Transcript

The International Debt Crisis, Global Governance Institutions, and the Role of US Policy

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Remarks have been edited for clarity.

Fae Rabin

My name is Fae Rabin and I'm thrilled to welcome you to tonight's teach-in and happy hour, brought to you by CEPR, the Center for Economic and Policy Research. Tonight's teach-in is on the international debt crisis, global governance institutions, and the role of US policy. This is the first of a series of teach-ins that CEPR will be putting on, bringing together experts to share research and analysis that Hill offices can use and our partners can count on in their own important work. We know everyone's joining at the end of the day and at the end of another fast-paced voting week on the Hill. We want to recognize that in the course of any day, you have to brief and provide counsel on high-stakes developments. And there's often not a lot of built-in opportunities for dedicated background research and deeper learning — you're often on the go. When those decisions need to be made rapidly, we want you to see these CEPR teach-ins as a space for learning directly from the deep bench of experts, both within and connected to CEPR.

So tonight — why is it important that we talk about global debt? Why is it in crisis? What do we need to understand about the International Monetary Fund, or the IMF, the World Bank and the Federal Reserve? What tools are available for Congress to influence these dynamics that play out with global and domestic impact? These are the kind of questions that we hope you'll leave tonight with a deeper understanding of, and you'll have a sense also of who you can go to for follow up questions, because we know it doesn't stop here. So, just the other week, the World Bank released its Global Economic Prospects, and they're not good. It's projecting just 2.4 percent world GDP growth this year. Compare that to 6.2 percent world GDP growth in 2021 and 3 percent in 2022. Around the world, sovereign debt continues to strain countries, particularly developing countries, where debt service obligations eat up a lot more government spending than investments in education or health. The international debt crisis is exacerbating one of the root causes of migration that we're also seeing. In the US, for example, it has led to a surge in asylum seekers fleeing from extreme poverty and dire humanitarian emergencies, which is made worse by unilateral economic sanctions.

This dismal projection isn't floating in a vacuum in space. The US dollar remains as a center of gravity in the global financial system at this time and US policy plays a direct, leading, course-shifting role in the institutions of global governance. Tonight, you'll hear about the dominant role the US has within the World Bank and the IMF. You'll also hear about how US policy actions and inactions, with a focus on the Fed, reverberate worldwide, and how the human cost at stake is steep — whether good or bad. Within the current structure, we see developing countries pushed further and further into poverty and inequality, crushed by sovereign debt with far too few mechanisms available for debt relief. We've seen this play out in many ways in just the last few years — throughout the economic response to the Covid-19 pandemic via US economic sanctions as a form of economic warfare, through interest rate hikes, and more. It doesn't need to be this way. The US can lead the world in humanely responding on the global stage by removing broad economic sanctions and by issuing new Special Drawing Rights (SDRs.) and just as US policy reverberates around the world, it's a boomerang that comes right back home.

To lead us in tonight's teach-in, we have the good fortune of having three expert economists to go into much more nuance and to also answer your questions. We are joined by Jomo Kwame Sundaram, Emeritus Professor at the University of Malaya who served for many years at the UN in critical leadership roles. We also have Mark Weisbrot, the co-founder and co-director of the Center for Economic and Policy Research. And while we wish she could be here, you'll hear from Jayati Ghosh virtually, as she was kind enough to send us pre-recorded remarks. Jayati is a professor of economics at the University of Massachusetts at Amherst and has held critical roles within the UN and the WHO Council on the Economics of Health for all. So, this trio really continues to expand and enrich the much-needed dialogue that we all need to be having, trained economists or not, about the repercussions of the international debt crisis already playing out, and economic policy more broadly. And truly, thank you to all of you for coming. Whether in person or virtually. Whether you're just beginning to learn more about tonight's topic or if it's something that you work on daily, we'd love to hear your questions during the Q and A.

And for those in person, we also invite you to stick around afterwards and chat with Mark and Jomo and the rest of the CEPR folks here. Now I'd like to turn it over to Jomo, who's going to kick us off.

