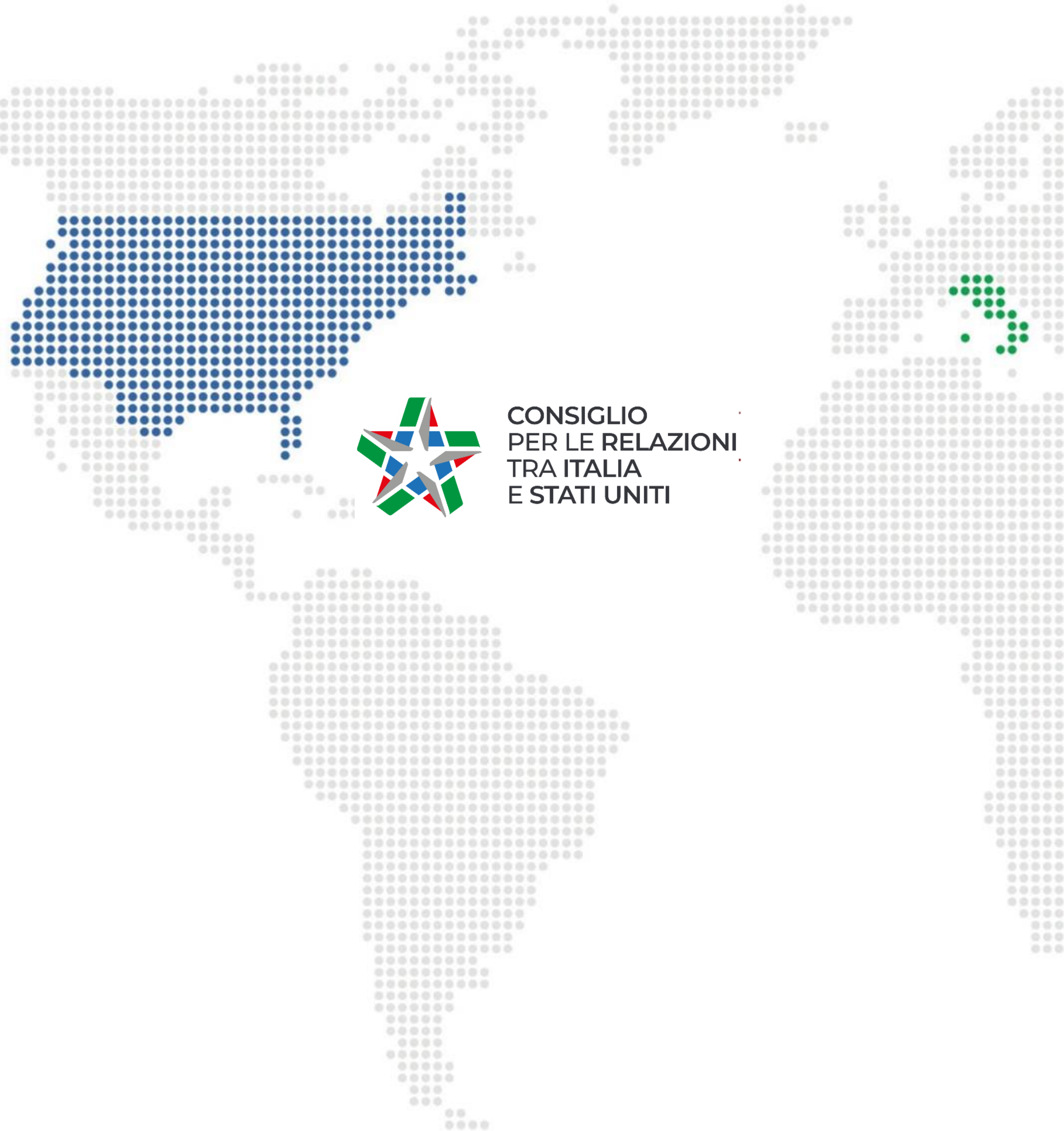
May 2022



CONSIGLIO PER LE RELAZIONI TRA ITALIA E STATI UNITI

TO FIGHT INFLATION, FIGHT PROTECTIONISM

(Project Syndicate – May 12, 2022)

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Surging inflation has made it much more difficult for US President Joe Biden's administration to justify a continuation of Donald Trump's protectionist policies. Though "openness" and "globalization" may have fallen out of political favor, free trade remains sound economic policy.

