F&D

FINANCE AND DEVELOPMENT

JUNE 2020

Policies, Politics, and Pandemics

INTERNATIONAL MONETARY FUND

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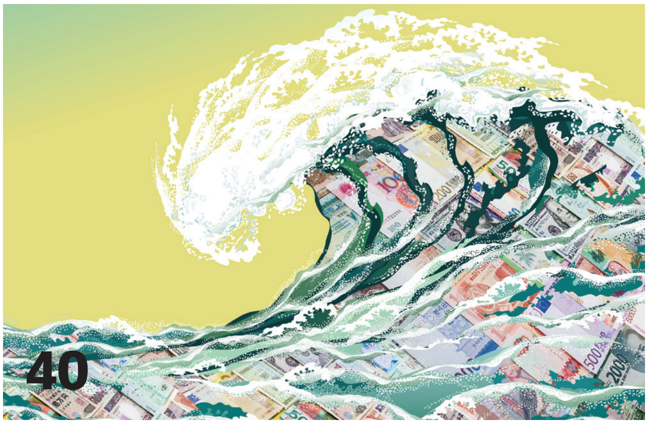
Government responses to the pandemic illustrate the difficult politics of global cooperation.

POLITICAL ECONOMY AND PANDEMICS

FINANCE & DEVELOPMENT
A Quarterly Publication of the International Monetary Fund
June 2020 | Volume 57 | Number 2



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Turning Point

FIVE MONTHS AGO we set out to write about political economy in this issue—how politics affects the economy and the economy affects politics. Few suspected then that, instead of exploring an academic question, we would be witnessing real-world political economy dynamics unfolding, tragically, in real time. The pandemic, with its appalling loss of life, has brought the Great Lockdown and frozen the wheels of commerce. People's lives have been turned upside down, punctuated by furloughs, face masks, and fear. While this health crisis reoriented our focus, the issue of political economy is more relevant than ever. It underscores the notion that policies are influenced not just by economic analysis but also by noneconomic, social, and political forces. And it compels us to think about how people and the economy will adjust in a post-pandemic world.

This issue features diverse articles through the lens of COVID-19. Jeff Frieden, Andrés Velasco, and others examine the importance of institutions, identity, and trust. Antoinette Sayeh weighs policy solutions as this crisis robs millions of migrants of work opportunities, slashing remittances, the single most important flow of income for many poor countries. Other articles discuss the need for social cohesion and solidarity, with policies that protect and lift the most vulnerable as jobs disappear and inequities deepen.

Managing the effects of the pandemic forces a real discussion of how best to implement the policy response to reach all segments of the population. To a large extent, economic policy will shape society's resilience to the emergency and its aftermath.

But a crisis of this scale is a global turning point, forcing economists and others to expand their imagination and experiment with radical new ideas about how the world works. Such a reimagining, as Kristalina Georgieva notes in her essay, could lead us to a greener, digitally smarter, fairer, and more compassionate world. Perhaps this is a chance to reset the fundamentals of our social and economic life. FD

GITA BHATT, editor-in-chief

ON THE COVER

Politics and economics are inextricably linked, and we see this relationship play out in our daily lives all the time. Illustrator John Cuneo's June 2020 cover shows the intersection of politics, special interests, and economics in the time of coronavirus.

FINANCE & DEVELOPMENT
A Quarterly Publication of the International Monetary Fund

Subscriber services, changes of address, and advertising inquiries:
IMF Publication Services
Finance & Development
PO Box 92780
Washington, DC 20090, USA
Telephone: (202) 623-7430
Fax: (202) 623-7201
E-mail: publications@imf.org

Postmaster: send changes of address to *Finance & Development*, International Monetary Fund, PO Box 92780, Washington, DC 20090, USA.

The English edition is printed at Dartmouth Printing Company, Hanover, NH.

Finance & Development is published quarterly by the International Monetary Fund, 700 19th Street NW, Washington, DC 20431, in English, Arabic, Chinese, French, Russian, and Spanish.
English edition ISSN 0145-1707

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THE POLITICAL ECONOMY OF ECONOMIC POLICY

We should pay closer attention to the interactions between politics, economics, and other realms

Jeffry Frieden

The COVID-19 pandemic strikingly illustrates the intersection of politics, economics, and other considerations. Public health experts have long warned that the world was likely to face a major pandemic and called for greater preparedness. Yet policymakers who have to focus on the next election find it difficult to invest the time, money, and political capital to address the abstract possibility of a future crisis. And so most of the world was unprepared for a global public health threat of the magnitude posed by the novel coronavirus.

As the pandemic has raced across the world, the policy response has continued to be tempered by political realities. Some members of the public, and some policymakers, have resisted the recommendations of public health experts, hoping for relaxed restrictions and a return to normalcy before the dangers have passed. At the same time, business interests have pressed for exceptions to benefit themselves, and for substantial subsidies—bailouts—to help them through difficult times.

At the international level, government responses to the pandemic illustrate the difficult politics of worldwide cooperation. A global pandemic requires a global response: microbes do not respect borders. A coordinated international response is clearly the best way to confront an international public health emergency. Yet policymakers under pressure from their constituents have diverted resources away from other countries, banned the export of food and drugs, and hoarded essential supplies. Each of these measures—popular as they may be to national publics—imposes costs on other countries. In the final analysis, the lack of cooperation makes everyone worse off. Such international institutions as the World Health Organization attempt to coordinate a cooperative global response to the global crisis—but they can be powerless in the face of potent nationalist political pressures (see, for example, Goodman and others 2010).

Every government faces tough decisions about the appropriate measures: what restrictions to impose and when to loosen them, where money will be spent and how it will be raised, and what national concerns can be limited to favor international cooperation. These decisions have to take into account public health recommendations, economic considerations, and political constraints. Just as the policy response to the 2007–08 financial crisis

ART: ISTOCK / YEVHENII DUBINKO; JAMIE CARROLL varied from country to country in line with local political economy conditions, so national policy responses to the COVID-19 pandemic vary for health, economic, and political reasons.

Politics at play

This hotly contested policy response to a universal threat is no surprise to political economists. It happens all the time. For example, just about every economist believes that small countries would be better off if they removed all barriers to trade. Yet unilateral free trade is practically unheard of, and no country in the world today pursues it. Why not? More generally, why do governments have so much trouble getting economic policies right? Why does the advice of independent observers, analysts, and scholars go so often unheeded?

Politics is the usual answer, and the answer is usually right. But that is too vague—like saying that some countries are rich and others poor due to economics. Exactly how does politics keep governments from making better policy, even in the face of imminent crises? What does that tell us about how economic policy can and should be made?

Political economy is about how politics affects the economy and the economy affects politics (see box). Governments try to pump up the economy before elections, so that so-called political business cycles create ebbs and flows of economic activity around elections. By the same token, economic conditions have a powerful impact on elections. Political economists have uncovered the simple (perhaps disturbing) fact that the rates of economic growth and inflation are all the information we need to predict quite accurately the results of the past 100 years of US presidential elections (see, for example, Fair 2018). So why don't elections work to push politicians to choose the best policies?

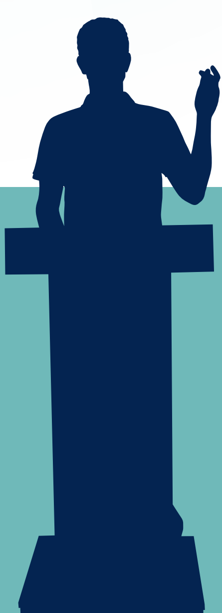
Where you stand depends on where you sit

A basic economic principle is that any policy that is good for society as a whole can be made to be good for everyone in society, even if the policy creates winners and losers. It requires only that the winners be taxed just a bit to compensate the losers—and everyone is better off. Economists use powerful tools to clarify which economic policies are best for society. So why should economic policy be controversial?

A basic *political economy* principle is that the winners don't like being taxed to compensate losers. And the battle is joined, not over what is best for society but rather over who will be the winners and losers. What is best for the country may not be best for my region, or group, or industry, or class—and so I will fight it.

Even in democracies, plenty of citizens might agree that politics obeys the golden rule: those with the gold make the rules. Special-interest groups do seem to play an outsize role around the world, democratic or not. These include wealthy individuals, powerful industries, big banks and corporations, and formidable labor unions.

How else to explain why Americans pay two or three times the world price for sugar? There are a handful of sugarcane plantations and a few thousand sugar beet farmers in the United States—and 330 million sugar consumers. You'd think that the 330 million would count for a lot more in politics than the several thousand, but you'd be wrong. For



WHAT IS POLITICAL ECONOMY?

Adam Smith, David Ricardo, and John Stuart Mill are widely regarded as the originators of modern economics. But they called themselves *political economists*, and Mill's *Principles of Political Economy* was the fundamental text of the discipline from its publication in 1848 until the end of the century. These early theorists could not conceive of the economic and political worlds as separate.

Two trends divided the political from the economic analysis. First, governments began to reduce their direct control over the economy. Second, different political forms emerged: Europe went from almost exclusively monarchical to increasingly representative, and highly varied, forms of government. By the early 20th century economics and political science were established as separate disciplines.

For much of the 20th century this division reigned. With the Great Depression and problems of development, the purely economic issues were daunting enough to occupy economists. By the same token, the political problems of the era—two world wars, the rise of fascism and communism—were so serious as to require separate attention.

By the 1970s, however, it was clear that the separation between the economic and political spheres was misleading. That decade saw the collapse of the Bretton Woods monetary order, two oil price shocks, and stagflation—all highlighting the fact that economic and political matters are intertwined.

In the final analysis, the lack of cooperation makes everyone worse off.

decades, subsidies and trade barriers have raised the price of sugar to the benefit of the sugar planters and farmers and to the detriment of everyone else.

Why does a tiny group of sugar producers matter more than the rest of the country? A commonplace of political economy is that *concentrated* interests usually win over *diffuse* interests. The sugar producers are well organized and work hard to influence politicians. If they didn't get favorable government treatment they'd go out of business, so it's important for them to organize to lobby and fund politicians. The cost to consumers is estimated at $2 billion to $3 billion a year. That's a lot of money—but it comes to a couple of cents a day for the average American. No consumer is going to talk to an elected representative or threaten to vote for an opponent over a couple of cents a day.

The fact that producers are concentrated while consumers are diffuse helps explain trade protection. A few automobile manufacturers can organize themselves; tens of millions of car buyers can't. That's not all. Management and labor in the auto industry may not agree on much, but automakers and autoworkers agree that they want to be protected from foreign competition. Politicians—especially politicians from areas where automobile manufacturing is important—have a hard time denying a common demand of workers and owners in a powerful industry.

Perhaps this is not such a bad thing. Sugar farmers and autoworkers depend for their livelihood on supportive policies. Who is to say that their jobs are less important than lower prices for consumers? There is no simple, widely accepted way to balance the benefits against the costs—is cheaper sugar important enough to bankrupt thousands of hardworking farmers? Politics is, in fact, the way society adjudicates among conflicting interests, and maybe those with more at stake should have a bigger say.

Political economists don't usually take stands on complicated moral and ethical issues of this sort. They try to understand *why* societies choose to do what they do. The fact that sugar or car producers have much more at stake and are much better organized than sugar or car consumers helps explain why government policies favor sugar and car producers over consumers.

Some consumers are concentrated, though. Sugar is sweet, and the corporations of the Sweetener Users Association want it to be cheap as well. Coca-Cola, Hershey, and the like have pushed hard to change American sugar policy. The fact that there are powerful concentrated interests on both sides of the issue helps explain why prices aren't even higher than they are. The same thing is true of industrial products. Steelmakers want protection; steel users—like the auto manufacturers—don't. Trade policy is not just a battle between big corporations and disunited households; it's also a battle *among* big corporations. Otherwise we'd expect

The economy was now high politics, and much of politics was about the economy.

Over the past 50 years, political economy has become increasingly prominent in both economics and political science, in three ways:

It analyzes how political forces affect the economy. Voters and interest groups have a powerful impact on virtually every possible economic policy. Political economists strive to identify the relevant groups and their interests, and how political institutions affect their impact on policy.

It assesses how the economy affects politics. Macroeconomic trends can boost or ruin an incumbent's chances. At the more microeconomic level, features of the economic organization or activities of particular firms or industries can have an impact on the nature and direction of their political activity.

It uses the tools of economics to study politics. Politicians can be thought of as analogous to firms, with voters as consumers, or governments as monopoly providers of goods and services to constituent customers. Scholars model political-economic interactions in order to develop a more theoretically rigorous understanding of the underlying features driving politics.

All three methods have profoundly affected both scholars and policymakers. And political economy has a lot to offer both to analysts of how societies work and to those who would like to change society.

Policymakers in democratic societies must always pay attention to the next election—otherwise they are likely to cease being policymakers.

every industry to be protected and trade to be tightly limited everywhere.

In fact, there are plenty of powerful interests in *favor* of international trade and investment. The world's multinational corporations and international banks depend on an open flow of goods and capital. This is especially the case today, when many of the world's largest companies depend on complex global supply chains. A typical international corporation today produces parts and components in dozens of countries, assembles them in dozens more, and sells the final products everywhere. Trade barriers interfere with these supply chains, which is why most of the world's biggest companies are also some of the biggest supporters of freer trade.

A complex web

Special interests as well as voters on different sides of every issue fight their battles in the political arena. But the rules of politics vary a lot from country to country. The way a political economy is organized affects who wins the battle over policy.

A logical starting point is elections, at least in democracies. Governments that don't satisfy their constituents don't remain governments very long. So we might expect democracies to choose policies that benefit the economy as a whole. However, the economy as a whole doesn't vote.

Politicians need votes from the people who decide elections. The decisive or pivotal voters vary with a country's electoral institutions and social divisions. In most political systems, the best targets are swing voters, who might change their vote in response to the policies of an incumbent or the promises of a challenger. If the poor vote for the left and the rich vote for the right, for example, the middle class could be decisive. In recent American presidential elections, the most important swing voters have been in distressed industrial regions of the Midwest. Many voters in these areas believe that foreign competition contributed to manufacturing decline. This helps explain why presidential candidates have become increasingly protectionist, even though most Americans support openness to trade.

In addition, policymakers in democratic societies must always pay attention to the next election—otherwise they are likely to cease being policymakers. This helps explain why it can be difficult for governments to pay money now for policies whose benefits will be realized only in the long run—such as pandemic prevention and preparedness.

The mass of special and general interests in society is overwhelming. *Institutions* help make sense of them. First are *social institutions*—the way people organize themselves. Some businesses, farmers, and workers are well organized, giving them more political clout. Farmers in rich countries are relatively few, are well organized, and are almost universally subsidized and protected. Farmers in poor countries are many, rarely organized, and almost universally taxed. Where workers are grouped into centralized labor federations, as in some northern European countries, they play a major role in national policymaking. The ways in which societies organize themselves—by economic sector, region, ethnicity—affect how they structure their politics.

Political institutions mediate the pressures constituents bring to bear on leaders. Even in authoritarian countries, rulers have to pay attention to at least some part of public opinion. Political economists call this the "selectorate," that portion of the population that matters to policymakers. In an authoritarian regime, this could be an economic elite or the armed forces. In an electoral democracy it would be voters and interest groups. No matter who matters, policymakers need their support to stay in office.

In democracies, the variety of *electoral institutions* affects how policymakers feel constituent pressures. Organized political parties can help extend the time horizons of politicians: while an individual politician may worry only about the next election, a party has to be concerned about its longer-term reputation. On another dimension, where politicians are elected by the country as a whole, as in Israel or the Netherlands, the focus is on national policy. Where politicians represent narrower geographic locations, as in the US House of Representatives, the general view is that "all politics is local" (usually attributed to 1970s–80s Democratic Speaker of the House Tip O'Neill). These different electoral systems can drive politics toward more national or more local concerns.

Electoral institutions affect the identity of the people politicians need to attract to win an election. The US Electoral College makes middle-of-the-road voters in the Midwestern industrial states pivotal in presidential elections, driving the emphasis on protection for manufacturing. In a multiparty parliamentary system, the pivotal voters may be the supporters of a small party that can swing back and forth between coalition partners, such as the fringe parties for the formation of Israeli governments. Whichever voters the electoral system makes pivotal are likely to have outsize influence over politics and policy.

The character o*f legislative institutions* also matters. For example, while a unitary parliamentary system can deliver big and fast change, in the US separation of powers system change is more modest and slower. Federal systems—in Australia, Brazil, Canada, Germany, the United States—give provincial or state governments a lot of power, while centralized systems allow the national government to rule unchallenged. Some governments have handed off control of important policies to independent bodies that are less subject to day-to-day political pressures—such as central banks and public health agencies.

These institutions matter because they affect the weights that politicians give to different groups in society. Some sociopolitical institutions give labor unions a great deal of influence; others privilege farmers; still others are dominated by business associations. Political economists analyze the interests in play and how the institutions of society transmit and transform them into government policy.

Second-best can be best

All this matters to policymakers or observers or even just people who care about the economy because it can profoundly change the way we think about policy and policy advice.

The policy that economic analysis indicates is best for the economy may not be politically feasible. To go back to free trade, virtually all economists would recommend that a small country's best bet is to remove all trade barriers unilaterally. Yet it is almost certain that a government that attempted to move to unilateral free trade would face massive opposition from special interests and from many in the public who would regard such a move as dangerous. The result might well be the collapse of the government and its replacement with one that could be relied on to maintain and even expand trade barriers. In this case, pursuit of the first-best policy could lead to a much worse outcome.

Politicians, analysts, observers, and just regular people who are interested in economic policy are well advised to evaluate not only the economic implications of policy initiatives but also their political feasibility. If the pursuit of a first-best policy is bound to fail and perhaps provoke a backlash, then truly the cure may be worse than the disease. It makes more sense to consider the political realities the government faces and to structure policy with those realities in mind. It is better to settle for second-best than to insist on first-best and end up worse—or, as folk wisdom has it, to let the perfect be the enemy of the good.

Bottom line

Political economy is the integration of political and economic factors in our analysis of modern society. Inasmuch as just about everyone would agree that politics and economics are intricately and irretrievably interwoven—politics affects the economy and the economy affects politics—this approach seems natural. It has proved itself powerful in *understanding* governments and societies; it can also be a powerful tool for those interested in *changing* governments and societies. Policymakers should hold these important lessons in mind today as they tackle the COVID-19 pandemic. FD

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PHOTO: IMF

Beyond the Crisis

Now is the time to take advantage of this opportunity to build a better world

Kristalina Georgieva

LOOKING BACK to the start of 2020, the world has changed almost beyond recognition. To protect public health, the global economy was put into stasis. Shops closed, factories were mothballed, and people's freedom of movement was severely curtailed.

No country has escaped the health, economic, and social impacts of the COVID-19 crisis. Tragically, more than 260,000 people have died and millions have been infected. The IMF is projecting global economic activity to decline on a scale not seen since the Great Depression. It is truly a crisis like no other.

Despite the bleak outlook, I am hopeful for the future. A crisis often brings the best out in people—I have seen it firsthand in countries hit by wars and natural disasters.

This is happening already in the fight against the pandemic as doctors and nurses around the world put saving lives of others ahead of their own lives. And governments are stepping up in an unprecedented manner. To fight the pandemic they have combined dramatic public health interventions with fiscal measures amounting to about \$8.7 trillion. Central banks have undertaken massive liquidity injections, and richer countries have stepped up to support poorer nations.

Record speed

The IMF has responded at record speed. We doubled our emergency rapid-disbursing capacity to meet expected demand of about \$100 billion—and by end-May the IMF had approved financing for 60 countries, a record. We also established a new short-term liquidity line, and we took steps to triple our concessional funding, targeting \$17 billion in new loan resources for our Poverty Reduction and Growth Trust, which helps poorer economies.