Jomo Kwame Sundaram

Thank you very much, Fae, and thanks to CEPR for organizing this evening's event. It's a great pleasure to be here. I, however, bring rather dismal news. As many of you probably are quite aware, the last 15 years have not been terribly great years from an economic point of view. We've had essentially a rather protracted stagnation at the world level, although some parts of the world economy have done better than others during this period.

It's important for us to recognize that this period begins with the global financial crisis in 2008, and following that, what is sometimes termed the "Great Recession." This was followed by a period when the US Fed and the European central banks basically orchestrated what might be termed as unconventional monetary policies, sometimes highlighted by one particular policy referred to as quantitative easing. Many of you might not quite remember that, but that was the rage for about a decade. And during this period, we saw very little growth of the real economy, but much more financialization. And this involved a great deal more debt. Except the nature of the debt also changed very significantly. It was no longer borrowing from banks as four decades ago, before the 1980s, but rather this time it involved much more market-based debt.

This is crucial for us to understand the nature of the debt problem today. I think it's also important for us to recognize that, as a consequence of this situation, we have seen a period of greater fiscal austerity. Governments have basically been discouraged from spending, and they have previously been discouraged from taxing. As a consequence of less taxes, you have less money to spend. And the only way you can spend is, especially in a downturn, by borrowing. This seemed to be very attractive during this period of quantitative easing because you could borrow relatively cheaply, but this has now come back to haunt economies, especially in the last couple of years. As interest rates have turned, they had become much more expensive and so on. Now, much of this, of course, was led by the US Federal Reserve, especially from the second quarter of 2022, and we have seen how all this has meant less government spending in many parts of the world.
Now, interest rates, as I mentioned, have, as you all know, gone up very significantly. And it's very unlikely it's going to help very much. The main reason for this, of course, is raising interest rates results in what economists call dampening demand — demand for government spending, demand for private spending, whether it's for investments or for consumption.

But what we have, really, in the recent period, has been what might be called a supply-side led recession, because what you have seen are major disruptions on the supply side. What do I mean by the supply side? For instance, even before the pandemic, there was the beginnings of what we now refer to as the second Cold War, the primacy of geopolitics. This has been very important. And so you had a disruption of the very globalization which the West, led by the US, had been promoting in an earlier period. As a consequence of this, you had disruptions due to supply-side difficulties, and this became worse during the pandemic. The pandemic resulted in a great deal of logistical supply disruptions and other supply disruptions. Then, of course, in the most recent period, you have seen geopolitical conflicts, and many of these geopolitical conflicts have brought about responses which have involved various types of economic sanctions.

These economic sanctions, of course, began even before the recent geopolitical conflicts. But all this has meant a great deal of difficulties in terms of supply-side disruptions and these supply-side disruptions are not going to be resolved by raising interest rates. Raising interest rates will only affect things on the demand side, it's not going to help things on the supply side. So, we have an inappropriate policy which is not going to help, but rather it will have the converse effect of worsening things. Now, all this, of course, has meant that we have a situation where we have inappropriate policies, and these inappropriate policies have basically meant that there's less spending. Less spending has meant less of what economists call demand. Less demand means less jobs and less incomes. Now, this is not true in the United States for a variety of reasons, which perhaps Mark and others will go into later. But I think that what we do have in most of the world, as a consequence of this raising of interest rates, is much, much less demand. You have less jobs, higher unemployment, less incomes, and so on and so forth.

The whole situation has resulted in a situation that is causing a lot of people in the world, in the world outside of the United States, to believe that this is a conspiracy on the part of the US. Of course, we know that the US Fed is quite independent in some ways from the US government, from the White House and so on. But nonetheless, this is the perception, because for the rest of the world, they don't see these different arms of the US government operating independently. They see them as acting in a fairly concerted way.

