

6. Macroeconomic Stability as a Precondition for Peace

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The views expressed are those of the author and do not necessarily represent the views of the International Monetary Fund (IMF), its Executive Board, or IMF management.

ABSTRACT

Macroeconomic stability is critical for peace. Macro-stability is achieved when public policies lead to strong growth, low inflation, employment, and a balance of payments position that does not lead to disruptive exchange rate movements. Lack of macro-stability can severely disrupt peace, as people often refuse to accept government failures and demand decent living and working conditions, sometimes through violent social action. Such discontent may threaten peace through disorderly migration, supply disruptions, and conflict.

Trade is critical for macro-stability as it directly impacts each macroeconomic sector, and trade policy is one of the levers the authorities can use to achieve macro-stability. A country's capacity to withstand shocks to macro-stability and peace can be assessed based on a policy space index. Preserving sufficient policy space to tackle potential macro-threats and deeper multilateral and bilateral international cooperation remain essential to ensuring macro-stability and peace.

1. What is macro-stability?

1.1. Defining macro-stability

Macro-stability is the ability of a country to stay an economic policy course. In principle, macroeconomic stability (macro-stability) can be achieved when each country conducts policies that promote its own domestic stability and balance of payments (BOP) stability, the latter sometimes referred to as external stability. Domestic stability is defined as orderly economic growth with reasonable price stability and the avoidance of erratic disruptions. External stability refers to a BOP position that does not give rise to disruptive exchange rate movements. The International Monetary Fund (IMF), a global economic and financial institution, is authorized by its 190 member countries to monitor their economic policies and provide policy advice to help countries achieve macro-stability and promote international trade (IMF, 2012).

The authorities of any country should pursue macro-policies that support stability. To achieve domestic stability, such policies usually focus on economic growth, low inflation, adequate employment, sustainable fiscal deficits and public debt, and low inequality. To achieve external stability, such policies usually focus on the competitiveness of the exchange rate, reserves adequacy, and current account and external debt sustainability. Accordingly, all macroeconomic policies – fiscal, monetary, financial, exchange rate, trade, and structural – can affect both domestic and external macro-stability. Other economic policies (such as sectoral or regional) can be considered relevant for macro-stability only if they significantly affect present or prospective domestic or external stability.

Macroeconomic stability is achieved by focusing policies on macro-critical issues. An issue is considered macro-critical if it significantly affects a country's present or prospective domestic or external stability. In practice, this means that fiscal, monetary, exchange rate, financial, and trade issues are always considered macro-critical, including in terms of their structural aspects (IMF, 2021). Other issues can be seen as relevant for macro-stability only if they meet the macro-critical threshold. Whether an issue meets this threshold can be determined on a case-by-case basis and will necessarily depend on the country's development level, structural characteristics, institutional capacity, and other relevant socio-economic factors.

Countries' own macro-policies affect stability of the international monetary system. The international

monetary system² is considered stable when it does not exhibit symptoms of malfunction such as, for example, persistent significant current account imbalances, exchange rate instability and misalignment, volatile capital flows, excessive reserve depletion or build up, and excessive or insufficient global liquidity. The stability of the international monetary system may be impacted by countries' own balance of payments and domestic stability because of real and financial links with other economies, cross-border spillovers of internal problems through the balance of payments, or through financial and other channels.

1.2. Literature on macro-stability and peace

Several strands of academic literature discuss the links between macro-stability and peace. Overall, the literature finds that fewer conflicts and more durable peace are associated with macro-stability supported by strong growth, stable prices, low inequality, climate change mitigation, open trade, strong institutions, and good governance. The opposite is also true: peace is needed for macro-stability, as conflicts, unrest, and insecurity all have direct implications for macro-stability. In conflict situations, governments must focus their macro-policies and limited resources on finding socially acceptable solutions to simmering tensions, thus diverting resources from key reforms needed to enhance growth, reduce inflation, inequality, and unemployment, and otherwise preserve macro-stability.

Low growth has been associated with risks to peace. Miguel, Satyanath, and Sergenti (2004) find that growth shocks have a dramatic causal impact on the likelihood of civil war in Africa: a five percentage point contraction increases the likelihood of a civil war the following year by nearly 0.5 percentage points. The impact of economic shocks is similar across countries with different economic, social, and political characteristics, suggesting that economic conditions are the most critical determinants for the triggering of civil conflict. Bazzi and Blattman (2014) argue that the level of income positively correlates with political stability, and while economic shocks may not trigger new wars directly, they may play an influential role in existing conflicts, contributing to their persistence. Berman and Couttenier (2015) provide evidence that income shocks are important determinants of civil conflict as the incidence, intensity, and onset of conflicts are generally negatively and significantly correlated with income levels.

Poverty and fragility pose threats to peace. Chami, Espinoza, and Montiel (2021) address this issue through the prism of feedback loops between the

poverty trap and the fragility trap. The poverty trap – the link between low income and inability to grow – can be reinforced by the fragility trap – the link between the state's inability to deliver public goods and the resulting societal unwillingness to support such a state. The two traps represent self-reinforcing feedback loops, as fragility worsens poverty, while poverty leads to yet more fragility.