To help vulnerable members through rapid debt-service relief on their IMF obligations we reformed our Catastrophe Containment and Relief Trust. Working with the World Bank, we catalyzed suspension of official bilateral debt repayments for the poorest countries through the end of 2020.

While moving at speed, the IMF has consistently emphasized its collective commitment and steadfast support for its members in addressing governance vulnerabilities. Corruption drains resources away from priorities like public health, social protection, distance learning, and other essential services. Distorted spending priorities will undermine the recovery and long-term efforts to promote sustainable, inclusive growth, or raise productivity and living standards. Our message to governments is clear: do whatever you can, but make sure you keep the receipts. We don't want accountability and transparency to take a back seat. In practice, this means support for countries in adopting a range of public financial management, anti-corruption, and anti-money-laundering measures.

During the crisis peak, governments have rightly been focused on saving lives and preserving livelihoods. In places where new infections and deaths are in decline, governments are considering how best to reopen the economy in a responsible fashion. In developing economies with large numbers of hand-to-mouth households, prolonged containment measures may not be a viable option and consideration needs to be given as to how to reopen safely given more limited health care capacity.

In the early phase at least, the recovery will be unusual as uncertainty remains about the path of the virus, potential vaccines, and therapeutics. This could hamper the rebound of investment and consumption, especially if infection rates climb back up as containment measures are eased.

Nonetheless, the recovery will share several features with previous episodes. Countries with stronger macroeconomic fundamentals, social cohesion, and safety nets are likely to experience faster and stronger recoveries. Existing vulnerabilities such as high sovereign debt; weak corporate, household, and bank balance sheets; and limited policy credibility will hinder the recovery. Governments will face the challenge of phasing out crisis-related policies. And more than ever, global cooperation will be vital, facilitated by international institutions, to coordinate actions, share data, protect supply chains, and support more vulnerable countries.

A green recovery

From a position nearing economic stasis there is nonetheless an opportunity to use policies to reshape how we live and to build a world that is **greener, smarter, and fairer**.

Greener: The current health crisis reminds us how vulnerable each person is in the face of the incredible power of nature. Yet just as scientists warned against the risk of a pandemic—a "black swan" event—they have also warned us of the terrible consequences of catastrophic climate change. We cannot turn back the COVID-19 clock, but we can invest in reducing emissions and adapting to new environmental conditions.

As economies stabilize, we have the chance to reorient them to prioritize sustainability and resilience alongside efficiency and profitability. The right policies will help allocate resources to investments that support public goods like clean air, flood defenses, resilient infrastructure, and renewable energy. Meanwhile, lower commodity prices can create the fiscal space to phase out regressive fuel subsidies that increase carbon emissions. The payoff would be considerable: in just the energy sector, a low-carbon transition could require $2.3 trillion in investment every year for a decade, bringing growth and jobs during the recovery phase.

Smarter: Through necessity many of us have been working remotely and using technology to remain productive. We have traveled less, consumed fewer resources, and introduced more agile business processes. While schools, businesses, and institutions will likely formalize some of the smarter ways of working that have proved successful, the crisis has thrown light on the importance of investing in robust digital infrastructure and policy frameworks.

In 2018, the IMF and the World Bank Group launched the Bali Fintech Agenda to help countries harness the benefits of rapid advances in financial technology while managing its risks. We are accelerating our work with members to broaden the digital transformation so that its benefits are shared even more widely. Well-managed fintech, for example, can help end financial exclusion for the 1.7 billion people in developing economies who have no access to banking.

Fairer: IMF research has also shown that lower income inequality is associated with stronger and more sustainable growth, yet many social disparities have become more pronounced during the Great Lockdown. For example, informal workers in unregulated sectors or outside the tax system are twice as likely to belong to poor households. These same workers typically have no access to sick leave or unemployment benefits, and their access to health benefits is often precarious.

As governments ramp up spending to support individuals, businesses, and communities, there is an opportunity to build fairer societies and economies by investing in people. That means spending more and spending better on schools, training, and reskilling. It means expanding social programs that are well targeted to reach the most vulnerable. And it means empowering women by reducing labor market discrimination. Such investment will need to be funded by more equitable taxation, especially given enhanced public debt levels stemming from the crisis.

A new spirt of solidarity

At a large and small scale we are helping each other. The staff of the IMF has made it possible for billions of dollars to support the world's most vulnerable people. They also have cooked meals for the vulnerable in our own community and have looked after neighbors who are sick.

It is this solidarity that makes me hopeful for the future. The IMF has already shown its mettle as an economic first responder during this crisis. As we enter the next phase, I am determined that we will support our members however we can—through policy advice, financing, and capacity development. Together, we will take the chance to build a better world. FD

KRISTALINA GEORGIEVA is managing director of the IMF.

The Long Economic Hangover of PANDEMICS

History shows COVID-19's economic fallout may be with us for decades

Òscar Jordà, Sanjay R. Singh, and Alan M. Taylor

The COVID-19 pandemic's toll on economic activity in recent months is only the beginning of the story. While the rapid and unprecedented collapse of production, trade, and employment may be reversed as the pandemic eases, historical data suggest that long-term economic consequences could persist for a generation or more.

Among these are a prolonged period of depressed real interest rates—akin to secular stagnation—that may linger for two decades or more. Still, one piece of good news is that these sustained periods of low borrowing costs are associated with higher real wages and create ample room for governments to finance stimulus measures to counteract economic damage caused by the pandemic.

Research on the economic fallout of the ongoing COVID-19 pandemic has so far naturally focused on the short-term impacts from mitigation and containment strategies. However, as governments engage in large-scale counter-pandemic fiscal programs, it is important to understand what the economic landscape will look like in the years and decades to come. That landscape will shape monetary and fiscal policy in ways that are not yet fully understood.

A look at previous pandemics, going back to the Black Death in the 1300s, can help fill this gap by shedding light on their medium- to long-term economic effects. In extrapolating from historical trends, though, it's important to note one crucial distinction. Past pandemics such as the Black Death occurred at times when virtually no one survived to old age. With today's longer life spans, perhaps this time may be different: COVID-19 mortality appears to disproportionately affect the elderly, who typically no longer participate in the labor force and tend to save more than the young.

Pandemics and macroeconomics

Historical studies have typically focused on one event, in one country or region, and have traced

Kleidüng wider den Tod zü Rom. Anno 1656.

Also gehen die Doctores Medici daher zü Rom, wann sie die, an der Pest erkranckte Personen besüchen, sie zü curiren ünd fragen, sich vor dem Gifft zü sichern, ein langes Kleid von gewächsten Tüch ihr Angesicht ist verlarvt, für den Aügen haben sie grosse Crÿstalline Brillen, vor der Nasen einen langen Schnabel voll wolriechender Specereÿ, in der Hände, welche mit handschühen wol versehen ist, eine lange Rüthe ünd darmit deüten sie, was man thün, ünd gebraüchen soll local outcomes a decade at most. But in large-scale pandemics, effects will be felt across whole economies, or across wider regions, for two reasons: either because the infection itself is widespread or because trade and market integration eventually propagate the economic shock across the map.

In a new paper, Jordà, Singh, and Taylor (2020), we take a global view of the macroeconomic consequences of pandemics across a number of European economies. We focus on the aftermath of 15 large pandemic events with at least 100,000 deaths, which are listed in the table.

Using newly available data on yields of long-term sovereign debt stretching back to the 14th century (Schmelzing 2020), we estimate the response of a so-called real (after-inflation) natural rate of interest in Europe following a major pandemic. In what follows, we refer simply to the "natural rate."

Economists speak of the natural, or neutral, rate of interest as the equilibrium level that would keep the economy growing at its potential rate with stable inflation. In the long run, the relative demand and supply of loanable funds by savers and borrowers determine the natural rate.

The natural rate is an important economic barometer. For example, as populations become more frugal, the relative supply of savings increases; when the underlying pace of growth wanes, investment becomes less attractive—in both cases, the natural rate declines to restore equilibrium.

As shown in Chart 1, pandemics have long-lasting effects on interest rates. Following a pandemic, the response of the natural rate of interest is tilted down by nearly 1.5 percentage points about 20 years later. For perspective, that decline is comparable to what we have experienced from the mid-1980s to today. We also find that it takes an additional 20 years for the natural rate to return to its original level.

Staggering findings

These results are staggering and speak to the large economic effects pandemics have had over the centuries. It is well known that after major recessions caused by financial crises, real safe rates—which are closely tied to the natural rate—can be depressed for 5 to 10 years (Jordà, Schularick, and Taylor 2013), but the persistence of the responses here is even more pronounced.

The evidence presented in Chart 1 is consistent with the well-known neoclassical growth model. Loss of labor without parallel destruction of capital leads to a rebalancing of the relative returns to labor and capital. The resulting drop in interest rates may also be amplified by increased saving by pandemic survivors—they may simply wish to rebuild their wealth or may just be more frugal out of caution.

If this explanation is correct, we should see a very different pattern following a quite different type of historical event that also leads to massive loss of life: war. Unlike pandemics, major armed conflicts also result in destruction of crops, land, structures, and machinery: in other words, the loss of capital.

To explore further, we extended our initial estimates to include major wars that resulted in large loss of life (and large loss of land, structures, and other traditional forms of capital). The results could not be clearer. In wars, the relative loss of capital to labor tilts the interest rate response up, not down, as Chart 1 also shows. Wars tend to leave real interest rates elevated for 30 to 40 years, and in an economically (and statistically) significant way.

If the neoclassical mechanism is correct, there is another dimension where the effects of pandemics should be visible. As the labor-to-capital ratio declines, the natural rate should decline but real wages should increase. Chart 2 shows the response

Historical perspective

Throughout recorded history, there have been at least 15 large pandemic events with at least 100,000 deaths.

Event	Start	End	Deaths
Black Death	1331	1353	75,000,000
Italian Plague	1623	1632	280,000
Great Plague of Seville	1647	1652	2,000,000
Great Plague of London	1665	1666	100,000
Great Plague of Marseille	1720	1722	100,000
First Cholera Pandemic	1816	1826	100,000
Second Cholera Pandemic	1829	1851	100,000
Russia Cholera Pandemic	1852	1860	1,000,000
Global Flu Pandemic	1889	1890	1,000,000
Sixth Cholera Pandemic	1899	1923	800,000
Encephalitis Lethargica Pandemic	1915	1926	1,500,000
Spanish Flu	1918	1920	100,000,000
Asian Flu	1957	1958	2,000,000
Hong Kong Flu	1968	1969	1,000,000
H1N1 Pandemic	2009	2010	203,000

Sources: Alfani and Murphy (2017); Taleb and Cirillo (2020); and https://en.wikipedia.org/wiki/List_of_epidemics and references therein.

of the real wage to pandemics; it rises gradually so that, 40 years out, the real wage is about 10 percent higher. This pattern is thus consistent with the logic of the neoclassical growth model.

Net result

The great historical pandemics of the past millennium have typically been associated with subsequent low returns on assets. Measured by deviations in the natural rate of interest, these responses indicate that pandemics are followed by sustained periods—over multiple decades—with depressed real interest rates. This may reflect a lack of needed investment (because of excess capital per unit of surviving labor), an increased desire to save (out of caution, greater uncertainty, or a desire to rebuild depleted wealth), or both.

If the historical trends we have highlighted play out similarly in the wake of COVID-19, then secular stagnation (Summers 2014) would be a concern for monetary and fiscal stabilization policy for the next two decades or more.

But should we expect declines of 1.5 percent to 2 percent in the natural rate this time? There are at least three factors that will likely attenuate the decline of the natural rate.

First, the death toll of COVID-19 relative to the total population could be smaller than that of some of the major pandemics of the past, if modern medical care and public health measures are more effective.

Second, COVID-19 affects primarily the elderly, who are no longer in the labor force and tend to save relatively more than the young—a big difference from past centuries, when people had shorter life expectancies.

Third, aggressive counter-pandemic fiscal expansion will further boost public debt, reducing the national saving rate and possibly putting upward pressure on real interest rates.

On net, we still expect a sustained period of low real interest rates (though attenuated by the factors we discussed). Low real rates should then provide welcome fiscal space for governments to aggressively mitigate the consequences of the pandemic. FD

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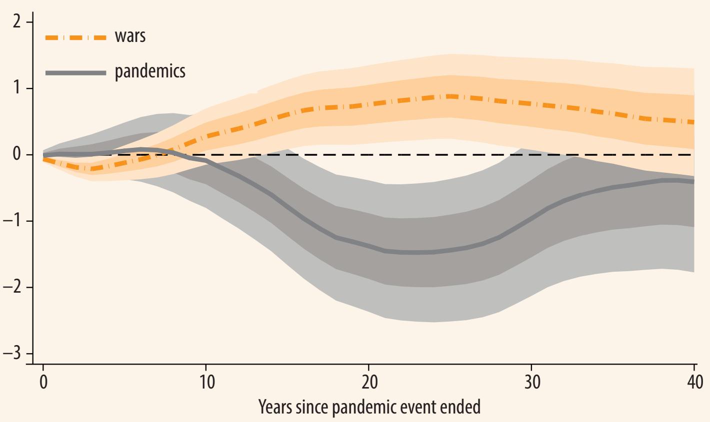
Chart 1

Wars versus pandemics

The real interest rate tends to stay elevated for decades following wars, which is the opposite of what happens following a pandemic.

(response of real interest rates to a pandemic, percent)



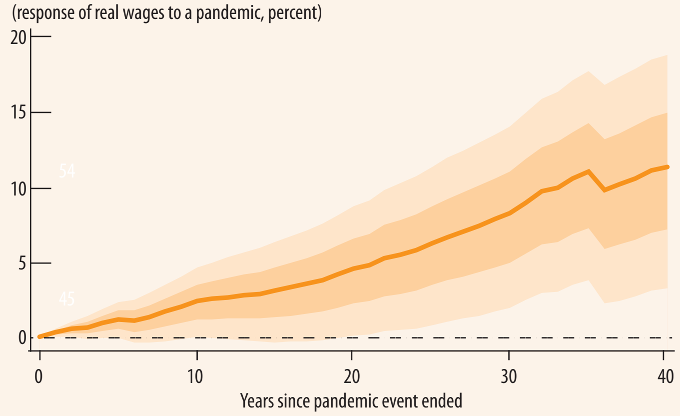
Source: Jordà, Singh, and Taylor (2020).
Note: Shaded regions represent standard deviation bands.

Chart 2

Steady rise

Real wages tend to rise gradually in the decade following a pandemic.

(response of real wages to a pandemic, percent)



Source: Jordà, Singh, and Taylor (2020).
Note: Shaded regions represent standard deviation bands.

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Migrant worker in Bangkok, Thailand.

Lifelines in Danger

The COVID-19 pandemic threatens to dry up a vital source of income for poor and fragile countries

Antoinette Sayeh and Ralph Chami

The COVID-19 pandemic is crippling the economies of rich and poor countries alike. Yet for many low-income and fragile states, the economic shock will be magnified by the loss of remittances—money sent home by migrant and guest workers employed in foreign countries.

Remittance flows into low-income and fragile states represent a lifeline that supports households as well as provides much-needed tax revenue. As of 2018, remittance flows to these countries reached $350 billion, surpassing foreign direct investment, portfolio investment, and foreign aid as the single most important source of income from abroad (see Chart 1). A drop in remittance flows is likely to heighten economic, fiscal, and social pressures on governments of these countries already struggling to cope even in normal times.

Remittances are private income transfers that are countercyclical—that is, they flow from migrants into their source country when that country is experiencing a macroeconomic shock. In this way, they insure families back home against income shocks, supporting and smoothing their consumption. Remittances also finance trade balances and are a source of tax revenue for governments in these countries that rely on value-added tax, trade, and sales taxes (Abdih and others 2012).

In this pandemic, the downside effect of remittances drying up calls for an all-hands-on-deck response—not just for the sake of the poor countries, but for the rich ones as well. First, the global community must recognize the benefit of keeping migrants where they are, in their host countries, as much as possible. Retaining migrants helps host countries sustain and restart core services in their economies and allows remittances to recipient countries to keep flowing, even if at a much-reduced level. Second, donor countries and international financial institutions must also step in to help migrant-source countries not only fight the pandemic but also cushion the shock of losing these private income flows, just when these low-income and fragile countries need them most.

PHOTO: URDEE IMAGE/ZUMA WIRE/ALAMY LIVE NEWS

Transmission of shocks

Remittances are income flows that sync the business cycle of many recipient countries with those of sending countries. During good times, this relationship is a win-win, furnishing much-needed labor to fuel the economies of host countries and providing much-needed income to families in the migrants' home countries. However, this close business cycle linkage between host and recipient countries has a downside risk. Shocks to the economies of migrant-host countries—just the sorts of shocks being caused by the coronavirus pandemic—can be transmitted to those of the remittance-recipient countries. For example, for a recipient country that receives remittances representing at least 10 percent of its annual GDP, a 1 percent decrease in the host country's output gap (the difference between actual and potential growth) will tend to decrease the recipient country's output gap by almost 1 percent (Barajas and others 2012). Remittances represent much more than 10 percent of GDP for many countries, led by Tajikistan and Bermuda, at more than 30 percent (see Chart 2).

The pandemic will deliver a blow to remittance flows that may be even worse than during the financial crisis of 2008, and it will come just as poor countries are grappling with the impact of COVID-19 on their own economies. Migrant workers who lose their employment are likely to reduce remittances to their families back home. Recipient countries will lose an important source of income and tax revenue just when they need it most (Abdih and others 2012). In fact, according to the World Bank, remittance flows are expected to drop by about $100 billion in 2020, which represents roughly a 20 percent drop from their 2019 level (see Chart 3). Fiscal and trade balances would be affected, and countries' ability to finance and service their debt would be reduced.

Banks in migrant-source countries rely on remittance inflows as a cheap source of deposit funding since these flows are altruistically motivated. Unfortunately, these banks are now likely to see their cost of operations increase, and their ability to extend credit—whether to the private sector or to finance government deficits—will be greatly reduced (Barajas and others 2018). Furthermore, the typically credit-constrained private sector—mostly comprising self-employed people and small and medium-sized enterprises—is likely to lose remittance funding, in addition to dealing with even tighter credit conditions from banks. All this will come on top of lower demand for their services and products as a result of the crisis.

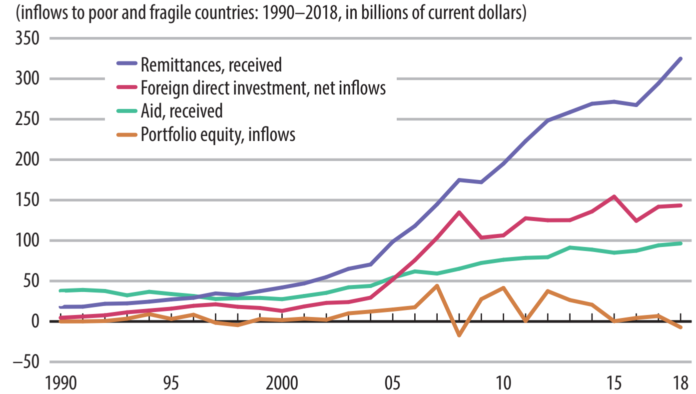
That's not all. A prolonged crisis could worsen pressure in labor markets of rich countries, and out-of-work migrants could lose their resident status in host countries and be forced to return home. For

Chart 1

Stabilizing force

Remittances are vital for many low-income and fragile states, serving as a lifeline for these countries when they experience a macroeconomic shock.