The next thing to consider, of course, is that in the developing world, developing countries have much more constraints on what they can do. They are not able to do very much on their own for a variety of reasons. Generally, they are heavily indebted and being heavily indebted, they are less likely to act independently. And also, what you find is that there's a tendency now, because much more has been left to the market, for there to be a pro-cyclical bias. What this basically means is that instead of acting against market trends, as happened during the New Deal or in more recent times during the 1960s — by surrendering to the market, you basically have very little leeway.
The consequence of all this is very considerable, especially for smaller developing countries, and the result is that they have become very vulnerable and they are subjected to the larger trends of a slowing economy. This is important for us to recognize because what has happened is that during the period of quantitative easing, there was a great deal more debt that was taken on. Much more money was available because interest rates were low in the developed countries, in the Western countries. Much more money became available to developing countries. So, developing countries felt that since the rich countries were not lending to them or not providing concessional finance to them, they borrowed much more heavily in the market. Now, that has come back in myriad ways. For the poorest developing countries, there's hardly any money coming into the markets. In fact, there has been a flight of capital in the last two years away from developing countries. For the so called "middle-income countries," they are now subjected to much, much higher interest rates, and they suffer greatly as a consequence. In other words, what we have now is — I guess Hollywood imagery would be that of the perfect storm, where you basically have things coming together in a rather bad way. Add to that the geopolitical situation, which has put a lot of pressure on developing countries to try to spend much more on military and other considerations.

I think what we have, as a consequence of this, is that the poorest countries are probably the most vulnerable. And I've tried to argue that this vulnerability has meant that the poorest countries have become poorer. But in addition, I think it's important to recognize that poorer countries also have very few options. From about seven or eight years ago, you find that, for example, there was a lot of fear generated about borrowing from China. China offered very low interest rates compared to other sources of lending, except perhaps for Japan. But as a consequence of these fears which were generated, China's lending to developing countries went down, and particularly to Sub-Saharan Africa; it has fallen since around 2016, roughly. The poorer countries also have borrowed much, much more, as I mentioned earlier, until recently, from private sources. And with private sources it's very difficult, in the case of a severe debt crunch, to deal with a myriad of different creditors. And that's basically what happens when you are dependent on markets rather than on intergovernmental arrangements.

A third problem, of course, is that you have much more private market funding. And again, dealing with governments does not help you because private funders and private financiers are not going to take their instructions from governments.

A fourth issue for us to remember is that, as a consequence of all this, what we find is that the poverty in the poorest countries has not declined for almost a decade now. And this is very serious. If you look at the figures, for example, of food insecurity, which is a polite way of saying hunger, the food insecurity numbers have not improved for a decade. So, you have food insecurity becoming worse, especially in recent periods, and much of these recent increases in prices were due to speculation. It wasn't particularly due to shortages, because, as you all know, in 2022, you actually had bumper harvests in both Russia and Ukraine. So, the increased prices, which happened over a period of less than half a year, were mainly due to speculation by those involved in the food supply chain rather than due to food shortages *per se*.

The last point I would like to make is that what we do have now are much more severe debt service costs for the variety of factors which I referred to earlier, which are much beyond not only developing countries' ability to resolve, but also even rich countries are unable to help to control this situation because it involves the private sector in important ways. What we do need to appreciate is that the likelihood of debt distress has grown tremendously in the recent period, and it continues to increase, together with the high costs of debt. And, as we have seen in many countries — most spectacularly in the case of Argentina, but also elsewhere as well, Sri Lanka, Zambia, and so on — it is extremely difficult to negotiate in a situation where you're already in a situation of distress. And there are no incentives for you to admit that you are having problems. So, you wait until the last possible moment before you have your problems. So we are likely to see a whole range of problems which are going to continue to increase, especially because although the US Fed has promised to reduce interest rates, interest rates have not gone down, money is not flowing back to developing countries, and the European Central Bank has promised to continue to raise interest rates, which probably will compound the gravity of the situation.

So let me stop here, but I'm sorry to bring you rather grim tidings but I think we have to try to anticipate the difficult situation in which we live before things get far worse. Thank you.

Fae Rabin

Thank you so much, Jomo. I think we can all appreciate the context that you've laid out for all of us and the magnitude and the depth and urgency of the outlook that we are facing. So, we're going to hear some pre-recorded remarks from Jayati Ghosh in just a moment here.

