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Global Economic Challenges and Global Solutions: an Address at The Wilson Center

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Good morning. It's a pleasure to be here. I would like to thank the Wilson Center for their kind invitation, and I would like especially to express my deep appreciation to Jane Harman. In her long and distinguished career, Jane has worked in the executive branch, academia, law, and of course Congress where she served nine terms in the House of Representatives. She has been, and continues to be, a devoted public servant. Thank you, Jane.

There couldn't be a more appropriate venue for my first major speech in Washington as IMF Managing Director. More than anyone else, it was Woodrow Wilson who championed the cause of multilateralism and global fraternity. The seeds he planted bore fruit in the postwar milieu that produced the IMF and its sister organizations. For at the heart of our mandate lies a simple but powerful idea—that cooperation can bestow not only economic stability, but a better future for all.

This idea has never been more important.

We are certainly living through times of great economic anxiety. Exactly three years after the collapse of Lehman Brothers, the economic skies look troubled and turbulent as global activity slows and downside risks increase.

We have entered a dangerous new phase of the crisis. Without collective resolve, the confidence that the world so badly needs will not return.

Woodrow Wilson once cautioned that "the thing to do is to supply light and not heat". I believe that the IMF's job is to see and show the light when the picture seems so dark, and shine the light on core economic problems—but it can also help by turning up the heat at times!

With that in mind, let me offer the following:

I believe there is a path to sustained recovery, much narrower than before, and getting narrower. To navigate it, we need strong political will across the world—leadership over brinksmanship, cooperation over competition, action over reaction.

Global outlook

Let me give you a short overview of global economic developments. Our forecasts are coming out next week, so I will confine myself today to broad trends.

Overall, global growth is continuing, but slowing down. The advanced countries in particular are facing an anemic and bumpy recovery, with unacceptably high unemployment. The euro area debt crisis has worsened. Financial strains are rising. And again—without collective, bold, action, there is a real risk that the major economies slip back instead of moving forward.

And while many advanced economies face these cold headwinds, many emerging markets are facing too much heat—inflation pressures, strong credit growth, rising current account deficits.

Low-income countries have been experiencing reasonable growth, but remain highly vulnerable to economic dislocation from elsewhere in the world—including from commodity price volatility, which comes with heavy social costs. I want to draw particular attention to the human suffering from the drought in the Horn of Africa, a devastating catastrophe. These countries need the help of the international community, urgently.

We should also keep in mind the Middle East and North Africa—embarking on a historic transformation, with people yearning for a better life and decent jobs. I am pleased to tell you that the IMF recently recognized the National Transition Council as the government of Libya, and we stand ready to help the people of Libya with technical assistance, policy advice, and financial support as requested.

What is the problem?

The title of my speech today is "Global Economic Challenges and Global Solutions". But before talking about solutions, we need to be clear about the problems. I would isolate three distinct, albeit related, issues—balance sheet pressures sapping growth, instability in the core of the global economic system, and social tensions.

A key short-run issue in advanced countries is that balance sheet pressures are knocking the wind out of the recovery. There is still too much debt in the system. Uncertainty hovers over sovereigns across the advanced economies, banks in Europe, and households in the United States. Weak growth and weak balance sheets—of governments, financial institutions, and households—are feeding negatively on each other, fueling a crisis of confidence and holding back demand, investment, and job creation. This vicious cycle is gaining momentum and, frankly, it has been exacerbated by policy indecision and political dysfunction.

This relates to the second, more long-term issue—the risk of core instability. In our inter-connected world, economic tremors in one country can reverberate swiftly and powerfully across the globe, especially if they originate in systemic economies. IMF research has shown that financial linkages transmit such tremors rapidly and broadly. And because of lingering debt problems, financial stability risks have risen significantly.

The third issue relates to social tensions bubbling below the surface. I see a number of interweaving strands here—entrenched high unemployment, especially among the younger generation; fiscal austerity that chips away at social protections; perceptions of unfairness in

"Wall Street" being given priority over "Main Street'; and legacies of growth in many countries that predominantly benefited the top echelons of society. These issues add more fuel to the confidence crisis.

What is the solution?

So, what can be done? I want to propose today four key policy dimensions needed to secure recovery and economic stability—*repair*, *rebalance*, *reform*, *rebuild*, the "4 R's".

First, *repair*. Before anything else, we must relieve some of the balance sheet pressures that risk smothering the recovery—on sovereigns, on households, on banks.

On sovereigns, advanced countries need credible medium-term plans to stabilize and lower public debt ratios. This must come first. But consolidating too quickly can hurt the recovery and worsen job prospects. So the challenge is to navigate between the twin perils of losing credibility and undermining growth. There is a way to do this. Credible measures that deliver and anchor savings in the medium term will help create space for accommodating growth *today*—by allowing a slower pace of consolidation.

Of course, the precise path is different for each country. Some have no choice but to cut deficits today, especially if they are under market pressure. Others should stick to their adjustment plans, but be ready to change course if growth falters further. Others still are probably pushing too hard today, and could slow down a bit.

One more point—it's not just the *what* of the adjustment, it's the *how*. In the short run, policymakers must focus on measures with the biggest bang-for-the-buck, that create jobs and kick-start growth, and that take distributional considerations into account. The *how* of adjustment is also important in the medium term, where fiscal plans should seek to support growth. I'm thinking of issues like tax reform, including by broadening bases. Equally, entitlement reforms will be essential in establishing long-term debt sustainability in virtually all advanced economies.

Policymakers must also deal with household and bank balance sheets.

In light of the jobs crisis in the United States, I welcome President Obama's recent proposals to address growth and employment. At the same time, it remains critical for policymakers to clarify in parallel their medium term plans to put public debt on a sustainable path. In tandem with this crucial employment agenda, it is important to relieve overburdened households through actions like more aggressive principal reduction programs, or helping homeowners take advantage of low interest rates.

In Europe, the sovereigns must address firmly their financing problems through credible fiscal consolidation. In addition, to support growth, via private sector lending, all banks must have sufficient capital buffers.

The second “R” is *reform*. If repair was about getting the economy moving today, reform is about laying the foundations for a more stable economic future tomorrow.

A priority here is financial sector reform. On the plus side, we have broad agreement on higher quality capital and liquidity standards with appropriate phase-in arrangements. But substantial gaps remain in areas like supervision, cross-border resolution, too-important-to-fail, and shadow banking systems. We need international cooperation across all dimensions to avoid regulatory arbitrage. The fact that so many of these issues are still unresolved three years after Lehman should be of concern to us all.

We also need to develop and fine-tune macro-prudential tools to guard against financial risks. I’m thinking here of policies like having banks hold more capital when times are good or implementing maximum loan-to-value ratios to guard against housing price bubbles.

Under the reform banner, I would also include the social dimension. Employment must be central. It not only sustains demand, but supports human dignity. In the words of Dostoevsky, “deprived of meaningful work, men and women lose their reason for existence”. This is especially important among the young, who risk losing the race even before the starting gun has sounded. We should also seek growth that is inclusive, benefiting the whole of society.

The third “R” is *rebalance*. This has two meanings. First, it means shifting back demand from the public to the private sector, when the private sector is strong enough to carry the load. This hasn’t happened yet.

The second rebalancing involves a global demand switch from external deficit to external surplus counties. The idea here is straightforward—with lower spending and higher savings in the advanced economies, key emerging markets must take up the slack and start providing the demand needed to power the global recovery. But any rebalancing so far is largely due to lower growth. In some countries, rebalancing is being held back by policies that keep domestic demand growth too slow and currency appreciation too modest. Some other emerging markets are dealing with dangers from capital inflows that are too rapid.

This lack of sufficient rebalancing hurts everyone. In our inter-connected world, any thought of decoupling is a mirage. If the advanced economies succumb to recession, the emerging markets will not escape. Nobody will. Rebalancing is in the global interest, but it is also in the national interest.

Woodrow Wilson would have appreciated that, I'm sure.

My fourth—and final—“R” is *rebuild*. Here I am thinking mainly of the low-income countries that need to rebuild their economic policy buffers—including fiscal positions—that served them so well during the crisis, to protect themselves against future storms. This will also help provide the space for growth-enhancing public investment and social safety nets—for example, allowing countries to deploy well-targeted subsidies to protect the poor from commodity price swings with minimal damage to fiscal sustainability.

So: these are my 4 "Rs" of recovery. But I think there is a 5th "R"—the *role of the IMF*.

I said earlier that the world has entered a dangerous new phase of the crisis. In these circumstances, the Fund—with its 187 member countries—is uniquely positioned to foster collective action among its global membership. How?

- Our surveillance capabilities can help identify the risks, but also the opportunities arising from the interconnectedness between economies.

- Our policy advice can help shine a light on the key issues—growth, core vulnerabilities, spillovers—and help guide international cooperation particularly if we use wisely our technical assistance to countries.

- Our lending can provide breathing space for countries to overcome a variety of immediate challenges—emerging markets falling victim to external instability, countries facing emergency or transition needs, and vulnerable low-income members.

- And looking beyond the crisis horizon, the Fund can also help construct a safer and more stable international financial system. This is our core mandate.

We are by no means complacent, of course. Like everyone else, given the new challenges facing the world, we too need to raise our game to respond—to be even more effective in serving our global membership. I will speak more about this next week, at our Annual Meetings—so stay tuned!

Conclusion

To conclude—this is no time for retreat, for half-measures, or for muddling through. Once again, it was Woodrow Wilson who said it best when he noted that "caution is the confidential agent of selfishness."

Policymakers must also act together. They must reclaim the spirit of 2008, or the spirit of 1944. The Wilsonian spirit—the belief that the whole is greater than the sum of its parts.

If we seize the moment, we can navigate our way out of this crisis and restore strong, sustainable, and balanced, global growth.

The path is clear. The time is now. We must act.

Thank you.