(inflows to poor and fragile countries: 1990–2018, in billions of current dollars)

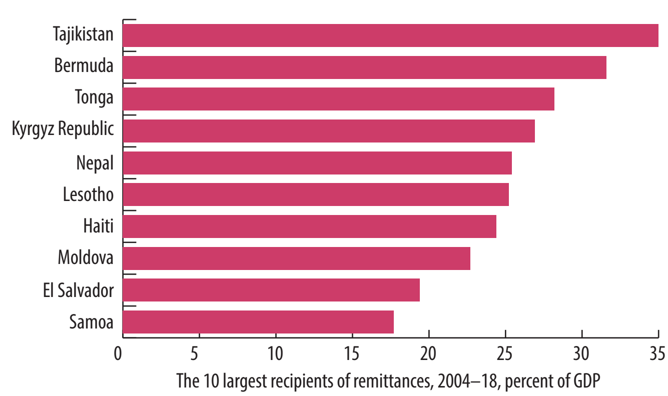


Source: World Bank, World Development Indicators.

Chart 2

Reliance on remittances

The 10 largest recipients of remittances are located in diverse regions, with the top ones receiving more than 30 percent of GDP through this channel.



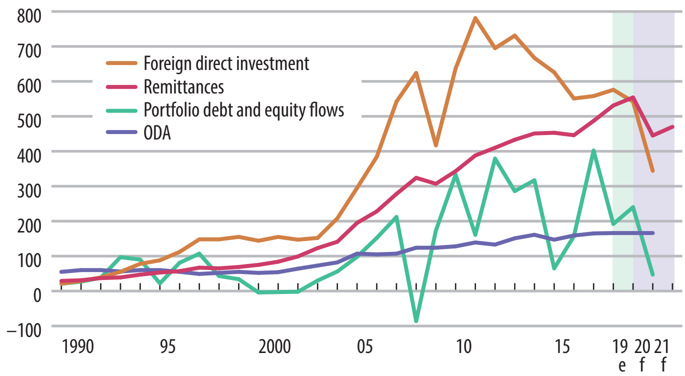
Source: World Bank, World Development Indicators.

Chart 3

Steep drop

Global remittance flows are expected to fall 20 percent this year as a result of the pandemic, deepening hardship for families in poor countries.

(billion dollars)



Sources: World Bank, World Development Indicators; and World Bank Development Prospects Group.
Note: e = estimate; f = forecast; ODA = official development assistance.

example, in Gulf states such as Saudi Arabia and the United Arab Emirates, which rely on migrant labor from the Middle East, North Africa, and Southeast Asia, the drop in the price of oil and economic activity could result in migrants (some of whom are already infected with the virus) returning home. They are likely to join the jobless in their home countries—in labor markets already brimming with unemployed youth—as well as put more pressure on already fragile public health systems. This could heighten social pressure in countries already ill prepared to deal with the pandemic and possibly also fuel spillovers beyond their borders. People escaping tough situations in their own countries are likely to seek other shores, but richer countries, also in the midst of fighting the virus, may have very little desire to allow migrants in—potentially leading to an even greater refugee crisis.

Global threat

Compared with previous economic crises, this pandemic poses an even greater threat to countries that rely heavily on remittance income. The global nature of this crisis means that not only will recipient countries see remittance flows dry up, they will simultaneously experience outflows of private capital, and maybe a reduction in aid from struggling donors. Typically, when private capital flees a country because of a macroeconomic shock, whether climate related or because of a deterioration in the country's terms of trade, remittance flows come in to lessen the impact of capital flight. By contrast, in this current crisis, poor countries can expect to experience both phenomena—capital flight as well as a drop in remittance flows.

With global demand likely to suffer, it would be hard for remittance-recipient countries to export their way out of this crisis. Currency depreciation cannot be expected to spur demand for their exports or attract tourism since this shock is systemic (Barajas and others 2010). Currency weakness will likely worsen the economic situation for many of these low-income and fragile states whose debt is in foreign currency, further depressing local demand and resulting in greater shrinkage of local economies.

What can be done?

The crisis has the unique effect of tightening fiscal constraints in low-income migrant-source countries just when there's much more for the public sector to do, both in terms of protecting the population from the pandemic and supporting local economies in weathering huge negative shocks. The loss of tax revenue resulting from the drop in remittance-supported consumption will only make things worse for governments already strapped for funds and severely strain their ability to engage in countercyclical fiscal measures. This creates tremendous urgency for the international community to help, even when rich countries are themselves facing huge fiscal burdens.

It is in the best interest of rich countries for migrants *not* to go home as well as to provide resources for poor countries to fight the pandemic. Infection rates are much higher in rich countries and are especially high among migrant workers owing to their dismal working and housing conditions. Migrants who go home are at risk of taking the virus with them. If this happens, poor countries will provide a rich incubator for the virus that will boomerang as refugees seek new shores. Then it will take decades—and many lives—for the world to be rid of this virus.

Three key actions need to be taken now.

This crisis has the unique effect of tightening fiscal constraints in low-income migrant-source countries just when there's much more for the public sector to do.

First, host countries need to stabilize the employment opportunities of the migrant workers in their economies. Relief packages that target employment protection for citizens in rich countries can also help migrant workers remain employed. Recognizing the need to protect and stabilize the welfare of migrant workers, the prime minister of Singapore recently assured migrant workers in his country that "we will look after your health, your welfare, and your livelihood. We will work with your employers to make sure that you get paid and you can send money home . . . This is our duty and responsibility to you and your families." Action by host countries can help keep the remittance lifeline alive, as well as reduce the likelihood of migrants returning home.

Extending protection to migrants will also help advanced economies get back to full production sooner. If host countries send migrants back, it will take even longer to restore production in rich countries to former levels. In countries such as the United States that depend on seasonal labor, keeping migrants within their borders and enhancing testing for infection will bring a double benefit—ensuring the supply of fresh agricultural products for the host country and preserving remittances for migrants' home countries.

Second, countries receiving returning migrants will need help to contain, mitigate, and reduce the escalation of outbreaks. Donor countries must help with the cost of virus mitigation, in an effort to lessen the severity of the crisis in local economies and stave off potential spillovers. Returning migrants are likely to place further stress on the health care systems of migrant-source countries, which are struggling to contain local infections and avoid a shutdown of the local economy. Authorities in these countries will need enhanced testing as much as possible in urban areas, as well as support in implementing quarantine measures for returning migrants who may be infected. If the return of migrants is handled in this manner, there could be longer-term benefits for their home countries as well. Migrants who expect to be permanently repatriated may bring their savings with them, and their work skills could bring development benefits to their home countries.

Third, given that poor countries' governments have limited room for maneuver, these countries will need the assistance of international financial institutions and the donor community. International financial institutions need to shore up fiscal and balance of payments assistance to these countries. This should include ensuring that these countries' most vulnerable people—those most reliant on remittance inflows for their consumption and well-being—are able to access social insurance programs. And, perhaps now more than ever, the global effort to meet Sustainable Development Goal 10, reducing the high cost of remittances to 3 percent, could take center stage.

This crisis makes it clear that as a global community we, rich and poor countries, are all in this together. We can either lift all boats or, together, face the consequences of rising social inequality. FD

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EMBRACING IDENTITY

Broadly shared identity can be the basis for the sense of shared destiny that is at the core of good politics

Andrés Velasco

What is populism? Economists, unsurprisingly, have defined the phenomenon in exclusively economic terms. The classic definition of populism is "an approach to economics that emphasizes growth and income redistribution and deemphasizes the risks of inflation and deficit finance, external constraints, and the reaction of economic agents to aggressive nonmarket policies" (Dornbusch and Edwards 1991).

The problem with this definition is that it does not apply to most regimes that are called populist nowadays. Even among left-wing populist governments in Latin America—precisely those the Dornbusch-Edwards definition is supposed to fit—one can find examples of the same. Former Bolivian president Evo Morales, at least in his early years in power, was prudent in the management of his country's gas revenues; in Mexico recently, President Andrés Manuel López Obrador has cut expenditures and stayed within the bounds of a small budget deficit.

Political populism, which is different from *economic* populism, offers a solution to this conundrum—and you can have one without the other.

Populism is a way of doing politics in which conflict takes center stage (Müller 2016; Mudde and Rovira 2017). A homogeneous group called "the people" is often pitted against others—"the elite," local minorities, immigrants, foreigners. Müller stresses populists' moralistic interpretation of politics: those on the side of the people are moral; the rest are immoral, doing the bidding of a corrupt elite.

The populist approach to politics rests on a triad: denial of complexity, anti-pluralism, and a personalist approach to political representation. Most of us believe that social choices (Build more schools or hospitals? Stimulate or discourage international trade? Liberalize or restrict abortion?) are complex, and that opposing views about what to do are a natural consequence of this complexity. Populists disagree.

Inevitably, then, populists do not believe in pluralism. For them there is only one correct opinion—that of the people—which is therefore the only view with political legitimacy. It follows that the complex mechanisms of liberal democracy, with its delegation and representation, are unnecessary. No need for endless parliamentary debate: the single "will of the people" can be expressed in a single vote. Populists hence love referenda and tend to walk the slippery slope toward authoritarianism or outright dictatorship.

Politics trumps economics

What is behind the rise of populism? The standard answer is the pocketbook. In countries like the United Kingdom and the United States, the distribution of income has worsened, and the top

ART: ISTOCK / GLOBALSTOCK; ALDOMURILLO; SENSORSPOT; PEOPLEIMAGES; CIYDEMIMAGES; LIZA5450; PIOVESEMPRE; RANTA IMAGES; M-IMAGEPHOTOGRAPHY; PATCHAKORN PHOM-IN

1 percent is reaping the lion's share. In places left behind by technological change and globalization, people have lost their jobs and their patience. The 2008 global financial crisis not only caused much pain, it also reinforced the conviction that Wall Street is Main Street's enemy. No wonder politics has become confrontational and populists have the upper hand.

If this narrative is right, the policy conclusion is simple: tax the rich, redistribute more income, and throw out the rascals who did the bankers' bidding. Populism will eventually fade away. The standard narrative is simple and appealing. But is it correct? Is it a sound basis for a policy response?

There is no shortage of empirical papers purporting to show that in North America and western Europe the forces behind populism are mostly economic. But there are also plenty of papers concluding that the rise of populism is the result of a cultural backlash. Evidence in favor of the latter is not limited to the United Kingdom and the United States, argue Inglehart and Norris (2016), who studied populist parties in 31 European countries. "Overall, we find the most consistent evidence supporting the cultural backlash thesis," they conclude.

So far, most formal evidence concerns the possible sources of populism in the prosperous countries of North America and western Europe. Formal empirical research into the causes of populism in emerging economies is much scarcer. But informal evidence suggests a story rather different from the one often told about rich nations.

In the rich-country narrative, economic stagnation and the frustrations of those left behind take center stage. In emerging economies, by contrast, right-wing populism is thriving in countries with strong economic performances—which is just the opposite of what the "economic insecurity" hypothesis would predict. India, the Philippines, and Turkey have grown at rates between 6.5 and 7 percent since 2010. Poland barely suffered the effects of the European financial crisis and has been Europe's growth champion, with an average per capita growth rate of more than 4 percent since 1992.

Or consider the neighboring Czech Republic, where unemployment is only 2.3 percent, the lowest rate in the European Union, and the economy grew 4.3 percent in 2017. The country has few immigrants and no refugee crisis to speak of. Nonetheless, populist parties attracted four of every ten voters in the most recent election—a tenfold increase in two decades.

So in these countries populism seems to have been the offspring of economic gain, not pain! Alternatively, in the standard narrative it is the losers of globalization that are supposed to turn populist, but countries like Hungary, India, the Philippines, Poland, and Turkey are clear winners of globalization—and yet they have gone populist too.

There is one last prickly fact to consider: if surging populism reflected a demand for redistribution, we would expect the surge to be on the left, not the right. Yet the spectacular success is that of right-wing populists, as we have seen in Brazil, Hungary, the United States, and many other corners of the world. Some of these populists' policies are likely to worsen, not improve, the distribution of income, yet middle-class and working-class voters are cheering them on.

A key role of politics is to manage grievances, economic and otherwise. The turn toward populism and authoritarianism suggests a failure of democratic politics to handle those grievances effectively. There is a one-word reason for that: identity.

Identity roots

In his recent book, *Identity: The Demand for Dignity and the Politics of Resentment*, Francis Fukuyama argues that "individuals often want not recognition of their individuality, but recognition of their sameness to other people." People also want that identity recognized and respected. Fukuyama reminds us that philosophers from Aristotle to Hegel placed the desire to be treated with respect at the center of human motivation. Therefore "identity politics is everywhere a struggle for the recognition of dignity."

What does populism have to do with this? A great deal. To the definitions above, add that populism is a style of politics that *manipulates and exacerbates identity* divisions for political gain. Populism is a kind of identity politics. It is always us against them.

Identity politics is not an easy subject for economists. Until recently, economic theory did not leave room for identity. Humans were supposed to have preferences, but liking this and disliking that did not amount to a coherent whole we could call an identity. George Akerlof and Rachel Kranton set out to change this. They argued that, in a wide range of contexts, preferences are structured by

POPULISM IS A KIND OF IDENTITY POLITICS. IT IS ALWAYS US AGAINST THEM.

individuals' choice of a social identity. The two economists then began to study the economic implications of those preferences.

The identity approach pioneered by Akerlof and Kranton is helpful in examining many issues, but for the purpose of understanding the link between identity politics and populism, three are particularly worth highlighting. The first is that people are willing to pay a steep price, financial and otherwise, to buttress their identity. For instance, in US high schools (Akerlof and Kranton 2002), students who identify as *nerds* will study hard, while students who identify as *jocks* or *burnouts* will fail to study and underperform, even at a high cost, because such behavior reinforces their identity and self-esteem. Similarly, populist politicians adopt extreme and ultimately unsustainable policies as a way of signaling to voters that they (the politicians) are not in the pocket of powerful elites. So what appears on the surface to be self-defeating economic behavior is quite rational once identity is accounted for. And populism certainly involves plenty of self-defeating economic policy choices.

Second, identity is subject to increasing social and political returns. As the share of people who identify with a certain group goes up, so does the social pressure to identify with that group and follow its code of conduct. Or people may choose a group to identify with and, once there, act in a way that minimizes the distance between them and the group.

Third, if and when identity becomes a primary determinant of political behavior, weapons other than economic policies become useful in political battle. Toxic and divisive speech is often used strategically by populist politicians to "mobilize the base" and change the size of competing identity groups. Populists are not nasty by mistake; they are nasty by design.

If identity is essential to populism, and populism is central to contemporary politics, how should democratic politicians and policymakers respond? First they must get their heads out of the sand and acknowledge that identity matters—and that its by-products are not always good.

A focus on identity also prompts greater focus on issues that have long been neglected or mishandled. Take, for example, the plight of cities where deindustrialization has destroyed jobs. The standard advice in the past was to move to a place with plentiful high-paying jobs. Today we understand that this is not necessarily sound advice. Not only do those who are most educated and enterprising move away, leaving behind communities that struggle to sustain businesses and make ends meet. The combination of job loss and outward migration also weakens the local community and challenges their shared identity. This is why place-based policies are an essential component of the tool kit of a democratic policymaker.

Something else must change as well: democratic leaders must learn to practice identity politics—but the right kind. Human beings cannot abandon their narrow identities, which are the most firmly rooted. But broadly shared identities matter too, and can form the basis of the sense of shared destiny that is at the core of good politics. As historian Michael Ignatieff observed in the September 5, 2019, edition of the *Financial Times*, "National identity is a continual contest about who belongs to the national we." The only alternative to this chasm is a shared identity, a love of country based not on a misplaced sense of racial superiority, but on the fact that our homeland stands for noble universal values. FD

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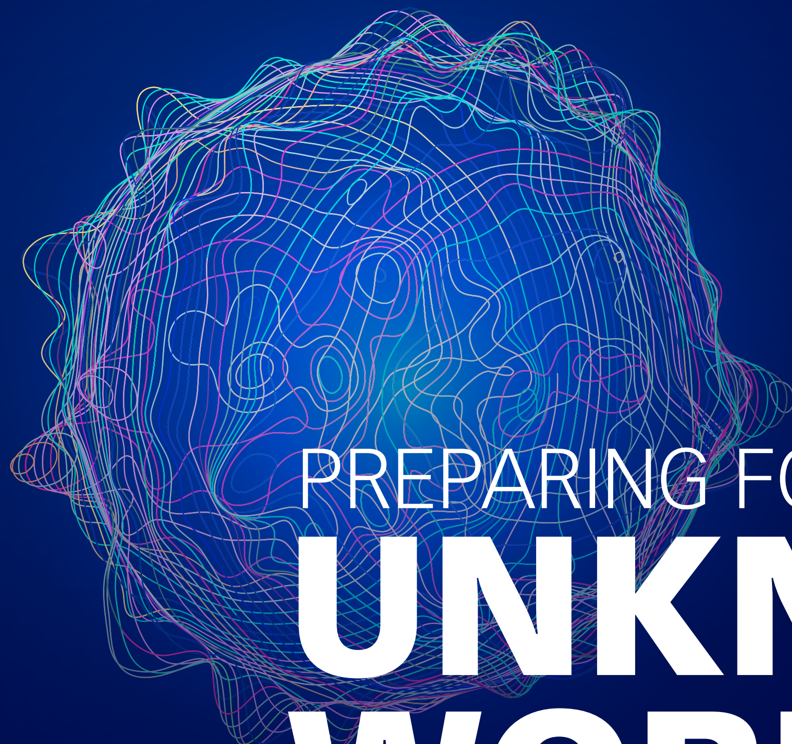


PREPARING FOR AN UNKNOWN WORLD

We must collectively work toward resolving the problems exposed by the crisis

Era Dabla-Norris, Vitor Gaspar, and Kalpana Kochhar

We must have cooperation, collaboration; utilize the machinery, the instrumentalities, that have been set up to provide succor to those who are hungry and ill; to set up, establish instrumentalities that will stabilize or tend toward stabilization of economies of our world.
—Fred Vinson (US delegate at Bretton Woods, future Supreme Court chief justice) Commission I, 1944

Had I been present at the Creation, I would have given some useful hints for the better ordering of the universe.
—Alfonso X, King of Spain, 1252–1284

Once COVID-19 abates, we will be reminded of how everything changed, of the world that was. But the unfolding crisis contains profound lessons for the future. When international delegates met at Bretton Woods in July 1944 to devise a postwar world, the war was still far from over. Yet, recalling the missed opportunities that had followed the previous world war, they understood that the focus had to shift from ending the war to establishing new foundations. Today's global economy faces very different challenges, but important parallels remain. Urgency and speed of action are as crucial as the need to mobilize resources at real scale.

There are large unknowns about how long it will take to develop and deploy effective vaccines, the duration and likelihood of repeat outbreaks and lockdowns, and the eventual economic ramifications. Even so, it is possible to identify some fixed points for an international post–COVID-19 order.

First, international collaboration on mounting effective public health responses that rely on solid scientific consensus on disease causes and mitigation is vital. Triumphs of international cooperation prior to this pandemic centered on public-private health initiatives that counted transparency, accountability, and broad engagement as hallmarks. Examples include the Global Fund to Fight Aids, Tuberculosis and Malaria, the Global Alliance for Vaccines and Immunization, and the Coalition for Epidemic Preparedness and Innovation. Governments would do well to reflect on what went wrong this time and try to understand how funding for projects in the public interest can build on existing initiatives. This could help drive research and development of vaccines and diagnostics for future disease outbreaks.