Jayati Ghosh

Thank you very much for this opportunity to speak to all of you on what I believe is a really important and central question of our times. I'm going to share a screen because we have very little time and I think it might make more sense for me to introduce the topic to you. So, first of all, let me just describe the ongoing debt crisis. I think Jomo has already presented it to you very graphically. Also, the involvement of the rich countries in this distress.

But at the moment, about 60 percent of low-income countries are either already in debt distress or at high risk of it. There are also middle-income countries involved. There have been defaults, like in Sri Lanka, or near defaults, and extreme debt stress in countries like Egypt and Pakistan. There has been some argument that now things have settled down, there are not that many countries that have defaulted, so it's not really a problem anymore. That's not true, because in fact, this is only a pause, not a resolution.

But also, even when they're not actually likely to default, the low and middle-income countries suffer greatly because of the impact on public spending and often the interest rates on their debt rise, even without new debt being taken. So as a result, debt servicing now accounts for more than all forms of social spending taken together, as I will show you soon. The other problem is that a lot of the new debt that is taken on is just to repay existing debt, what is called "Ponzi borrowing." And even in countries that don't have debt distress this is now a problem. Jomo will have shown you how this is not just a problem of debtor countries' own making, they result from the currency hierarchies and policies of the advanced economies.

To give you some examples of how this plays out, this is what happens just before, during and after the pandemic. The high-income countries dramatically increased government spending by around 6 percent of GDP, additional on average; the middle-income countries much less so, about three and a half percent of GDP (and it was already lower as a share of GDP); and the low-income countries barely increased it at all. In fact, the average of the low-income countries' increase in government spending in this period between January 2020 and March 2021 was only $2 per person, per capita, compared to around $30,000 in the US. Now, as a result, the primary deficit went up massively for the high-income countries, less for the middle-income countries, much less for the low-income countries.

But despite this, the low-income countries have faced dramatically increasing debt service, as you can see. And of course, it's gone up even more since the last year here, which is 2021. And the debt service as a share of total government spending is really high for the low-income countries, it's around one-third of government spending.

But despite the fact that their fiscal restraint has been so marked at the cost of their own citizens, the general government gross debt, as you can see, has barely gone up for low-income countries and just slightly gone up for middle-income countries, whereas it went up hugely for the rich countries and has stayed quite high. Despite that, if you look at the right-hand side of this chart, you will find that the spreads on sovereign debt above the US Fed rate barely increased. In fact, they were below 0.1 basis points throughout this period for the advanced economies. But they went up to an average of about 700 basis points for the middle and low-income countries. And for some of the low-income debt-stressed countries, it went up to 1100 basis points. That's eleven percentage points over the debt paid by advanced economies.

Now, what this does, as you can see, is that it dramatically intrudes on fiscal space. If you're spending so much money on debt service, you really don't have money for anything else. And as you can see, all forms of social spending — health, education, social protection — all of that taken together, the low-income countries were spending 171 percent. That is 1.7 times what they're spending on all of these forms of social protection — health, education — just on debt service. Even for the lower middle-income countries, it was more than 100 percent.

Now, obviously this also affects public investment, and we know how necessary that is for dealing with climate change, for addressing future health challenges, for meeting the needed infrastructure needs, for the Sustainable Development Goals. But also, if you have such pressure to earn foreign exchange for debt servicing, you are much more inclined to brown and fossil fuel investment. So, for example, Chad celebrated when it discovered oil because it could actually now start to repay more debt. So many, many countries are affected, not just the debt-stressed countries listed by the IMF, because they're servicing external debt at great cost to the domestic population.

So even a minor shock makes it difficult to finance, and climate disasters actually make things worse. They make it more expensive to access debt because the spread goes up after a climate shock. The attempts that have been made so far to deal with this have not worked. The Debt Service Suspension Initiative, the DSSI, came in the wake of the Covid-19 pandemic, but it only postponed payments. It didn't change the volumes of debt, which are really unpayable, and it didn't cover debt owed to private or multilateral creditors.

The G20 has a common framework for debt treatment; that isn't working either. Only four countries have applied, but after two years, no country achieved any outcome. The latest one that came close to a resolution was Zambia, but even that deal has fallen apart because private creditors were demanding much more favorable terms.