NEW HAVEN - One of the main goals that US President Joe Biden has set for his administration is to empower American workers and the country's middle class. Many believe that globalization (along with several other factors) contributed to stagnating real wages, rising inequality, and the sense that American workers have lost out to workers in other countries with lower labor standards. But in its attempt to reverse these trends, the Biden administration has embraced protectionist rhetoric and policies that will cause American workers to lose once again.

Though any mention of the word "openness" is met with suspicion nowadays, the surge in inflation – the US Consumer Price Index was up 8.3% in April – has nonetheless prompted a discussion among economists about whether trade liberalization (and openness more generally) could be used to rein in rising prices. Since one of the main arguments for free trade is that it lowers prices for consumers, the link between open borders and inflation is worth contemplating.

To be clear, no reasonable economist claims that the recent inflation is the result of trade restrictions. By now, the causes are well understood to be a combination of pandemic-driven supply-side shortages, policy-fueled demand, and further supply-side disruptions caused by Russia's war in Ukraine. But as policymakers struggle to contain inflation without causing a recession, they must recognize that "Buy American" requirements, tariffs, and immigration restrictions may be making a bad situation worse.

Well, cryptocurrencies serve many purposes, but let's focus on just a few. For starters, they are an investment vehicle for a lot of people. Any investment vehicle requires a certain amount of regulation to exclude fly-by-night operators who will take your money and run. This is especially important when you have more than 6,000 different cryptocurrencies, and when you have a lot of people who have issued tokens, cryptocurrencies, versions of the same kind of digital asset, and so forth. Who knows whether they are legitimate or not? Answering that basic question requires a certain amount of regulation, by at least requiring that everyone register to show that they are on the up and up.

According to a recent Peterson Institute for International Economics (PIIE) policy brief, a feasible reduction of trade barriers "could deliver a one-time reduction in [CPI] inflation of around 1.3 percentage points." The study is conservative, focusing only on trade restrictions that can plausibly be lifted in the short term, and its authors are careful to emphasize that the result would be a one-time outcome. The proposed reduction of trade barriers would not solve the problem of rising prices; but it would make today's high prices lower.

US consumers would welcome such short-term relief. If the Biden administration finds it necessary to sell oil out of the Strategic Petroleum Reserve despite its commitment to addressing climate change, why shouldn't it also recognize the need to reverse Donald Trump's tariffs? In 2021, according to the PIIE brief, these duties still applied to more than half of US imports "subject to high tariffs, penalty duties, or severe quotas."

Perhaps more importantly, openness, whether it is free trade or immigration, also contributes to consumer welfare in indirect ways. Though these effects are often hard to quantify, they are of first-order importance, which is why economists often turn to first principles when debating them.

One of the most important benefits of free trade is that it exposes domestic firms (and labor markets) to greater competition, which induces them to keep prices low and to innovate constantly to stay ahead of the curve. Similarly, immigration eases labor-supply shortages, and high-skilled newcomers can boost productivity and innovation. Forward-looking countries understand this and embrace immigration. The United Kingdom, for example, has adopted a new skilled-worker visa program that welcomes graduates of top global universities.

It is deeply misguided to restrict trade and immigration at a time when rising domestic prices are of paramount concern. Now that everyone is fixated on inflation, it is worth considering why inflation was so low these past two decades, despite full employment in the United States (prior to the pandemic) and despite ultra-expansionary monetary policies. Globalization (now a loaded term) arguably had a lot to do with it, as did automation (another loaded term).

The prospect of outsourcing jobs to lower-wage countries or to machines constrained workers' bargaining power. At the same time, foreign competition constrained domestic firms' pricing power (though there is ample evidence that the cost reductions they achieved by globalizing production still allowed them to make hefty profits).