Public health responses require a universal focus on pandemics. Emerging market and developing economies, many of which are grossly ill-equipped to combat the current health and economic shock, are increasingly on the front lines of the spread of

ART: ISTOCK / ANADMIST

the disease. Chances of third and further waves of pandemic outbreaks cannot be ruled out unless the virus is contained everywhere. Calls for funding to mitigate the pandemic's economic fallout in poorer countries are being heeded. But attention to assuring that the production and distribution of future vaccines and therapeutics worldwide will be rapid, affordable, and universally available is equally paramount. Realizing this goal will require that rules regarding pricing and manufacturing are designed and enforced in ways that value international collaboration and solidarity.

Second, the Great Lockdown has placed technology squarely at the forefront of work, consumption, supply, interaction, and delivery. From predicting and modeling outbreaks to community-driven contact tracing, technology is being used widely to tackle the pandemic. Videoconferencing, remote desktops, and new social platforms are powering remote work almost overnight, a trend that will likely endure when lockdowns are lifted. Digitalization of services—from telehealth to online education to cashless transfers and emergency assistance to support the vulnerable—has been at the center of country responses. The need for contactless payments is propelling the shift from cash to digital payments, and digitalization of business models and supply chains is reshaping commerce and delivery. Technology could play a crucial role in creating new sources of growth, boosting productivity, and helping workers and businesses transition and adjust to a new world.

Harnessing the benefits of technology while leaving no one behind in the post–COVID-19 digital world is key. Connectivity is a requisite for telework, but more than 21 million people in the United States lack advanced broadband internet access. About 60 percent of the global population, mostly women in emerging market and developing economies, still has no computers or access to the internet, and 250 million fewer women are online than men. Emerging technologies have the potential to be a great equalizer, but without the right infrastructure and governance in place, we could see the digital divide intensify. As in public health, there is scope for innovative public-private partnerships to bridge this divide and ensure that digital inclusion represents economic inclusion.

There is also an urgent need to adapt and reform education systems and workforce training to reduce skill mismatches for a technology-enabled workplace. But not all jobs can be done from home. COVID-19 shows us more clearly than ever before that, in the words of Martin Luther King, "all labor has dignity." The pandemic has also exposed the disconnect between workers deemed essential in this fight—such as those working in health care, eldercare, agriculture, and grocery stores—and their precarious benefits and job security. Severe social protection deficits for these workers and the countless others who work in the informal economy will need to be addressed.

Third, pandemics, like climate hazards, are a harsh reminder of the relevance of natural phenomena and the need for ensuring long-term resilience. Climate action and sustainability can gain renewed priority as fiscal stimulus packages are deployed to jump-start the economic recovery. Investments in climate-resilient infrastructure and the transition to a lower-carbon future can drive significant near-term job creation and capital formation while increasing economic and environmental resilience. These investments could include building renewable-energy infrastructure and more resilient roads and structures, expanding the capacity of the power grid, retrofitting buildings, and developing and deploying technologies to decarbonize heavy industries. Moving toward a lower-carbon economy is daunting but imperative, and we must rise to this challenge collectively.

The post–COVID-19 order will be created. But the problems thrown into sharp relief by the crisis remain. Poverty, rampant inequality, declining biodiversity, environmental degradation, and scarcity of clean water still need to be tackled. So do the long-standing inequities in our societies. How we protect and lift our most vulnerable will be a test of our humanity.

There could be a silver lining. We have seen mobilization of resources for public purposes on a scale witnessed only in times of war. But this current war is being waged against a common enemy. The solidarity accumulated in times of global lockdown and disease could be a valuable foundation on which to build. FD

ERA DABLA-NORRIS is a division chief in the IMF's Asia-Pacific Department; **VITOR GASPAR** is director of the IMF's Fiscal Affairs Department; and **KALPANA KOCHHAR** is director of the IMF's Human Resources Department.

How will the world be different after COVID-19?

Six prominent thinkers reflect on how the pandemic has changed the world

Daniel Susskind

In March 2020, Rabbi Jonathan Sacks, an influential figure in British intellectual life, described the COVID-19 catastrophe as "the nearest we have to a revelation for atheists."

At the time I thought the comparison was apt. It captured the biblical sense of shock that many of us felt in the face of such a sudden, extreme, and swiftly accelerating crisis. We "have been coasting along for more than half a century," he remarked, and all at once "we are facing the fragility and vulnerability of the human situation."

Now, a few months on, Rabbi Sacks' comparison with revelation still seems fitting, but for a different reason, and one that matters for thinking about a world after COVID-19.

This crisis is alarming, in part, because it has several new and unfamiliar features. A global medical emergency caused by a virus we still do not fully understand. A self-inflicted economic catastrophe as a necessary policy response to contain its spread.

ART: ISTOCK / DRAFTER123; PHOTO: SUKI DHANDA

And yet as time has passed, it has also become clear that much of what is most distressing about this crisis is not new at all. Striking variations in COVID-19 infections and outcomes appear to reflect existing economic inequalities. Remarkable mismatches between the social value of what "key workers" do and the low wages they receive follow from the familiar failure of the market to value adequately what really matters.

The happy embrace of disinformation and misinformation about the virus was to be expected, given a decade of rising populism and declining faith in experts. And the absence of a properly coordinated international response ought to have come as no surprise, given the celebration of "my country first" global politics in recent years.

The crisis then is a revelation in a far more literal sense—it is focusing our collective attention on the many injustices and weaknesses that already exist in how we live together. If people were blind to these faults before, it is hard not to see them now.

What will the world look like after COVID-19? Many of the problems we will face in the next decade will simply be more extreme versions of those that we already confront today. The world will only look significantly different this time if, as we emerge from this crisis, we decide to take action to resolve these problems and bring about fundamental change.

DANIEL SUSSKIND is a fellow in economics at Balliol College, Oxford University, and author of *A World Without Work* (Allen Lane, 2020).

James Manyika

The world after COVID-19 is unlikely to return to the world that was. Many trends already underway in the global economy are being accelerated by the impact of the pandemic.

This is especially true of the digital economy, with the rise of digital behavior such as remote working and learning, telemedicine, and delivery services. Other structural changes may also accelerate, including regionalization of supply chains and a further explosion of cross-border data flows.

The future of work has arrived faster, along with its challenges—many of them potentially multiplied—such as income polarization, worker vulnerability, more gig work, and the need for workers to adapt to occupational transitions. This acceleration is the result not only of technological advances but also of new considerations for health and safety, and economies and labor markets will take time to recover and will likely emerge changed.

With the amplification of these trends, the realities of this crisis have triggered reconsideration of several beliefs, with possible effects on long-term choices for the economy and society. These effects range from attitudes about efficiency versus resilience, the future of capitalism, densification of economic activity and living, industrial policy, our approach to problems that affect us all and call for global and collective action—such as pandemics and climate change—to the role of government and institutions.

Over the past two decades, in advanced economies, responsibility has generally shifted from institutions to individuals. Yet health systems are being tested and often found wanting, while benefits from paid sick leave to universal basic income are getting a second look. There is potential for a long-term shift in how institutions support people, through safety nets and a more inclusive social contract.

As history has shown, choices made during crises can shape the world for decades to come. What will remain critical is the need for collective action to build economies that deliver inclusive economic growth, prosperity, and safety for all.

JAMES MANYIKA is chairman and director of the McKinsey Global Institute.

Jean Saldanha

In *The Pandemic Is a Portal*, Indian author Arundhati Roy writes, "Historically, pandemics have forced humans to break with the past and imagine their world anew. This one is no different. It is a portal, a gateway between one world and the next."

The way multilateralism operates will have to change to reflect this very different world. The COVID-19 pandemic has been testing the limits of global cooperation. Support for developing economies in particular remains inadequate. They were hit early by the global economic downturn,

PHOTOS: COURTESY OF MCKINSEY GLOBAL INSTITUTE; COURTESY OF EURODAD including through record capital outflows and tightening financial conditions. Facing the worst humanitarian crisis since World War II, these economies are experiencing unprecedented pressure on their already limited fiscal capacity to tackle urgent public health and social needs.

Choices made now will have far-reaching consequences. Reliance on more of the same is untenable and ignores the scale of human suffering unleashed by the pandemic.

A fitting UN-led reform agenda must include the IMF in addressing the structural problems that have driven debt vulnerability across developing economies. Such an agenda must shift development finance away from market-friendly reforms and incentives for private investment. It must abandon the dogma of austerity. Furthermore, rich countries must finally meet their official development assistance commitments.

Power imbalances in global institutions must also be corrected to give fair recognition to the needs and rights of the two-thirds of the world's population who reside in the Global South.

If the international community fails to respond decisively now, the 2030 Agenda and the Paris Agreement will be fatally derailed. A new multilateralism—in which reform of the Bretton Woods institutions will play a key role—is needed now and must be based on a vision of development that puts human rights, gender equality, and climate at its center.

JEAN SALDANHA is director of the European Network on Debt and Development.

Sharan Burrow

The world after the first wave of COVID-19 must be more inclusive, resilient, and sustainable. Today, we live in a world in which inequality between and within countries has grown as a result of businesses' race to the bottom and working poverty among a vast portion of the global workforce. Too many countries suffered the external shocks of COVID-19 without universal social protection, robust public health systems, a plan to reach net-zero carbon emissions by 2050, or a sustainable real economy with quality jobs.

The Bretton Woods conference occurred while a war was still raging and helped formed the basis of a postwar social contract. Similarly, we need to craft an ambitious reconstruction plan while working to end the pandemic. International support is a matter of collective survival and an investment in the future of health, the global economy, and multilateralism. The choice is ours, and the actions of the IMF and the multilateral system will be a deciding factor.

Our goal for recovery should be full employment and a new social contract. Public investment in the care economy, education, and low-carbon infrastructure can form the backbone of stimulus that reduces inequality. Wage policy, collective bargaining, and labor market regulation can revive demand and income while putting an end to a business model that allows companies to take no responsibility for their workers.

Debt should be addressed through a relief process focused on the United Nations Sustainable Development Goals and enduring economic growth for every country. Shortsighted fiscal consolidation hindered debt management and reduction after the global financial crisis and would again leave us even less able to deal with future health and economic crises.

Shared prosperity can be the fruit of a COVID-19 world marked by shared ambition and global solidarity.

SHARAN BURROW is general secretary of the International Trade Union Confederation.

Sergio Rebelo

COVID-19 will leave a lasting imprint on the world economy, causing permanent changes and teaching important lessons.

Virus screening is likely to become part of our life, just like security measures became ubiquitous after 9/11. It is important to invest in the infrastructure necessary to detect future viral outbreaks. This investment protects economies in case immunity to COVID-19 turns out to be temporary.

Many economies adopted versions of Germany's *Kurzarbeit* (short work) subsidy during the pandemic. This policy keeps workers employed at reduced hours and pay, with the government compensating some of the shortfall in wages. By keeping matches between firms and workers intact, the economy is better prepared for a quick recovery. It is important to improve

PHOTO: HORSTWAGNER.EU/ITUC

the implementation of these policies and make them a permanent part of our economic recovery tool kit.

Remote work is likely to become more common. We had some evidence that working from home is at least as productive as working at the office. However, many companies were reluctant to embrace remote work. Now that many have tried it with good results, remote work might be here to stay.

The pandemic crisis has accelerated the pace of digital transformation, with further expansion in e-commerce and increases in the pace of adoption of telemedicine, videoconferencing, online teaching, and fintech.

Companies with international supply chains are dealing with shortages and bottlenecks. We are likely to see many of these companies reshore some of their production. Unfortunately, this trend will not create many jobs because most of the production is likely to be automated.

Governments will be bigger after playing the role of insurer and investor of last resort during the crisis. Public debt will balloon, creating financial challenges around the world.

The most important lesson from the COVID-19 pandemic is the importance of working together on problems that affect the entire human race. We are much stronger united than divided.

SERGIO REBELO is a professor of international finance at the Kellogg School of Management at Northwestern University.

Ian Bremmer

The global order was in flux well before the COVID-19 crisis. Coronavirus has accelerated three of the key geopolitical trends that will shape our next world order… which will await us on the other side of this pandemic.

The first trend is **deglobalization**; the logistic difficulties brought to light by the current crisis are already pointing to a shift away from global just-in-time supply chains. Yet as economic difficulties mount, **the inevitable growth of nationalism and "my nation first"** politics will push companies to localize business operations that favor national and regional supply chains.

The third trend, **China's geopolitical rise**, has been more than three decades in the making. But while China has successfully transformed itself into an economic and technological superpower, no one expected it to become a "soft power" superpower. This crisis can change that, if China's crisis diplomacy continues and the perception endures that Beijing has been far more effective than the rest of the world in its response to the outbreak.

Of course, just because China appears to be faring better doesn't mean it actually is. There's a reason people take Chinese numbers with a grain of salt. This general distrust was further fueled by the initial Chinese cover-up of the outbreak, which enabled its global spread. Donald Trump and his administration are leaning into this narrative as an election strategy and to deflect attention from their own handling of the pandemic. China won't take this lying down, making it increasingly likely that once the world emerges from the current pandemic, we will be plunged into a new cold war, this time between the United States and China.

New world order or not, some things just don't change. FD

IAN BREMMER is president and founder of Eurasia Group.

PHOTOS: MARIA REBELO; RICHARD JOPSON

TRUST IMPERATIVE

Trust is at rock bottom, and we must urgently restore it

Richard Edelman

THE CORONAVIRUS POSES an extraordinary threat to global health and economic prosperity. It has also reaffirmed the lack of trust in our institutions by triggering financial market volatility and anger over slow or inadequate government responses.

Before COVID-19, many countries were enjoying strong economic performance and nearly full employment. The major societal institutions—government, business, media, and nongovernmental organizations (NGOs)—should have been trusted. Instead, the 2020 Edelman Trust Barometer—published in January—showed that globally people do not trust any institution to do what is right. The key to this paradox is the shifting dynamics of trust over the past 20 years.

In this period, five seismic events significantly altered people's trust: concerns about globalization, the Iraq War, the global recession of 2008–09, the rise of China and India, and the advent of social networks. The second decade brought a trust divide between elites and the general population, alongside government failure to lead change. Disinformation and fear became rife.

COVID-19 is the new decade's first jolt to the system. In this extraordinarily difficult moment, institutions have a duty to outperform expectations and rebuild public confidence. Most people want to resume listening to experts—who have been much maligned in recent times.

Government must demonstrate its competence in responding to the crisis. Media must be an objective arbiter of the facts. Business can provide necessary products and reliable information. NGOs must help develop a vaccine and ensure its fair distribution.

This is the time for institutions to work together, laying the groundwork for a new era of trust. FD

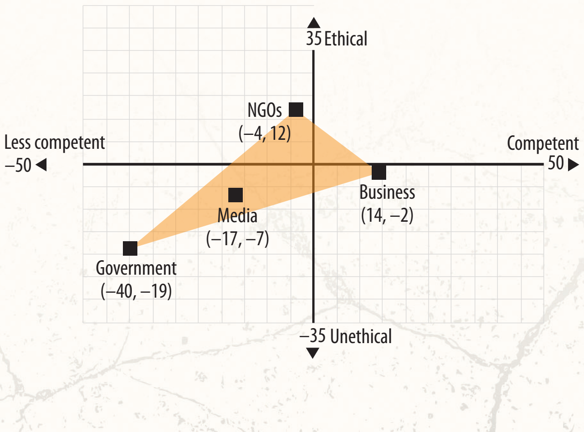
RICHARD EDELMAN is the CEO of Edelman, a global communications firm. This feature is based on Edelman's 2020 Trust Barometer and the 2020 Edelman Trust Barometer Special Report: Trust and the Coronavirus.

The nature of trust has changed

Trust: Competence and ethics

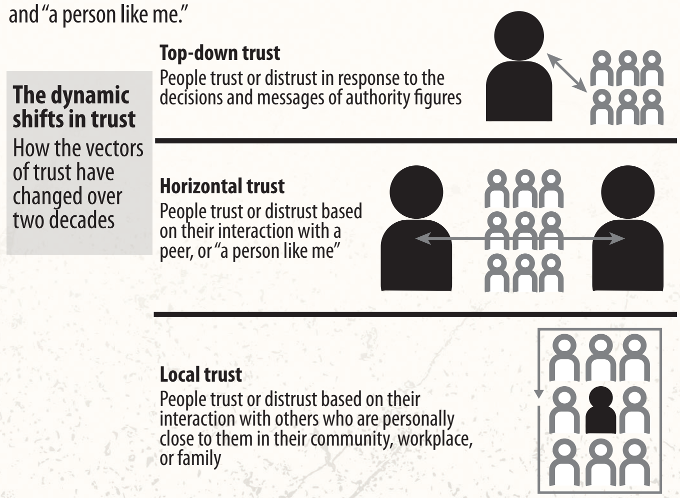
Trust today is granted on two distinct attributes: competence (delivering on promises) and ethical behavior (doing the right thing and working to improve society). Currently, no one institution is considered both competent and ethical.

(no institution seen as both competent and ethical, competence score, net ethical score)



Trust moves local

Trust has moved from a top-down vertical model, dependent on traditional leaders, to to a horizontal one, in which people rely more on friends, family, and "a person like me."



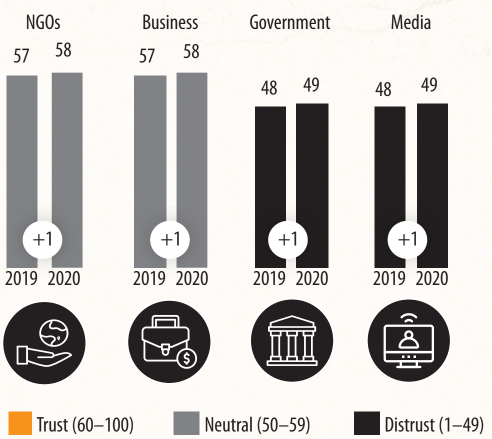
ART: ISTOCK / ULIMI

Trust in institutions is stagnant overall

No institution is trusted

Trust is stagnant, with no institution climbing into trusted territory.

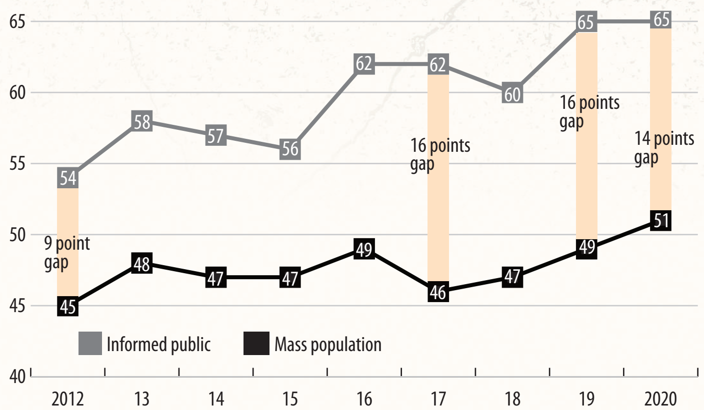
(2020 Edelman Trust Barometer, percent of trust)



Trust inequality remains high

Trust among the informed public has soared to record highs, while most people continue to distrust institutions.

(Trust Index, 23-market average)



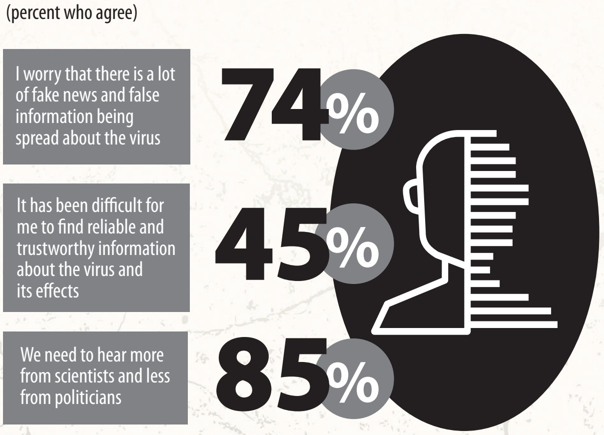
Note: Trust = 60–100, neutral = 50–59, distrust = 1–49.

