EconoFact Chats: Understanding the Role of the IMF in the World Today
Charles Collyns, EconoFact
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I'm Michael Klein, executive editor of EconoFact, a nonpartisan, web-based publication of the Fletcher School at Tufts University. At EconoFact, we bring key facts and incisive analysis to the national debate on economic and social policies, publishing work from leading economists across the country. You can learn more about us and see our work at www.econofact.org.

Michael Klein
The International Monetary Fund, the IMF, is one of those institutions that gets in the news only when it is at the center of a controversy, like when it imposes economic conditions on a country that is facing default on its government debts, for that country to then receive a loan from the IMF, one that often catalyzes lending from other sources. IMF conditionality is viewed by some as necessary medicine, and by others as punitive. How did the IMF come to be the arbitrator of crisis countries' policies? How does the IMF operate and towards what ends? Has it been capable of self-analysis, and when necessary changed its approaches? I'm joined today by Charles Collyns, who is uniquely well-qualified to address these questions. Charles worked in a number of capacities at the IMF for over three decades, including heading the team, producing the semi-annual world economic outlook, and working on many challenging lending operations. He left the IMF to serve as the Assistant Secretary for International Finance at the U.S. Department of Treasury from 2010 to 2013. After that, he was the Chief Economist at the Institute of International Finance. He then returned to the IMF to be the Director of its Independent Evaluation Office from 2017 to 2023. And in the interest of full disclosure, Charles was my boss when I was the Chief Economist in the U.S. Treasury's International Finance Office, and he is now a senior advisor to EconoFact. Charles, welcome to EconoFact chats.

Charles Collyns
Thanks so much, Michael. It's a real pleasure to participate in this EconoFact Chat. I'm also very pleased to be joining the EconoFact team.

Michael Klein
It's great to have you on the team. I guess I'm your boss now.

Charles Collyns
Absolutely.

Michael Klein
I'll try to be as nice to you as you were to me. Charles, the IMF is one of the three so-called Bretton Woods institutions, the others being the World Bank, whose official name is the International Bank for Reconstruction and Development, and the World Trade Organization, the WTO, which is the successor to the general agreement on tariffs and trades, the GATT. What was the original concept behind the establishment of these institutions?

Charles Collyns
Well, if we go back to 1944, as the end of the Second World War approached, 44 countries led by the U.S. and the United Kingdom met at the Bretton Woods Hotel, in Mount Washington in New Hampshire, to set out an overarching vision for the post-war international trade and financial system, which aimed at restoring global prosperity after the war ended and avoiding a repeat of the calamity of the Great Depression of the 1930s, when countries had resorted to tit-for-tat trade wars and competitive devaluations of their currencies. At the conference, it was agreed to establish three new international organizations to underpin the new architecture, the IMF to oversee a stable international currency system, the World Bank to help finance European reconstruction and the development of poor countries, and the GATT to watch over the trade system and drive trade liberalization.

Michael Klein
The mission of these organizations has evolved over time. For example, the World Bank shifted its focus from reconstructing war-ravaged Europe to developing countries as an increasing number of colonies achieved independence. How has the mission of the IMF shifted?

Charles Collyns
Originally, the IMF was intended to police the Bretton Woods system, the fixed exchange rate parities. Its main task was to judge when adjustments to the parities were justified, and it also offered short-term financial assistance to help countries respond to balance of payment pressures that could threaten their fixed exchange rates. However, this system of fixed parities came under increasing pressure in the early 1970s, as the United States in particular faced sustained large current account deficit. When the Bretton Woods system broke apart in 1973, the world shifted towards the floating exchange rate system, and it was not clear what the IMF's role would be in this new world. But then, after the Latin American debt crisis erupted in 1982, the Fund found a new role when it stepped in to help deal with the very large-scale financing needs of these countries as they lost access to international capital. And ever since, the Fund has been heavily involved in dealing with a series of global shocks and crises, including the breakup of the Soviet Union, the Asian crisis, the global financial crisis, and the COVID pandemic. It's also been increasingly concerned with helping low-income countries meet their balance of payments' financing needs, especially as many of these countries have become increasingly over-indebted and face debt crises of their own.

Michael Klein
Well, you mentioned how the IMF shifted its focus in 1982 with the Latin American debt crisis and other debt crises as well. Charles, can you describe the types of challenges facing a country that has a debt crisis, and why and how the IMF has taken a lead role in addressing these crises?

