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Managing an Inclusive Transition for the Global Economy

By Christine Lagarde

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Let me express our concern and convey our warm thoughts and condolences to all those who are currently affected by Hurricane Matthew, who are suffering and struggling to escape the disaster caused by yet another weather catastrophe. We all feel the same—and we stand ready to help.

Chairman Cardenas, President Kim, Governors, honored guests: on behalf of the IMF, let me warmly welcome you to the 2016 Annual Meetings!

Beyond economic forecasts and policies, our discussions over the last few days have also been about the economic transition that looms ahead—driven by innovation and new technology, but by other factors too.

Today, as we review our work and look ahead, I would like to talk about how we can manage that transition in a way that is inclusive—that benefits everyone.

And I was wondering, wouldn't it be marvelous if we could call on some of the Great Thinkers of the past to help us in this task? They would have plenty to tell us about economic transitions. So I am going to invite some of them into our conversation today.

Who better to start with than John Maynard Keynes, one of the IMF's founding fathers? He said that the challenge often "lies not so much in developing new ideas, as in escaping from old ones." ¹

I will try to meet that challenge this morning—just as I have tried during the five years since I first stood before you here.

1. A changing IMF, a changing world

What a journey! The IMF has embraced change at a phenomenal pace:

From dealing with the financial crisis, to reform of our lending facilities, surveillance, and capacity building. About 75 programs for a total of US\$415 billion; close to 670 Article IV consultations; and almost 17,000 technical assistance missions.

Just since our Annual Meetings last year, we have been able to complete the 2010 Quota and Governance reforms, following ratification by the U.S. Congress. This led to an important shift in the Fund's representation—with four emerging market countries now in our top-ten shareholders. Let me thank President Obama for his personal support in getting us across the finish line.

¹ Keynes, *The General Theory of Employment, Interest and Money*, Preface.

Just a week ago, we were able to include the Chinese renminbi in the Special Drawing Rights basket—a significant step for China and the global economy. I would like to recognize the Chinese authorities for their efforts in fulfilling the SDR criteria.

Just a few days ago, our membership decided to extend zero interest rates on all IMF concessional facilities—an important step to help low-income countries deal with future shocks and to achieve the Sustainable Development Goals

And as of today, our members have pledged to strengthen our third line of defense with a framework of bilateral borrowing agreements totaling more than \$340 billion – which will help to maintain the IMF's firepower at around \$1 trillion. Our thanks to those countries that have already committed to this effort—and to those who intend to commit.

How have we been able to reach these milestones? With the tremendous support received from *you*—and from your representatives on our Executive Board. And, of course, we would not have been able to do anything had it not been for my exceptional colleagues on the Management team; and our talented, dedicated, and excellent staff.

Please join me in acknowledging them.

One more thing: I want to thank you, our members, for putting your trust in me—by supporting my second term as Managing Director. It is my greatest honor to serve this institution.

2. The global outlook

So... some positive developments for the Fund. Global developments have been less encouraging.

Advanced economies remain stuck in a low-growth, low-investment, low-inflation cycle. And while growth in emerging markets is picking up, low-income commodity exporters are struggling with low prices.

We project global growth at 3.1 percent this year, with only a modest acceleration to 3.4 percent next year. Putting it simply: growth has been too low, for too long, and benefiting too few.

The social and political consequences are becoming all too apparent. Inequality remains too high in too many countries. Conflict and migration exert a terrible toll. Trade has become a political football. And supporters of economic integration—and cooperation—are on the defensive.

If our founders were here today, they would surely be concerned. They shared a conviction that trade and openness are beneficial to those who embrace them. They agreed that multilateral dialogue is key to the stability of the global economy.

This is the essence of Article 1 of the IMF's Articles of Agreement. Now, those principles are facing their biggest test in decades.

And yet, we know that openness and international cooperation are needed more than ever to improve the lives of people everywhere. We also know that they are needed to face the challenges posed by demographic pressures, climate change, and new technology.

3. Moving into the digital age

You have heard me talk about these challenges before. But as is becoming increasingly clear, nowhere are the changes coming so fast as in *technology*.

The way we think about the *industrial* revolution, our grandchildren may well look back on the first quarter of the 21st century as the *digital* revolution.

We could approach an inflection point where autonomous cars and trucks become ubiquitous. Where robots and automation become indispensable in all industries. Where cell phones replace bank branches. Where artificial intelligence and quantum computing turbocharge research and revolutionize the global economy.

Nobody knows exactly how this future will unfold. But it seems safe to say that this new machine age will lead to further gains for higher-skilled workers, and put further pressure on those who are less well-equipped to compete – whether in advanced, emerging, or developing economies.

What would our Great Thinkers make of it? Well, there is one who argued that:

"Substitution of machinery for human labor... may render the population redundant."²

Well – wait a minute!

The Great Thinker I just quoted is—David Ricardo. He voiced his concern about 200 years ago, at the dawn of the industrial age. And on this particular point, he was proven wrong.

Time and again—from the Bronze Age, to the steam engine, to electricity—great innovations have reshaped and created new industries, lifted productivity, and increased employment.

There is no doubt that technology has added to global welfare. Just imagine, for example, where would we be if agriculture would still rely on ploughs pulled by horses?