COVID-19 has rekindled trust in experts

Worry about reliability of coronavirus information

Large majorities of respondents are concerned about false information and want to hear more from scientists.

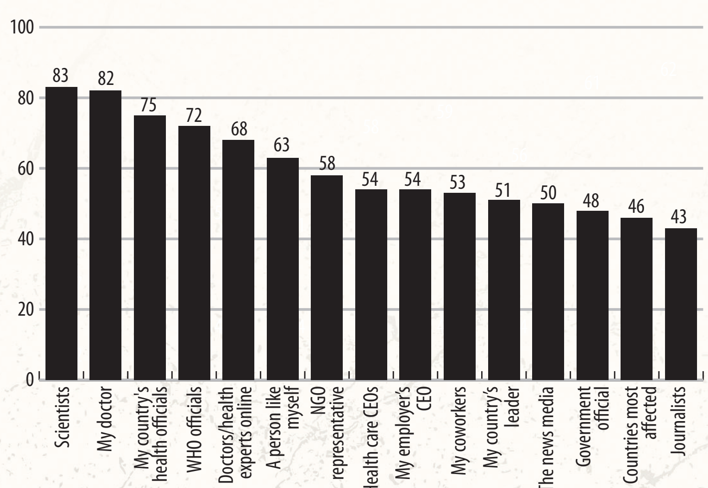
(percent who agree)



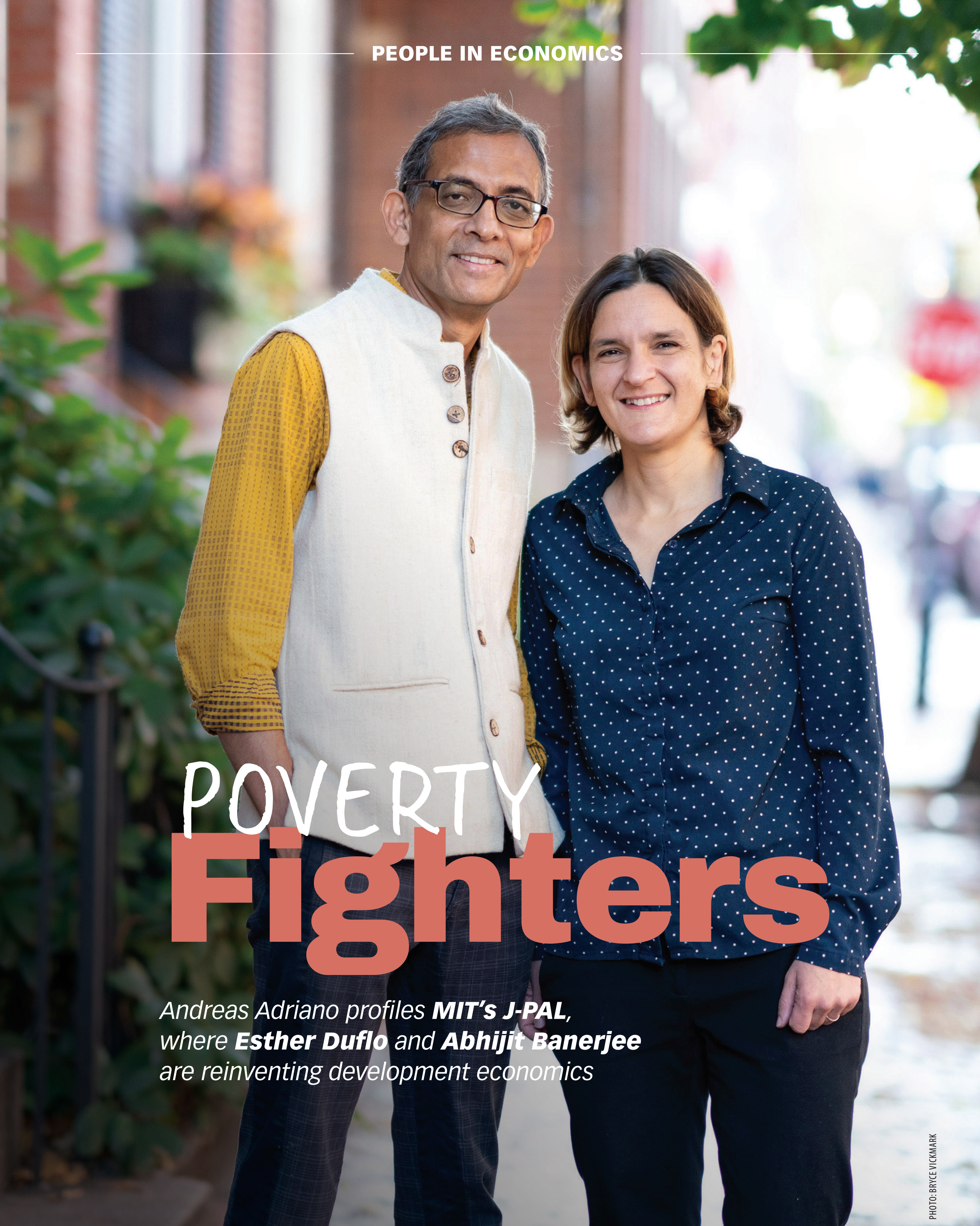
Most trusted spokespeople

Scientists, health officials, and doctors are the most trusted.

(percent who trust each information source to tell the truth about the coronavirus)



Note: WHO = World Health Organization.



POVERTY Fighters

*Andreas Adriano profiles **MIT's J-PAL**, where **Esther Duflo** and **Abhijit Banerjee** are reinventing development economics*

PHOTO: BRYCE VICKMARK

Some seemingly great development ideas don't work out as expected. One that famously flopped was to replace open-fire cooking used by 3 billion of the world's poorest people with more efficient, less polluting stoves under the Global Alliance for Clean Cookstoves initiative. The $400 million project was backed by the United Nations and launched by former US Secretary of State Hillary Clinton in 2010. It set out to reduce indoor air pollution, which kills 2 million people a year, while empowering women and helping the environment. After initial success, millions of stoves built in India were largely abandoned after four years.

Why didn't it succeed? Researchers from the Abdul Latif Jameel Poverty Action Lab, known as J-PAL, went to the field to find out. Following about 2,500 households in 44 villages in the eastern Indian state of Odisha, they discovered many seemingly minor reasons. The new stoves needed more attention, would break down and weren't repaired, took longer to cook food, and couldn't be moved outdoors because of the chimneys that sent the smoke outside, the research showed.

"For the hyper-rational being that lives in economic models, none of this ought to matter," wrote Abhijit Banerjee, a Massachusetts Institute of Technology (MIT) economics professor who is a cofounder and director of J-PAL, in an article. However, the experience was a reminder that "the fact that we think something should work is not enough—it needs to work for the people who use them." During its 17-year history, J-PAL has developed a scientific, evidence-driven-economics approach to fighting poverty. According to Executive Director Iqbal Dhaliwal, this provides an alternative to "basing decisions on instinct, ideology, or inertia."

On the second floor of a nondescript MIT building in Cambridge, across the Charles River from Boston, J-PAL's headquarters could easily be mistaken for any ordinary office in a large university. But J-PAL's reach is broad. On its own or through a network of affiliated researchers around the world, the donor-funded organization has carried out more than 1,000 randomized controlled trials in more than 80 countries, applying to economics the research methodology that's long been the gold standard for testing new drugs and medical treatments. Programs verified in this way have been scaled up to reach more than 400 million people around the world, J-PAL says.

This record was behind the 2019 Nobel Prize in economics awarded to Banerjee, his wife and J-PAL cofounder Esther Duflo, and their friend and frequent collaborator, Harvard economist Michael Kremer.

"Their experimental research methods now entirely dominate development economics," the Nobel Prize committee said. This has "transformed development economics" with its ability to provide "reliable answers about the best ways to fight global poverty."

In a world that increasingly despises expertise and academic research, where the very perception of reality is often shaped by political beliefs, J-PAL can claim objectivity, providing policy advice based on evidence tested in the field using a scientific approach. It can show palpable results in helping vulnerable people solve very practical problems.

Banerjee and Duflo are at its center. They founded the organization in 2003 as the Poverty Action Lab, along with Sendhil Mullainathan, a former Harvard professor who is still a contributor. They set out to change the world's approach to poverty, no less.

In 2005, the Lab was renamed to honor the father of Mohammed Jameel, an MIT alum and Saudi businessman and philanthropist whose family foundation is an ongoing supporter. Other backers include large private donors and advanced economy development agencies.

J-PAL's staff includes about 400 research, policy, education, and training professionals, with headquarters in Cambridge and regional centers in North America, Latin America and the Caribbean, Europe, Africa, the Middle East, South Asia, and Southeast Asia. An additional 200 researchers oversee projects that are executed by about 1,000 contractors. The organization has awarded $63 million in grants to fund new research since its founding in 2003.

Although its focus was initially on poor and emerging market economies, J-PAL is now active in Europe, researching, for example, initiatives to promote social inclusion of immigrants. Its North America branch has projects on retraining and skills development for workers, homelessness and housing, criminal justice reform, and health.

Divide to conquer

Duflo, a 47-year-old French economist who earned her doctorate at MIT and made the institution break a rule against hiring its own students, describes the randomized trials at the core of

ART: ISTOCK / SAVUSHKIN

J-PAL's approach as taking "a big problem and breaking it into manageable pieces, smaller questions that admit rigorous answers."

The method consists of testing a potential solution to a development problem—such as how to increase the use of bed nets to fight malaria—by comparing a group that receives a treatment with a control group that receives nothing. The groups should be as similar as possible and randomly created so that no other factors have an influence and researchers can understand the treatment's impact. There can be multiple groups to compare different solutions. Developed in the 19th century, such trials were applied in agriculture, medicine, and political science much earlier than in economics, where the first such studies date from the 1960s.

Macroeconomic research often deals with lofty topics expressed in complex equations and tested with intricate econometric techniques. Even Nobel laureates struggle with some of it. In their 2019 book *Good Economics for Hard Times*, Duflo and Banerjee acknowledge that part of productivity growth "cannot be explained by changes in things economists can measure. To make ourselves feel better, economists have given it its own name: *Total Factor Productivity*." Their MIT colleague and fellow Nobel laureate Robert Solow defined the concept as "a measure of our ignorance."

By contrast, development research can sound prosaic. Should anti-malaria bed nets in Kenya be given away, subsidized, or sold at market price? Is a buyback program a viable way to mop up the large amount of unused opioid pills in the United States? How do you make sure poor Indonesian households receive all the rice they are entitled to under a federal program?

Information for the poor

Those are all questions J-PAL has taken on. Researchers often uncover surprisingly simple solutions.

One of Indonesia's largest social assistance programs is Rice for the Poor, known locally as Raskin. The $1.5 billion-a-year system aimed to distribute 15 kg of rice a month to the poorest households at a fifth of the market price. However, bureaucracy and corruption were getting in the way. Community leaders responsible for distributing the rice would often tinker with pricing, allowances, or qualifying criteria. Eligible households ended up receiving a third of what they were entitled to at a cost 40 percent higher than it should have been.

PHOTO: COURTESY OF J-PAL

J-PAL Executive Director Iqbal Dhaliwal.

Rather than toughening up controls, Indonesia in 2012 assigned researchers to work with J-PAL in testing ways to raise awareness about qualification criteria, monthly allotments, and prices using information-bearing "social protection cards." Randomized tests showed they were so effective that within a year the government issued about 15 million of them and bundled two other cash-transfer programs into the project, adding up to more than $4 billion.

Expecting that there will be differences between theory and practice is one advantage of J-PAL's approach. So is not presuming that well-trained lab scientists are wiser or more rational than the people they hope to help.

"The poor are no less rational than anyone else—quite the contrary," Banerjee and Duflo wrote in their 2011 book, *Poor Economics*. "Precisely because they have so little, we often find them putting much careful thought into their choices: They have to be sophisticated economists just to survive."

Born in Mumbai in 1961 to two accomplished economics professors, the Harvard PhD Banerjee has little patience with those "hyper-rational" beings living inside models. He derides the "presumption of knowledge" that he says accompanies much of macroeconomic research, often stemming from little more than "a whole bunch of correlations, many of which are very hard to interpret, and some actual concrete facts, which are probably reasonably reliable." He spoke to *F&D* in his small office in the

Women at a cookstove in Bhojpur, India.

PHOTO: THOMAS CHUPEIN

MIT economics department. Behind a door covered with economics and political cartoons, the cramped space full of books contrasts with expansive views of the Charles River and the Boston skyline.

Duflo's somewhat roomier office is two doors down from Banerjee's. They met when he was her PhD supervisor at MIT in 1999, married in 2015, and have two children together.

She has learned never to be disappointed by any set of research results. "One thing that we've learned very early from randomized control trials is that you generally get surprised by what you find," she says.

Does it add up?

Breaking a big problem down does not necessarily mean the smaller pieces are simpler. In a 2016 lecture at the IMF, Duflo presented several studies showing how micro interventions can have significant macro effects. One involved better enforcement of environmental regulations in heavily polluting textile plants in the Indian state of Gujarat, home to some of the earth's most polluted cities. The randomized trial changed the rules for assigning auditors to companies and found that enforcement improved when inspectors were not paid by those they were auditing. Although that's not exactly a groundbreaking finding, having the data to prove it strengthens the case.

Duflo argued that broad principles that often guide international institutions—such as democracy and good governance—may be of little value because they're too general. Economists could achieve more concrete results by fixing the plumbing, the part of any system that's taken for granted and people notice only when it stops working. She titled the lecture "The Economist as Plumber."

One problem with randomized controlled trials is that the small answers might not add up to address the big problem. Another is that conclusions may be too specific to where the research was conducted. The findings of a malaria study in Kenya might be completely irrelevant for Brazil, for example. Economists refer to this as the "transportation" problem.

"Demonstrating that a treatment works in one situation is exceedingly weak evidence that it will work in the same way elsewhere," wrote Angus Deaton, the eminent Scottish development economist and 2015 economics Nobel laureate, in an article last year.

Deaton wrote several papers laying out his reservations about randomized trials. The only way to apply the findings from one study in a new context, he wrote in the same article, is by using "previous knowledge and understanding," interpreting the trial results "within some structure, the structure that, somewhat paradoxically, the RCT [randomized controlled trial] gets its credibility from refusing to use."

Macro versus micro

Dhaliwal, the J-PAL executive director, was hired 11 years ago to address that specific problem. He is a fast-talking Indian economist with degrees from the University of Delhi and Princeton and is married to Gita Gopinath, the IMF chief economist.

"When Esther hired me in 2009, they had realized that the journey from a research result into a policy action requires much more considered effort," Dhaliwal says. To bridge the gap, evidence must be made accessible to policymakers and validated by other studies in different contexts. In addition, implementation needs to be monitored to bring new reality checks back to the policy findings, Dhaliwal says.

When asked how best to bridge the gaps between research and policy and between micro- and macroeconomics, Duflo points to a copy of *Good Economics for Hard Times*.

"This book and *Poor Economics* present what we've learned about one topic as a narrative that makes sense of it all together," she says. *Good Economics for Hard Times* compiles vast amounts of research to dismiss common assumptions on topics like migration, labor, and trade. It shows economists often get a lot of things right but still fail to establish trust with the wider public. Banerjee blames his profession's shortcomings.

"People put faith in populist narratives because they don't put faith in economists' narrative anymore," he says.

As she contemplates the future, Duflo says she hopes the recognition of the Nobel Prize will put J-PAL "in a different level" and help expand its work into areas like climate change and helping governments improve the quality and make better use of the vast amounts of data they collect.

J-PAL's method of breaking a big problem down into smaller questions can be applied even to a quintessentially global problem like climate change. Field studies conducted in Mexico, Wisconsin, and Michigan showed that residential energy-efficiency-improving technologies often don't deliver the savings promised. Measures like updating appliances and retrofitting and weatherproofing houses have low uptake. And when they are adopted, the resulting efficiency gains are usually offset by higher consumption.

Similarly, an investigation in India showed that when small farms were provided consulting help and loans to acquire new, more efficient equipment, they produced more and made more money–but didn't save energy. Duflo attributes this to "optimizing behavior" that often is not properly calculated in estimates of potential benefits.

Bigger problems

As of mid-March, J-PAL, like the rest of the world, was locking down to stop the spread of the COVID-19 pandemic. The organization quickly made operational adjustments like pulling staff from the field and increasing phone surveys. It offered financing to quickly launch new research initiatives such as cash transfers, digital identification, and innovation in government practices.

The pandemic presented a new set of big problems and showed how critical it can be to have accurate, timely statistics. It underscored the importance of using government administrative data to improve decision-making and share results "faster and cheaper than [with] field work," Dhaliwal says.

Dhaliwal says the post–COVID-19 world will reassess the role and value of governments in a crisis, leading to better public management and more appreciation of the importance of social protection.

"For the last few years, a lot of new philanthropy has premised itself on the belief that governments are unnecessary and can be bypassed," he says. "This crisis makes it clearer that we all need to invest in building governments' capacity to make good decisions and to be resilient to handle big events like this one," he adds, mentioning as an example the ability to make quick emergency cash transfers, which has been a challenge even for a country like the United States.

Dhaliwal sees the coronavirus plague as foreshadowing what a climate crisis could look like.

"This pandemic has shown us, first, the supremacy of nature and, second, how once a tipping point is hit (community spread of infections or increase in earth's temperature), it is very hard to avoid significant damage and death," he says. "So the time to act is now. It has also shown that if we do the right thing (like social distancing), and do it drastically, it can have a positive impact." FD

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THE *DEVIL* IS IN THE *DETAILS*

If properly designed, tax-based fiscal consolidation does not have to be politically costly

Era Dabla-Norris and Aleksandra Zdzienicka

Most countries around the world have rightfully taken a "whatever it takes" approach to combating the COVID-19 pandemic. On the fiscal side, extraordinary and far-reaching tax and spending measures have been implemented to save lives, support individuals and firms, and set the stage for recovery. It is still too early to predict an endgame for this crisis. But once the virus is beaten back and the global recession bottoms out, public finances will have to be put back in order, especially in countries where debt was already high before the pandemic arrived. This will inevitably raise questions about what taxes to increase and which spending to cut, decisions that are politically unpopular.

Jean-Claude Juncker, the former president of the European Commission, referring to the political obstacles facing those undertaking structural reforms, famously remarked, "We all know what to do; we just don't know how to get re-elected after we've done it" (*Economist* 2007). One could argue that this applies especially to fiscal consolidation. Among consolidation measures, tax hikes are typically associated with higher short-term growth costs than spending cuts (Alesina, Favero, and Giavazzi 2015). But does that mean governments always pay a price at the ballot box for raising taxes?

While there is broad agreement on the economic benefits of fiscal adjustments to reduce runaway deficits and debt, the political ramifications are less clear-cut.

