Evolution Not Revolution: Rethinking Policy at the IMF

www.imf.org/external/pubs/ft/survey/so/2016/pol060216a.htm

Maurice Obstfeld: “The Fund has long tried to build on its experiences in the field and on new research to improve its effectiveness in economic surveillance, technical assistance, and crisis response.” (photo: IMF)

Chief Economist Interview

June 2, 2016

- Important for IMF to continually re-evaluate its thinking
- Fiscal policy should support long-term growth and equity; policy advice varies by country and situation
- Capital flows, trade on future research agenda

The global financial crisis led to a broad rethink of macroeconomic and financial policies in the global academic and policy community. Eight months into the job as IMF Chief Economist, Maury Obstfeld reflects on the IMF’s role in this rethinking and in furthering economic and financial stability.

***IMF Survey*: The Fund has made clear in recent years its willingness to examine its macroeconomic thinking and policy approaches. Some have called this revolutionary—is this the case?**

Obstfeld: I would describe the process as evolution, not revolution. The Fund has long tried to build on its experiences in the field and on new research to improve its effectiveness in economic surveillance, technical assistance, and crisis response.

It’s fair to say that the shock of the global financial crisis led to a broad rethink of macroeconomic and financial policy in the global academic and policy community. The Fund has been part of that, but, given the impacts of our decisions on member countries and the global economic system, we view it as especially important for us constantly to re-evaluate our thinking in light of new evidence.

That process has not fundamentally changed the core of our approach, which is based on open and competitive markets, robust macro policy frameworks, financial stability, and strong institutions. But it has added important insights about how best to achieve those results in a sustainable way.

***IMF Survey*: Do you agree with some who have argued that a recent article in *F&D* (“Neoliberalism: Oversold?”) signifies a major change in Fund thinking? For example, is the IMF now saying that austerity does not work and, indeed, that it exacerbates inequality?**

Obstfeld: That article has been widely misinterpreted—it does not signify a major change in the Fund's approach.

I think it is misleading to frame the question as the Fund being for or against austerity. Nobody wants needless austerity. We are in favor of fiscal policies that support growth and equity over the long term. What those policies will be can differ from country to country and from situation to situation.

Governments simply have to live within their means on a long-term basis, or face some form of debt default, which normally is quite costly for citizens, and especially the poorest. This is a fact, not an ideological position.

Our job is to advise how governments can best manage their fiscal policies so as to avoid bad outcomes. Sometimes, this requires us to recognize situations in which excessive budget cutting can be counterproductive to growth, equity, and even fiscal sustainability goals.

***IMF Survey:* How does this rethinking translate at the operational level?**

Obstfeld: Countries need credible medium-term fiscal frameworks that leave markets confident the public debt can be repaid without very high inflation. Countries with such frameworks will typically have room to soften economic slumps through fiscal means, including automatic stabilizers.

Unfortunately, some countries let public debt rise to such high levels that they risk losing market access, and have no choice but to tighten their belts even when their economies are doing badly. Our research indicates that in such cases, the poor often suffer disproportionately, and so it is important always to consider the most vulnerable when planning fiscal adjustment.

Of course, there are limits to the pain economies can or should sustain, so in especially difficult cases we recommend debt re-profiling or debt reduction, which require creditors to bear part of the cost of adjustment. That is the approach we are currently recommending for Greece.

***IMF Survey:* The Fund has looked carefully at capital flows as part of this rethinking. Where do you see work on this heading the next year?**

Obstfeld: The global financial crisis, as well as earlier crises, showed that capital inflow surges could have destabilizing effects, especially by fueling domestic credit booms and financial instability. These left economies very exposed when the direction of capital flow reversed and money headed for the exits.

In 2012, the Fund adopted an " Institutional View" on conditions in which measures limiting capital flow could be helpful, based in part on important work done in the Research Department. The Fund is now undertaking a stocktaking of experience with capital flow measures in recent years, and asking if and how the Institutional View should be amended. One challenge is to incorporate the sometimes complementary role of macroprudential policies. This is a great example of our trying to learn from experience and let our thinking evolve accordingly.

***IMF Survey*: What about recent developments in global trade—how does the decline in activity figure into your thinking?**

Obstfeld: In the postwar period trade has been a remarkable engine of global growth, and can continue to be so.

The reasons for the recent slowdown in trade growth are not fully understood—they range from low global investment, to the commodity-price decline, to the possible contraction of global value chains—but we do see the deceleration as concentrated in emerging markets.

We will have a much fuller analysis of the causes in the forthcoming October 2016 *World Economic Outlook*. One thing we have learned about trade, however, is that its consequences are complex, and include changes in the income and job distribution that many countries have addressed inadequately. This failure has fueled protectionist sentiments.

I would draw this conclusion, however—the recent slowdown in trade growth may be more or less worrisome, but it is unlikely to represent good news for anyone.