Workers and firms face a different reality today. Their jobs and businesses seem more secure now that the US has turned inward and embraced protectionism. The "Great Resignation" and other developments have reduced the supply of workers, increasing the bargaining power of those still in the labor force.

This could be a positive development, except that the high inflation rate has undermined efforts to make the average American worker better off. While nominal wages in the US rose by 5.6% in the year ending in March (more than an extrapolation of the earlier trend would have implied), that month's 8.5% inflation rate implied that real wages fell by 2.7%.

If there is any silver lining to today's inflation, it lies in the lessons that this episode has provided to policymakers and the public alike. Because the benefits of open borders (lower prices) are less salient than the costs (lost jobs or lower wages), and because consumer interests are not organized, while worker interests often are, there is a bias toward protectionist sentiment. Today's inflation highlights the need to resist this bias.

The current decline in real wages is a reminder that our well-being depends not only on the nominal wages we earn as workers but also on the prices we pay as consumers. Open borders can help keep prices low during a challenging time. Reversing the tariffs imposed by the Trump administration would be a step in the right direction.

BEWARE A GLOBAL ECONOMY WITH LITTLE FIRES EVERYWHERE

(Project Syndicate – May 13, 2022)

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Rich countries have shown impressive unity in helping Ukraine counter the Russian invasion. They now need to demonstrate the same level of resolve to prevent the global economic fallout from the conflict from destroying the lives or livelihoods of many of the world's most vulnerable people.

CAMBRIDGE - Big shocks to the global economy, such as Russia's invasion of Ukraine, understandably capture the most attention. But a new worldwide pattern of "little fires everywhere" may be equally consequential for longer-term economic well-being. Over time, these small fires can coalesce into one that is just as threatening as the initial large fire that acted as the catalyst.

In addition to causing widespread death and destruction, and displacing millions of people, the Ukraine war continues to stoke strong stagflationary winds throughout the global economy. The resulting damage – whether in the form of higher food and energy prices or new supply-chain disruptions – cannot be easily or rapidly countered by domestic policy adjustments.

For most countries, the war's immediate economic consequences include higher inflation (which erodes purchasing power), lower growth, increased inequality, and greater financial instability. The multilateral system, meanwhile, now faces greater obstacles to the type of cross-border policy coordination needed to deal with pressing global problems such as climate change, pandemics, and life-threatening migration.

The challenges are particularly acute for fragile commodity importers in the developing world, especially when compared to the problems facing advanced economies. It is the difference between legitimate worries about the cost-of-living crisis in the United Kingdom, for example, and fear of famine in some African countries. The United States' higher trade and budget deficits appear considerably less problematic than potential defaults by heavily indebted low-income countries. And while the recent decline in the yen's value may be attention-grabbing in a Japanese context, a disorderly collapse of poorer countries' exchange rates could fuel widespread financial instability.

As Michael Spence, the Nobel laureate economist and an expert on growth and development dynamics, pointed out to me recently, the probability of simultaneous growth, energy, food, and debt crises is worryingly high for too many developing countries. If that nightmare scenario materializes, the effects will be felt far beyond individual developing countries – and will extend well beyond economics and finance.

It is therefore in advanced economies' interest to help poorer countries reduce the mounting risk of little economic fires everywhere. Fortunately, there is a rich historical record, especially from the 1970s and 1980s, to draw on in this regard. Effective action today will require policymakers to refine proven solutions and support their sustained implementation with strong leadership, coordination, and perseverance.

For starters, a preemptive multilateral debt-restructuring and relief initiative is needed to provide essential space for overly indebted countries and overstretched creditors to achieve orderly outcomes on a case-by-case basis. A multilaterally-coordinated approach is also crucial in order to reduce the disruptive – and sometimes paralyzing – risk of free riders, and to ensure fair burden-sharing among official creditors, as well as with private lenders.

