

INTERNATIONAL MONETARY FUND

2011 TRIENNIAL SURVEILLANCE REVIEW—OVERVIEW PAPER

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Background. This paper assesses progress in strengthening Fund surveillance and identifies needed improvements. It differs from past reviews insofar as it: (A) encompasses not only bilateral but also multilateral surveillance; and (B) steps-up external inputs in the form of studies by outside observers, commentaries, and assessment of recommendations by an external advisory group.

Progress and gaps. The crisis has catalyzed important changes in the content of surveillance and country officials view Fund policy advice as timely and responsive. Nevertheless, surveillance is still seen to be too fragmented, and its risk assessments lacking requisite depth and attention to interconnections and transmission channels. Traction is uneven across the membership, especially in systemic countries. The current legal framework suffers from limitations that play into these weaknesses.

Key recommendations. Fund surveillance should be as interconnected as the global economy itself. This argues for:

- More work on interconnections and spillovers.
- In-depth risk assessments in all Article IVs and in the WEO/GFSR/Fiscal Monitor, taking into account interconnections and spillovers.
- More work on financial stability, including deeper coverage in Article IVs and a regular strategic work plan for promoting financial stability endorsed by the Board and IMFC.
- Renewed emphasis on external stability, including by regularly publishing a multilaterally-consistent assessment of external balances and exchange rates.
- Efforts to gain traction in surveillance, with incentives for candor (e.g., external reviews of systemic country Article IVs), collaboration (e.g. dialogue with authorities ahead of consultations), and relevance (e.g. adequate coverage of macro-social issues).
- Changes in the Fund's legal framework for surveillance to facilitate an integrated and balanced approach to global economic and financial stability. This issue is covered in the companion paper [*Review of 2007 Surveillance Decision and the Broader Legal Framework for Surveillance*](#).

Follow up. Following the conclusion of the Board's discussion, staff will operationalize the recommendations that garner broad support from the membership. This will be done through various channels, including the Board's *Work Program* (e.g., on spillover and external stability reports), the *Revised Staff Guidance Note on Surveillance* (e.g., on risk assessments), the proposed *Financial Sector Strategy* (e.g., on financial stability work), regular Board papers (e.g., on the legal framework for surveillance), and staff's own review process.

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Acronyms

ASEAN+3	-	Association of Southeast Asian Nations plus Japan, Korea, and China
CSOs	-	Civil Society Organizations
CGER	-	Consultative Group on Exchange Rate Issues
EWE	-	Early Warning Exercise
FM	-	Fiscal Monitor
FSAPs	-	Financial Sector Assessment Program
FSB	-	Financial Stability Board
G-20 MAP	-	G-20 Mutual Assessment Process
GFSR	-	Global Financial Stability Report
IEO	-	Independent Evaluation Office
IMS	-	International Monetary System
LICs	-	Low-Income Countries
REO	-	Regional Economic Outlook
SSP	-	Statement of Surveillance Priorities
TSR	-	Triennial Surveillance Review
VEA	-	Vulnerability Exercise for Advanced Countries
VEE	-	Vulnerability Exercise for Emerging Market Countries
VE-LIC	-	Vulnerability Exercise for Low-Income Countries
WEO	-	World Economic Outlook

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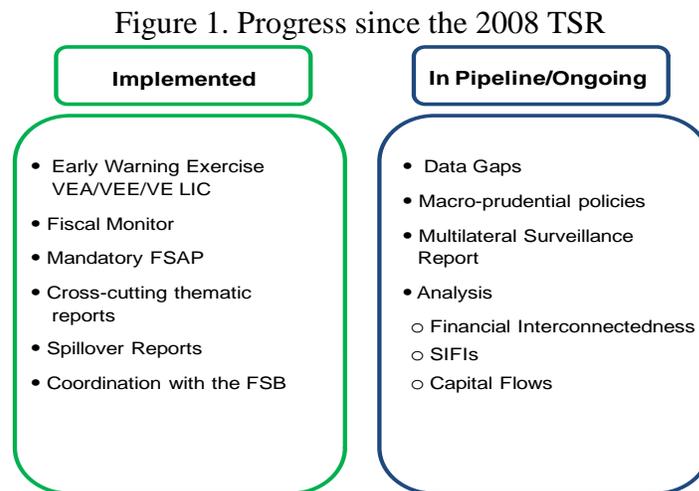
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I. INTRODUCTION

1. **Pre-crisis surveillance suffered from well-documented weaknesses.** Surveillance did not adequately identify and warn about mounting risks, in particular from advanced economies. It also did not anticipate transmission channels of shocks and contagion across sectors and countries, paying insufficient attention to the interaction between financial, fiscal, and macro-stability. While some of the risks that subsequently materialized were identified, warnings were too scattered and nonspecific to trigger policy reaction. These failures have been amply documented in external and internal reviews (Box 1).