Charles Collyns
Well, sure. I mean, a country faces a debt crisis when it is no longer able to borrow, to meet its immediate financing needs, or to meet the interests and principal payments falling due on its debt. Typically, this happens when investors, both domestic and foreign, lose confidence in the government's ability to prudently manage its finances, which often results in a sharp drop in the exchange rate and rising inflation. Resolving this problem will usually require a combination of credible domestic policy adjustments, together with debt relief from creditors, to at least stretch out debt service repayments, and sometimes to forgive a part of the debt altogether. The IMF's role is to help countries deal with this very dangerous situation that incurs the least damage for the economy of the country, but also limits stress to the global financial system. It does this in a number of ways. It will provide advice and technical support to country officials as they seek to design an effective and convincing adjustment program. It also provides short-term financing to a country that meets the agreed policy conditions so that adjustment can be spread out over time, and thus reduces the need for harsh upfront measures. This can often make the program more politically acceptable, and that's more likely to be effectively implemented. In addition, the IMF's involvement provides reassurances to foreign investors and to other official lenders like the World Bank that the country's policies are being corrected as needed, and thus help to catalyze new lending. The IMF can also play a very useful role in coordinating debt relief from the creditors by setting a benchmark for how much relief may be needed overall, and helping to facilitate agreement on appropriate relief from different creditor groups.

Michael Klein
Has this approach been effective?

Charles Collyns
Often it is very effective, particularly when the IMF works with committed and politically empowered governments. In fact, I myself have worked on some very successful programs, including India in the early 1990s and Brazil in the early 2000s, but there are certainly cases where programs have not worked so well, and prominent recent examples include the programs with Greece during the Eurozone crisis when you and I were at the U.S. Treasury, and Argentina in 2018. In these cases, the IMF provided very large amounts of financing, but the programs did not restore confidence, and stability was not quickly restored either.

Michael Klein
In these programs, Charles, what are the typical prescriptions for countries?

Charles Collyns
Well, typically the IMF wants to make sure that the country's fiscal policy is corrected to ensure that the government finances are sustainable, and that the most pressing fiscal needs can be met. It will also want to make sure that the monetary and exchange rate policies are consistent with low inflation and stable balance of payments that can be financed as needed, and I believe that a robust program should also include commitments to address structural impediments to growth and ensure adequate attention to income disparities, since otherwise the country may find itself returning again and again to a crisis as popular support for good policies wanes, as economic outcomes continue to disappoint.

Michael Klein
So as to the popular support for policies, some of the biggest criticisms of the IMF's policy prescriptions are that they typically include cutting government spending and raising taxes. One quip is that IMF stands for "It's Mostly Fiscal". People complain that this thrusts the country into an even deeper crisis, one that particularly hurts the middle class and the poor. Why does or did the IMF emphasize fiscal retrenchment, and has experience supported this approach?

Charles Collyns
Well, as I said, fiscal imbalances is often a root cause of the crisis. It must therefore be addressed to provide a lasting solution and restore confidence, but there is certainly a risk that harsh austerity does cause great immediate pain, as social benefits may be cut, as public spending is slashed, jobs may also be lost, as the economy falls into a deep recession. So over time, learning from this experience, I think the fund has applied some lessons for how to achieve the necessary fiscal adjustment while incurring less pain on the country and therefore actually increasing the chances of success. For example, a credible fiscal adjustment can be spread over more years if it involves a demonstrated commitment to institutional change that, for example, raises the revenue base, or makes spending less subject to waste and corruption. Similarly, the spending cutbacks should be concentrated in cutting wasteful spending such as, for example, big white elephant projects that really may not be needed, while actually devoting more money to the social safety net to protect poor and vulnerable groups in a very difficult situation. That said, I have to say that a recent report by the Independent Evaluation Office that I ran, found that more could indeed be done. For example, to address structural impediments to growth since fiscal sustainability is much easier to achieve in a growing economy. So the fund certainly needs to include fiscal within its recipe, but I think the notion that 'it's mostly fiscal' probably needs to be corrected. It's probably fiscal, and a bunch of other stuff as well.

Michael Klein
Okay, I won't use that anymore. You mentioned earlier that some prominent programs did not work out as intended. Can you explain or do you know what went wrong in those cases?

Charles Collyns
That's a tough question and the answer is different in the different cases. After all, many things can go wrong in very risky situations. The program itself may be poorly designed. The external financing raised may be inadequate and fall short of what was expected. The implementation of the program by the government may fall short of the commitments that it made and there may also be new shocks that push a program off track. And often the failure is the result of a combination of these factors. But I have to say that one factor common to a number of very large programs that failed like Greek and Argentina programs is that the fund came under a lot of political pressure from its shareholders to provide support for a program that was not truly adequate for dealing with the very deep imbalances that prevailed. For example, the Greek program in 2010 did not insist on the debt reduction that was ultimately required. But I also have to recognize the Fund faces very difficult choices in highly uncertain volatile situations. And the Fund's job indeed is to take on risks when no other creditor is prepared to lend. But I think another lesson from the IEO's work is that in these situations it's particularly important that the Fund's decision making process needs to be transparent and based on the best technical analysis, to reduce these risks that political pressures lead to support for inadequate programs.

