Kenneth Rogoff

The International Monetary Fund (IMF) was founded in 1945, along with its sister institution, the World Bank, in an effort to stabilize the international economic order. In recent years, the IMF has come under intense scrutiny from a wide range of sources. It has been the target of anti-globalization activists, who have taken to the streets to protest the organization's policies, and of the Nobel Prize winning economist Joseph Stiglitz, who has taken the IMF to task on a panoply of issues in his book *Globalization and Its Discontents.*

In August 2001, Kenneth Rogoff took a two-year leave of absence from Harvard University to become the chief economist at the IMF. (He will rejoin the Harvard faculty in the fall of 2003.) During his academic career and earlier stints with the IMF and the Federal Reserve's Board of Governors, Rogoff established himself as an expert on international finance, debt, and monetary issues. His 1985 article for the *Quarterly Journal of Economics*, "The Optimal Degree of Commitment to an Intermediate Monetary Target," spawned a vast literature on central bank design. And his textbook, *Foundations of International Macroeconomics*, co-authored with Maurice Obstfeld, is widely used in graduate classes.

Rogoff is also an expert chess player, obtaining the lifetime title of International Grandmaster (the highest rank awarded by the World Chess Federation) in 1978. He retired from tournament competition at the age of 25 to focus on his economic research. Aaron Steelman interviewed Rogoff at the IMF's headquarters in Washington, D.C., on April 15, 2003.

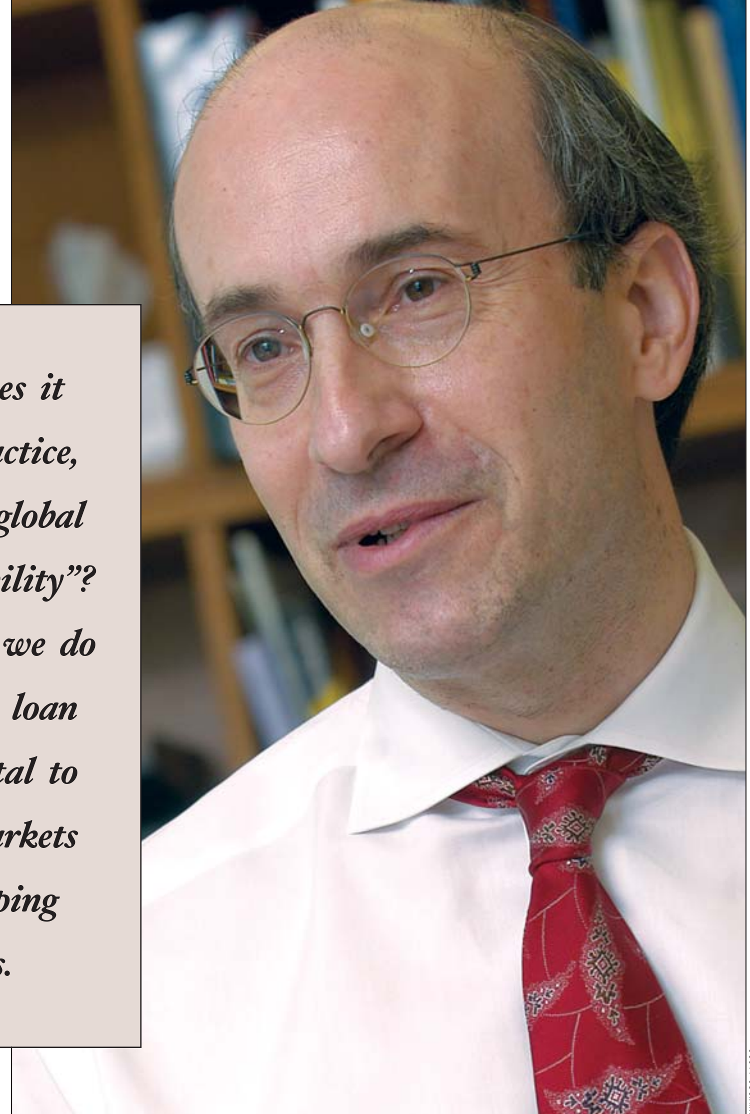
RF: How does the IMF's role differ from the World Bank's?