2. **The Fund has worked intensively over the past three years to address these shortcomings.** It has developed new vehicles to sharpen the focus on risks (e.g., the Early Warning Exercise, enhanced focus on risks to financial stability in the GFSR, vulnerability exercise for advanced countries), explored cross-country themes (e.g., papers on oversized banking systems and responses to unemployment), analyzed spillovers (e.g., dedicated reports for five systemic economies), and worked on better integrating existing products. These efforts are detailed in Annex 1. There have also been changes in internal structures and practices (e.g., a revamped interdepartmental review process, more financial sector expertise and analysis, stepped-up communication and outreach, and innovative Article IV report formats). More recent initiatives are in the pipeline as illustrated in Figure 1 below.



3. **Despite these efforts, any sense that a new equilibrium has been found would be false.** This review covers a period of exceptional systemic stress and contagion (2008-2011). Global economic conditions remain extraordinary and the international financial system continues to change rapidly—suggesting no scope for a pause in the evolution of the Fund’s surveillance. The crisis has highlighted the global impact of country-specific vulnerabilities, given the extent of financial interconnectedness across countries. This has important implications for both the substance and modalities of surveillance. And, since the last Triennial Surveillance Review (TSR), there have been major changes in the landscape of global surveillance, with a more prominent role for various groups and entities (including the

G-20, regional economic groups, the Financial Stability Board (FSB), and regional/country-specific financial stability risk boards). These too have implications for the Fund's surveillance.

Box 1. Evaluations of the IMF's Surveillance Demonstrate a Failure to Properly Assess Risks

Lessons on the Run-Up to the Crisis

[*The IEO Report on the Run-Up to the Global Economic and Financial Crisis*](#) (January 10, 2011) provided a stark account of the Fund's failure to properly assess risks in the run-up to the crisis. The study noted that the Fund provided few clear warnings about the buildup of vulnerabilities and risks in the global financial system. Surveillance paid insufficient attention to risks of contagion or spillovers from a crisis in advanced economies. Some risks that subsequently materialized were presented in general terms in the GFSR, but without an assessment of scale, and were undermined by the accompanying sanguine overall outlook. These risks were not reflected in the WEO or in the IMF's public declarations. The IEO found that groupthink, intellectual capture, and governance that discouraged contrarian views hindered the Fund's performance. It proposed five general recommendations to improve the setting for surveillance: create an environment that encourages candor and diverse/dissenting views; strengthen incentives to "speak truth to power"; better integrate financial sector issues into macroeconomic assessments; overcome silo behavior and mentality; and deliver a clear, consistent message on the global outlook and risks.

[*Initial Lessons from the Crisis*](#) (February 6, 2009). This staff review noted that the Fund did not provide strong or focused warnings prior to the crisis—warnings were too scattered and nonspecific to attract policy reaction. Surveillance underestimated the combined risk across sectors and the importance of financial sector feedback and spillovers. Bottom line messages on some economies (such as the US and UK) were too optimistic. Recommendations included the establishment of the vulnerability exercise for advanced economies (VEA) and the early warning exercise (EWE), and greater attention to financial sector surveillance.

Surveillance Modalities

[*Modernizing the Surveillance Mandate and Modalities*](#) (March 26, 2010) illustrated the lack of progress in adopting a more multilateral perspective in surveillance and analyzing outward spillovers. Moreover, it noted that the need to pay attention to spillovers was not a new concern. The IEO 2006 Report on Multilateral Surveillance had noted that the absence of an overall strategy for multilateral surveillance, and the silo structure of the Fund, had resulted in outputs that gave too much weight to providing information on economic developments and prospects (a bottom-up approach) and too little weight to analyzing economic policy linkages and proactively identifying the scope for collective action.