Michael Klein
So it's a little like the Tolstoy effect. All unhappy programs are unhappy in their own way.

Charles Collyns
Absolutely.

Michael Klein
Tolstoy didn't work with you at the IMF, did he?

Charles Collyns
We would've liked to have a man of his vision, yes.

Michael Klein
Well, you were there. Maybe that was a good substitute. The IMF takes on other roles as well. One of them is whether countries have a fairly valued exchange rate. And this is often politically charged. For example, successive U.S. governments under both Democratic and Republican administrations have accused China of manipulating its currency, keeping the renminbi cheap to advantage its exporters. Without going into too much detail, how does the IMF gauge whether currencies are fairly valued? And what do these analyses say about the current landscape?

Charles Collyns
It's a very politically charged issue, of course. And it's been a difficult one throughout the IMF's many years of existence. So over time, the IMF has developed a very complicated methodology for exchange rate assessment. Essentially, it tries to answer the question, is a country's external balance aligned with long-term fundamentals? And if not, what are the sources of the deviations? I'm not going to try to explain the full complexity of the approach, but to simplify, if the country has a medium-term projection of its current account surplus prepared by the IMF, if that projection is persistently much higher than the surplus that the IMF estimates should be expected on the basis of country fundamentals, like demographics, productivity, and fiscal position, then this is a sign that the exchange rate is undervalued, raising concerns that a country is unfairly manipulating its currency to keep the currency low and generate large amounts of exports, which may be good for the country, but may be less good for the rest of the world. The IMF then produces a report each year which goes through country by country, gives the IMF's assessment based on this technical analysis, as well as judgment from country-specific circumstances. The most recent report is available for 2022 and finds that the overall current account imbalances have actually been on a declining trend since the mid-2000s, when concerns that you mentioned about currency manipulation by China and others were strongest. And in fact, China's current account has been judged to be brought in line with fundamentals since 2017, which is consistent, I think, with the fact that the RMB's value, China's currency's value, is now much more influenced by market forces than it used to be.

Michael Klein
So along with coming in in crises and doing these exchange rate overviews, even when countries are not in crisis, the IMF conducts country surveillance, and issues reports. What is considered in these reports and do countries tend to follow its recommendation?

Charles Collyns
Well, that's a good question. And the answer, of course, is that the countries do not always follow the recommendations. But to step back, the IMF produces an annual report on a country's policies. It's called an Article IV consultation report. Additionally, these reports were directed primarily at whether countries were following the commitments made to the IMF in Article IV of the Articles of Agreement about managing the exchange and payment system. But over time, particularly after the collapse of the fixed parity system, these reports have become geared much more towards providing more general advice to countries on macroeconomic management, consistent with the country's particular stability and growth needs and challenges, as well as the broader concern to foster a more stable and well-functioning global economy at its national financial system. More attention has now been given to what the IMF calls cross-border spill-overs, which means the impact of one country's policies on other countries. For example, given their size, the largest economies such as the US and China, their policy choice, it's going to have a very big impact on the global economic and financial environment. So when countries

sign the Articles of Agreement, they are undertaking an obligation to follow the commitments that are laid out in Article IV for managing exchange and payment systems. But there is no obligation to follow this more general advice given by the Fund. Now, I think in some countries, the IMF advice can actually be very influential, very helpful, especially in smaller, lower-income countries, which do not have sophisticated institutional capacity for macroeconomic policy making. The Fund can also be influential in larger countries too. For example, if the Fund brings insights from cross-country experience, or influences the public policy debate, most IMF Article IV reports are now made public and often get a lot of attention in the press. But it's also true that countries may not follow IMF advice, particularly where that advice involves very hard political choices. So in practice, the truth is that the IMF advice only really has teeth when a country runs into such problems that it needs to gain access to IMF financial support.

Michael Klein
Charles, as I mentioned, your last position at the IMF was to be the Director of the Independent Evaluation Office or the IEO. This office, which is fully independent from the management and the staff, studies a range of IMF policies, and draws on outside experts to write reports on the efficacy of these policies. You've already mentioned a couple examples of these reports. Can you discuss how the IMF responded to the criticisms in the IEO reports?