Rogoff: The two organizations are quite similar in some ways. They are both, broadly speaking, United Nations (U.N.) family institutions. But they have different voting structures than the U.N. Votes in the IMF and the World Bank are loosely weighted by size of economic contribution to the global economy, so that the European countries, Japan, and the United States have a disproportionately large vote. The IMF and the World Bank also have interlocking boards of directors, so some people sit on both boards.

As for how they differ, the IMF is charged with trying to promote global financial stability and growth, while the World Bank directs its efforts at alleviating poverty. The IMF provides support to the World Bank in working toward that goal, but that is not our primary mission. Importantly, the IMF is only allowed to lend to sovereigns, whereas the World Bank does not face any such restriction. It is also worth noting that the World Bank is also much larger in terms of staff and budget than the IMF.

So what does it mean, in practice, to "promote global financial stability"? Part of what we do is constantly loan paid-in capital to emerging markets and developing countries. For instance, in the 1990s we made some large loans to South Korea, Thailand, and Indonesia, and more recently we have loaned to Argentina, Brazil, and Turkey. But there are also many smaller loans out there. It's not unusual for us to have so-called "programs" going in 30 or 40 countries at one time. The important issue we look at in assessing the size and structure of a program is whether an individual country's problems might pose systemic risks to the global financial system.

Such lending is the headline activity of the IMF, but there is also another big element to what the IMF does. We provide a forum for countries to meet and provide information—both formally and informally—to one another. This allows policymakers to exchange ideas about best practices during noncrisis periods. In fact, many of our staff papers deal not with crisis issues but instead with more general macroeconomic issues. Finally, of course, every member country must submit themselves to bilateral review of their economic policies every year or two.



SCOTT SUCHMAN

RF: When you came to the IMF, were there certain economic issues that you thought should be the focus of your department's research?

Rogoff: I think it's very important, when coming to a job like this, to have an open mind and to realize that some of the best ideas come from the bottom up. You have to really listen to people and to give people room to be creative. But, yes, there are some specific issues that I wanted us to work on, such as exchange rates for developing countries. Before I came to the IMF, I had done a lot of work on industrialized countries but I had never really worked on low-income countries, and it quickly became apparent that they have many interesting special problems. For instance, the amounts of international aid going to poor countries are very large as a percentage of their overall budgets—we're sometimes talking 10 or 20 percent. How do you manage this macroeconomically? Also, consider Africa. Many of those countries are subject to huge commodity price shocks. How do you conduct monetary policy when your main export—which produces, say, 80 percent of your country's income—can vary up or down by more than 40 percent? These are very interesting questions that just never would have occurred to me if I hadn't come here.

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We are also interested, of course, in the international financial architecture and all that entails: capital controls, the international bankruptcy court, and other issues. And I'm very interested in new open-economy macroeconomics, an interest that grows out of my work with Maury Obstfeld. When I came here, the Fund had a model that was, I think, very effective at looking at what occurs if there is an oil or global productivity shock. But the model was 20 or 25 years old, so I wanted to replace it with a newer model, and we have made a lot of progress in that direction. I must say, though, that much of what we have been able to accomplish is because other places—such as the European Central Bank and the Federal Reserve Bank of New York—have been refining their own models. Not surprisingly, I would say that most of the work we do has more of an empirical, policy bent than you would see at a university seminar series.

RF: The IMF has been attacked from all sides: from the left for pushing "neo-liberal" policies in developing countries, and from the right for creating moral hazard problems as a result of its lending. How would you respond to such critics?

Rogoff: The most important thing for us to do, and it's the honest truth, is not to respond to the critics but to listen to them. Indeed, broadly speaking, the IMF and the World Bank are quite receptive to criticism and have made some serious changes over time. In 1980, for instance, the World Bank was not in favor of free trade. Similarly, the IMF was much more Keynesian 25 years ago than it is today. It's not easy for these institutions to move quickly—you need to achieve consensus among a large number of board members, some of which represent a large number of countries—but the critics have made a difference.

The second thing that I want to say is that almost everyone in academia has some criticisms of the World Bank and the IMF. I sure did. I wrote some of the first papers on moral hazard and IMF lending in the late 1980s with Jeremy Bulow. We took a fairly cynical view of the whole process. I also wrote a paper with Maury Obstfeld called "The Mirage of Fixed Exchange Rates" that said it was a disaster to support fixed exchange rates, which was conventional wisdom at the time. This view, which has now by and large become the conventional one, is an example of why one has to resist always trying to come down somewhere in the middle on debates, which is a natural tendency in an institution like this.

RF: It's pretty surprising that 25 years ago free trade would have been a controversial idea at the World Bank or IMF, since liberal trade policies were so widely accepted by the profession as a whole.

Rogoff: You have to understand that the institutions are governed by their member states. A lot of countries will say that if you look at the history of the industrialized world, many countries have had protectionist policies. Even today, the United States and the European Union remain quite protectionist in some areas, albeit far less than most developing countries. I think that is very unfortunate. It strengthens the hand of protectionists in developing countries who say, "Look— today's rich countries got that way by using protectionist policies. Why are you so sure that we should reduce our trade barriers? Shouldn't we protect our infant industries?" So, the free trade position, which economists will say is obviously correct, will not be so obvious to some of the people from our member states. This is a good example where the middle ground was not right. Free trade was, in many ways, the radical position 25 years ago, even though it was right. And I think that some of the people who still remain skeptical of liberal trade policies are coming to the realization that globalization is something that you can't really stop.

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RF: Your open letter to Joe Stiglitz drew a lot of attention from economists, but may not be as familiar to others. Could you briefly describe what you had to say in response to the criticisms he has made of the IMF?

Rogoff: I think that it's a very passionate and angry book, which is part of its effectiveness. It is directed at a broad audience and it clearly hits a chord with many people. Certainly if you asked professional economists if they agreed with some of the arguments in the book, they would say yes. It covers a laundry list of problems with the IMF, from the left, from the center, from the right, from outer space. And as Jagdish Bhagwati said in his review, if you launch enough missiles, you're bound to hit some targets. In that regard, I would highlight the issue of premature financial liberalization being something that one wants to be very wary about. I certainly agree with Joe on that, though I also think that if Asian countries had genuinely flexible exchange rates in the 1990s, we might have only seen a mini-Asian crisis instead of a full-blown one. And Stiglitz's book agrees with the general proposition of having an international bankruptcy court, an idea the IMF has advanced over the past couple of years.

But there are some areas where I think he takes very odd positions. For example, let's say you have a country in a severe debt crisis that has been cut off by its lenders. Should the IMF criticize the country for not engaging in countercyclical fiscal policy? Or if a country's exchange rate is under attack, I don't think it should respond to it by printing more money.

In general, I have trouble summarizing my take on the book, because it draws in everything anyone has ever written. But, at the end of the day, when you set aside the personal attacks on the competence, intelligence, and moral character of the IMF staff, there are clearly some well-taken points in the book.

RF: The IMF gets a lot of attention for its efforts to help prevent and deal with crises. But there are some very important issues that can't be characterized as crises, but which still probably lower the standards of living of millions of people — such as Europe's rigid labor market policies. What sort of counsel can you provide to member countries on these types of issues?

Rogoff: We have an analytical piece on that very topic in the April 2003 issue of *World Economic Outlook*. We ask what are the costs to Europe because of its labor market institutions — and what would be the gains if those institutions were brought to U.S. levels? We use two different models to look at those issues. We come up with estimates that Euro-area unemployment would fall about 3 percent and output would be 10 percent higher if those institutions were brought to U.S. levels. That doesn't prove that they should make these changes, because there are transition costs and allocative issues, not to mention some noneconomic concerns that might affect Europe's decisions.