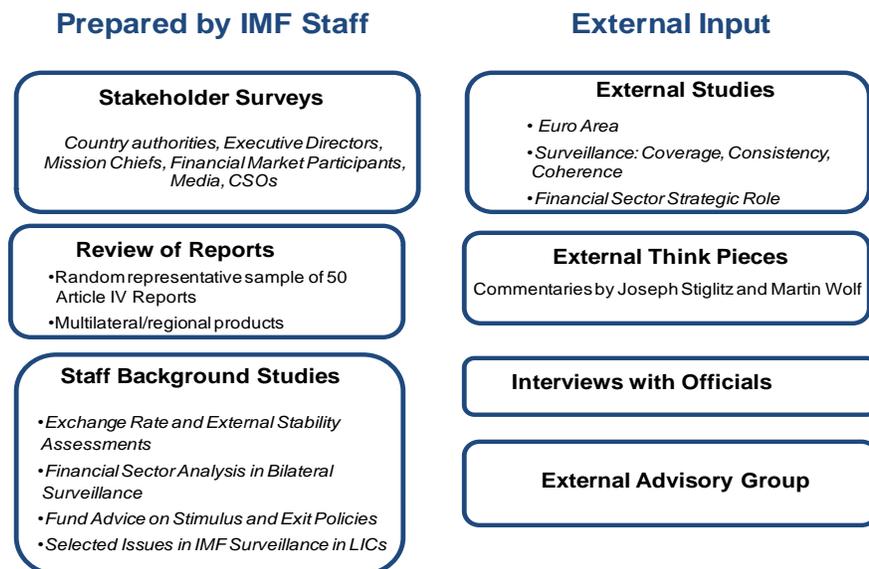
[*The Fund's Mandate: An Overview*](#) (January 22, 2010) noted that, while the world has changed since the late 1970s, the way that the Fund undertakes surveillance is pretty much the same. The Fund has tended to emphasize country-level surveillance and lending. Yet, a lesson of the crisis is that the larger risks in a globalized world are systemic in nature, requiring the Fund to adopt a more systemic perspective, and for this to be supported by country authorities through the provision of the requisite data and dialogue.

[*The IEO Report on the IMF's Interactions with Member Countries*](#) (November 30, 2009) noted that most country groups wanted greater Fund presence in international policy coordination and spillover analysis (except for large advanced economies) and gave the Fund low marks for effectiveness in this area. Outreach beyond governments had done little to improve traction of IMF surveillance. Moreover, interactions with authorities were undermanaged.

4. **The focus of this TSR reflects this changing environment.** Whereas earlier reviews concentrated on bilateral surveillance, this TSR also covers multilateral surveillance and related products, given the systemic nature of the challenges faced by the membership. It takes stock of steps taken to address gaps identified in pre-crisis surveillance, assesses the extent to which surveillance meets stakeholders' expectations, and identifies areas for progress. A companion paper discusses deficiencies in the current legal framework for surveillance and provides options for reform.

5. **This review was informed by wide-ranging input.** This included stakeholder surveys, staff document reviews, background studies, and stepped up external input—comprising external studies, commentaries, interviews with officials, and an independent review by an external advisory group (EAG) (Figure 2).¹ These inputs provided diverse perspectives and analyses, helping to formulate and articulate the thematic findings and recommendations of this review.

Figure 2. Background Inputs for TSR



6. **The overarching theme of this review is making Fund surveillance as interconnected as the global economy itself.** Drawing on the background inputs, lessons learnt from recent evaluations, and priorities identified in the 2008 TSR, five areas emerged as deserving priority attention in the period ahead.² These include: (i) interconnections; (ii) risk assessments; (iii) financial stability; (iv) external stability; and (v) generating greater

¹ All these are being issued separately as part of this review.

² The [2008 TSR](#) adopted four operational priorities for surveillance: (i) risk assessments; (ii) financial sector surveillance and real-financial linkages; (iii) multilateral perspective; and (iv) analysis of exchange rate and external stability risks.

traction. These areas speak to the effectiveness of Fund surveillance in supporting both country-level and global stability in an interconnected world.

7. **A major reform of the legal framework is needed to support more effective surveillance.** The *Review of 2007 Surveillance Decision and the Broader Legal Framework for Surveillance* undertaken as part of this TSR, argues that the current system, heavily tilted toward exchange rate policies as the primary contributor to external imbalances, does not capture economic realities, fails to sufficiently integrate bilateral and multilateral surveillance, and suffers from a serious legitimacy deficit, thus, undermining traction. In other words, it falls short of supporting the type of surveillance this TSR deems essential (Box 2).

8. **The structure of the paper is as follows.** Box 3 illustrates the key messages from the TSR surveys. The following sections provide evidence from the background inputs in support of the five priority areas. These include specific recommendations, which together with the reform of the legal system, would help make progress on these priorities. Section VII discusses organizational aspects and resource implications, while Section VIII sets out operational priorities for the medium term.

Box 2. Reform of Legal Framework: Options Going Forward

The accompanying paper on the [review of the legal framework](#) discusses two options to address limitations in the current framework, which are not mutually exclusive.