International price instability was found to be harmful to peace. Besley and Persson (2008) find that high world market prices of exported and imported commodities are strong, significant predictors of within-country incidence of civil war. Berman, Couttenier et al. (2017) indicate that the historical rise in mineral prices might explain up to one-fourth of the average level of violence across African countries and a fighting group's control of a mining area contributes to escalation from local to global violence. Leepipatiboon, Castrovillari, and Mineyama (2023) show that shocks associated with negative terms of trade significantly and persistently increase conflicts in low-income countries (LICs), in particular those with high inequality and debt. In addition, increases in import prices weaken the quality of institutions, which create a breeding ground for future conflicts.

Food price surges are significant drivers of conflict. Bellemare (2015) shows that throughout history food price increases have led to increases in social unrest, whereas food price volatility has not been associated with increases in social unrest. McGuirk and Burke (2020) study the impact of global food price shocks on local violence across Africa and find that in food-producing areas higher food prices reduce conflict over the control of territory and increase conflict over the appropriation of surplus. Van Weezel (2016) shows that food price increases are associated with higher levels of violence in Africa, although food prices are a relatively poor predictor of violence.

Macro-shocks related to climate change can also undermine peace. Hsiang, Burke, and Miguel (2013) suggest that past climatic events have exerted considerable influence on human conflict. This influence appears to extend across the world, throughout history, and at all scales of social organization. Diallo (2021) shows the economic costs of climate change are greater in developing economies than elsewhere, mainly because climate change harms the agricultural yield.

Finally, macro-governance, including of natural resources, is also found important for peace. Collier and Hoeffler (2005) suggest that countries with an abundance of natural resources are more prone to

violent conflict. The “resource curse” leads to low growth rates and income, which in turn make civil war more likely. Dal Bo and Dal Bo (2011) show that not all shocks that could make society richer reduce conflict: positive shocks to labour-intensive industries diminish conflict, while positive shocks to capital-intensive industries increase it. Ross (2015) finds robust evidence that petroleum wealth makes authoritarian regimes more durable, increases corruption, and triggers violent conflict in LICs.

Although the academic literature strongly points at the need for macro-stability to preserve peace, the opposite is also true: peace is needed for maintaining macro-stability. For example, Hadzi-Vaskov, Pienknagura and Ricci (2021) explore the impact of episodes of social unrest on the macroeconomy. They find that unrest has an adverse effect, as GDP remains below the pre-shock baseline for a prolonged period after unrest because of sharp contractions in manufacturing, services, and consumption. Novta and Pugacheva (2021) also find that conflicts generally lead to large macroeconomic costs.

Conflict is usually associated with dramatic declines in official trade and induces significant refugee outflows to neighbouring non-advanced countries in the short run, and relatively small but very persistent refugee outflows to advanced countries over the long run. Rother et al. (2022) document the impact of higher prices for food staples and fertilizers on countries' balance-of-payments, the budgetary cost of mitigating fiscal measures, and the cost of providing food to ameliorate food insecurity.

1.3. Threats to macro-stability

Numerous shocks continue threatening macro-stability and peace. Internationally, fragmentation, geopolitical tensions and regional wars, supply chain disruptions, food crises, volatile capital flows, abrupt exchange rate adjustments, soaring debt, and rising interest rates can put the macro-stability of any country at risk.

Domestically, socio-political and geopolitical factors, including declining social capital and trust in the government, political polarization, fragmentation, and regional tensions, can limit the scope for sustained growth by weakening macroeconomic management and governance, stalling necessary reforms and policy actions, increasing fiscal and external deficits, and limiting gains from trade, technology, and integration (IMF, 2022b). As a result, with limited or no policy space, and the risk of rising social disparities and unrest, a growing number of countries would face the risk of macro-instability.

Several major threats to macro-stability remain particularly acute (IMF, 2022a; IMF, 2022c; Georgieva, 2023).

- **Fragmentation.** With international cooperation in retreat, the world is witnessing mounting barriers to trade, investment, free movement of people across borders, and the emergence of rival blocs. Fragmentation makes it nearly impossible to manage all the other threats to macro-stability outlined below, which have traditionally been addressed through cooperation. Because of fragmentation, global growth in the medium term will be only around 3 per cent, the lowest in the past three decades, making further poverty reduction and job creation virtually impossible (Georgieva, 2023). The WTO estimated that welfare losses for the global economy of a decoupling scenario can be drastic, as large as 12 per cent in some regions, and are largest in the lower income regions as they would benefit less from technology spillovers from richer areas (Goes and Bekkers, 2022).
- **Geopolitical strain.** Geopolitical tensions increasingly spill into open wars leading to the destruction of the factors of production, forced displacement of people, exorbitant public spending on security, and trade flow disruptions. Such resource misallocations inevitably bear significant risks to macro-stability, growth, and equality.
- **Climate change.** Climate change can pose threats to macro-stability through natural disasters, destruction of physical capital, deterioration in human health, loss in productivity and output, higher inequality, social tensions, and rises in fiscal and financial imbalances. Moreover, climate change and climate-related policies can also be a source of cross-border spillovers.
- **Debt distress.** Debt distress, or the risk of it, is a growing concern for more than 60 per cent of LICs and over 25 per cent of emerging markets (IMF, 2022a). Excessive debt service undermines sustainability of public finances and diverts limited resources from investment and social programmes, which are critical for growth and social peace. To control the potential threat to peace stemming from unmanageable debt levels, it is essential for the government to introduce a sustainable medium-term macroeconomic framework and for the international community to develop debt resolution mechanisms.
- **Food insecurity.** The threat of a major food crisis emerges regularly. Macro-instability reduces

agricultural production, while rises in food prices lead to higher import prices because of a deterioration in the terms of trade.