Yet, we also know that during major economic transitions, some get left behind, and many suffer. History tells us that education and social safety nets must be retooled to support and *enable* people to adjust to a fast-changing world.

Otherwise, globalization may face major reversals—think of what happened during the Great Depression and the infamous Smoot–Hawley Tariff.

So, while *embracing* the coming transition, we must *manage* it wisely.

² David Ricardo: *Principles*, chapter 31, "On Machinery," 1821.

We need growth—but we need *inclusive* growth. We need to transition to the digital age—but a transition that benefits everyone. And we need to accelerate *now*.

4. Policies for inclusive growth

The first priority for inclusive growth is to escape the "new mediocre" of low growth, low employment, and low wages.

That means using all policy tools – monetary, fiscal, and structural: to maximize the synergies *within* countries—and amplify the impact though coordination *across* countries.

This "three-pronged" approach would free up more policy space – *more room to act* – than is commonly assumed.

Implementing structural reforms to unleash economic potential is key. Using fiscal tools—where available—to prepare for the transition is also key.

With interest rates at historic lows, there is no better time for public investment: to expand access to high-speed internet, promote energy-efficient transport, and build climate-friendly infrastructure.

Even where fiscal space is unavailable, governments can reallocate funds into R&D—by offering tax credits and supporting public research institutions.

Remember: all the technologies that make our mobile phones "smart" have benefited from public funding—wireless networks, GPS, touch screens.

This shows that good public policies can boost growth for decades to come.

To reinvigorate growth, we also need to reinvigorate trade. Over the past 25 years, trade has leveraged new technologies into productivity increases worldwide—helping to reduce by half the proportion of the global population living in extreme poverty.³ and creating millions of new jobs with higher wages.⁴

Conversely, building trade barriers is a sure way to reduce overall output, investment, and jobs.

But again, we need to put greater emphasis on policies that can help mitigate the negative effects of trade, and make everybody benefit.

Achieving greater inclusion is actually a tall order. It requires more than macroeconomics. It also involves politics. And social contracts—which must reflect national, regional, and cultural diversity.

³ From 1990–2010. World Bank figures: World Development Indicators.

⁴ In the U.S., for instance, workers in export-intensive industries earn a premium perhaps as high as 15 percent over other industries.

But still, economists know policies that can help.

Indeed, the second priority for inclusive growth is providing everybody with a level playing field. Let me give you three examples:

First – increase equality of opportunity. Think of smart education policies, especially for girls. Think of retraining to help workers displaced by outsourcing. Think of minimum wages and tax incentives to give women more opportunities in the labor market.

Second – promote fair burden-sharing. We need an international tax system that minimizes loopholes and guards against the corrosive effects of corruption. And we need to protect low-income countries from the harmful effects of tax base erosion and profit-shifting.

Third – preserve competition and market access. This is especially important for the digital economy, where network effects can lead to increases in market concentration—which harms innovation and concentrates wealth at the top. By injecting more—and fairer—competition, we can ensure that the vast potential of the digital age can be managed for the benefit of all.

5. International cooperation and the role of the IMF

Let us assume that, with all these policies, we manage to reduce inequality *within* countries. How then will we reduce inequality *between* countries?

The international community made a big step toward this objective when it came together last year to set the 2030 Sustainable Development Goals. But to reach them, low-income countries need higher and more reliable government revenue—so they can invest in infrastructure, healthcare, and education. Building capacity in this area is a priority for them. It is also a priority for the IMF.

Every year, we help more than 100 countries improve their domestic revenue mobilization – and we are responding to increasing demand.

Reducing inequality also means creating a stronger global financial safety net—to help emerging and developing countries better cope with volatility. Strengthening the IMF's lending toolkit will help here—as will stronger cooperation with other regional institutions.

At last year's Annual Meetings, I talked to you about "AIM"—an IMF that is more Agile, Integrated, and Member-focused. Have we made progress? Yes!

- We have stepped up efforts in our core areas of expertise—including fiscal, monetary, and exchange rates, as well as expanding our macro-financial analysis.
- We have stepped up work on other macro-critical issues—such as financial inclusion, gender equality, corruption, migration, and climate change.
- And we have grown our ability to support capacity development through a growing number of regional training centers and through technology. More than 13,000 people—from 184 countries—have successfully completed our online courses (MOOCs).

So we have raised our game—and we will continue to do so. That is *our* commitment—*my* commitment—to you.

Conclusion

Let me conclude by turning to one more Great Thinker—U.S. Treasury Secretary Henry Morgenthau. Speaking at the original Bretton Woods conference, he said:

"Prosperity has no fixed limits... Prosperity, like peace, is indivisible. We cannot afford to have it scattered here or there among the fortunate or to enjoy it at the expense of others." 5

So our task is to manage wisely the economic transition facing us, so that we can achieve greater prosperity—not just for the fortunate few, but for *all*.

Since I became Managing Director, I have travelled to more than 60 member countries. I have learned so much. I have so many wonderful memories. But what stands out most are the people I have met.

One unforgettable example is the Syrian woman in a refugee camp in Jordan who held my hand and said: "Can you help us rebuild my country?"

These are the *people* who inspire me. The *people* that we serve. The *people* that we can help build a better world, if we work together.

Thank you.

⁵ Inaugural <u>address</u> by Henry Morgenthau Jr, Bretton Woods Conference, July 1, 1944.