In fact, in general, private creditors have either refused to participate or are only willing to accept favorable terms — terms that are better than those of the public creditors or the multilaterals. That's why it's so important to emphasize legislation. In the US and New York state, there are some pending to bring sovereign debt in line with bankruptcy procedures for other debtors.

The other problem is that multilateral financial institutions, like the IMF and the development banks, also refuse to accept any haircuts. This is really no longer valid or acceptable. They must also be part of any debt workout. In addition, the IMF's Debt Sustainability Analysis has really major flaws that make it underestimate the debt reduction required for all creditors.

Usually, it's common to blame China for this failure. But the real problems, as I've highlighted, are in the design of the framework.

So, what can the IMF do? First, the IMF can issue more Special Drawing Rights. Especially Special Drawing Rights that are now selective, not just going to everybody, including countries that won't use it, but to countries that are facing crises not of their own making, like a climate shock, an interest rate shock, something like that. The IMF should also stop charging surcharges on interest rates for large loans, or to countries with very prolonged IMF agreements. It's actually a crime to charge these surcharges because these are countries already facing extremely high repayment costs. And part of the reason that they have to keep taking these large loans and persistent loans is the IMF's own fault, in terms of the conditions that it's imposing.

The Debt Sustainability Framework has to be changed. It underestimates the actual requirements of debt reduction, and that means that we must have a more realistic macro model that would take account of contractionary impacts of policies required by the IMF, like cutting public spending, reducing subsidies on basic needs, demanding more indirect taxes or interest rate hikes. And the debt workouts must include a standstill on all debt payments during negotiation processes, as well as the automatic inclusion of private creditors.

All of this actually matters for the world. Of course, it matters for the international community. It's about global justice and accountability. But I would argue that it also really has important implications for the United States.

Letting this problem fester will add to economic and financial instability in debtor countries. It will further reduce their fiscal space, and it will add to the problems faced by already poor and suffering populations. As a result, just as an example, you will get more and more people risking death to flee extreme poverty and dire humanitarian emergencies in search of asylum at US borders. We can have political tensions and conflicts in debtor countries which can spill over into other locations in often unpredictable ways, as we now know from what is going on in many parts of the world. I think it's important to emphasize that this will also reduce the global economic legitimacy of the US, which, let's face it, has already been very badly affected by recent geopolitical events.

So, I argue that it's very much in the US's own self-interest to be proactive in addressing the sovereign debt problem. And of course, it will cost the US government next to nothing. So, there's very little to lose if you do this, and so much to gain if you do. Thank you very much.

Fae Rabin

I'm going to turn it over to Mark, who’s going to pick it up from there.

Mark Weisbrot

Thanks, Fae, and thanks to everybody for being here. The world needs your help and Congress has done a lot. And that's what I want to talk about, what can be done here to help resolve some of the problems or reduce some of the harm, at the very least, that Jomo and Jayati talked about. So, at CEPR we focus on this a lot — on harm reduction and also structural reforms that can move the ball down the road. And this is what I think Congress can do.

The first thing we have to realize is that we're facing this economic and political order, which was partly described here, that really is very far from the so-called rules-based international order or the other euphemisms that you commonly hear. It's really controlled overwhelmingly by the governments of the high-income countries, that is, the multilateral institutions, the so-called institutions of global governance. It's all led by the US government — many of the most important economic and political issues, including some life and death issues, as we'll see.

There's an alliance of high-income countries and it's really against most of the world. You can see it, here's an example: the head of the IMF, Kristalina Georgieva, made a speech back in March of 2020, and she said that developing country governments, with the pandemic developing and the world economy getting hit by it, needed more international foreign exchange reserves. She said they were short about two and a half trillion dollars and maybe more than that. And she proposed a new issuance of the IMF's reserve asset, which is called Special Drawing Rights — I'll explain that in a little bit — to member countries. And then the treasury secretary Steven Mnuchin said no, and that was the end of discussion at the IMF, despite the fact that almost everybody else of the 190 member countries wanted this to happen.

