF, which is to promote and ensure global macroeconomic and financial stability. It would be a dereliction of responsibility if the IMF were to have paid insufficient attention to these three crises. Indeed, the IMF has responded impressively well to fulfilling its mandate as circumstances have changed.

The consequences of the pandemic should be obvious. The speed and magnitude of the downturn in the US were unprecedented. It would have been an economic and financial disaster if our government had not responded with the force that it did. But the economic and financial consequences in some other countries have been even greater, and most did not and do not have the resources with which to respond as effectively. The result is that in many places the magnitude and impact of the downturn is far greater.

Moreover, even though their responses were more limited, debt has grown enormously in these countries, both because tax revenues plummeted as GDP declined and because expenditures on health and social protections had to increase. Many in the developing world and emerging markets have had to pay high interest rates even when the T-bill rate is near zero. There is a growing concern that rising interest rates combined with high levels of debt could precipitate debt as well as balance-of-payments crises. The concern is exacerbated for oil-importing countries by the increased price of oil. This crisis would be much harder to manage, with possibly greater global repercussions than earlier such crises.

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[1] University Professor, Columbia University. Testimony prepared for presentation to the U.S. House Committee on Financial Services, February 17, 2022.

[2] The importance of what happens in the rest of the world is highlighted by the fact that the United States lost over 2 million export-related jobs from January 2020 to May 2021 from a global loss of demand. Cashman, Kevin. "Special Drawing Rights Could Help Recover Millions of Export-Related US Jobs, and Create Even More." Center for Economic and Policy Research, August 2, 2021. https://cepr.net/report/special-drawing-rights-could-help-recover-millions-of-export-related-us-jobs-and-create-even-more/.

[3] "The Pandemic and the Economic Crisis: A Global Agenda for Urgent Action." Interim Report on the Global Response to the Pandemic by the Commission on Global Economic Transformation. Institute for New Economic Thinking, March 11, 2021. https://www.ineteconomics.org/uploads/papers/INET-Commission-Interim-Report.pdf.

Over the intermediate term, the consequences of the climate crisis could be even greater. In 2008, we saw what could happen to global financial markets as a result of the mispricing of the US mortgage market. It is clear that there is a significant risk of a mispricing of a much greater part of the global asset base, both fossil fuels and real estate. The correlated risks would be hard to contain.

The inequality crisis too has macroeconomic and financial consequences. The growth in inequality has depressed global aggregate demand,[4] and has adverse effects on economic performance of a kind that are at the center of the Fund's mandate.

Obviously, there are no simple solutions to the multiplicity of challenges facing the global financial and economic system today. Still, what the IMF can and should do for international financial stability and shared economic prosperity is vital. In the remaining time I would like to call attention to a few areas.

First, the $650 billion issuance of Special Drawing Rights was of extraordinary importance.[5] I am pleased that several of the advanced countries that did not need these funds agreed to recycle them to those that did (some desperately), including through the proposed Resilience and Sustainable Trust for low-income and vulnerable middle-income countries. I hope more countries will do this, and that the final design of the RST will enable *all* developing countries and emerging markets to get access to sufficient funds at reasonable terms and without counterproductive and stiff conditionalities.

It is important that there be more issuances of Special Drawing Rights, and not just in response to emergencies such as pandemics. SDRs can be an important tool for sustaining global aggregate demand during periods when global demand is insufficient.[6] The international community has made a commitment to help developing countries and emerging markets make the green transition. We won't achieve the internationally recognized goals without the efforts of all countries, and such financial assistance is absolutely essential. Yet the advanced countries have not yet fulfilled their promise of $100 billion, an amount that by itself is insufficient. An annual emission of $200 to $300 billion of SDR's would be a reliable way to achieve our climate commitments in a world of budget stringency. I must emphasize that issuances of SDRs do not cost the US government anything, either in present or future costs.

Second, as I noted above, many countries will need to restructure their debt, or at the very least obtain debt stays. Every country has a bankruptcy law to facilitate debt restructuring; yet there is no international framework, even though cross-border debt restructuring is more difficult than within-country debt restructuring. It is imperative that we work to create such a framework. As the IMF has recognized, the Common Framework for Debt Restructuring has not been functioning as well as had

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[4] "Report of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System." United Nations, September 21, 2009. https://www.un.org/en/ga/econcrisissummit/docs/FinalReport_CoE.pdf.

[5] In footnote 2 we noted the importance of the strength of our trading partners' economies for our economy; SDR's, by helping to strengthen the global economy including and especially the less developed countries and emerging markets, help to create export jobs here and to strengthen the American economy.

[6] See, e.g., Greenwald, Bruce C., and J. E. Stiglitz. "A Modest Proposal for International Monetary Reform." In *Time for a Visible Hand: Lessons from the 2008 World Financial Crisis*, edited by Stephany Griffith-Jones, José Antonio Ocampo, and J. E. Stiglitz, 314–44. The Initiative for Policy Dialogue Series. Oxford: Oxford University Press, 2010; and Greenwald, Bruce C. and J. E. Stiglitz, "Towards a New Global Reserves System." *Journal of Globalization and Development* 1, no. 2 (2010). https://doi.org/10.2202/1948-1837.1126.

been hoped[7]. The private sector, unfortunately, was not as helpful in the Debt Service Suspension Initiative as it could or should have been.[8] If we are to avoid the too-little-too-late syndrome[9] that has proven so costly, it is imperative that all creditors cooperate.