We can present our analysis and try to create a dialogue, but it's really hard to do much more than that. We don't have much traction with developed countries on these types of issues. It's also important to note that countries do look at each other and notice when certain countries are growing and they ask what it is that they are doing correctly. That doesn't mean that they will change their policies overnight. But it can have an effect. In the 1990s, certainly, I think countries looked at the financial liberalization of the United States and asked how they could follow that type of framework. And they were much more affected by this than by anything that the IMF might have told them about the issue.

RF: What do you think are the prospects for economic liberalization in the Middle East?

Rogoff: Growth in the Middle East has been very, very poor. Per capita GDP over the past 20 years in the Middle East region as a whole has fallen by 1.6 percent a year. It has been the worst performing region in the world — and this includes the oil countries. There's another chapter in the *World Economic Outlook* that looks at how much higher growth could be in the Middle East if institutions — here we are talking about corruption, political rights, and other related issues — were brought into line with the world average, forget about the industrialized average. It concludes that the Middle East could see gigantic income changes.

The Middle Eastern countries have very large public sectors with very large budget deficits. They have very shallow banking systems. And they have very serious issues with corruption. These are fundamental problems that need to be addressed.

There is a role for regulation and for government intervention in certain areas, but most countries don't have the balance right. They have too much state involvement and state control. The Middle East is a region where this is particularly problematic. That said, we believe that such governance issues have to be decided by the people of these countries themselves. All we can really do is provide technical analysis and demonstrate that their economies are performing very poorly.

RF: In the 1980s, Japan was the envy of the rest of the world. What has happened to its economy?

Rogoff: Japan has a lot of banks that are not fully functional, because they have a great deal invested in real estate and equities. And, as we know from Ben Bernanke's work on the 1930s, when the banking system goes awry, it's very hard to get it back into shape. Many corporations are being supported by banks which are themselves insolvent. Banks are keeping these corporations afloat when, in fact, they should be folded. Also, Japan's weak social safety net doesn't give them the ability to absorb changes as well as the United States can. Eventually, they will need very deep restructuring of their banking system. It's going to be painful, but until they do that, they will not have growth.

Another big problem is deflation, which is aggravating the problems that the banks have. I think the Bank of Japan should end deflation, and I think that it would be very straightforward to do it — they need to be more aggressive with their monetary policy. Even if they ended deflation, I recognize that they would still have many problems. But it still would be a big step forward.

Japan also has dire fiscal problems, in part because they have run deficits in an effort to try to jumpstart the economy. And, moreover, they have an even more urgent aging problem than does the United States; Japan's labor force is already falling.

RF: Are there certain skills that you acquired playing chess that have helped you as an economist?

Rogoff: It's hard to say. When I was an academic I did a number of papers that involved game theory. I find that game theory comes very naturally to me, whereas algebra is something I can do, but I wouldn't describe myself as very facile with it. So I definitely think there is some connection between my chess career and my ability with game theory. Also, it's certainly true that, in my current position working on policy issues, I find myself drawing on chess analogies. That's because, in chess, there is seldom a "right" answer. You very much need to consider what the other person is thinking. You're not just objectively looking at the board — you are trying to understand the other person. And in a policy environment, when you're discussing a problem or negotiating a program, you are doing much the same thing. **RF**

Kenneth Rogoff

➤ Present Position

Economic Counsellor and Director of the Research Department, International Monetary Fund

➤ Previous Positions

Faculty appointments at Harvard University and Princeton University; Economist, International Monetary Fund; Economist, Board of Governors of the Federal Reserve System

➤ Education

B.A., Yale University (1975); Ph.D., Massachusetts Institute of Technology (1980)

➤ Selected Publications

Co-author, *Foundations of International Macroeconomics* (Cambridge, Mass.: MIT Press, 1996); author or co-author of numerous scholarly articles in such publications as the *American Economic Review, Journal of Political Economy, Quarterly Journal of Economics, Journal of Monetary Economics,* and *Journal of International Economics*

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