Reinvigorating emergency commodity buffers and financing facilities is critical in order to reduce the risk of food riots and famines. Such measures can also play a useful role in countering some countries' understandable but short-sighted inclination to ban agricultural exports and/or engage in inefficient self-insurance through excessive stockpiling.

Finally, rich-country governments will need to provide more official development assistance to support individual countries' reform efforts. This aid should be extended under highly concessional terms through long-maturity, low-interest loans or outright grants.

Absent more rapid progress in these areas, the little-fires-everywhere phenomenon will damage global economic well-being by further weakening growth, increasing the risk of a recession, and fueling additional financial instability. This would add to current migration challenges, impede efforts to tackle the climate crisis, and delay the worldwide vaccination drive that is key to living more safely with COVID-19. Moreover, all these problems would promote geopolitical instability at a time when the global system is already subject to growing fragmentation pressures.

The rich world has shown impressive unity in helping Ukraine counter the Russian invasion. It now needs to demonstrate the same level of resolve to protect the well-being of its own citizens and of the world in the face of mounting economic and financial challenges. Policymakers must aim to ensure that the many economic fires fueled elsewhere by the Ukraine conflict do not end up causing a second devastating inferno that destroys the lives or livelihoods of many of the world's most vulnerable people.

FISCAL CAPTURE AT THE ECB

(Project Syndicate – May 16, 2022)

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By using all the means at its disposal to support potentially debt-distressed member states, the European Central Bank is not merely serving as a market maker of last resort. Rather, it is engaged in fiscal-support operations, potentially to the detriment of its mandated objectives.

LONDON - Since the second quarter of 2021, inflation in the United Kingdom, the United States, and the eurozone has far exceeded their central banks' 2% target. This surge could well be explained by the unexpected severity and duration of the COVID-19 pandemic, the fallout from Russia's war in Ukraine, and repeated errors of judgment by the Bank of England, the US Federal Reserve, and the European Central Bank.

But another possible explanation is that monetary policy has been subject to fiscal dominance or fiscal capture. In this interpretation, major central banks have engaged in aggressive low-interest-rate and asset-purchase policies to support their governments' expansionary fiscal policies, even though they knew such policies were likely to run counter to their price-stability mandates and were not necessary to preserve financial stability.

The "fiscal capture" interpretation is particularly convincing for the ECB, which must deal with several sovereigns that are facing debt-sustainability issues. Greece, Italy, Portugal, and Spain are all fiscally fragile. And France, Belgium, and Cyprus could also face sovereign-funding problems when the next cyclical downturn hits, or when risk-free interest rates normalize from the past decade's extraordinarily low levels, or when sovereign risk is priced more realistically.

In April 2022, headline inflation for the eurozone was 7.5%, and core inflation (excluding food and energy) was 3.5%. Yet the ECB remains very concerned with financing sovereign deficits. This was apparent in its March 24, 2022, announcement that it would continue to accept Greek government bonds as collateral until at least the end of 2024. Greek sovereign debt does not meet the ECB's investment-grade credit requirement, but it has been purchased and held by the Eurosystem (the ECB and member states' central banks) under the Pandemic Emergency Purchase Program (PEPP) since March 2020.

In December 2021, the ECB Governing Council announced that it would discontinue net asset purchases under the PEPP at the end of March 2022. But it also decided that the maturing principal payments would be reinvested until at least the end of 2024, so that "the future roll-off of the PEPP portfolio [could] be managed to avoid interference with the appropriate monetary stance."

Moreover, in March 2022, the Governing Council made clear that it might continue to buy and accept as collateral the debt of other governments that could fall below investment grade. The ECB "reserves the right to deviate also in the future from credit rating agencies' ratings if warranted, in line with its discretion under the monetary policy framework, thereby avoiding mechanistic reliance on these ratings."

All told, the Eurosystem's holdings of public-sector securities under the PEPP at the end of March 2022 amounted to more than €1.6 trillion ($1.7 trillion), or 13.4% of 2021 eurozone GDP, and cumulative net purchases of Greek sovereign debt under the PEPP were €38.5 billion (21.1% of Greece's 2021 GDP). For Portugal, Italy, and Spain, the corresponding GDP shares of net PEPP purchases were 16.4%, 16%, and 15.7%, respectively.