This is really important for people to understand. All the journalists know this, but they almost never write about it, as though it doesn't matter — it's supposed to be a multilateral organization, right? And here's Treasury with a veto. They also have another veto, a formal veto, because of their quota share in the voting. They have a formal veto for any decision that requires 85 percent because they have more than 15 percent of the votes. But it's much more than that, because they have this alliance with the other high-income countries and they all stick together.

I've been working on this for 25 years and there's only been a literal handful of times that Treasury has wanted something at the IMF, and not gotten what they wanted. On the positive side, three of those things, which is most of them, happened just in the last couple of years. So that's a sign of hope, because you'll see how important those were.

So, this time was one of them. We can say with high confidence, as the UN Intergovernmental Panel on Climate Change likes to say, that it was Congress that made this happen; because Treasury didn't want to do it. And the House twice passed legislation — one of the reasons that Treasury eventually gave in, and accepted the new issuance, is that at one moment we had 51 votes in the Senate and it looked like it was going to be 2.8 trillion dollars that would pass Congress. That's what the bill was that passed the House twice and finally got Treasury to give in. And so Treasury agreed to support the new issuance at the IMF, and therefore allowed the IMF to pass a $650 billion issuance of this reserve asset to the member countries. And of course, this was then quickly approved at the IMF, approved August 2, and then three weeks later, it went out. That's the other great thing about this particular form of aid, it can move very quickly.

So, I want to first thank all the members of Congress and their offices, who might watch this and who helped with this. I have to emphasize, because this is kind of an esoteric thing, right? Most of the world's never heard of this thing, and I'm going to explain it more. But this is the biggest aid, the largest aid that the developing world has gotten from a decision of high-income countries, because it doesn't cost them anything. It's the biggest in decades. Maybe 50 years, you can look back at and you won't find anything. I couldn't find anything this big.

That's just the $209 billion that goes to the developing countries, not including China, because China can't actually use them (they have too many reserves and have a lot of reserves already, so that's why I take that number.) That is really huge. And by the way — I think this is really important —I think it saved at least 100,000 lives in the world and maybe more. You can look at the research, we've linked to it in our publications, on the relation between recessions and death rates in developing countries. That's assuming that this addition to reserves actually did help prevent crises, balance of payments problems. And also, the countries used it as well, they used billions of dollars of these reserves because they can convert it to hard currency. They used it to buy essential items, including medicine and food. It was really a huge thing in the world.

We need the IMF to do another issuance. And there is support for it, of course, again, the same support in the U.S. House and Senate as last time. Obviously, they can't pass it in the House again right now because Republicans are against it; but the Treasury can be convinced once again and they can therefore support another new issuance. Treasury can support another issuance at the IMF, which, again, most of the world will want. According to US law, the Treasury can vote to approve that much ($650 billion) at the IMF, without a vote of Congress.

I think that this also benefits people here. Jayati made a point out of that, that the policy changes that the rest of the world needs also benefit people here. We can talk about that in the question and answer if we have time.

But the thing about this, besides the harm reduction that it does immediately, is that it's kind of a structural change. When you look at the world economy and you look at what happens during a downturn — and by the way, the majority of recessions in the US since World War II were actually caused by the Federal Reserve, and you can't find too many economists who would actually disagree with that statement. So what's happened is that there's been a big change in macro policy, in the United States especially. It's another thing we can talk about, both fiscal and monetary policy.

But there's still this gigantic difference between what the developing countries can do to counteract an economic downturn, and what the high-income countries can do. During the Great Recession and the recovery, we had seven years of zero interest rates; we've never had that before. We also had quantitative easing; $8 trillion from the US Federal Reserve were created to help stabilize this economy

— and Jomo mentioned that because it had some side effects on the rest of the world, but we can talk about that, too. But I think that this is really important, because what this does is take a small but really important step that we can build on towards bringing the rest of the world into the world that the rich countries have; that they can do counter-cyclical policies instead of, as Jomo mentioned, the pro-cyclical policies that the IMF and its allied multilateral institutions tend to force on them. That would make a world of difference. So, I'll stop there and we can talk about it more.