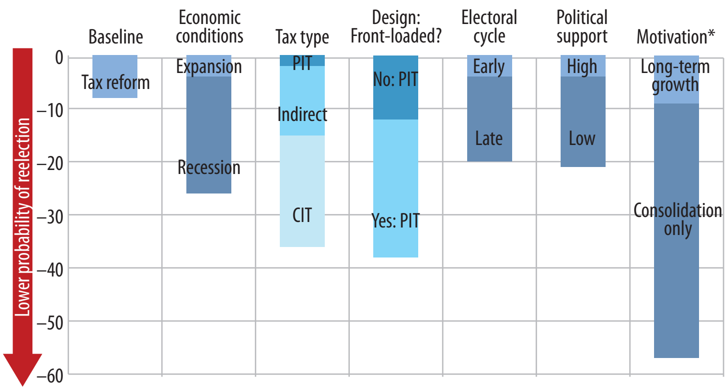
On the one hand, tax increases may generate gains for society as a whole only in the longer term while inflicting short-term pain on certain segments of society. Those affected may be highly vocal and well organized. The rich and middle-class voters may also have very different notions about which tax hikes are palatable (Alt, Preston, and Sibieta 2010). This suggests that voters can penalize governments for undertaking actions that go against their policy preferences and economic interests.

ART: ISTOCK / NEYRO2008

Design matters

How tax reforms are designed and implemented affects whether political incumbents are reelected.

(percent)



Source: Chen and others (2019).
Note: Selected results, with a significant test for the difference in regression coefficients (beta). For instance, baseline (first column) results indicate that a 1 percent of GDP tax consolidation reform lowers the probability of government party reelection by 8 percent. CIT and PIT refer to corporate income tax and personal income tax, respectively. * = Reforms motivated by other factors are not reported.

On the other hand, tax hikes may not be a deal breaker if voters themselves are fiscally prudent and view them as being economically necessary. It could also be the case that the electorate places relatively less weight on fiscal adjustments—even when unpopular—if undertaken alongside other beneficial reforms, or if they care more about other political attributes, such as party ideology.

What, then, can be learned from past tax-based consolidations?

Tax reform and election outcomes

In a recent study, we sought to answer this question, using a newly compiled database of tax-based fiscal consolidations for 10 advanced economies (Dabla-Norris and Lima 2018). The database has comprehensive information on a series of tax reforms, including their magnitude, precise announcement and implementation dates, and the motivation behind each. We looked at both direct (corporate and personal income tax) and indirect tax (value-added tax and excises) reforms from 1973 to 2014. We then examined electoral outcomes such as reelection of the incumbent government party, its leader (usually the prime minister, or the president in presidential regimes), or the percentage of votes the incumbent government party received when reelected. We controlled for a wide range of other economic and political factors (for example, government popularity at the time of reforms, parliamentary support for the government), other country-specific characteristics, and global shocks that could affect reelection outcomes.

Voters indeed seem to punish political incumbents for undertaking tax-based fiscal consolidation (see chart). The likelihood of reelection of the incumbent government or its leader falls significantly after these episodes. For example, 1 percentage point of GDP tax consolidation lowers the probability of reelection of the government by about 8 percentage points. The incumbent party is also likely to receive fewer votes than in the previous election.

A political strategist in the United States once noted, “It’s the economy, stupid.” This is not just a pithy catchphrase—prevailing economic conditions do make a difference at the ballot box. Voters tend to penalize the ruling party even more when tax reforms are implemented during recessions. This is because when countries tighten fiscal policy during bad times, the economy can contract even further, creating more short-term pain than would otherwise be the case (Auerbach and Gorodnichenko 2012). When voters are subjected to this additional pain, tax hikes become more challenging politically.

Further, not all tax reforms are equal from an electoral perspective. On the surface, voters appeared to penalize governments equally for implementing direct and indirect tax reforms. But among direct taxes, corporate income tax increases can exact a higher cost at election time than personal income taxes. This is not entirely surprising, since corporate income tax reforms affect more organized and politically influential interest groups. By contrast, personal income tax increases are more diffuse because they often include offsetting measures targeted toward specific groups. For instance, higher tax rates for certain income tax brackets are typically accompanied by changes to particular allowances and deductions, tax credits, and special tax treatment for capital gains—all of which tend to have a differential impact on taxpayers.

Once the virus is beaten back and the global recession bottoms out, public finances will have to be put back in order, especially in countries where debt was already high.

Reform design in terms of the timing of tax measures and the electoral cycle can shape political costs. Voters tend to penalize governments more for announcing front-loaded reform efforts that result in higher tax payments immediately than for back-loaded measures that entail a gradual increase in tax liabilities.

Does this indicate electoral myopia? Yes, but not entirely. While reforms announced in the run-up to elections entail higher electoral costs, the effect again depends on reform type. For example, personal income tax reforms have virtually no impact on reelection odds when announced two years before the beginning of the government's new mandate but can exact a heavy toll just before an election (the probability of reelection falls by almost 15 percentage points). Politically influential corporate lobbies that are narrowly focused on their interests, however, tend to be less forgiving if corporate income tax reforms are implemented, irrespective of the electoral cycle.

Ideology matters

A popular government that enjoys broad-based support for its policies, as measured by the percentage of votes it received when first elected, is less likely to be punished in subsequent elections for implementing tax reforms, even politically costly corporate income tax hikes. Not surprisingly, voters have no such reservations when it comes to governments with a weaker political mandate, which invariably pay a price at the polls.

Interestingly, the political orientation of the incumbent government matters for some tax reforms. Voters, on average, tend to punish right-wing governments, which typically run on low-tax, pro-business platforms, for implementing personal income tax reforms that lower the progressivity of the tax system and—to a lesser extent—for raising corporate income taxes.

Finally, voters seem to care about the reasons behind the tax consolidation. Contractionary tax measures aimed primarily at lowering existing deficits and debt entail larger electoral costs than consolidation measures aimed at improving long-term growth prospects. Examples of such long-term growth reforms include measures announced by the Australian government in September 1985 or the UK government in 1991, when some tax rates were increased to finance long-term growth. This is because voters care about their own long-term prospects or the well-being of future generations. Or voters may perceive tax measures implemented to ameliorate existing large deficits and debt as a signal of the government's inability to tackle economic problems.

Bottom line

Politicians may view the eventual consolidation of public finances from the COVID-19 shock with some trepidation given the tough fiscal choices they will inevitably face. But tax-based fiscal consolidation does not necessarily have to be politically costly. Electoral costs can be avoided, or at least significantly reduced, if economic and political considerations are factored into policy design. FD

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CAUGHT *by the* CRESTING DEBT WAVE

Past debt crises can teach developing economies to cope with COVID-19 financing shocks

M. Ayhan Kose, Franziska Ohnsorge, Peter Nagle, and Naotaka Sugawara

The COVID-19 pandemic is a blow to an already fragile global economic outlook. The health crisis, sharp downturn in activity, and turmoil in global financial markets caught emerging market and developing economies at a bad moment. The past decade has seen the largest, fastest, and most broad-based increase in debt in these economies in the past 50 years. Since 2010, their total debt rose by 60 percentage points of GDP to a historic peak of more than 170 percent of GDP in 2019 (see Chart 1). Although China accounted for the bulk of this increase—in part due to its sheer size—the debt buildup was broad-based: in about 80 percent of these economies, total debt was higher in 2018 than in 2010. Even excluding China, debt rose by 20 percentage points of GDP, to 108 percent, in 2019. As these economies respond to the pandemic, their debt will only increase.

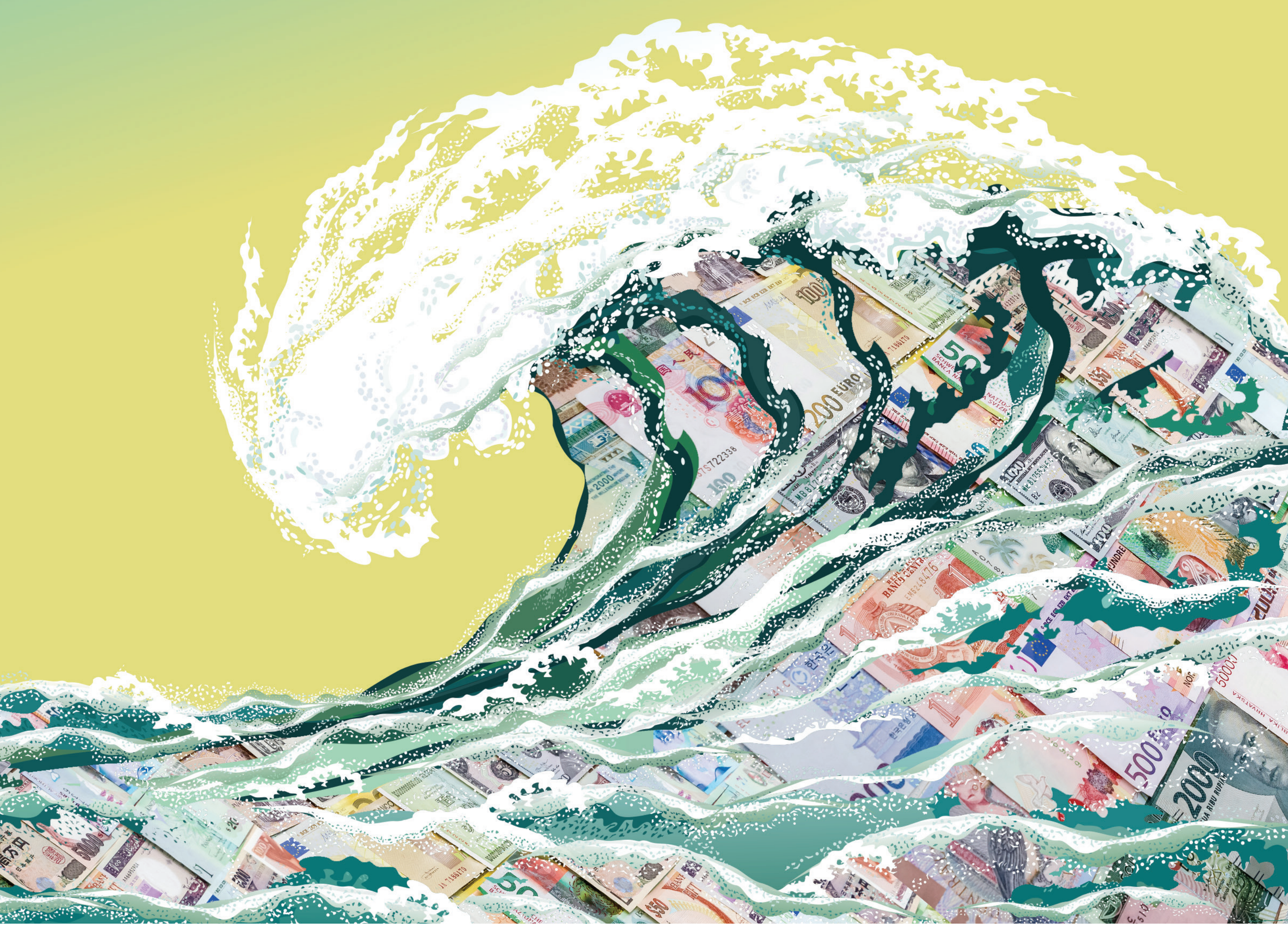
The current global recession is unusual in its severity. Like previous crises, it is testing the resilience of heavily indebted countries and companies.

What policies do highly indebted emerging market and developing economies need to implement to mitigate the damage of the pandemic and support a durable recovery? History can give policymakers some useful pointers.

Debt waves

As documented in our recent study, *Global Waves of Debt,* before the current period, emerging market and developing economies experienced the following three waves of broad-based debt accumulation between 1970 and 2009:

- ***1970–89:*** A combination of low real interest rates and a rapidly growing syndicated loan market through much of the 1970s encouraged governments in Latin America and low-income countries, especially in sub-Saharan Africa, to borrow heavily—culminating in a series of financial crises in the early 1980s. A prolonged period of debt relief and restructuring followed—through the Brady Plan, the Heavily Indebted Poor Countries Initiative, and the Multilateral Debt Relief Initiative (the latter two with IMF and World Bank support)—yet this was still a lost decade for growth and poverty reduction.
- ***1990–2001:*** Financial and capital market liberalization enabled banks and businesses in east Asia and the Pacific and governments in Europe



and central Asia to borrow heavily, particularly in foreign currencies—ending with a series of crises during 1997–2001 once investor sentiment soured. Resolution of private debt required large-scale bank and corporate bailouts, often with assistance from the World Bank and the IMF.

- ***2002–09:*** A run-up in private sector borrowing in Europe and central Asia from EU-headquartered megabanks followed regulatory easing—when the global financial crisis disrupted bank financing during 2007–09—and tipped several of these economies into recession. Debt resolution was a pan-European effort and, again, required bank bailouts and international assistance.

The three historical waves of debt had several things in common. They all began during periods of low real interest rates and were often facilitated by financial innovations or changes in financial markets that promoted borrowing. The waves ended with widespread financial crises and coincided with global recessions (1982, 1991, 2009) or downturns (1998, 2001). These crises were typically triggered by shocks that resulted in sharp increases in investor risk aversion, risk premiums, or borrowing costs, followed by sudden stops of capital inflows and deep recessions. The financial crises were usually followed by reforms designed to lower vulnerabilities (including greater reserve accumulation) and strengthen policy frameworks. Many emerging economies introduced inflation targeting, greater exchange rate flexibility, fiscal rules, or more robust financial sector supervision following financial crises.

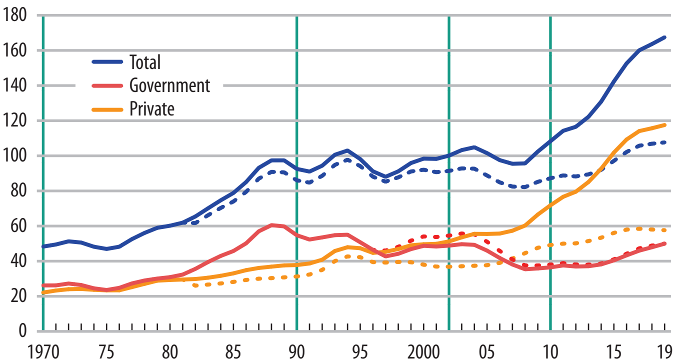
The first three waves also differed in important ways. The financial instruments used for borrowing evolved as new instruments and financial actors emerged. The first wave saw rapid debt accumulation by emerging economy sovereigns, whereas the subsequent two waves were mostly about borrowing by the private sector (although during the Asian crisis, many companies were quasi sovereign). The severity of the economic damage varied among financial crises and across regions. Output losses were particularly large and protracted in the wake of the first wave, when most of the debt was accumulated by governments. Meanwhile, in many economies, better policy frameworks after the first two debt waves helped mitigate the damage of the global financial crisis that marked the end of the third wave.

ART: ISTOCK / TATIANA LIUBIMOVA; ALFEXE

Chart 1

Ballooning debt (1970–2019)

During the past decade, total debt in emerging market and developing economies rose to a historic peak.

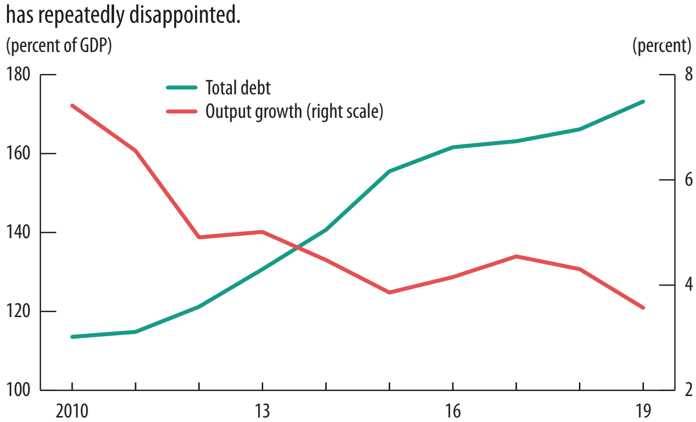


Sources: International Monetary Fund; Kose and others (2020); and World Bank.
Note: Aggregates are calculated using current US dollar GDP weight and are shown as a three-year moving average. Dashed lines show debt, excluding China. The vertical lines represent the beginning of debt waves in 1970, 1990, 2002, and 2010.

Chart 2

Growth and debt (2010–19)

Accompanied by higher debt in emerging market and developing economies, growth has repeatedly disappointed.



Sources: International Monetary Fund; Kose and others (2020); and World Bank.
Note: Total debt (in percent of GDP) and real GDP growth (weighted by GDP at 2010 prices and exchange rates) in emerging market and developing economies.

Fourth wave

During the current debt wave—which began in 2010—debt has reached record highs, and private sector debt has risen particularly fast. Among commodity exporters, public sector debt increased substantially following the 2014–15 commodity price plunge. The current wave shows some interesting similarities and differences compared with previous waves. Echoing some of the historical cases, global interest rates have been very low since the global financial crisis, and—until the pandemic hit—the ensuing search for yield by investors contributed to narrowing spreads for emerging economies. Until recently, some major changes in financial markets again boosted borrowing, including through a rise in regional banks, growing appetite for local currency bonds, and increased demand for emerging market and developing economy debt from the expanding nonbank financial sector. As during the earlier waves, vulnerabilities have mounted in these economies with the advance of the current wave amid slowing economic growth.

There are also key differences. The average annual increase in debt since 2010 of almost 7 percentage points of GDP for this category of countries is significantly larger than during each of the previous three waves. In addition, whereas previous waves were largely regional, the fourth wave has been widespread, with total debt rising in almost 80 percent of these economies and by at least 20 percentage points of GDP in more than 45 percent. Following a steep decline during 2000–10, debt also rose in low-income countries, to 65 percent of GDP in 2019, up from 47 percent of GDP in 2010. Last, debt has risen in the nonbank financial system, which appears to be more lightly supervised and less resilient than the banking system, which was thoroughly restructured after the global financial crisis.

Emerging market and developing economies have endured periods of volatility during the current wave of debt accumulation, but widespread and severe financial stress emerged only after the COVID-19 pandemic hit. These economies' ability to withstand financial stress is further complicated by other weaknesses, such as growing fiscal and current account deficits and a shift toward riskier debt. The share of government debt held by nonresident investors climbed to 43 percent in 2018, and foreign-currency-denominated corporate debt rose from 19 percent of GDP in 2010 to 26 percent of GDP in 2018. Among low-income countries, more than half of government debt is on nonconcessional terms. A mounting stock of debt and riskier debt composition have accompanied a decade of repeated growth disappointment (see Chart 2).

The pandemic has brought an abrupt end to financial market tranquility and is now testing the resilience of the economies, institutions, and policies of emerging economies. They are facing an unfolding global recession in a much more vulnerable position than when the 2009 crisis hit. Recent developments may tip some of them into the widespread debt distress that marked the

end of previous waves. This is all the more likely given, first, the exceptional severity of the current recession, which is reaching into every corner of the global economy, and second, poorer prospects for a robust rebound amid possible repeat outbreaks and mounting backlash against globalization.

Surfing the wave

Right now, tackling the health crisis is paramount, whatever the fiscal cost. Fiscal deficits in these economies are expected to widen by about 5 percentage points of GDP, on average, in 2020 (IMF 2020). Investors are more likely to accept these precarious fiscal positions, including high debt and large deficits, if countries introduce mechanisms and institutions today that will restore fiscal sustainability once the recovery gets underway.