The Debt Sustainability Analyses, which are the cornerstone of debt restructurings, have to be improved. For instance, there are analyses that don't recognize that making excessive demands on a country will reduce growth.[10] That's one of the reasons that programs based on DSA's that take growth rates and other key variables as exogenous so often go awry.[11]

Third, for many countries facing debt crises, IMF programs can play a helpful, even vital role. But that requires that they be structured appropriately. The question is not about whether conditions should be imposed, but what conditions, and how they should be determined. In the IMF's 2018 loan to Argentina, the failure to impose conditions that money could not be used to finance capital flight was a major mistake and the IMF recognized that. The country now owes more than $40 billion with nothing to show for it. On the other hand, austerity has almost always and everywhere led to economic contraction, worsening government budgets, and more difficulty in repaying what is owed.[12] This was a major and damaging result of the 2018 loan agreement.[13]

In some of its more recent programs, the IMF has shown more sensitivity to what I will call simply, for lack of time, "good economics." That includes ensuring that the burden of economic adjustments do not fall disproportionately on workers or harm the most vulnerable. Most importantly, the preliminary agreement reached between Argentina and the IMF last month allows for economic recovery to

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[7] See Georgieva, Kristalina and Ceyla Pazarbasioglu. "The G20 Common Framework for Debt Treatments Must Be Stepped Up," *IMFBlog*, December 2, 2021. https://blogs.imf.org/2021/12/02/the-g20-common-framework-for-debt-treatments-must-be-stepped-up/.

[8] Among other failings of these initiatives has been the lack of involvement of middle-income countries and the absence of an adequate link to development outcomes.

[9] See, e.g., Guzman, Martin, José Antonio Ocampo, and J. E. Stiglitz, eds. *Too Little, Too Late: The Quest to Resolve Sovereign Debt Crises*. Initiative for Policy Dialogue at Columbia: Challenges in Development and Globalization. New York: Columbia University Press, 2016.

[10] Pablo Gluzmann, Martin Guzman and J. E. Stiglitz, "An Analysis of Puerto Rico's Debt Relief Needs to Restore Debt Sustainability," NBER Working Paper No. 25256, November 2018 provides an example of a more economically sound approach to DSA's. See https://www.nber.org/papers/w25256.pdf.

[11] The IMF has recognized this problem, noting that "Programs…appear to have systematically underestimated the impact of adjustment on growth." It went on to recommend the strengthening of "the discussion and analysis of the impact of program policies on growth, including fiscal multipliers and pay-offs from structural reforms." It also recommended "increase[d] scrutiny of the realism of program baselines. Better calibrate risks, discuss downside scenarios, and development contingency plans." See "2018 Review of Program Design and Conditionality." Policy Paper No. 19/012. International Monetary Fund. Strategy, Policy, & Review Department, May 20, 2019. https://www.imf.org/en/Publications/Policy-Papers/Issues/2019/05/20/2018-Review-of-Program-Design-and-Conditionality-46910. Further improvements could be made through more realism on spending needs, including for meeting climate and SDG targets.

[12] The 2019 IMF Review of Conditionality came out with much the same conclusions, including noting that among the reasons for the systematic overestimate of growth under Fund programs could be that "assumed payoffs from structural reforms were overly optimistic, that staff overestimated confidence effects." Ibid.

[13] See "IMF Executive Board Discusses the Ex-Post Evaluation of Argentina's Exceptional Access Under the 2018 Stand-By Arrangement," International Monetary Fund Communications Department, December 22, 2021, https://www.imf.org/en/News/Articles/2021/12/22/pr21401-argentina for the IMF's own critical evaluation of this program.

continue, rather than be stifled by unnecessary and counter-productive fiscal tightening. Hopefully this reflects a change in IMF policy that will continue in the future.

Fourth, the IMF is to be commended for its new institutional view on capital account management. It is an important step forward. But the Fund needs to go further. Such techniques should not be viewed only as a last resort. They are among the instruments that many countries will need to draw upon in this world of financial instability.

Fifth, unfortunately, the IMF has come to increasingly rely on surcharges on borrowing countries to finance its operations. [14] This is inappropriate and counterproductive. The IMF was supposed to help countries deal with foreign exchange problems. It is now *contributing* to their foreign exchange problems. Helping countries requires putting in place countercyclical policies. The surcharges go in exactly the opposite direction: they are procyclical. And while they are highly burdensome for the countries from which they are extracted, they can and should easily be replaced by other sources of income.

I have focused my remarks on global economic and financial risks and the pivotal role that the IMF plays in addressing them. But I hardly need to remind any of you of the perilous times we live in. With so much turmoil in the world, it is in our interest to strengthen our allies and our friendships. The US plays a critical role at the IMF. We are the only country with veto power. Rightly or wrongly, we will be held accountable for the successes and failures of the IMF. What I shall for shorthand call the "old" IMF won few friends and made many enemies. It was marked by hypocrisy, with the advanced countries, for instance, employing countercyclical policies as they demanded that others engage in procyclical policies.

We live in a different world than we did two or three decades ago, with different geopolitics and geoeconomics. It is imperative that we adapt to these new realities, and that multilateral institutions do as well. It is in our interest that they do. We are lucky that last year the IMF responded to global needs with the largest issuance of Special Drawing Rights in its history, but there are many challenges ahead. I hope my brief remarks will have pointed the way to how they might best be addressed.

[14] See Stiglitz, J. E. and Kevin P. Gallagher. "IMF Surcharges: A Lose-Lose Policy for Global Recovery." *VoxEU*, February 7, 2022. https://voxeu.org/article/imf-surcharges-lose-lose-policy-global-recovery.