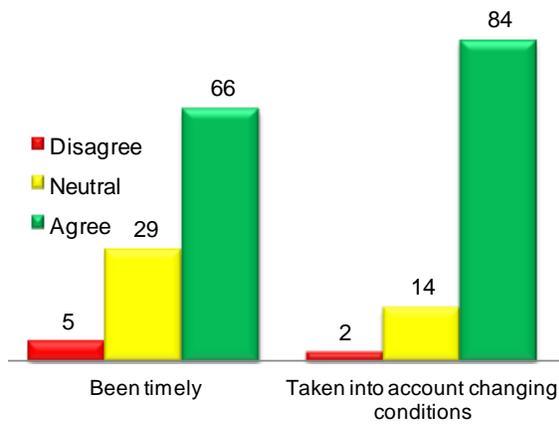
- **Amending the Articles.** The most comprehensive solution would be to amend the Articles. The scope of any such reform could vary, depending on the precise nature of the amendment. This could entail: (i) broadening the ultimate objective of all surveillance activities to the promotion of stability of the international monetary system (IMS); (ii) establishing obligations that recognize the contributions of all policies to the stability of a member and, globally to the effective operation of the IMS; (iii) eliminating the difficult-to-assess concept of intent; and (iv) abolishing the distinction between bilateral and multilateral surveillance.
- **Integrated surveillance decision.** A more immediate but less far reaching solution would be the adoption of an integrated surveillance decision governing both bilateral and multilateral surveillance activities. This could be adopted within the confines of the existing Articles and would replace the 2007 Surveillance Decision. While the conceptual distinction between bilateral and multilateral surveillance would not be eliminated, it could help foster better integration of surveillance activities at all levels. In addition, it would clarify the scope, modalities, and procedures for multilateral surveillance, and go some way toward rebalancing the focus of bilateral surveillance.

Box 3. Summary of Survey Findings

These charts illustrate some of the key survey findings that are set out in more detail in the [Health Check and Statistical Information](#). Country officials view Fund policy advice in the aftermath of the crisis as timely and responsive, but progress on the 2008 operational priorities has been mixed. Stakeholders seek surveillance that brings more tailored advice and cross-country perspectives. Traction is uneven across countries, and is lower for systemic members.

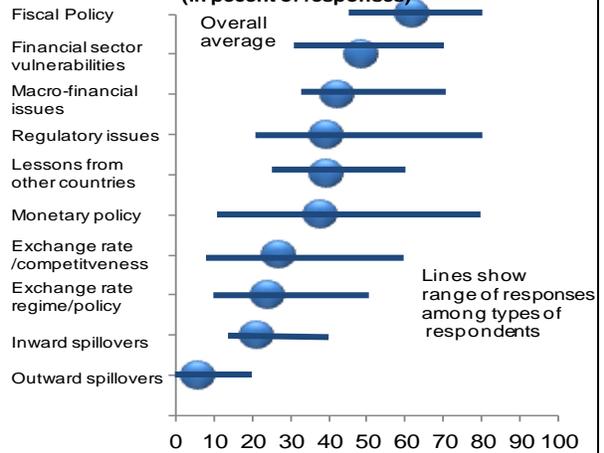
Country authorities generally thought the Fund handled the crisis well.

In the aftermath of the crisis, the Fund's policy advice has:
(in percent of responses)



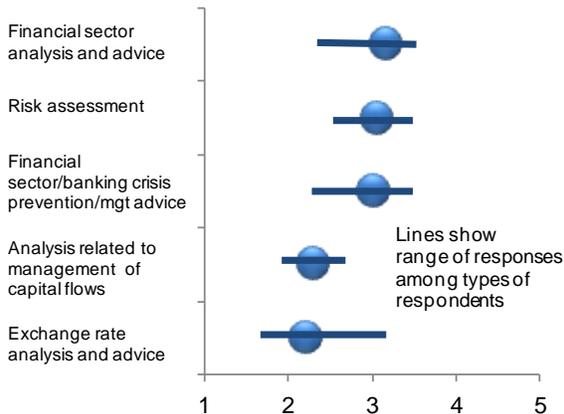
Most value the contribution of fiscal and macro-financial policy advice; exchange rates and spillovers lag behind

Areas Contributing Most to Your Understanding of Issues
(in percent of responses)



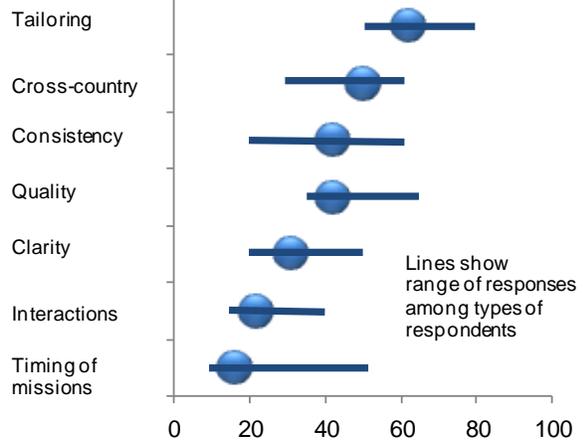
Stakeholders see progress in two key operational priority areas (financial sector and risk assessment), but less on exchange rate analysis