Charles Collyns
Sure. Be happy to do that. But let me first perhaps give an overall background on the IEO. The IEO is a mandate to look at the broad range of IMF activities, but it is a very small office and it therefore tries to be quite strategic. It focuses on areas [inaudible] the greatest current concerns. In my experience, the IEO is indeed operationally very independent in choosing its topics, reaching its own conclusions, although it does work closely with Fund management staff and support, which helps make the IEO more persuasive, I think, in helping the institution learn from its experience. You're a professor. I think you understand that if you come out with too harsh criticism of your students, they tend to be unhappy and leave your class. What you want is to keep the students engaged by giving them from time to time some recognition that their work is doing well. It's sort of similar for the IEO. One of the aspects, though, that makes the IEO quite effective, is that there is a well-established follow-up process, which involves a management implementation plan to act on the recommendations that the IEO makes that are endorsed by the executive board, which is then carefully monitored by the IMF's audit office. The board itself has to endorse this implementation plan, which provides an additional layer of discipline on management and staff to take the implementation plan very seriously. In practice, the IEO, I think, has had a really pretty substantial impact on the fund in its 20 years of existence. We laid this out in a recent book that was just published that provides a retrospective, or perhaps a self-evaluation of the IEO's activities. A good example is how the IMF has greatly stepped up its work on fragile and conflict-affected states, offering those aversion from very unpleasant civil wars. IMF work is now based on much more care to recognize the particular deeds and capacities

of these countries, rather than just to apply a cookie-cutter approach used in other countries in less strange circumstances. But I also have to recognize that some change can come quite slowly, where it involves a major shift in corporate culture. So the IEO has to be patient in the same way that professors have to be patient for their students.

Michael Klein
Well, I try to be patient, but I also am known as sometimes being harsh for their own good. We know that economic policy is supposed to be done technocratically and outside of politics, but in fact, we know that at the domestic level, politics impinges upon what choices are made. And it should, I suppose, in some ways – it's reflecting the will of the voters. How does politics play a role for the IMF, which is a transnational institution?

Charles Collyns
I think that's a very good question. It's important to recognize that, unlike central banks, which are very technical institutions, given a certain mandate, and then given independence to pursue the mandate, the IMF is political in the sense it's deploying taxpayers' money, often in quite large amounts. And not surprisingly, the shareholders, the countries that have contributed to the IMF, want to keep very close tabs on what the IMF is doing and are not prepared to give the IMF fully technocratic governance structure that independent central banks now have. At the same time, it's important that the IMF operates according to the best economic reasoning. This is important, I think, for the IMF's legitimacy, particularly when giving very hard advice and making tough judgments. So how does this work in practice? Well, the IMF staff is indeed fully meritocratic in all but the most senior positions. And, you know, their job is to provide the best technical advice that they can to the senior decision makers, the management and the executive board. Decisions are made by the executive board. It meets three times a week and considers the recommendations made by management. And this is where the political considerations play an important role. The directors on the board effectively represent the country's shareholders while the managing director is appointed by the shareholders, and to be effective, must retain the full confidence of the shareholders. Now, most of the time this governance structure does work quite well. But as I have mentioned, there can be unresolved tensions between political and technocratic considerations in some of the biggest and most important decisions, such as on large loans, which can lead to unfortunate outcomes.

Michael Klein
Finally, Charles, much of your professional career has been as an insider in public service, and most of that was in the IMF. But then you had this experience in the Independent Evaluation Office. Did that alter your view of the work of the IMF, or did it help to reinforce a view you might have already had?

Charles Collyns
To a large extent, my time at the IEO reinforced my perception that the fund is a very capable institution, able to adapt effectively to take on newly emerging challenges. I mean, pretty much all of our reports find very good things to say about what the IMF is doing. But on the other hand, there's certainly room for improvement. I think you have to be worried about whether the Fund can continue to be as effective going ahead as the world continues to be battered by big global shocks. One of the problems is that as the fund has taken on a broader role, taking on new issues like climate change, for example, its expertise in core competencies, like fiscal policies, balance of payments policies, monetary policies, has been spread, increasingly thin. And from my perspective, part of the problem is that the cooperation with the Bretton Woods sibling, the World Bank, is not very effective or even very deep, even though they're neighbors facing each other across the street. And for me, there's an increasing problem with the two institutions' activities increasingly overlap, which is something we pointed out in other of our IEO reports. Another related challenge is that IMF staff are encouraged to be jack and jills of all trades, able to move quickly onto new challenges, which gives versatility and quickness to IMF responses, but also can contribute to a lack of depth of expertise, needs to provide real value added advice to experienced country officials who themselves have just as good economic education as IMF staff. And finally, this political dimension of the Fund's work, my sense is it's becoming increasingly difficult as the rising geopolitical tensions among the major IMF shareholders make it increasingly challenging to reach consensus on how to deal with critical problems, such as, for example, the rising debt burden now faced by many low income countries.

Michael Klein
Well, Charles, a lot of people have heard of the IMF and understand it's important, but I don't think they had the depth of understanding that they would have liked about this very key international institution. And drawing on your experience and explaining these things today has been really helpful. So thank you very much for joining me today on EconoFact Chats.

Charles Collyns
You're very welcome. It's been a great pleasure. And I hope I've helped to increase people's understanding of the IMF, the positive aspects, but also some of the challenges that it certainly does face.

Michael Klein
You certainly have. Thank you, Charles.

Michael Klein
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