The Eurosystem's Public Sector Purchase Program (PSPP) also made net purchases of investment-grade sovereign debt. From November 2019 until the end of March 2022, these totaled €503.6 billion, or 4.1% of eurozone GDP. In total, the Eurosystem bought more than 120% of net eurozone sovereign debt issuances in 2020 and 2021.

Now, the ECB is said to be working on a "new instrument" to support eurozone member states confronting higher borrowing costs stemming from the ECB's own expected future policy-rate increases. Sovereign yield spreads on risky eurozone sovereign debt are rising again – with the Italy-Germany ten-year yield spread reaching 2% on May 10, 2022 – at a time when many vulnerable sovereigns are still planning additional large net debt issuances.

I expect that either the PSPP eligibility rules will be changed to allow the purchase of sub-investment grade debt, or that a new PEPP-like facility will be created for the purpose. Either way, the ECB is the only institution with the resources and the necessary reaction speed to engage in fiscal-rescue operations. The entity specifically created to address eurozone sovereign debt issues, the European Stability Mechanism, has neither the deep pockets nor the flexibility to respond promptly and decisively to a looming sovereign funding crisis.

Indeed, as of April 2022, the total amount of loans disbursed by the ESM (and its predecessor) since 2010 was just €295 billion, or 2.4% of GDP. And Germany has just rejected a proposal by the ESM to create a new permanent aid fund worth €250 billion (about 2% of eurozone GDP).

Whenever the ECB starts raising its policy rates (which should be soon, though it will be too little, too late), I expect that it will continue its bond purchases. Most likely, these will be targeted at the high-risk sovereign debt issued by countries like Greece and Italy, though targeted purchases of corporate bonds and asset-backed securities could also be part of the "new purchase program."

When such asset purchases occur under disorderly market conditions, they can be justified as "market maker of last resort" measures. That will likely be the case with Eurosystem purchases of corporate debt, provided that these are reversed as soon as orderly market conditions are restored. But by becoming a long-term holder of a growing stock of vulnerable sovereign debt, which is not justifiable on the grounds of systemic financial stability, the Eurosystem will be engaging in still more fiscal-support (and sometimes fiscal-rescue) operations.

No member-state finance minister is laying siege to the ECB's headquarters, of course, so one could argue that this manifestation of fiscal capture is voluntary or internalized. But that does not mean it is not detrimental to the objective of price stability.

THE IMF IS STILL BEHIND THE TIMES ON CAPITAL CONTROLS

(Project Syndicate – May 16, 2022)


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Jonathan D. Ostry, an incoming professor of the practice of economics at Georgetown University, is a former deputy director at the IMF, where co-he led the team responsible for the Institutional View on Capital Flows, and co-author of *Taming the Tide of Capital Flows*

Although the International Monetary Fund's newly revised policy framework on capital controls makes some improvements on what came before, it is still likely to do more harm than good. Real-world experience and advances in economic theory have shown that the IMF's suspicions about such policies are misplaced.

GENEVA - The International Monetary Fund's revised policy framework for managing cross-border financial flows, approved by its Executive Board last month, broadens the circumstances under which countries may restrict capital inflows. Unfortunately, it also ties countries' hands excessively and fails to contend with the myriad real-world contexts in which the proffered IMF advice is, or is not, appropriate. So, while volatile capital flows already pose an ongoing challenge for many emerging and developing economies, the IMF's framework will reduce countries' options for achieving their social objectives and may ultimately make the global economy less stable.

The previous IMF framework, approved in 2012 and known as the "Institutional View" (IV), held that controls on capital outflows were legitimate only when a country was in the throes of a crisis, and that controls on inflows should be used only as a last resort when the country was experiencing a surge in foreign money. The IV was a political compromise, reflecting deep divisions between IMF member states (including some of the largest shareholders) that favored fully liberalized capital movements, and those (including many emerging and developing economies) that wanted the IMF's blessing to adopt policies to mitigate volatility.