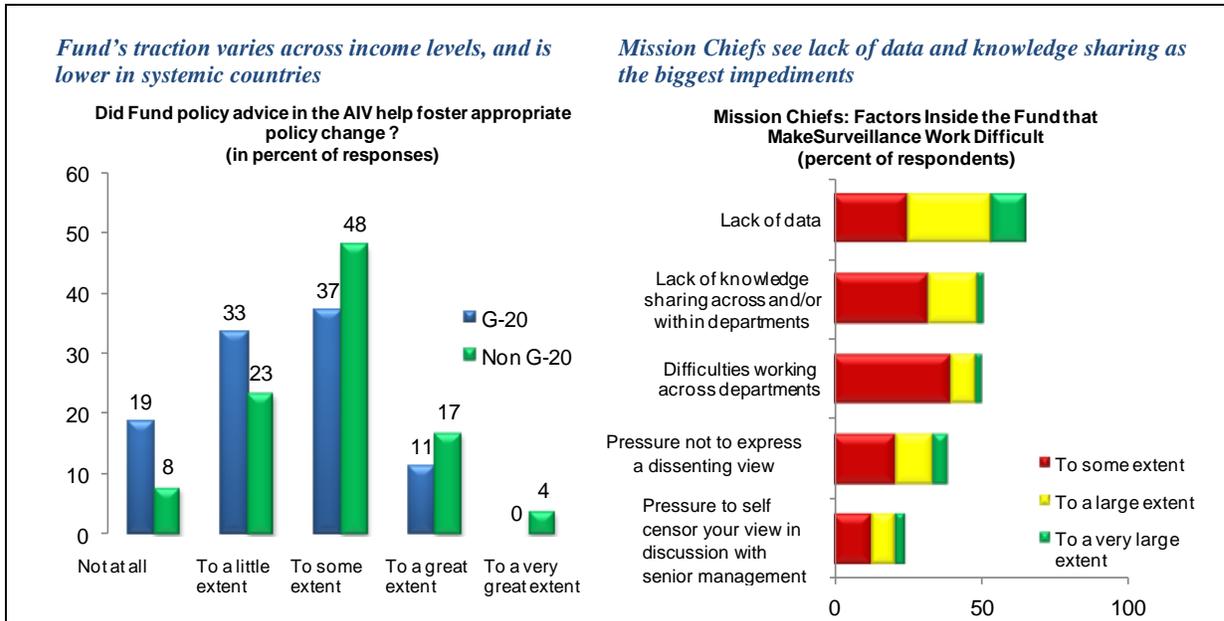
Compared with pre-global crisis Article IV consultations, have you noticed an improvement in the quality of:
(1 = "Not at all" to 5 = "to a very large extent")



Countries want more tailored advice and more cross-country perspective

Areas which should be improved to strengthen Fund surveillance
(Percent of respondents)





II. INTERCONNECTIONS

Surveillance is still seen to be too fragmented. The background work undertaken for this TSR points to the need to better leverage the Fund's universal membership, its cross-country experience, and macro and financial expertise to provide a more integrated view. In particular, policymakers would like to see greater efforts to bring an international dimension, and provide a holistic view of the risks facing them and the appropriate policy responses. This section discusses the need for progress in making connections across countries and levels of surveillance.

9. **Integration of top-down analyses and policy recommendations with country-level surveillance needs to be strengthened.** The background studies illustrate the implications of the failure to integrate properly an area-wide approach with country-level analysis (e.g., insufficient follow-up of euro area-wide recommendations in bilateral surveillance, see Box 4). The studies also demonstrate the gains from having a clear top-down message and effective integration (e.g., when the Fund pushed for a global stimulus at the onset of the crisis, see [stimulus and exit study](#)). Building a global picture from country-level analysis, as done through the WEO process, ensures a sufficiently granular approach—as does the provision of tailored policy advice. But developing top-down approaches of globally (or area-wide) relevant aggregates and policies, and ensuring that they translate into bilateral surveillance, is essential to ensure multilateral consistency and relevance of policy recommendations. For instance, having a top-down view on the global policy mix and desirable global demand rebalancing, as also stressed by Rajan (2011), is useful for

informing policy advice in each of the major economies.³ Efforts should continue to promote work in key areas (e.g., global policy mix, liquidity, and capital flows) to inform bilateral surveillance.