- **Technological change.** Irrespective of potential benefits, the risks to macro-stability stemming from untested technologies and hasty digitalization are substantial. Digitalization and automation can impact macro-stability through reducing the labour share of income.
- **Inequality.** Inequality in income and opportunities, including gender gaps, can be detrimental to macro-stability by undermining growth through weakening aggregate demand, hampering human capital accumulation, and increasing social and political tensions.
- **Demographics.** Aging and declining population growth can impact macro-stability through reducing the size of the labour force, weakening incentives for capital accumulation, public debt accumulation because of unfunded rises in salaries and social benefits, and disrupted cross-border labour and capital flows including immigration.
- **Gender and youth exclusion.** Women and the youth face specific and heightened challenges of deepening fragility, lower labour force participation, and less access to education, leading to higher levels of unemployment and lower income. Gender and youth gaps remain high in many countries. The lack of job opportunities and education for women may threaten peace by triggering social unrest, with pervasive losses in productivity and human capital.

Macro-stability contributes to macro-sustainability. Macro-sustainability refers to policies that lead to sustained, balanced, and inclusive growth, without the need for large or disruptive adjustments to internal and external balances. While this implies that macro-sustainability ensures macro-stability, the latter does not necessarily ensure the former. It is possible that achieving macro-stability in the short term, for example by correcting external imbalances by an abrupt fixed exchange rate devaluation, could harm macro-sustainability in the future if the underlying macro-problems in the saving-investment balance remain unaddressed. Akin to macro-stability, macro-sustainability depends on a broad range of factors that affect an economy in the long run, including distribution and inclusiveness, health and education, environment and climate, pandemic preparedness, and socio-political and geopolitical factors.

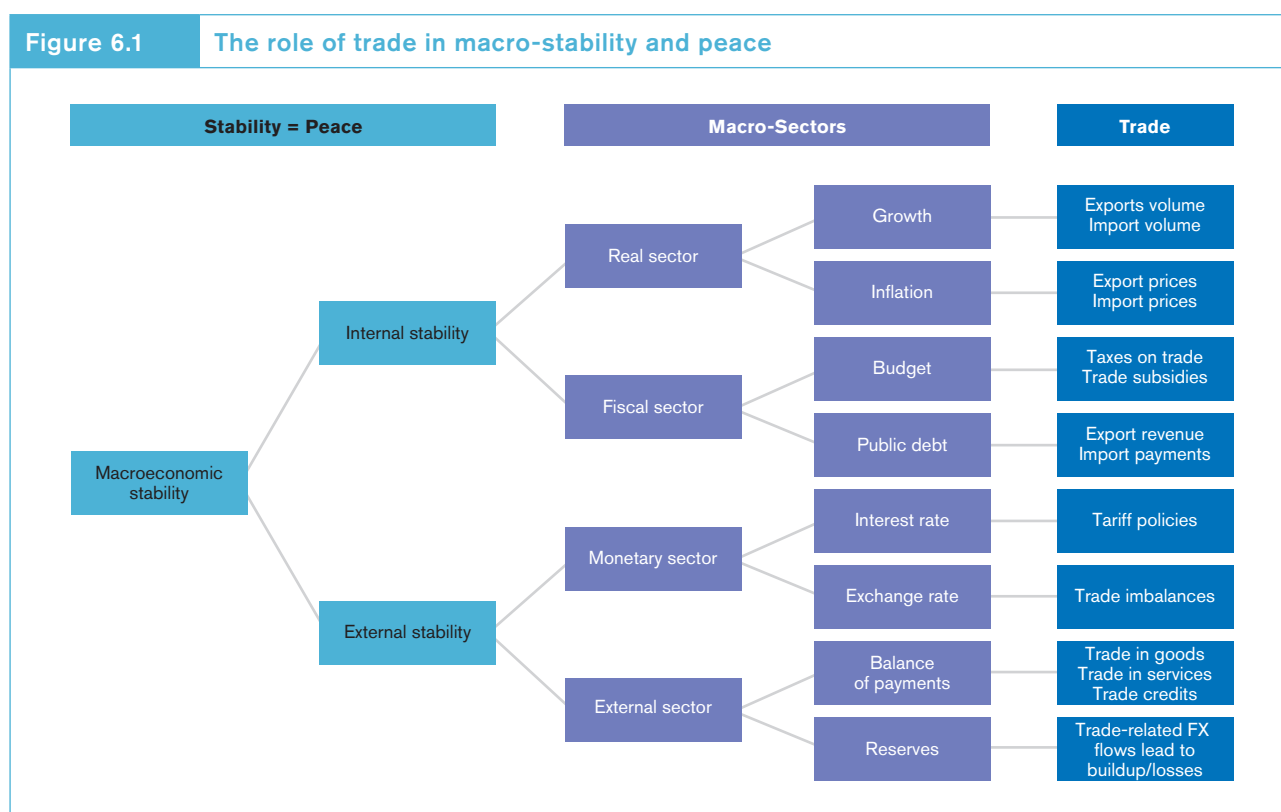
1.4 The impact of trade on macro-stability