Some countries opposed the IV not because they disagreed with it, but because they saw it as "overreach." They worried that the IMF was going beyond the remit defined by its constitution (the Articles of Agreement), which gives countries considerable latitude on capital-control policies, and that a future IMF Board might suddenly change course and try to constrain what countries could do.

The IMF's job is to prevent national policies from generating negative international spillovers. The Fund's founding fathers, John Maynard Keynes and Henry Dexter White, deeply worried about the implications of competitive currency depreciations, emphasized rules against "beggar-thy-neighbor" policies in the IMF's Articles. More recently, we have seen what can happen when one country's financial problems spread to others, as occurred during the global financial crisis.

When the IMF's Articles of Agreement were written, most countries – including today's advanced economies – used capital controls extensively. The Articles thus did not give the IMF the authority to push for capital-market liberalization. Moreover, the last attempt to extend the Articles – at the IMF's 1997 Annual Meeting in Hong

Kong – came at the worst moment, just when the Asian financial crisis, precipitated by massive capital outflows, was erupting.

In any case, small countries without undervalued currencies neither generate negative externalities nor engage in beggar-thy-neighbor policies. Thus, when they are using capital controls, it is usually in circumstances that have little to do with the IMF's remit.

Consider the social objective of ensuring affordable housing for the middle class, which many advanced and emerging-market economies have pursued by restricting foreign purchases of domestic real estate. These restrictions do not fall within the IMF's responsibility, especially if they don't significantly depreciate the exchange rate or cause salient cross-border financial spillovers. Nonetheless, the IMF recently urged Australia to reconsider a small tax on real-estate inflows to Tasmania (population 541,000), even though the measure could not possibly be macroeconomically significant. And that is just one glaring example among many. Such advice, and related positions involving countries as diverse as Canada and Singapore, undermine the credibility of IMF "surveillance" (monitoring).

The IMF's revised framework wisely allows for preemptive measures against inflows in some circumstances. The Fund has come to realize that it is unwise to wait until financial imbalances reach a tipping point before doing something about them. This rationale, essentially for preemptive macroprudential regulation, applies as much to imbalances generated by hot money from abroad as it does to those generated by excess borrowing from domestic sources.

But what about the outflow side of the equation? Now that the US Federal Reserve is raising interest rates, this question has become acutely relevant for many emerging markets. Yet the IMF's new framework oddly sidesteps the issue.

Economists generally are deeply suspicious of outflow controls, owing to a concern that such policies necessarily are tantamount to partial expropriation. But the issue is one of policy design, and whether the rules of the game are clear and known ahead of time. For example, a pre-announced policy to tax short-term capital outflows (but not longer-duration flows), and to impose more extensive controls in the event of a crisis, could ultimately enhance macroeconomic stability and, in that respect, make foreign investment more attractive. It is part of the IMF's job to assess whether outflow controls are needed, how their design can be improved, and what role they might play within the country.

Conventional wisdom is constantly evolving to account for advances in economic theory, which has clearly demonstrated the prudence of imposing capital controls in certain circumstances. What was taboo in the late 1990s (when the IMF was championing full capital-account liberalization) differs from what was taboo in 2012 (when the IMF endorsed inflow controls during surges) and in 2022 (when it endorsed preemptive inflow controls).

It seems clear, including to the IMF, that capital-outflow controls might have been desirable as part of its loan to Argentina under former President Mauricio Macri. Without such controls, the IMF was simply allowing international investors to take their money out of the country, leaving Argentina with a $44 billion debt burden and little to show for it. In circumstances such as those that Argentina faced, the IMF should consider not just allowing controls on capital outflows but actually insisting on them.

The IMF's Articles of Agreement correctly give wide latitude to member-state governments in deploying capital controls, provided that such policies do not harm other countries in a beggar-thy-neighbor fashion. Rich countries have exploited this flexibility to the fullest. The IMF could do worse than to uphold the spirit of its founders.