10. **The analysis of spillovers has been wanting.** In surveys conducted prior to the pilot spillover reports, a majority of officials felt that staff’s analysis of spillovers contributed little to their understanding of issues compared to other policy areas. However, interviews and survey results suggest that country officials and Executive Directors would like more in-depth analysis of spillovers, their channels of transmission, and discussion of appropriate policy responses. Indeed, a review of staff reports found that Article IV reports often identified sources of inward spillovers, but less than a quarter provided detailed analysis of their transmission channels to document their impact. An institutional focus on understanding spillovers is important as it bridges the gap between bilateral and multilateral surveillance, contributes to building the basis for coordinated policy action, and increases the legitimacy of surveillance and, thus, traction. The [recent pilot spillover reports](#) were a first step towards better understanding spillovers emanating from five systemic economies. Their Board discussions suggest broad support for such analysis and encouragement for further work in that direction.

11. **Cross-country analysis remains another area of insufficiently met demand.** Interviews and surveys suggest that country officials would like to see a greater use of cross-country comparisons and relevant experiences than is currently the case. While three quarters of Article IV reports reviewed for this study included some form of peer comparisons, only about 30 percent drew lessons from the experience of other countries—the type of analysis that is highly valued by officials. Mission chief surveys confirm that most (88 percent) saw scope for more cross-country analysis, but three quarters noted data constraints, and over half the lack of adequate knowledge sharing as limiting factors.

Recommendation 1. Regular analysis of spillovers and cross-country issues. Work on spillovers should continue, with modalities (e.g., frequency, coverage, and context) that could evolve as experience is gained with the exercise. Cross-country analysis could be supported by bringing inter-connected countries (e.g., with financial links) to the Board in clusters, or even as multi-country Article IV consultations, while taking into account the need to ensure traction (e.g., timing missions to account for budget cycles) and strengthening knowledge sharing (e.g., through the review process).

³ See [Currencies Aren't the Problem](#) (Rajan, April 2011).

Box 4. IMF Surveillance in the Euro Area

An [external study](#) provides an independent view of the Fund's surveillance in the euro area in recent years, with the aim of assessing bilateral as well as region-wide surveillance. The report assesses the Fund's pre-crisis advice as often strong and relevant, but also suffering from institutional deficiencies and a failure to make connections between country/regional and macro/financial sector issues.

- In the pre-crisis period, the report finds that the Fund issued strong and pertinent policy recommendations for several member states of the euro area, but surveillance sometimes focused on less pressing policy issues, with important issues left untouched. Furthermore, follow up on previous policy recommendations was weak.
- The report finds it particularly problematic that economic linkages in a monetary union were not systematically taken into account; the link between capital inflows and systemic risk was ignored; the vulnerability deriving from the link between high debt and competitiveness adjustment was not identified; FSAPs were too infrequent to be used as a warning tool; and multilateral surveillance provided only general input that was not always carried through at the level of member countries. The report also suggests that the Fund was focusing excessively on issues relevant to the EU agenda without taking an independent view of the key strategic questions. More broadly, it argues that a “Europe is different” mentality prevented the Fund from exploiting its comparative advantage derived from experience with crisis-prone countries.
- Once the crisis hit, the report finds that Fund surveillance became more intensive and often took on a different form than in earlier years. For example, the Fund made a positive contribution to the debate on monetary policy in the euro area, aggregate fiscal policy advice was appropriate and timely, and it played a positive role in the surveillance of banks. The Fund is also seen to have played an important role in the discussion of crisis management and solutions, and fiscal reforms, but was not a major player in discussions of the reform of financial supervision or macro imbalances. Finally, data limitations reduced the precision of the analysis of banking related issues.
- The report recommends revising the 2007 Decision, noting that while the external stability concept is sensible, instability in a currency union does not travel via the nominal exchange rate. Surveillance should better account for other channels of instability, place greater emphasis on risk assessments, and strengthen financial sector assessments. The report also argues for measures to address the “Europe is different” mindset, strengthen independence (while continuing to work collaboratively with regional institutions), and resist efforts to limit the scope of Fund surveillance or tone down assessments. To better exploit the Fund's comparative advantage, the report calls for restructuring the Fund's euro area work, better coordinating euro area and country-level surveillance, and makes recommendations to generate traction, including having the Managing Director present the Euro Area Surveillance Report to the Eurogroup and the European Parliament.

III. RISK ASSESSMENTS

Background work undertaken for this TSR suggests that more needs to be done to ensure an in-depth discussion of risks, especially systemic risks, alongside a well-designed central forecast. This section discusses why, despite some progress, further strengthening risk assessments and recognizing transmission channels and linkages are imperative if the Fund is to play a more effective role as systemic risk advisor, globally and at the country level.

12. **The focus on risks has improved in recent years.** Around 75 percent of country authorities and Executive Directors perceived an improvement in the quality of risk assessments since the pre-crisis period. Interviewees also welcomed the increased focus on the analysis of systemic risks, especially those stemming from the financial sector. Consistent with this, background studies found that the attention to risks, particularly around the baseline, has increased in bilateral surveillance and in multilateral flagship products.