Trade is an integral part of a macroeconomic framework and trade policies contribute to macro-stability. A macro-framework – a coherent set of interlinked macroeconomic accounts – can be seen as an organizing structure of policies needed to achieve macro-stability. Trade policies are part of macro-policies – along with fiscal, monetary, financial, exchange rate, and structural policies – that the authorities of a country can use to achieve macro-stability. Trade policies can help create a favorable environment for economic performance, external viability, aid effectiveness, and good governance. However, trade policies can also negatively affect stability, if they lead to trade distortions, a poor environment for economic performance, undermine external viability, reduce aid effectiveness, or weaken governance.

Trade policy reforms can be a crucial ingredient of macro-strategies. For example, openness to trade can become key for growth strategies that rely on increased competitiveness and exports. Exports and imports translate domestic prices into international prices and vice versa, with a direct impact on inflation. Trade policies reflected in customs duties and other trade-related taxation directly influence countries' fiscal positions. Trade policies directly impact the

trade balance, thereby affecting the current account. Trade policies can also impact financial sector stability, mainly through trade-related financing. Finally, trade reforms can also be instrumental for the success of structural adjustments in other areas, as trade commitments taken at an international level help lock in internal reforms, strengthen market disciplines, and reduce the scope for corruption (IMF, 2015).

The role of trade in macro-stability can be schematically presented as follows (see Figure 6.1). As discussed above, macro-stability broadly means simultaneous achievement of internal and external stability. While numerical targets are usually speculative and country specific, some can still be included for general orientation. Internal stability is usually associated with the levels of output and inflation that lead to full employment (the usual ingredients include unemployment at less than 3 per cent, a closed output gap, and inflation at between 2 and 4 per cent, depending on the country's level of development). External stability is the balance of payments (BOP) position that does not lead to abrupt changes in the exchange rate, which is usually the case when the current account deficit can be sustainably financed with capital inflows and does not lead to unsustainable debt accumulation. The current account on the BOP should not necessarily be equal to zero.



Source: Author's presentation.

Internal and external stability are achieved through policy action in four sectors. Although somewhat schematic, the presentation of any economy as consisting of four main sectors is helpful in diagnosing macro-problems and identifying the macro-policies needed to address them. The real sector covers growth policies, inflation outcome, the labour market, the saving-investment balance, and associated structural policies. The fiscal sector includes the government's budget, fiscal policies, public debt, and corresponding policies. The monetary sector is responsible for inflation, interest rates, reserve accumulation, and exchange rate policies. Finally, the external sector covers the balance of payments and external debt policies.

Trade and trade policies are squarely integrated in each of the four macro-sectors. In the real sector, exports and imports volumes are directly included in the calculation of real GDP and therefore in economic growth. Export and import prices indirectly affect inflation and therefore nominal GDP calculations. Export prices are reflected in the GDP deflator, while import prices are included in consumer price inflation.

The ratio of export to import prices – the terms of trade – is an important measure of relative prices, a source of exogenous shocks and one of the fundamentals behind the real effective exchange rate. In the fiscal sector, taxes on international trade often contribute a significant share to fiscal revenue, particularly in LICs, while trade-related subsidies may absorb a significant share of government expenditure. For public debt, the balance of export revenue and import payments is an important determinant of the capacity to repay and therefore of debt sustainability.

Furthermore, trade policy may affect the monetary and external sectors. Trade policy influences the interest rates in the monetary sector, as tariffs may worsen the trade balance of a large country, causing its real interest rate to fall if the country is running a deficit and to rise if it is running a surplus. Also, trade deficits provoked by structural and supply-side deficiencies usually lead to exchange rate depreciation under a flexible exchange rate regime and to downward pressure on currencies with a fixed exchange rate regime.

Finally, in the external sector, the balances of trade in goods and services are usually the main determinant of the current account in the BOP, whereas direct trade credits and intergovernmental credit that are used to pay for imports are an integral part of the financial account. The resulting BOP balance directly impacts central bank reserves, as trade-related foreign

exchange inflows help build reserves, while outflows may lead to losses.

2. What policy space does a country have to preserve macro-stability?

2.1 Policy space concept

Macro-stability and therefore the prospects for peace often depend on a country's response to shocks. A strong macro-framework and solid macro-policies should be viewed as the first layer of defense against endogenous and exogenous shocks. But how can a government assess what policy space it has at its disposal to respond to such shocks, or in other words, how can it evaluate its own preparedness to preserve macro-stability? Such evaluation usually boils down to an assessment of its fiscal space, defined as the room for undertaking discretionary fiscal policy by raising expenditure or reducing taxes relative to the existing baseline without compromising market access and debt sustainability (IMF, 2018). In the context of macro-stability as a precondition for peace, a broader approach to policy space seems warranted and was proposed in Ferrer and Kireyev (2022).

Policy space can be defined as a country's ability to respond to macro-threats to peace. This response can be based on the use of existing or newly created instruments, or its own or borrowed resources. But in any case, measures taken should not undermine macroeconomic stability during the current year. Therefore, the policy space in this restricted and somewhat static definition depends on a country's own policies, for example, its fiscal and monetary policies, and the willingness of its partners to assist in times of difficulties, for example, by providing lending.

The policy space needed to maintain macro-stability can be assessed quantitatively. This can be done by way of a policy space index, which combines a quantitative, albeit relatively limited and narrow, fiscal space concept with the indicators of nominal monetary space and reserve space. Each nominal policy space indicator is then adjusted for an individual country's institutional features, such as the status of its currency, income group, access to capital markets, debt distress level, and the exchange rate regime. The final policy space index is derived as a composite of the three nominal policy space indicators, each adjusted for five institutional features. This index allows the overall measurement of policy space in each country directly in per cent of GDP.

The short-term policy space concept can be presented in a matrix form (see Figure 6.2). This is a three by five matrix, which reflects the quantitative and qualitative components of policy space. Quantitatively, policy space should reflect at a minimum the country's fiscal, monetary, and reserve space. This is usually calculated using the limits of debt and other fiscal indicators, floors on the value of reserves, or lower bounds of the central bank's policy rate. Qualitatively, the assessment of policy space under each of these components depends on the country's reserve currency or national currency status, income group (advanced economies (AE), emerging markets (EM) or low-income countries (LIC)), its access to capital markets (full, limited or none), debt distress risk (low, moderate, high, in distress), and its exchange rate regime (flexible, soft peg or hard peg).

2.2 Policy space components

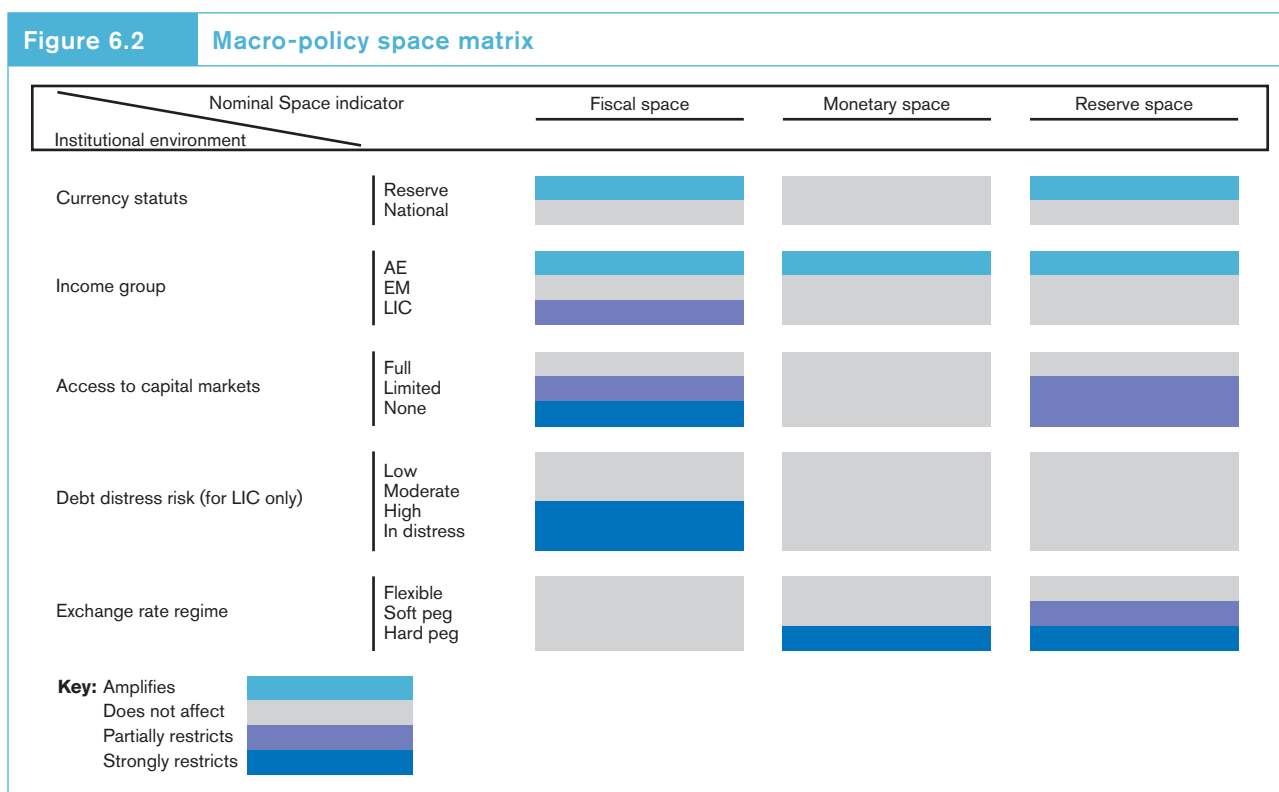
Fiscal space can be defined as the sum of borrowing space and financing space. Borrowing space can be calculated as the difference between a country's public debt-to-GDP ratio and its sustainability threshold. Similarly, financing space can be calculated as the difference between a country's gross financing needs as per cent of GDP and the corresponding sustainability threshold. Thresholds for both variables

are defined as a function of the country's income group (AE, EM, LIC) and their access to capital markets.

Monetary space is defined as the ability to stimulate the economy without compromising price stability. Monetary space is measured here as an intersection of growth and inflation. On one side, central banks' monetary policy can be constrained by the zero-lower bound, but to capture the reality that in some AEs interest rates dropped in the past below zero, an effective lower bound of minus 1 per cent can be applied to calculations. On the other hand, monetary policy is also constrained by the need to ensure controlled inflation as defined by countries' inflation targets. Therefore, the measure of monetary space will be the central bank's room to support growth through both conventional and unconventional monetary policy, as long as inflation remains reasonably close to the target.

Reserve space is defined as the level of reserves exceeding two reserve adequacy metrics. Assuming that countries hold reserves for precautionary and liquidity purposes, the adequacy level depends on the country's income group and access to capital markets.

Adequacy thresholds for both metrics (months of next year's imports and per cent of short-term debt) depend on the county's income group and access to capital markets. For instance, EM and LIC reserves



Source: Ferrer and Kireyev (2022).

Note: AE=advanced economies, EM=emerging markets, LIC=low-income countries.

are considered adequate if the country maintains three or more months of the prospective value of imports of goods and services. Additionally, EM and LIC reserves need to accrue to 100 per cent of short-term debt if they have at least some constraints on access to international capital markets. If not, we assume only 50 per cent of short-term debt cover is adequate. On the other hand, AE reserves are considered adequate when they include more than one month of imports and no short-term debt cover is required.

The reserve currency status of the national currency amplifies policy space. Reserve currency is conventionally defined as a foreign currency held in significant quantities by central banks as part of their foreign exchange reserves. The IMF Articles of Agreement do not define reserve currency directly, but they mention reserve assets.

Reserve currencies are just one form of reserve assets and refer narrowly to currencies providing the official sector with a good store of value and ready access to international liquidity. Reserve currency countries (RCCs) can be defined as the United States and countries in the Euro area. Their central banks issue reserve currencies (US dollars and Euros, respectively), their governments repay their debts mainly in national currencies, can readily swap their national currencies for other currencies, and their currencies are widely accepted for international transactions.

Higher income levels also amplify policy space. High-income economies are generally characterized by stronger institutional stability, rule of law, sound business practices, and resilience to shocks than lower-income economies. Therefore, AEs have at least some advantages in all three quantitative components of policy space. For example, their fiscal space is amplified by their internationally recognized public debt and more stable public finances reflected in higher sustainability thresholds with respect to EMs and LICs.

AEs' monetary space is also amplified by their capacity to set negative policy rates, which can be attributed to higher central bank credibility and the higher overall stability and maturity of financial markets in AEs. Finally, AEs' reserve space is amplified by the lower probability of balance of payments shortfalls and their higher access to international markets in case of external shocks. This translates into lower reserve adequacy thresholds for AEs than for EMs and LICs. The combination of higher debt/GFN thresholds, negative policy rates, and lower reserve coverage by itself creates additional policy space in AEs relative to all other countries.

Restricted access to capital markets can limit a country's policy space. In principle, the capacity of countries to borrow from international capital markets can decrease their policy space. In a nutshell, if a government has access to capital market financing at a reasonable risk premium, it has fiscal space; if, however, the country's debt is classified as a highly speculative investment or similar, the country is considered to have no fiscal space. This is meant to reflect the unwillingness of foreign investors to buy sovereign bonds from such a country which would in turn restrict the said country's ability to obtain funding through the issue of debt.

The assessment of market access is often based on the sovereign bond spreads: the higher the spread, the higher the risk premium and therefore the lower market access. Also, debt indicators such as public debt held by non-residents, public debt in foreign currency, the short-term debt share, and external financing requirements, can also indirectly signal the degree of market stress.

The risk of debt distress severely limits policy space. The risk of debt distress indicator is available only for LICs. The indicator is derived by comparing debt burden indicators with indicative thresholds over a projection period.

There are four ratings for the risk of external public debt distress: low risk, if none of the debt burden indicators breach their respective thresholds under the baseline and stress tests; moderate risk, if none of the debt burden indicators breach their thresholds under the baseline scenario, but at least one indicator breaches its threshold under the stress tests; high risk, if any of the external debt burden indicators breaches the threshold under the baseline scenario, but the country does not currently face any repayment difficulties; or in debt distress, when the country is already experiencing difficulties in servicing its debt, as evidenced, for example, by the existence of arrears, ongoing or impending debt restructuring, or indications there is a high probability of a future debt distress event (e.g., debt and debt service indicators show large near-term breaches, or significant or sustained breach of thresholds).

Finally, the exchange rate regime has an ambiguous impact on policy space. A fixed exchange rate regime severely limits policy space, whereas floating exchange rate regime amplifies it. For members of currency unions from their individual points of view, the flexible exchange rate is not unreserved, as the exchange rate with other members of the union is fixed. Policy space would depend on the need to defend a certain level of exchange rate. Countries with floating exchange

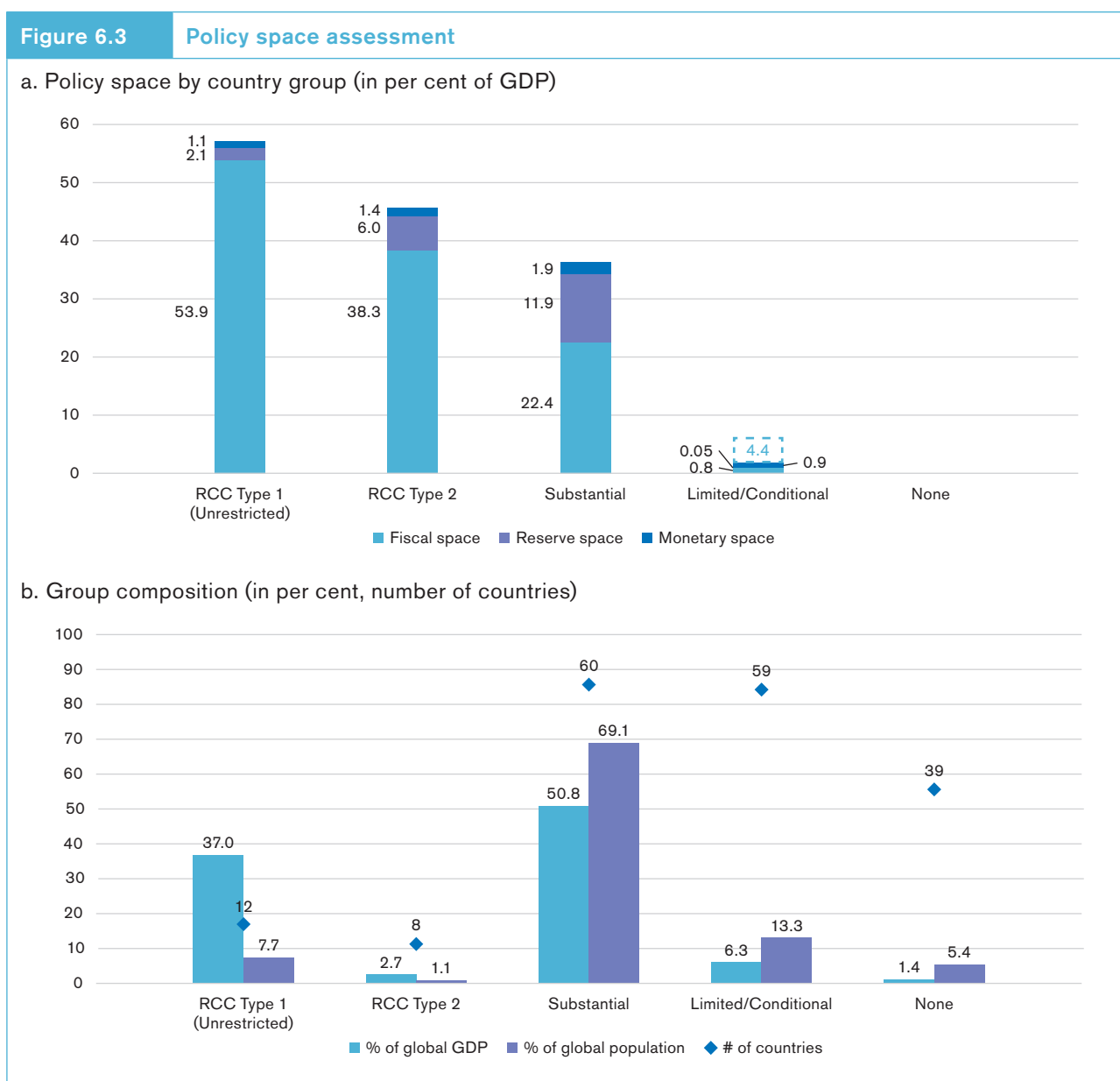
rate regimes, where there is no explicit or implicit commitment to a specific level of exchange rate, have more policy space than countries with any form of managed exchange rates.

Policy space is then calculated as a conditional measure of all its components. Nominal policy space consists of the three quantitative components discussed above – fiscal space, monetary space, and reserve space – all expressed as a percentage of GDP. Nominal space for each of the three quantitative components is a priori defined as the distance to its respective threshold weighted by the probability of constraint, which increases as the target indicator moves closer to its threshold. Each quantitative component is then adjusted to reflect the country’s institutional environment that has

not been accounted for so far, such as its exchange rate regime, or the risk of debt distress (only for LICs). The effective policy space index is then calculated as an aggregated index of the three quantitative and five institutional components.

2.3 Policy space assessment

The calculation of the policy space can be illustrated using the COVID-19 macro-shock. How much policy space did governments have to immediately fight this shock so that it did not translate into macro-instability and therefore threaten peace? The 178 countries included in the sample can be classified in five groups by the decreasing level of available policy space (see Figure 6.3).



Source: Ferrer and Kireyev (2022).

Group 1. Reserve currency countries with unrestricted policy space (RCC Type 1). This group includes reserve currency countries (RCCs) with full access to capital markets and low fiscal risks. In the short run, countries in this group have virtually unrestricted resources to fight crises, even those comparable in magnitude to the COVID-19 pandemic. There are 12 countries in this group, all of them advanced economies, representing over one third of global GDP and almost 8 per cent of the world's population.

Group 2. Reserve currency countries with somewhat restricted policy space (RCC Type 2). This group includes RCCs with limited access to capital markets and mounting signs of fiscal risks. In the short run, countries in this group still have enough resources to fight most crises but need to address mounting vulnerabilities. For example, some Euro area member countries can be classified as type 2 RCC countries. This group includes only eight countries, all of them advanced economies, representing about 3 per cent of world GDP.

Group 3. Non-reserve currency countries with substantial policy space. Countries in this group are not RCCs but have considerable policy space, large enough to absorb all costs of the COVID-19 crisis or a similar-size negative shock in the short run. A country having substantial space is defined as one having total policy space in excess to the median decrease in real GDP in the year 2020. This threshold is thus set at 5 per cent. A total of 60 countries accounting for about 69 per cent of the global population producing roughly half of global GDP can be included in this group. Many advanced economies with non-reserve currencies as well as oil producers and other commodity exporters fall into this group.

Group 4. Non-reserve currency countries with limited and/or conditional policy space. Countries in this group have either very limited or no effective policy space. In the latter case, these countries would still qualify for conditional or concessional lending. The subgroup of countries with limited effective policy space includes countries with some positive effective space but that is still insufficient to cover all financing needs from the COVID-19 crisis in the short run. This group includes 59 countries, accounting for 13 per cent of the global population and producing 6.3 per cent of global GDP. The group is very diverse and includes advanced, middle-income and LICs, each of them facing country-specific problems that severely limit their policy space.

Group 5. Non-reserve currency countries with no policy space. This is a residual group, which includes

all other countries with a policy space index equal to zero. Although its individual components may indicate some nominal space in particular areas, the institutional characteristics of these countries suggest that this space cannot be used. Countries in this group have effective policy space equal to zero and have no room even for conditional financing. They will have to rely on grants and donors willing to take substantial default risks. Some 39 middle- and low-income countries, representing 1.4 per cent of global GDP and 5.4 per cent of the global population are included in this group.

3. How to achieve macro-stability for peace?

Macro-stability for peace should be tackled from multiple angles. Building on enhanced information and analysis of the link between macro-stability and peace, governments have a range of options for moving forward. This range includes using their existing domestic macro-policies and instruments as well as international consultation mechanisms, regulations, and legal commitments (IMF et al., 2022).

All countries should build and maintain their own resilience. Macro-stability, in its internal and external dimensions, is a critical precondition for peace. Such macro-stability can be achieved and preserved only through good national macro-policies. The objective for any authorities would be to maintain at each point of time sufficient policy space to be able to address any potential threats to macro-stability and peace.

As a tool, the governments could use the proposed policy space index to take a snapshot of a country's readiness to address a catastrophic event in the short run. The index can also guide them in taking decisions on how to strengthen their policy space. Finally, the policy space index can also be included as an additional variable in analytical frameworks to examine options available to the authorities to react to unforeseen macro-threats to peace.

A broader dialogue among governments can support macro-stability for peace. To achieve the policy objective of preserving macro-stability and peace, governments should learn from their peers' experiences and alternative policy approaches. A deeper dialogue among governments can promote macro-stability by demonstrating good practices, exerting peer pressure, and providing others with the opportunity to benefit from positive spillovers and prevent negative spillovers on each other's economies. Also, difficult domestic reforms can often be easier to negotiate and implement referring to the successful examples of peers.

International organizations can help strengthen the dialogue on macro-stability for peace. They can offer a platform for such a dialogue, services, and secretariats, and prepare objective background analyses. They can also support dialogue across and within countries by serving as a sounding board for governments on their existing and proposed policies, highlighting their costs and benefits. Such fora where a dialogue on macro-stability for peace seems appropriate and is largely already ongoing including the IMF, World Bank, and the WTO.

The IMF contributes to the dialogue by providing advice on macro-stability and trade. IMF multilateral

surveillance mechanisms, such as the World Economic Outlook and bilateral Article IV consultations, have proved useful for the purpose of maintaining macro-stability. Fund financing through a gamut of different arrangements designed to address specific BOP vulnerabilities has also proven useful to members. When requested, the IMF can also provide technical assistance in specific areas of its expertise, including on those related to macro-stability and trade. Finally, to contribute further to macro-stability and peace in the most vulnerable part of its membership, in 2022 the IMF adopted a Strategy for Fragile and Conflict-affected States.³

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Endnotes

- 1 Senior economist, International Monetary Fund.
- 2 Defined as the rules governing exchange arrangements and exchange rates; the rules on payments and transfers for current international transactions; and the regulation of international capital movements and the arrangements under which international reserves are held (IMF, 2012).
- 3 See, in particular, the chapter by Bousquet in this volume.