The experience of past waves of debt points to the critical role of policy choices in determining the outcomes of debt waves. While external shocks typically triggered financial crises, the impact on individual economies was heavily influenced by domestic policy frameworks and choices. Specific policy priorities ultimately depend on country circumstances, but—based on our analysis—there are four broad strands of policy that can help emerging economies weather the current global recession despite high debt:

- ***Sound debt management and transparency:*** Countries are in dire need of financing, and sound debt management and debt transparency are critical to ensure that today's debt can be repaid tomorrow and that borrowing costs are kept in check, debt sustainability is eventually restored, and fiscal risks are contained. If central banks contribute to fiscal financing, frameworks ensuring a return to pre-pandemic monetary policy can encourage investor confidence. Creditors, including international financial institutions, can spearhead efforts in this area by promoting common standards.
- ***Good governance:*** Even with large-scale fiscal stimulus to support today's plunging activity, money must still be spent wisely. In several previous crisis cases, it became apparent after the fact that borrowed funds went toward purposes that did not raise export proceeds, productivity, or potential output. Especially in light of the dramatic economic disruption in the current global economy, sound bankruptcy frameworks are needed to help prevent debt overhangs from weighing on investment for prolonged periods.
- ***Effective regulation and supervision:*** While temporary regulatory easing is appropriate in the current context, proactive financial sector regulation and supervision can help policymakers identify and act on emerging risks. As the recovery gets underway, deeper financial markets can help mobilize domestic saving, which may be a more stable source of financing than foreign borrowing.
- ***Robust macroeconomic policies:*** Robust monetary, exchange rate, and fiscal policy frameworks can safeguard emerging market and developing economies' resilience in a highly fragile global economic environment. Current market pressure limits foreign currency exposure, but flexible exchange rates can soften some of the blow on the domestic economy in the short term; longer term, flexible rates can discourage the buildup of substantial balance sheet mismatches and ward off large exchange rate misalignments. Amid today's financing pressures, revenue and expenditure policies must be adjusted to expand fiscal resources for priority spending on health and support for vulnerable groups. Invoking escape clauses to fiscal rules during the crisis may be necessary, but it is these rules that will help restore fiscal sustainability when recovery gets underway. Once the recovery gets going, though, fiscal rules and frameworks that ensure the eventual unwinding of stimulus and return to fiscal sustainability are essential.

Only time will tell whether the current debt wave will end as its predecessors did, with a string of financial crises. The nature and magnitude of the shock imposed by the pandemic will stretch even the most resilient economies. Global cooperation and support are more critical than ever. But we must remember the number one lesson of previous debt waves: domestic policies are essential when it comes to fending off financial crises. FD

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On Central Bank Independence

The author of Unelected Power *discusses constitutionalist central banking in a world of inert politics*

Paul Tucker

PHOTO: MARTHA STEWART

LET'S BRIEFLY TAKE A STEP back to the world of 2018–19. Politicians were attacking central bank monetary policy and bank supervision across the world: from the United States, via Italy and Turkey, to India. Powerful private sector actors wanted central banks to buy equities from them whenever the next recession arrived. And technocrats themselves were embracing think tank calls to steer the supply of credit to tackle climate change, inequality, productivity growth, and other pressing social problems, even while some were hauled up for intervening in politics and so departing from their mission.

Around the world, the political left was calling for "People's Quantitative Easing"; libertarians sought salvation in privately issued cryptocurrencies; and the conspiratorialist fringe persisted in seeing monetary officials as in league with enemies of the people.

Whether you cheer or choke on that, it was obvious, even before COVID-19, that something was going on in the once-sober world of central banking. Being the only game in town was turning out to be a political, even constitutional, nightmare.

And then came COVID-19, returning central banking to the kind of role it played when, from the 1930s to the 1980s, it was merely an instrument for finance ministries. In some jurisdictions (notably the United States and the euro area), the central bank has in effect been standing in for governments that cannot act decisively or promptly, risking becoming the de facto fiscal authority. In others (perhaps the United Kingdom), the central bank will finance executive government, possibly without a framework that ensures an exit route, and risking releasing executive government from the constraints of the elected assembly.

Two models of central banking

Those latest developments remind us that two quite different models of central banking prevailed in the past. One sees a country's central bank as the operational arm of government financial policy, its functions determined by technocratic comparative advantage. This model is rooted in central banks being the pivot of the payment system, as Francis Baring observed toward the end of the 18th century. As the banking community's team captain, they provide, in economic terms, club goods.

Under the other model, central banks are independent authorities delegated specific responsibilities and formally insulated from day-to-day politics. They provide public goods (such as price stability) and preserve common goods (such as financial stability) that can be enjoyed by all but eroded by the exploitative.

Those modes of existence are so distinct that passage from one to the other is often fraught. In emerging market economies, even after formal independence, central banks are sometimes expected (and occasionally want) to continue to provide a very wide range of services to their society. In advanced economies, the transition from subordinate agent to independent trustee has typically raised questions about boundaries, sometimes at the cost of welfare.

For example, as the Bank of England sought during the late 1980s and early 1990s to make itself tolerably fit for monetary independence, it voluntarily dropped its involvement in industrial finance, corporate governance, some noncore banking services, and all securities settlement services. And yet, in 1997, when independence finally arrived, banking supervision was still transferred elsewhere, with fairly catastrophic effects in the years leading up to and through the 2007–08 crisis. This episode has lessons for all as it reflected underlying tensions in the division of power between monetary authorities and treasuries.

Central banks' power today

Today's central banks are, of course, extraordinarily powerful. First, the right to create money is always latently a power of taxation, capable of redistributing resources across society and between generations through a burst of surprise inflation (or deflation). Second, as lenders of last resort, central banks can potentially pick winners and losers. Third, through the terms of their financial operations (collateral, counterparties, and so on), they can affect the allocation of credit in the economy. Fourth, acting as banking system supervisors, they are, like regulators in other fields, effectively delegated lawmakers and judges.

It might not seem surprising, then, that the emblematic crisis managers of the 2008–09 collapse were Ben Bernanke, Tim Geithner, Jean-Claude Trichet, and Mario Draghi, none of whom has ever held elective office. But it used to be different. The face most people associate with the world's response to the Great Depression is that of President Franklin D. Roosevelt. Eighty years later, elected politicians did not even take the lead in explaining to the public the crisis-management measures taken in their name and for their sake. Something has changed, and not for the better.

We need some principles: political principles. Anyone committed to the separation of powers that lies at the heart of constitutional government should want central bank independence to be preserved. Otherwise, presidents and prime ministers could use the printing press to fund their pet projects and enrich supporters without having to go to the representative assembly for legislated approval. Aspirant authoritarians, on the left or right, will be alert to the attractions of seizing or suborning the monetary power; the IMF should catalogue past examples.

But while an arm's length monetary authority, insulated from day-to-day politics, can help underpin a constitutional system of government, unelected central bankers surely need to be constrained by legislation. Legitimacy depends on it, which matters greatly because that is what holds things together when, occasionally but inevitably, public policy fails the people.

To be accepted as legitimate, a government institution's design and operation must comport with a political society's deepest political values. For constitutional democracies, these include the values of democracy, of constitutionalism itself, and of the rule of law. Central banking cannot be excluded.

Anyone committed to the separation of powers that lies at the heart of constitutional government should want central bank independence to be preserved.

My book *Unelected Power* sets out principles of delegation for independent agencies. These include, to mention just a few, being set an objective that can be monitored; not making big distributional choices; one-person, one-vote committee decision-making; published operating principles for the exercise of delegated discretion; transparency and public comprehensibility; formal suspension of independence; and a lot more.

For central banking, those principles can guide the articulation of an economy's *money-credit constitution*, covering the private as well as the public elements of the monetary system, including

- For *monetary policy:* a clear nominal objective, and no autonomous power to inflate away the debt, which should be reserved to legislators
- For *balance sheet operations:* operations and balance sheets that are as simple and as small as possible, consistent with achieving objective(s); major distributive effects should be cooked into the delegation and not result from discretionary choices
- As *lender of last resort:* no lending to firms that are fundamentally insolvent or broken
- For *stability policy* (in which the lender of last resort cannot avoid involvement): a mandate to achieve a monitorable standard for the

It is important to remember that there have always been enemies of independence.

resilience of the private components of the monetary system, including shadow banking

- For *microprudential policy:* a requirement that banking intermediaries hold reserves (or assets readily exchanged for reserves), which increases with leverage and riskiness and with the social costs of their failure
- *Across the board:* not exceeding powers during an emergency, and any temporary expansion or unusual use of powers being made subject to a clear framework that is consistent with central banking's core mission and provides an exit route
- *Organizationally:* the chair not being the sole decision-maker on anything
- *Accountability:* transparency in all things, even if only with a lag where immediacy would be perverse
- *Communications:* use of the language of the public rather than only of high finance and monetary economics
- *Self-restraint:* staying out of affairs that are neither mandated nor intimately connected to legal objectives

Operational arm redux

The pandemic that began at the turn of 2019–20 seems a world away from those principles. In both the United States and the euro area, central bankers have, at times, again been the de facto actors, because the wider constitutional setup deprives elected officials of decisiveness.

When evaluating the constitutional politics of central banks' extraordinary measures to preserve our economies—ensuring cash reaches households and businesses—it is necessary to discern where each facility lies on a spectrum between independence and subordination. At one end, the central bank operates freely within its mandate but is guaranteed by the finance ministry in recognition that taxpayers ultimately bear the risk.

Moving toward the other end, the central bank acts on behalf of the government. It merely executes the finance ministry's discretionary decisions, taking no risk itself and providing monetary financing (directly or indirectly) only if, acting independently, it so chooses. This is still the central bank as arm's length institution. Beyond are facilities conducted on the central bank's balance sheet on the instruction of government, as well as operations conducted on the government's balance sheet that are forcibly financed via the printing press.

For each intervention, the survival of independence turns on who is really deciding what. Where independence is in effect suspended, that ought to be clear, as should the exit route.

In confronting these possibilities, it is important to remember that there have always been enemies of independence. Within a rich repertoire for undoing an economy's monetary constitution, they can deploy two broad strategies, each with obvious and opaque variants.

One way to bring central banks to heel is through appointments. As seen recently in the United States, that is not easy when favored candidates fall well short of the normal credentials. More troubling are appointees who seem reasonable, excellent even, but turn out to be discreetly committed allies of leading politicians. The most famous case, also during turbulent times, is the former Federal Reserve chairman Arthur Burns, a leading economist who put Richard Nixon's 1972 reelection prospects ahead of the Fed's statutory mandate. No one should think that was the last example of a political outrider occupying the monetary corridors.

The other way to undermine independence is through a change in mandate. The crude variant involves simply voting to compromise or repeal the central bank law. That isn't easy, because it is highly visible. The subtle, almost paradoxical, strategy gives the central bank *more* responsibility—so much so that any decent official would feel duty bound to consult political leaders on how to use their extensive powers. The more central banks acquiesce (even revel) in the "only game in town" label, the easier it becomes for politicians to give them more to do, and so undo them.

Restoring independence

If our societies want to maintain the institution of central bank independence as a way of committing to monetary system stability and the fiscal separation of powers, and if we want to be able to reinstate independence after the pandemic crisis, care is needed. Here are five steps.

- *An exit route from being the finance ministry's operational arm back to independence* once the pandemic has passed, and defensible decision-making authority meanwhile
- *Revision of monetary regimes to allow stabilization policy to operate when the zero lower bound might bite more frequently* (if productivity growth does not rebound)
- *A review of stability mandates, including a general policy regime for shadow banking, a legislated standard for financial system resilience, a statutory bar on lending to fundamentally broken financial firms, and increased independence from the industry*—such a package might have impeded the rash of imprudent deregulatory measures introduced over the past few years, which left trading markets overleveraged when the pandemic crisis broke
- *Restraint by central bankers,* limiting themselves, when independence is operative, to the mission of preserving monetary system stability rather than offering to solve all society's problems
- *Widespread vigilance and awareness of subtle but cumulative attempts to repoliticize central banking to serve sectional interests*—what is cheered today might bring tears tomorrow. Politics is an opportunistic trade, and there is scant scrutiny of the subtleties of monetary institutions.

Whatever the current pressing expedients, which are obviously very real and urgent, it is worth preserving the integrity of our institutions in the longer run.

PAUL TUCKER is chair of the Systemic Risk Council and a research fellow at Harvard University's John F. Kennedy School of Government. This article draws on his 2018 book *Unelected Power: The Quest for Legitimacy in Central Banking and the Regulatory State*, published by Princeton University Press.

RECKONING WITH SYSTEMIC HAZARDS

The 21st century is set to be one of massive disruptions that pose serious threats to society

Ann Florini and Sunil Sharma

The pressures of the COVID-19 pandemic are forcing an overdue reckoning about our world's ability to manage systemic hazards. Driven by increasing fragility in our political, social, economic, and financial orders—all dependent on a natural environment nearing the brink—these apparent bolts from the blue will keep striking. With all systems simultaneously in flux, the 21st century is set to experience massive disruptions that pose serious and possibly existential threats to society.

Coping with such problems will require major changes to how we make and carry out decisions. For decades, humanity has tried to run economies, indeed whole societies, as though they were complicated machines that just needed tinkering and control of a few key levers to obtain optimum performance. But lately, we have begun to see the error of such thinking. The myopic behavior and narrow focus on efficiency and shareholder financial returns that have dominated political and economic decision-making for decades have yielded somewhat efficient but largely fragile systems stripped of resilience.

Political economy thinking has long expanded the technocratic view of governance to encompass the importance of political power and vested interests in shaping rules, incentive structures, and resource allocation. Now, to address the complexity of a much larger population interacting ever more intensively, with much greater social and environmental impacts, our understanding of political economy must extend further. Instead of putting efficiency first, policies must ensure societies' resilience to the full range of threats, including pandemic diseases, climate volatility, and economic and financial stress.

Political turmoil

Political systems today often reflect the preferences of their elites and struggle to serve the needs of the broader public. Until the pandemic hit, mass protests were erupting around the world, from Chile to Hong Kong SAR, often spurred by sparks of discontent that triggered firestorms of anger. The rise of national populism and political polarization in many parts of the world, including leading democracies, reflects a breakdown of trust in institutions and in fellow citizens—undermining the social trust on which governance depends. And at the global level, the post–World War II formal international order that underpinned stability and prosperity for a large share of humanity is currently rudderless and possibly disintegrating.

The pandemic has exposed, not caused, these weaknesses, and societal responses offer clues about how to build more resilient polities based on renewed social trust. Much of the biomedical science community has jettisoned competition for prestigious publications and grants to share research. Foundations and informal networks, from alumni associations to coders to entrepreneurs, have organized volunteers and mobilized supplies, first for Wuhan and now around the world. Most important, growing recognition of the social value of inadequately compensated service workers, from health aides to meatpackers to teachers, may foster political momentum to redress the inequalities that have polarized societies and undermined social trust.

Economic and financial fragilities

Policy responses to the 2008 financial crisis staved off imminent collapse but failed to put us on a path toward sustainable and inclusive growth. Politically constrained fiscal policy did not fully rise to the task. Monetary policy, traditional and novel, tried to fill the gaps but now seems exhausted and ineffective. Asset prices recovered after the crisis, but private and public debt have continued to grow, and wealth inequality within many countries has soared. Global demand remains deficient, and inflation rates refuse to rise to the targets set by many central banks.

The response to the coronavirus pandemic has effectively put the global economy in a temporary coma, exacerbating the difficulty of tackling the ongoing challenges: inadequate health and social security systems; high debt among financial and nonfinancial institutions, households, and governments; income inequality; deficiencies in corporate governance; weak government oversight and regulation; and destruction of the environment. These challenges are taking place in economic and financial systems on the brink of profound change driven by innovations, from blockchain technology to artificial intelligence.

ART: ISTOCK / MUSTAFAHACALAKI

The 2008 crisis provided a crucial lesson in the need for systemic approaches to financial stability (see Agur and Sharma 2015 and Arner and others 2019). It demonstrated that traditional microprudential rules had focused too much on individual financial actors, ignoring the inadvertent collective outcomes of market interactions. Countries responded to the financial crisis by creating macroprudential regulatory frameworks and agencies to ensure the stability and resilience of the financial sector. Decision-makers must expand this systemic thinking to encompass the entire economy and invest in broader public engagement to enable reform and development of durable solutions.

Planetary upheaval

The scale of the environmental crisis finally seems to be hitting home across the world. Battered oceans, collapsing ecosystems, species extinctions, and extreme weather are generating refugee flows, undermining agriculture, and threatening global supply chains. Without dramatic action, within decades rising seas will swamp cities from Shanghai to Miami, and temperatures may soar beyond habitable levels for a large swath of the planet. But the standard policy tool kit does not adequately support action at the local level, where the impacts are felt, and is still divided into unconnected regulatory structures for managing pollution and environmental destruction as "externalities" rather than elements of an interconnected system.

The 2015 Paris Agreement on climate change illustrates how a broad common goal and appropriate institutional structures are a better approach to managing systemic complexity (Florini and Florini 2017). The Paris Agreement set a goal of global warming below 2°C and preferably below 1.5°C, but, unlike previous failed efforts, it does not demand agreement on the solution. Instead, it requires its parties to determine nationally what actions they want to take, report regularly on their emissions and actions, and come together every five years to update those national plans as scientific understanding and technology develop. Crucially, it actively promotes the engagement of cities and other subnational actors, civil society, and the private sector, unleashing an abundance of meaningful, loosely connected multi-stakeholder initiatives that could, if fully implemented, bring us close to meeting the 2°C target. The Paris approach combines a centrally shared vision with strong encouragement for decentralized, flexible execution by multiple actors: an approach well suited to managing complex systems (Kupers 2020).

Interactions of the spheres

All three spheres that determine human well-being—politics, economics, and natural systems—are becoming more fragile and harder to manage. And those fragilities interact.

An economy that produces rising inequality and a physical environment marked by climate volatility and collapsing ecosystems make it harder for the average household to fend for itself, leading to more divisive politics that are then less able to build broad societal resilience to downward income trends and climate change. Corporate and financial sectors that focus solely on profits while shirking responsibility for the environment and society—coupled with weak political and regulatory oversight—are likely to worsen both inequality and the climate emergency. This in turn will damage both the corporate and financial sectors as well as the political system. A climate crisis, coupled with dysfunctional governance, is likely to lead to an economy that is bad for business and the financial sector, as firestorms, extreme weather, and rising sea levels disrupt supply chains and drive workers to unwanted migration.

Now we face the monumental task of rethinking how to govern and manage. If our existing tools are not working, what should we do instead?

Governing systemic hazards

Our current political systems—governments, legislatures, and bureaucracies—can do a good job with predictable problems. They apply rules developed through experience and analyses that draw on historical data. This approach works for many tasks. But standard government processes assume predictability, depend on agreement about likely future events, and divide decision-making into narrow silos. They cannot effectively manage hazards that cross silos and are inherently unpredictable.

Because we know that pandemics, economic crises, and environmental instability will hit hard, but cannot predict exactly where or when, we need to give resilience—society's ability to absorb and adapt to change and prevent systemic breakdowns—equal billing with the efficiency concerns that now dominate. Complex systems involve multilayered interactions across a variety of people, sectors, institutions, and policies—interactions with a dizzying array of feedback loops, path dependencies, time lags between cause and effect, and tipping points.

The reality of systemic hazards—with their complexity, uncertainty, and ambiguity—calls for decision criteria based on a new set of principles:

- **Robustness:** Decision-makers should aim for robust, rather than narrowly optimized, choices that will work in a wide range of future scenarios. These choices should be flexible enough to take advantage of opportunities for a variety of future interventions and should not unduly constrain future options.
- **Multilayered governance:** Complex societies need both integrated and broad perspectives to make good decisions, requiring a "whole-of-government" approach and "whole-of-society" solutions. Collaboration between the public, policymakers, experts, and other stakeholders regarding knowledge, experience, interpretation, concerns, and perspectives is critical.
- **Empowered self-organization** (McChrystal and others 2015): Systemic fragility can manifest in different ways in different places—for example, as in the case of climate impacts that require flexible self-organized action by a wide range of societal actors. Policymakers can do much to inform, empower, and coordinate such bottom-up responses, which are beyond the capacity of central governments alone.
- **Communication:** Communication of societal dynamics to the public is difficult but crucial. It is hard to agree on a set of policies or structural changes without some shared understanding of the nature of the complex problems we face. Public comprehension generates trust and collective ownership of decisions.
- **"Horizon Scanning" and early action:** Despite the unpredictability of complex systems, such techniques as horizon scanning and scenario analysis can often detect signs of emerging problems that could cause systemic disruption. The recent global financial crisis and the current pandemic have made it clear that systemic disruptions inflict huge societal costs. Societies must motivate their leaders to focus on prevention.

The 21st century is less and less the world of our forebears. Technology is upending the nature of economies and human interaction. Power is flowing away from traditional governors but not toward any well-structured institutions that can reliably manage the changing global order. Storms, heat waves, floods, and droughts are regular and deadly reminders of shifting climate patterns. Social unrest is rising along with inequality, and no one is sure where the jobs of the future will come from or what the social contract will look like.

In this world, there is no way to predict the exact consequences of systemic fragilities. Our decision-making institutions and processes, which assume an unrealistic degree of predictability, have yet to adapt to this reality.

But recent action on the political, economic, and environmental fronts gives clues about how to proceed and key principles that can guide us through the transition to a new political economy. People around the planet are experimenting with ways to implement these principles, from "futures" departments in national governments, to "circular economy" production designs that eliminate waste, to multi-stakeholder networks focused on systemic transformation. The pandemic and its consequences should spur the scaling up of those experiments to bring about the kind of resilience that our complex global society so desperately needs. FD

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PHOTO: COURTESY OF FEDERICO GUTIÉRREZ

The Medellín Miracle

*Former mayor **Federico Gutiérrez** discusses how prioritizing security and sustainability paved the way for a 21st century city*

IN 1991, MEDELLÍN, Colombia's second-largest urban area, was the world's most violent city. Today, the "City of Eternal Spring" is internationally recognized as one of the most innovative, inclusive, and sustainable cities in the world.

Federico Gutiérrez, born in Medellín in 1974 at the advent of Colombia's violent period of armed conflict, was the city's mayor from January 2016 until January 2020—helping spearhead many efforts to cement the city's future as one of peace and prosperity. He credits the determination and unity shown by the people of Medellín for their commitment to overcoming violence and conflict, which has won their city accolades and admiration. Speaking with F&D's Marjorie Henríquez, Gutiérrez shares his thoughts on the city's remarkable transformation over the past three decades.

F&D: What was the turning point for Medellín?
FG: In the 1980s and 1990s our society hit rock bottom with the tragedy of narcoterrorism. In 1991 we recorded a homicide rate of 381 murders per 100,000 inhabitants. Today the rate is approximately 20 per 100,000 inhabitants—a 95 percent decrease. Although the only acceptable figure is zero, we have achieved significant progress in curbing violence and ensuring respect for life.

As to whether there was a specific turning point, that is complicated and open to debate. Ever since businesspeople decided to stay in Medellín in the 1980s and 1990s—not giving in to the violence—we began to develop a vital strategy rooted in teamwork. The business fabric of our city is extremely solid, and this can be explained to a great extent by the difficulties that the private sector had to face in order to survive. In the midst of violence, staying was a great act of bravery.

There were no shortcuts, but there were practical solutions. One of the latter involved partnerships between the public sector, private sector, academia, and civil society. Teamwork as a society was a determining factor in the city's social transformation. The mafia upended our values: it turned hard and honest work into easy money, sobriety into opulence and, worst of all, it took the value out of life and instead put a price on it. Though we still have a long way to go, we have started recovering such values as life, respect, and freedom.

In fewer than three decades, Medellín has become a benchmark for the world. It is a socially innovative city that is today an affiliate center for the Fourth Industrial Revolution for Latin America, in partnership with the World Economic Forum. Experiencing the worst things possible as a society has made us stronger and more resilient. Medellín is a city that acknowledges its past, takes pride in its present, and above all, views its future optimistically.

F&D: As mayor, what were your key priorities?
FG: A government's priorities must, in some way, be the priorities of the people. For us, they were education, security, and sustainability.

We had the highest education budget in Medellín's history. With one of the flagship programs, we managed to return more than 8,000 children who were outside the educational system for various reasons to the classrooms. We also gave more than 43,000 scholarships for higher education. That is the best strategy for security in the long term—giving opportunities to succeed within the framework of legality.

On security, we dealt forceful blows to structures that had been operating for decades. The security issue is still quite complex. There is criminality, but it is much quieter than that of the cartels of the 1980s and 1990s. Our approach involves more than police strategies—it is a comprehensive model that provides opportunities and builds trust, fights crime, and focuses on strategic social investment by the state where there had previously been a vacuum, allowing lawlessness to prevail.

On sustainability, the first thing we did was to put air quality on the city's agenda. Due to Medellín's topography and winds, air quality decreases significantly twice a year: March and October. Institutions had the data on this for years without sharing it with the public. People thought smog was haze. We started by openly recognizing the problem. Then we set out to become Latin America's capital of sustainable mobility: we added 65 electric buses to the city's fleet, and the older buses were renovated with clean technologies. New *Metrocables* (the city's gondola lift system), 80 kilometers of new bike paths, and more sidewalks. We finished the technical, legal, and financial structuring of a new tram in the western part of the city. We also started a pilot of 100 percent electric taxis. I am an advocate of public transportation. Few things are more democratic than a good public space and a good system of mass public transport.

We also created 36 green corridors that open up the most congested roads in the city, and we planted more than 890,000 trees.

F&D: Describe some of Medellín's most innovative achievements.

FG: Some call what has happened here "The Medellín miracle." But this was no miracle—it reflects many years of hard work.

For example, with the help of the business sector, we launched Weaving Homes (*Tejiendo hogares*), a commitment to building social fabric through training in positive discipline for families. We understood that it was useless to have the best neighborhood infrastructure if what happened inside homes included violence against women and children. We also launched Medellín Embraces Its History (*Medellín abraza su historia*) to memorialize the fight for the culture of legality, which included an upgrade to the House of Memory Museum, filming documentaries, and demolishing the Monaco building—Pablo Escobar's former residence—to create space for a memorial park honoring narcoterrorism victims. We also


Medellín, Colombia

PHOTO: KAROL KOZLOWSKI/NEWSCOM

created *Parceros*—"Buddies"—a program focused on recovering young people from criminal activity.

We have built an institutional framework to support social investment. Successive administrations have given continuity to city projects with the understanding that things do not simply start afresh every four years with an election.

F&D: How did you ensure that Medellín stayed on track?

FG: Medellín's success is based on its people and shared trust. The long-term process of rebuilding the city is a collective endeavor—nobody succeeds in isolation.

The first step was to acknowledge results achieved in the past, continuing but also building on them, bearing in mind that a leader's time in office is short. We improved the quality of life, as shown by the fact that we have reached our highest point in the multidimensional quality of life index. We invested resources efficiently and transparently where needed—not where we would have garnered the most votes. We took action in areas where the city continues to reap benefits even today: fighting crime and standing up for law and order, raising awareness about the environment and air quality, curbing the school dropout rate, making a bid to become a Latin American champion for sustainable mobility, and showcasing Medellín as an affiliate center for the fourth industrial revolution.

F&D: How did you learn about the people's needs?

FG: For years I walked the streets of Medellín, talking to people even before I became mayor. As a leader, you must know how to listen, put yourself in somebody else's shoes, and understand their daily struggles. FD

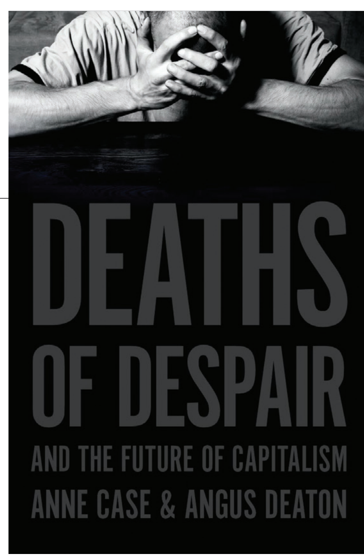
Ailing and Unequal

THIS BOOK BUILDS ON Case and Deaton's extraordinarily influential research on the mortality resulting from the tragic opioid epidemic in the United States, including suicides and alcoholic liver disease. The book is extraordinarily well written, sweeping yet succinct.

There is a brilliant tension that runs throughout the book between the boldface portion of the title, "Deaths of Despair" (a phrase Case and Deaton made famous), and the sweeping subtext of "and the Future of Capitalism." To understand it fully, one has to appreciate that Case and Deaton's studies have become a Rorschach test for journalists, opinion writers, and even many social scientists for what they believe ails America today.

Inequality, urbanization, globalization, the education divide, and the overpriced yet inadequate US

Anne Case and Angus Deaton
Deaths of Despair and the Future of Capitalism
Princeton University Press,
Princeton, NJ, 2020, 312 pp., $27.97



health system have all been singularly blamed for the shocking rise in death rates, particularly among middle-aged white men and disproportionately in poorer rural communities that have been left behind.

The authors express sympathy for progressive perspectives on modern society and what might be done to improve it, but are cautious in pinning the blame. Looking at cross-state evidence, they show "poverty is not the source of the surge of deaths of despair." While West Virginia and Kentucky are poor and have high overdose rates, Mississippi and Arkansas are also poor but do not have nearly as severe a problem. On the other hand, there are relatively rich states such as New Hampshire and Utah that have been severely impacted. New York City and San Francisco are ground zero for inequality, but have had less of an opioid problem.

Another popular culprit the authors take up is the global financial crisis. The timing would seem to make sense. Countries such as Greece had vastly deeper and longer recessions than the United States,

The real villain in the book is the US health care system.

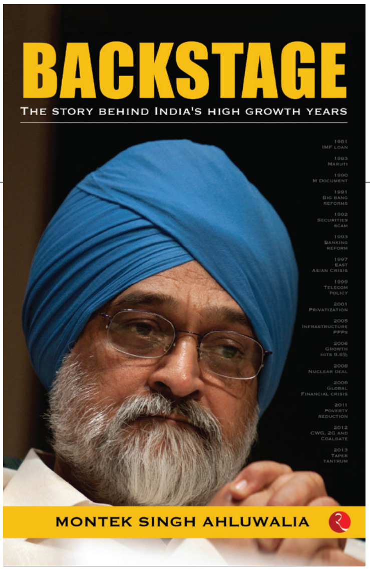
however, and even during that country's darkest hours, life expectancy continued to climb. The same was true in Spain and most of the rest of Europe. Despite these reservations about standard progressive explanations of "deaths of despair," Case and Deaton accept that in rural communities a loss of jobs and empowerment may have helped fuel the crisis.

The real villain in the book is the US health care system. The authors argue that hospitals, insurance companies, pharmaceutical companies, doctors, and device makers are all wildly overpaid by international standards, often because of the curious US tolerance for monopoly in recent decades. Case and Deaton offer an array of sensible solutions to foster lower prices and inclusion. Interestingly, however, they have no patience for those who see "Medicare for all" as a panacea. They emphasize that many countries have successful mixes of public and private care, that there is no one size fits all, and that transition effects need to be considered.

Simply put, this is a terrific book. I suspect it will be on many people's top 10 book lists of 2020. Although written before COVID-19, the book's critique of the US approach to health care and inequality is remarkably prescient. In many ways, the opioid crisis Case and Deaton analyze is a microcosm of the anguish the world is experiencing today, and we would be remiss not to pay attention to their insights. FD

KENNETH ROGOFF, Thomas D. Cabot Professor of Public Policy and professor of economics at Harvard University

India's Rise and Stall



Montek Singh Ahluwalia
Backstage: The Story Behind India's High Growth Years
Rupa Publications
New Delhi, 2020, 464 pp., $35.99

MONTEK SINGH AHLUWALIA provides an invaluable insider's account of the making of India's economic policy between 1979, when he returned to his home country from the World Bank, where we worked briefly together and became good friends, and 2014. It is the story of a substantial success.

Ahluwalia was sure that the aim in a country as poor as India had to be high economic growth. This, in turn, required economic liberalization, supported by pragmatic institutional reform. The book details how the balance of payments crisis of 1991 made this possible. The book gives due justice for seizing this opportunity to the prime minister, Narasimha Rao, one of India's most underestimated politicians. But the hero is former Prime Minister Manmohan Singh, with whom Ahluwalia worked closely throughout. Ahluwalia himself provided the needed plan in 1990 with the "M Document," which "presented an integrated strategy for reform—of fiscal policy, industrial policy, trade policy, and exchange rate policy."

Beyond question, these reforms shifted India onto a higher growth path. This became even more evident in the first decade of the new millennium, when Ahluwalia joined the United Progressive Alliance (UPA) government as deputy chairman of the Planning Commission, under Prime Minister Singh, between 2004 and 2014. As he states, "The first seven years [of the UPA government] recorded a growth rate of 8.5 percent. Indicators such as export growth, private investment, and reduction in poverty also showed excellent performance."

Yet the book also raises important questions. Here are just three.

First, as Ahluwalia notes of the 1990s, "The approach to change was a combination of gradualism and what I have called 'reform by stealth.' Why were politicians, notably the Congress Party, never willing to make the success of these reforms and the need to take them further the center of their political platform?"

Second, why has growth decelerated? Two complementary explanations emerge from the book. One is that the growth was in part a result of an unsustainable credit boom in the private sector. That left a legacy of bankrupt companies and weakened financial institutions—the "twin-balance-sheet problem." Another is that the initial reforms, predominantly liberalization following the dismantling of the "License Raj," had by then done all they could do. India needed second-generation reforms, notably of its institutions. But, as Ahluwalia writes, "we did not pay enough attention to the need to build institutions that would promote good governance."

India's economic future was quite uncertain, even before COVID-19.

Finally, what happens next? Ahluwalia describes the economic record of the six years of Narendra Modi's National Democratic Alliance government as "beginning with a bang and ending with a whimper." The government has achievements to its credit. But it has done undesirable things (notably demonetization) and not done desirable things (notably resolving the debt problem). India's economic future was quite uncertain, even before the COVID-19 pandemic.

Yet Ahluwalia himself was an optimist when he returned to India in 1979. He was also an optimist throughout his career. He is, he concludes, still today "an unrelenting optimist that...the India story of high growth and development will...continue." We must hope he is right. FD

MARTIN WOLF, *Financial Times* associate editor and chief economics commentator

Star Turn

Aruba's new banknotes spotlight the heroes among its flora and fauna

Niccole Braynen-Kimani and Melinda Weir

IT IS SAID THAT laughter is the best medicine, and for Arubans, a good dose of humor was just the remedy to help them accept the first new currency design since 1990. Before last year's overhaul, the florin had been upgraded only once, in 2003, but the former series had become outdated and a target for counterfeiting. Armed with a small team in a small bank on a small island, the Central Bank of Aruba (CBA) set out to upgrade its currency—a journey that lasted seven years, celebrated some native stars, and won the country an international award.

Blessed with beautiful beaches, cool breezes, and lots of sunshine, Arubans have plenty to smile about. But getting the local population to accept what the CBA was trying to do with its new banknote series was a challenge. "Central banks are very dry institutions," says Jane Semeleer, president of the CBA. She and her team knew that just putting the new notes into circulation and hoping they caught on might not work—an easygoing Aruban smile and nod were not going to be enough.

To introduce the elements contained in the new 2019 series to a population still attached to the country's old banknotes, the bank hit on the idea of featuring the island's indigenous wildlife in a series of comical poses for an outreach campaign called "Streanan di Aruba" ("Stars of Aruba"). Ads depicted the currency's fauna celebrities being primped for their starring roles—think Hollywood glam meets tropical wildlife: birds getting "pedicures," an iguana at the salon.

The CBA team wanted to spark public curiosity and dialogue about the native stars on the new bills, so they promoted them via social and traditional media. The campaign was a "huge success," according to Semeleer, and more than 85 percent of the old notes were returned before they were taken out of circulation.

PHOTOS: COURTESY OF THE CENTRAL BANK OF ARUBA

Humorous ads, like this one depicting the 25 florin banknote's troupial bird getting camera-ready, helped to introduce Aruba's 2019 banknote series. The 25 florin's features include the passion flower, known for its medicinal value, and traditional pottery.

Local pride

The CBA worked with local artists accustomed to capturing the island's beauty in paintings. The new designs needed to feature Aruba's flora and fauna—particularly animals that rarely get a second glance, like the red land crab, the endangered green turtle, the Caracara cheriway and the troupial bird, and the iguana—all of which now have their perpetual day in the sun on the new banknotes. Semeleer says it was important to showcase a side of Aruba other than its renowned beaches. "Nature competes with tourism, and to have a sustainable industry, we have to keep our natural habitat in balance," she stressed. "Aruba's nature is beautiful, and worth preserving."

The vibrant colors and enhanced security features of the new family of notes signaled that the CBA team might have an award-winning design series on its hands. The International Bank Note Society (IBNS) agreed, choosing the Aruban 100 florin banknote, with its cheeky young green iguana (they turn gray as they age) as 2019 Banknote of the Year.

The new banknotes also highlight historical landmarks, artifacts, and traditional Aruban culture. The back of the winning 100 florin, the most widely circulated banknote in Aruba, features dancers braiding ribbons in a folklore dance, while the 25 florin banknote heralds Amerindian pottery, and the 10 and 50 banknotes pay homage to architecture past and present.

Safe and sound

In addition to their playful characteristics, the new notes are highly durable and among the world's most secure, using such technology as high-relief printing; color-changing ink; and a 3D "motion surface," a moving stripe with miniaturized micro-optics—forensic features that make the currency easily identifiable by law enforcement and the central bank and help mitigate counterfeiting. The enhanced security features were designed by Crane Currency of Sweden.

Like those of its Caribbean neighbors and other countries around the world, Aruba's economy, with its heavy reliance on tourism, is being hurt by the COVID-19 pandemic. The island nation, however, prides itself on its resilience and its people's ability to overcome adversity.

Semeleer says that's why her personal favorite new banknote is the 200 florin, with its unassuming Caracara cheriway bird on the front and a *caha di orgel* (self-playing piano) on the back. "To me, [this bird] exudes courage and fearlessness," she says. "If you look over the years of how we survive on this small island, you need to have strength, you need to have courage." The stars of Aruba's new banknotes appear to embody the indomitable spirit Semeleer attributes to all living things on the island. FD

NICCOLE BRAYNEN-KIMANI and **MELINDA WEIR** are on the staff of *Finance & Development.*

Like all the banknotes in the new series, Aruba's 100 florin note is vertically oriented and security enhanced. As a first-time entrant in the IBNS's currency competition, the 100 florin won the 2019 Banknote of the Year award. The note's features include the charismatic iguana, ribbon dancers, and the aloe plant, one of Aruba's first exports.

The IMF and COVID-19 crisis

The IMF has responded to the COVID-19 crisis by quickly deploying financial assistance, developing policy advice, and creating special tools to assist member countries. Visit IMF.org/COVID19 to access the latest analysis and research from IMF staff in response to the pandemic.

IMF COVID-19 Hub

To find the latest news, blogs, factsheets, podcasts, and all the information on the IMF's response to the crisis IMF.org/COVID19

Policy Tracker

Learn more about key policy responses governments are taking to limit the human and economic impact of this global pandemic by country at IMF.org/COVID19policytracker

Emergency Financing

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Special Series

These notes are produced by IMF experts to provide guidance and help members address the economic effects of COVID-19. IMF.org/COVID19notes

> ***"A global crisis like no other needs a global response like no other."***
>
> —Kristalina Georgieva

Finance & Development, June 2020

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