13. **However, there is clear scope to further deepen risk analysis.** Country authorities expressed the need for a greater focus on transmission channels of risks and discussion of possible policy responses, both to attenuate risks (insurance) and to deal with their materialization (contingency planning). Around half of Executive Directors thought that the discussion of transmission channels of risks in staff reports was insufficient, with more than 30 percent of financial market participants sharing this view. The review of staff reports supports this assessment. The background study—[*Financial Sector Analysis in Bilateral Surveillance*](#) found that the clarity and depth of the discussion on risks in bilateral surveillance was wanting. In addition, there was little discussion of tail risks (covered in only 16 percent of reports reviewed), a point also highlighted by Executive Directors. This could be related to the sensitive nature of the discussions—although the transparency policy allows for deletions of highly market sensitive material before publication. But the mission chief surveys suggest that country authorities are also reluctant to discuss such risks. Progress in this area, therefore, requires additional efforts both from staff and the authorities.

14. **A key challenge is to sustain a focus on risks and avoid complacency in benign times.** While the increased focus on risks does not come as a surprise in times of elevated stress, the litmus test will be to warn about risks at other times—a point made powerfully by Martin Wolf in his think piece for this review (see Box 5). Attention to the baseline is a given, but as noted by the [EAG report](#), the Fund is “paid to worry”, especially about systemic risks. The external study on the Euro Area and the EAG report also emphasized that risk assessments feature more prominently in surveillance. However, both Martin Wolf and the EAG report noted that this needs to be approached with humility, given our imperfect understanding of economic relationships and the evolving nature of crises. Furthermore, in providing warning about risks, it should be recognized that not identifying risks that materialize (type I errors) and warning unduly (type II errors) can both be detrimental to credibility. Thus, risk assessments should not only highlight key risks, but include an assessment of the likelihood of their realization and their possible impact. This could help provide a nuanced message, while serving as a trigger for policy dialogue and preparedness to deal with risks, should they materialize.

Box 5. External Commentary by Martin Wolf

What are the limits to surveillance? The [commentary](#) highlights the limits to the influence of Fund’s surveillance noting that the IMF must rely on analysis, persuasion, and “ruthless truth-telling” to be effective. In this sense, it is like an English monarch who possesses only “the right to be consulted, the right to encourage, and the right to warn.”

Does the Fund exercise “these rights” effectively? The commentary concludes that the answer is no—the Fund, as the principal institution dedicated to promoting global stability, missed the most devastating crisis since the 1930s. The IMF was overconfident in the soundness and resilience of large financial institutions, downplayed the risks associated with housing booms and financial innovations, and thought a crisis in advanced economies was unlikely.

Impediments to surveillance. Six impediments to effective surveillance are highlighted: (i) *ignorance*—economic systems are complex and dependent on human nature, it is important to acknowledge the limits of understanding, the assumptions made, and what is being ignored; (ii) *ideology*—simplifying assumptions that become orthodoxy but are wrong (e.g., the infallibility of liberalized markets); (iii) *insularity*—a restricted perspective arising from policy orthodoxy and insular inter and intra-institutional thinking; (iv) *incentives*—that discourage consideration of ideas too far outside the mainstream; (v) *intimidation*—by powerful members that discourage truth-telling; and (vi) *impotence*—the Fund has no direct power, it only has its voice, particularly with systemic members.

Future directions. Successful surveillance will require the IMF to: (i) acknowledge ignorance and the limits of its knowledge—and how and why it might be wrong; (ii) welcome unorthodox ideas and invite exponents of these ideas to present their views; (iii) reach out to outsiders (including financial markets and trade unions); (iv) reward questioning by staff; (v) better integrate perspectives (e.g., global balance of payments with the flow of funds within countries and balance sheets of financial sectors); (vi) dare to speak the truth, in particular, in public; and (vii) admit errors and systematically evaluate past advice in the WEO and GFSR, Article IV consultations, and FSAPs, to look at earlier judgments and assess how and why they went wrong.

In short, Mr. Wolf argues that: “*The Fund needs to be more humble, and yet braver, more open to outside ideas and yet determined to put forward its own, more skeptical of orthodoxies and yet a central player in official discussions among and within the great powers.*”

15. **Seeking outside perspectives and unorthodox views can be an important avenue for understanding risks.** As noted by Martin Wolf, being exposed to outside and minority views does not mean accepting them. But considering and evaluating such perspectives could help in forming judgments about risks and understanding both the robustness of the central scenario and the sources and probabilities of risks—a point also highlighted by the EAG. The MD may consider establishing an external advisory group to provide a forum for discussion of risks. This could draw attention to a wider range of risks and bring in diverse ideas.

16. **Multilateral products and risk analyses exercises could be better leveraged in bilateral surveillance.** The [Coverage, Consistency and Coherence Study](#) and the case study of the euro area point to the limited integration in bilateral surveillance of risks identified in the vulnerability exercises (VEs) and EWE—and more broadly of the different downside risk scenarios developed for the GFSR and WEO. Consistent with this, the background

study—*Financial Sector Analysis in Bilateral Surveillance* found little use of existing risk identification tools in staff reports. A wider dissemination of the toolkit and results, and greater ownership by country teams of the analytical tools underpinning these exercises, could help ensure that this work is more effectively leveraged in bilateral surveillance.

17. The coverage of risks in multilateral products should be enhanced and clarified.

Background studies and interviewees saw scope for better cross-referencing of risks highlighted in the various multilateral products. The EWE has been an effective tool for engaging top policy makers on global risks, but its role relative to other multilateral products needs to be clarified. Interviews found the EWE to have been favorably received. But there were calls to take stock of early experience and clarify the role of the EWE (which should cover tail risks) with respect to the WEO, GFSR, and Fiscal Monitor (which should cover more mainstream risks). Concerns have also been raised in interviews about the limited access to EWE analysis (the results are presented solely to the Board and Ministers/Governors and are therefore unable to inform other stakeholders).

18. There is limited coverage of LIC-specific risks among flagship multilateral surveillance products. While recent efforts by cross-departmental working groups have provided a cohesive framework for policy advice on topical issues (e.g., the impact of the global crisis on LICs), these processes are still ad-hoc in nature. The recent introduction of a vulnerability exercise focused on LICs (the VE-LIC), which complements similar exercises for advanced countries and emerging markets, should strengthen systematic assessment of risks and spillovers across all LICs (see background study on [selected issues in surveillance in LICs](#)). Analysis of LIC-specific cross-country issues, risks, and vulnerabilities should be stepped-up, based on the annual VE-LIC exercise.

Recommendation 2. In-depth risk assessments in Article IVs and multilateral flagships.

A starting point would be a more explicit discussion of risks in the text, drawing upon existing risk assessment tools (e.g., VEs, EWE) and country-specific risk assessments. This could be supplemented with Risk Assessment Matrices (RAMs) in Article IV reports, which would identify key risks, assess their probabilities, and potential impact. Coverage of risks in multilateral surveillance products, notably the WEO, should be enhanced, including those identified in the GFSR.

IV. FINANCIAL STABILITY

Despite progress, background studies and interviews suggest that more could be done to integrate financial stability assessments, including analysis of cross-border and macro-financial linkages, in bilateral and multilateral surveillance. Stakeholders see the Fund as having a unique role to play in the promotion of global financial stability. This section discusses steps to buttress the Fund's financial stability role by increasing the effectiveness of financial sector surveillance.

19. **Surveillance has an instrumental role to play in the promotion of global financial stability.** As amply demonstrated by the crisis, the financial sector can be a major source of country-level and systemic instability, and effective financial sector surveillance is key to the Fund's mandate. Furthermore, while other bodies have mandates that include financial stability, at the global (e.g., the FSB) or regional (e.g., the ESRB) levels, the Fund represents the broadest membership, with macroeconomic and financial expertise that could be better leveraged. As noted in the *External Study on the IMF and Global Financial Stability*, Fund surveillance could more pointedly draw macro-financial risks to the attention of the FSB, regional systemic risk bodies, standard setters, and country authorities (Box 6).

20. **Financial stability analysis adds value and has improved over the past three years, but more progress is warranted.** Across policy areas, financial sector analysis was perceived to have made the most progress, with 36 percent of country officials noting an improvement at least to a great extent. Authorities ranked the Fund's analyses of financial sector vulnerabilities and macro-financial linkages as contributing most (after fiscal policy) to their understanding of policy issues. While further work is underway to better understand financial networks and connections, financial sector surveillance still falls short along a number of dimensions. Background studies found that insufficient attention was paid to financial stability issues in the euro area; financial sector policy advice in Article IVs often lacked specificity; and there was little follow up from year-to-year, except in program cases or where an FSAP was very recent.

21. A number of points stand out:

- *Interconnectedness.* Surveys suggest that the Fund's contribution to surveillance of cross-border linkages should be further strengthened. While efforts to better understand the extent and nature of financial linkages were stepped up in recent years, such efforts are hampered by data constraints⁴

⁴ See for instance [Understanding Financial Interconnectedness](#) and [Monitoring Financial Interconnectedness, Including the Data Template for Global Systemically Important Financial Institutions \(G-SIFIS\)](#), and the [Financial Crisis and Information Gaps—Implementation Progress Report](#) which report on the Fund's progress on these initiatives.

Box 6. