

Introduction

The IMF has three core functions: surveillance over the policies of its member countries, financing in support of IMF-backed adjustment programs, and technical assistance. Of these three core functions, surveillance is the most important and has the broadest implications. Given this importance, the International Monetary and Financial Committee (IMFC), the Executive Board, and the Managing Director have called surveillance a critical area in need of strengthening.¹

This report presents the findings of an evaluation of the IMF's multilateral surveillance. The evaluation has two goals: contributing to transparency by showing how multilateral surveillance works in practice, and identifying areas where improvement can be made to enhance its effectiveness and impact. The evaluation pays particular attention to the key outputs and procedures involved, seeking to assess how and how well these contribute to the IMF's overall objective in multilateral surveillance of global financial stability. Although IMF surveillance has been extensively assessed in the past, this is the first evaluation that focuses exclusively on multilateral surveillance.²

While the legal basis of IMF surveillance is established in the IMF Articles of Agreement (Box 1.1), its precise operational meaning has yet to be explicitly stated in IMF documents. What is clear is that it is a multidimensional concept that involves "all aspects of the Fund's analysis of, scrutiny over, and advice concerning, member countries' economic situations, policies, and prospects."³ While the IMF conducts surveillance, it is also a participant in a broader process of multilateral surveillance involving other organizations and country groups.

¹Initiatives to strengthen surveillance are currently under way, including the recently announced decision by management to restructure financial sector and capital markets work in the IMF. This report also hopes to contribute to this process.

²See Background Documents, pp. 3–8, for a summary of the references made in previous reviews to multilateral surveillance. The Background Documents are available via the Internet at www.imf.org/ieo.

³"External Evaluation of IMF Surveillance—Report by a Group of Independent Experts" (EBAP/99/86), July 15, 1999. Hereafter referred to as the Crow Report. Published as IMF (1999).

In IMF terminology, it has been customary to use the expressions *bilateral* and *multilateral* to characterize the two broad categories of surveillance activities.⁴ Bilateral surveillance refers to the IMF's surveillance over the policies of individual countries. It is typically conducted through periodic Article IV consultations with all member countries. Multilateral surveillance refers to the surveillance of economic linkages and policy spillovers between countries as well as international economic and market developments. It can complement bilateral surveillance by bringing into the analysis global and cross-country perspectives. And it contributes to the overall objectives of IMF surveillance, which are to promote policies that are consistent with "the continuing development of the orderly underlying conditions that are necessary for financial stability," as specified in Article IV of the IMF Articles of Agreement.

The rest of this chapter makes the concept of multilateral surveillance operational for the purpose of this evaluation, presents a brief description of how multilateral surveillance is conducted in the IMF, and describes the scope and methodology of the IEO evaluation. Chapter 2 then assesses the content and quality of the IMF's multilateral surveillance outputs and Chapter 3 discusses their use and delivery. The Background Documents contain supplementary and other supporting information, including evidence for the statements we make in the report. (The Background Documents are available via the Internet at www.imf.org/ieo.)

Characteristics of Multilateral Surveillance

In making the concept of multilateral surveillance operational for the evaluation, we emphasize the

⁴Alternatively, surveillance activities can be classified into country, regional, and global surveillance. What we call multilateral surveillance may to some extent overlap with global surveillance, but it also involves the analysis of linkage-related and cross-country issues more broadly, including some aspects of regional surveillance.

Box I.1. The Legal Basis for IMF Surveillance

Under Article I of the IMF Articles of Agreement, among the purposes of the IMF is to “promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.” In order to achieve this mandate, surveillance was introduced into the Articles at the time of the Second Amendment in 1978, which formally eliminated the par value system and permitted each member country to choose an exchange rate arrangement of its own liking. With this amendment, “the responsibilities of the IMF changed from those of a guardian of member countries’ observance of exchange rate rules to those of an overseer of individual country exchange rate policy” (Gutián, 1992). Surveillance thus became “a central pillar of IMF activities and responsibilities in the modern era” (Boughton, 2001; also Mussa, 1997).¹

Article IV of the amended Articles of Agreement endowed the IMF with the responsibility to “oversee the international monetary system in order to ensure its effective operation.” This is the basis for multilateral surveillance under the IMF’s Articles. Moreover, the amended Articles also require the IMF to oversee the compliance of each member with its obligations respecting exchange rate policies and economic and financial regarding policies under Article IV, Section 1

¹Boughton (2001) further notes that the term surveillance was used for the first time in an IMF document in 1974.

and to exercise firm surveillance over the exchange rate policies of members. This is the basis for bilateral surveillance under the IMF’s Articles.

In 1977, the Executive Board adopted a decision on the “Surveillance over Exchange Rate Policies” (Decision No. 5392, as amended), which took effect when the Second Amendment entered into force in 1978, as a means of providing guidance to members with respect to their exchange rate policies and of implementing the IMF’s surveillance responsibilities over those policies:

“The Fund’s appraisal of a member’s exchange rate policies . . . shall be made within the framework of a comprehensive analysis of the general economic situation and economic policy strategy of the member, and shall recognize that domestic as well as external policies can contribute to timely adjustment of the balance of payments. The appraisal shall take into account the extent to which the policies of the member, including its exchange rate policies, serve the objectives of the continuing development of the orderly underlying conditions that are necessary for financial stability, the promotion of sustained sound economic growth, and reasonable levels of employment.”

Thus, the scope of IMF surveillance can be broad, but it derives from the IMF’s more narrow responsibility to oversee the international monetary system and to exercise surveillance over the exchange rate policies of members under Article IV.

characteristics of multilateral surveillance that differentiate it from bilateral surveillance. In our view, multilateral surveillance has at least four distinguishing characteristics. First, its value added cannot just be the sum of bilateral surveillance across all member countries. Multilateral surveillance must bring to bear the perspectives that cannot be obtained from bilateral surveillance alone. These are the implications of economic linkages and policy spillovers across countries, as well as the analysis of global economic and market developments that may constrain the pursuit of economic policies globally or by individual countries.

Second, multilateral surveillance is more asymmetric than bilateral surveillance. In the surveillance of the global economy, not all countries are equally important. Larger economies inevitably exert greater impact on the rest of the world than smaller ones; even economies of the same size may have different systemic consequences for the world economy, depending on the degree of integration with the rest of the world. The systemically more important economies should receive greater attention in multilateral surveillance. In large measure, multilateral

surveillance is concerned with the analysis of economic linkages among the systemically more important economies and the impact of their policies on the rest of the world. This analysis should in turn feed into the bilateral surveillance of systemically less important economies.

Third, the peer review (or collective discussion) aspect of IMF surveillance is more prominent in multilateral surveillance than in bilateral surveillance. All IMF surveillance activities, including Article IV consultations, involve an element of peer review as their outputs are discussed by the Executive Board. Given its focus on economic linkages and policy spillovers, however, multilateral surveillance can identify potential opportunities for cooperative or collective action and thereby increase the relevance of peer review. The effectiveness of multilateral surveillance in bringing about a measure of policy cooperation or coordination critically depends on the extent to which it can bring peer pressure to bear.

Finally, the IMF is only one of many players in multilateral surveillance. A number of other institutions and country groups are active in addressing the different aspects of global cooperation on monetary

Box 1.2. Principal Institutions and Country Groups Engaged in Global Cooperation on Monetary and Financial Issues

Institutions

- *The IMF* occupies a special place in the international financial system because of its near universal membership. It has an associated ministerial steering committee that meets twice a year—the International Monetary and Financial Committee (IMFC)—to discuss policy issues.
- *The BIS*, based in Basel, Switzerland, is an international organization established to foster cooperation among the central banks of industrial countries. In recent years, the BIS’s membership has expanded to include a number of emerging market countries.
- *The OECD* regularly brings together, for an exchange of views on policy issues, a group of industrial country finance ministry and central bank deputies in Working Party 3 of its Economic Policy Committee.

Country groups

- *The Group of Seven (G-7)* superseded in the mid-1980s the Group of Five (G-5) finance ministers and central bank governors (from the United States, Japan, Germany, France, and the United Kingdom) by including the counterparts from Canada and Italy. From early on, discussions focused on exchange rates and economic policy coordination. More recently, however, discussions have focused on such other issues as global financial stability and the role of international financial institutions (IFIs).

- *The Group of Ten (G-10)* includes 11 industrial countries that are parties to the General Arrangements to Borrow (GAB), established in 1961 to lend to the IMF in the event of insufficient liquidity.
- *The Group of Twenty (G-20)* was created in 1999 as a forum of finance ministers and central bank governors from the major emerging market countries as well as the G-7 and Australia. The IMF participates as an ex officio member. The G-20’s current agenda covers all the key aspects of global financial stability and economic cooperation.
- *The Financial Stability Forum (FSF)* was also created in 1999 explicitly to promote global financial stability. Members include representatives of national authorities responsible for financial stability from the G-7, Australia, the Netherlands, Singapore, and Hong Kong SAR, along with representatives of international financial institutions and regulatory bodies, including the IMF. It meets twice a year and is serviced by a small secretariat based at the BIS.

Others

- The various Basel-based committees, including the Basel Committee on Banking Supervision.
- A wide range of regional forums exist to bring senior policymakers together in different regions, including meetings of the Asia Pacific Economic Cooperation Council (APEC), Western Hemisphere, and European Union (EU) Finance Ministers.

and financial issues (see Box 1.2 for a partial list). When the IMF was established, it was in some respects a monopoly or near-monopoly supplier of analysis and advice on international financial and monetary issues. This is no longer the case. The IMF’s effectiveness now depends in part on how well it interacts with these other institutions, and how far it builds on and exploits its areas of comparative advantage. The IMF’s role in multilateral surveillance thus needs to be seen in the context of this wider global effort.

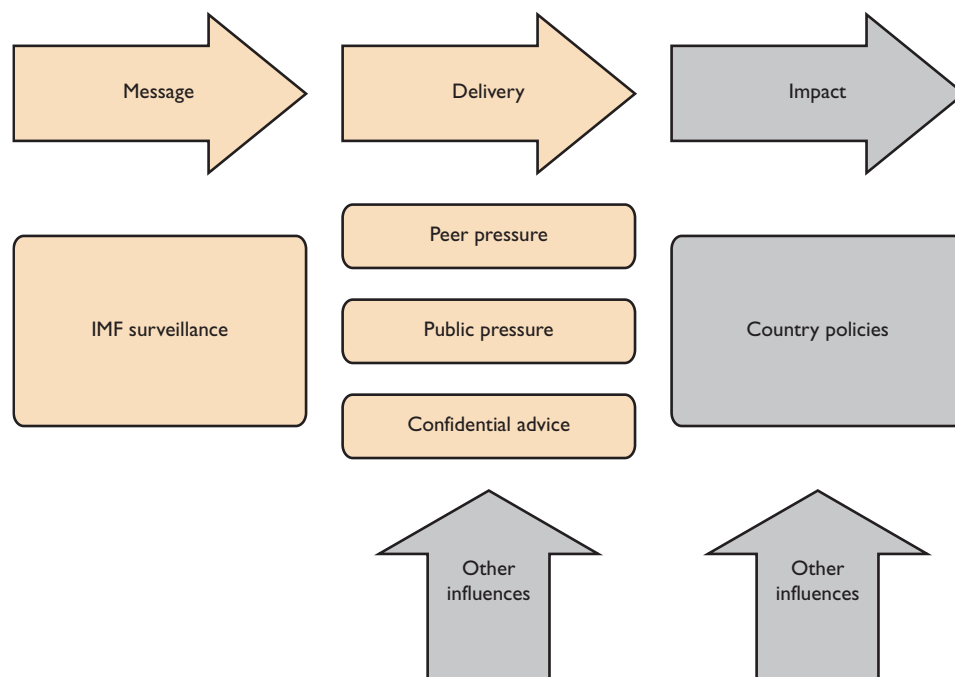
To assess multilateral surveillance, we consider four channels through which it seeks to achieve its objectives:

- at the global level, by directly interacting with international groups of national policymakers;
- by informing and helping shape public debate across the membership, which in turn can influence policy decisions;

- at the national level, by transmitting advice through bilateral surveillance to individual countries, particularly the major economies whose policies have the largest global economic impact; and
- by informing internal decision making within the IMF.

We may call the dominant forms of influence that operate through the three “external” channels as “peer pressure,” “public pressure,” and “confidential advice,” respectively, though in practice each could work in varying degrees through all three channels.

Evaluating surveillance is easier to grasp if it is viewed in terms of a results chain, namely, “message,” “delivery,” and “impact” (Figure 1.1). Effectiveness can then be measured at each of these stages. However, it should be acknowledged at the outset that the impact of multilateral surveillance on member countries’ policies is particularly difficult to

Figure I.1. The Results Chain of IMF Surveillance

assess for a number of reasons, not the least of which is the presence of multiple influences.

Multilateral Surveillance in the IMF

Multilateral and bilateral surveillance are closely linked concepts. Multilateral surveillance often draws on the country-specific information obtained from bilateral surveillance. At the same time, the global and cross-country perspectives obtained from multilateral surveillance ideally feed back into discussions with individual countries in the context of bilateral surveillance. Although the IMF carries out clearly distinctive *multilateral* and *bilateral* surveillance activities, a simple demarcation between the two is not always possible. In some cases, the same vehicle may serve both multilateral and bilateral surveillance functions, thus making them joint products. With this caveat, we review below the organization and resource costs of multilateral surveillance in the IMF.

Organization of multilateral surveillance

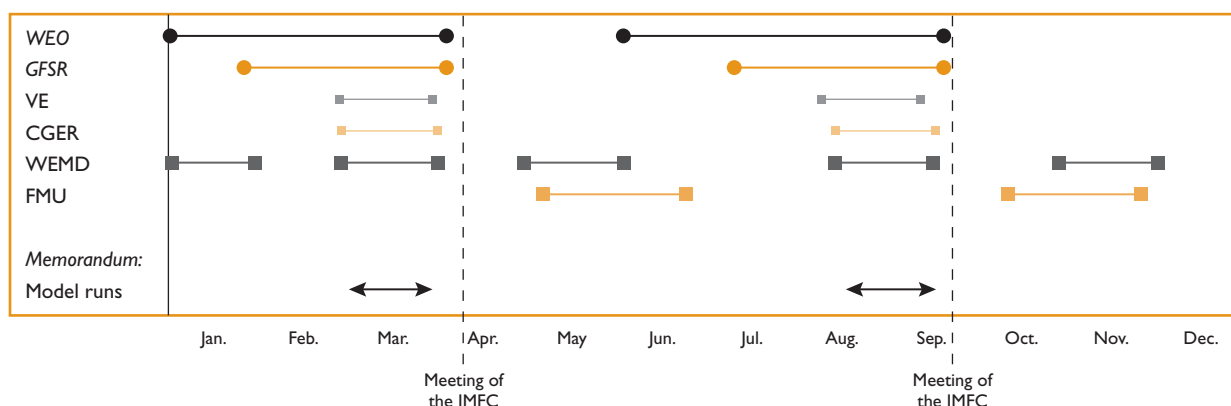
The IMF's multilateral surveillance works through a number of established outputs and procedures that include reports and internal exercises. Except for the production of regional outlooks, in which area departments take the lead, most of the

other multilateral-surveillance-related outputs and procedures are either produced or coordinated by functional departments, notably the Research Department (RES), the International Capital Markets Department (ICM), and the Policy Development and Review Department (PDR). Many of the internal exercises, including model runs, are timed to provide quantitative inputs into the production process of the *World Economic Outlook (WEO)* document and, to a much lesser extent, the *Global Financial Stability Report (GFSR)* document. In this sense, the *WEO* occupies a special place in the IMF's multilateral surveillance (Figure 1.2).

The *WEO* is both an output and a process. As an output, it is prepared twice a year by RES to communicate the views of IMF staff on global economic developments, prospects, and risks, as well as to present analysis of selected economic policy issues. The report is submitted to, and discussed by, the Executive Board, but it is published as a staff document, along with the Summing Up of the Board discussion. As a process, the *WEO* is almost continuous and involves the entire institution. Although RES takes the lead in its production, RES interacts extensively with other IMF departments; country-specific forecasts are provided by area departments.

The *GFSR*, prepared twice a year, to date by ICM, is designed to identify vulnerabilities in the global financial system. Like the *WEO*, it is submitted to, and discussed by, the Board and is published as a

Figure I.2. Approximate Cycles of Key Outputs and Procedures



staff document, along with the Summing Up of the Board discussion. In contrast with the interactive approach of the *WEO*, the *GFSR* uses relatively little input from other departments. Even input on banking sector issues from the Monetary and Financial Systems Department (MFD) has been limited, largely confined to self-contained blocks. ICM staff does interact early on with RES, however, to ensure that the selection of topics for the *GFSR* and the *WEO* is coordinated. Inputs to the *GFSR* are more likely to come from outside the IMF, through extensive ICM consultations with regulators and market participants.

The internal exercises also provide inputs to the *WEO* and the *GFSR*. The vulnerability exercise takes place semiannually and results in a report prepared by PDR that identifies underlying vulnerabilities and crisis risks in about 50 emerging market economies.⁵ The report is submitted to management following clearance from RES and ICM. The Coordinating Group on Exchange Rate Issues (CGER), an interdepartmental group of IMF economists, prepares a semiannual report on the likely medium-term paths of industrial country currencies. After clearance from RES and PDR, the report is submitted to management, with a major portion of it also circulated to the Executive Board for information.

The World Economic and Market Developments (WEMD) exercise is a vehicle by which the IMF's Economic Counselor provides the Executive Board with up-to-date information on the global economy. The Board's WEMD sessions normally take place five times a year. Sessions in March and August are combined with *WEO* discussions, while sessions in June and November are coordinated with ICM, which si-

⁵Crisis risks in a subset of countries, however, are assessed on a quarterly basis.

multaneously prepares a Financial Market Update (FMU) as input into the discussion. The update consists of a short note that summarizes global financial market developments following each *GFSR*.

Surveillance notes prepared by RES for various intergovernmental groups—notably the G-7 and the G-20—are derivatives of these intellectual efforts within the IMF. The production of these notes, coordinated by a single senior staff member in RES, often involves an update of the latest *WEO* or WEMD material, subject to the usual interdepartmental review process.

Regardless of which department is actually responsible for production, area departments exert critical influence on any judgment expressed about individual member countries. Even in such an internal exercise as the vulnerability exercise, the final judgment on a particular country's crisis vulnerability rests with the relevant area department. Views expressed in the *WEO* or surveillance notes on individual countries must also be explicitly or implicitly endorsed by the area departments. The production process of the *WEO*, moreover, involves an aggregation of country desk inputs (albeit shaped by common global assumptions); this assures the *WEO*'s consistency with bilateral surveillance.

The resource costs of multilateral surveillance

Because multilateral and bilateral surveillance are closely linked, it is difficult to agree on a precise estimate of the allocation of resources and time between them and between other IMF activities. Even so, multilateral surveillance claims a relatively small share of the IMF's budgetary and human resources, relative to bilateral surveillance or the use of IMF resources (that is, financing provided to member countries under IMF-supported adjustment programs). About 260

Table I.1. Human Resource Cost of Multilateral Surveillance Activities, FY2005¹

	Staff-Years (As percent of IMF total)
<i>WEO</i> and <i>GFSR</i>	60.2 (2.0)
Research and policy on the international monetary system	115.2 (3.8)
Regional surveillance	47.5 (1.6)
Others ²	37.3 (1.2)
Total	260.2 (8.5)
Memorandum items	
Bilateral surveillance	885.9 (28.9)
Use of Fund resources	883.0 (28.8)

Source: IMF, Office of Budget and Planning, Time Reporting System and Budget Reporting System.

¹Includes a prorated distribution of the time attributed to IMF-wide management and administration activities.

²Includes participation in the IMFC and other forums, surveillance over exchange rate regimes, and the vulnerability exercise.

Table I.2. Executive Board Meetings on Multilateral Surveillance, 2003–05¹

	2003		2004		2005 ²	
	Number	Hours	Number	Hours	Number	Hours
Multilateral surveillance ³	14 (3.3)	28 (4.7)	14 (3.1)	20 (4.1)	13 (3.4)	18 (4.6)
Total	422	596	453	487	386	394
Memorandum items						
Stand-alone Article IV	94 (22.3)	144 (24.2)	93 (20.5)	106 (21.8)	89 (23.1)	81 (20.6)
Use of Fund resources (UFR)	86 (20.4)	130 (21.8)	87 (19.2)	122 (25.1)	53 (13.7)	60 (15.2)
Combined Article IV/UFR	28 (6.6)	51 (8.6)	28 (6.2)	40 (8.2)	31 (8.0)	34 (8.6)

Source: IMF, Secretary's Department, Operations Division.

¹Percent of total in parentheses.

²Through October.

³Includes *WEO*, *GFSR*, *WEMD*, and regional surveillance.

staff-years were used for multilateral surveillance (including regional surveillance) in financial year 2005 (May 1, 2004, to April 30, 2005), accounting for 9 percent of the IMF's total staff resources (Table 1.1). This is no small sum, even though it represents less than a third of the resource costs of bilateral surveillance or use of IMF resources.⁶

Multilateral surveillance claims an even smaller share of Executive Board time, reflecting both the bilateral orientation of the IMF's work and the fact that multilateral surveillance involves some internal procedures and outputs that are not shared with the Board, let alone made public. In recent years, the

Board has typically held about 14 meetings on multilateral surveillance issues (including regional surveillance) a year,⁷ spending an average of about 20 hours each year (Table 1.2).⁸ These represent no more than 4–5 percent of total Board time.

Scope and Methodology of the Evaluation

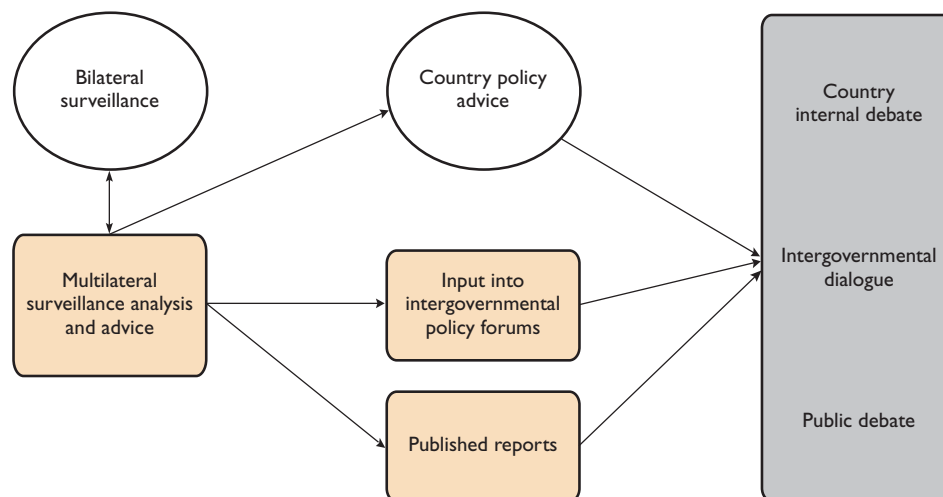
Because multilateral surveillance is conducted through various vehicles, our evaluation must necessarily assess the effectiveness of specific outputs and procedures, some of which may well have dual

⁶This may well overestimate the actual cost of multilateral surveillance proper, as the IMF's Time Reporting System combines multilateral surveillance, policy development, and operation of the international monetary system together in one category. Additional inaccuracies may have resulted from the transition from the Budget Reporting System to the Time Reporting System, which took place in FY2005.

⁷This includes the Article IV consultation with the euro area but excludes informal seminars.

⁸The increasing use of "gray" statements (prepared statements submitted for minutes instead of verbal interventions) in recent years has further reduced the length of Board meetings.

Figure I.3. Linkages in Multilateral Surveillance



multilateral-bilateral surveillance functions. Although many IMF analytical activities have a multilateral surveillance dimension, for the purpose of this evaluation, we focus on four types of outputs and procedures:

- published reports: the *WEO* and the *GFSR*;
- internal exercises: the vulnerability exercise (VE), the Coordinating Group on Exchange Rate Issues (CGER), and World Economic and Market Developments (WEMD);
- G-7 and G-20 surveillance notes; and
- regional outlooks.

We consider regional outlooks because regional considerations, with a focus that transcends country-specific issues, have a multilateral character. Although regional work by area departments takes many forms (such as cross-country analytical work and regional policy discussions with national authorities), regional outlooks are the most visible part and deserve special attention.

These outputs and procedures have multiple audiences and objectives. Internal procedures (e.g., the vulnerability exercise and WEMD) address IMF staff, management, or the Executive Board. Some outputs (e.g., G-7 and G-20 surveillance notes) are directed at a single external audience, such as senior policymakers of major member countries. Yet others (e.g., the *WEO*) are targeted at several different audiences simultaneously, including IMF staff, the Executive Board, member country authorities, the press, and the public at large.

The evaluation is based on a desk study of published and internal documents, which were selected primarily from the 2000–05 period (following the 1999 external evaluation). In examining the integration of multilateral and bilateral surveillance, we pay particular attention to a sample of staff reports for Article IV consultations issued during 2004–05.⁹

To supplement the desk study, the evaluation team sent out questionnaire surveys to users of the IMF’s multilateral surveillance outputs, and also interviewed a large number of IMF staff; all 24 Executive Directors (or their alternates); senior policymakers, especially in the finance ministries and central banks of major countries; officials of regional and international organizations; and relevant representatives of the public, including key market participants and the press.

We developed and applied several criteria to assess the content of multilateral surveillance outputs and the effectiveness of delivering the multilateral surveillance message. The two areas of focus in the report—“content” and “delivery”—can be depicted schematically (Figure 1.3). Content refers to what is inside the box on the left-hand side—multilateral surveillance analysis and advice. Delivery involves the arrows going from “multilateral surveillance analysis and advice” to the circle above and the two boxes on the right.

⁹We chose this period because the 2004 Biennial Surveillance Review examined the staff reports for Article IV consultations concluded through early 2004.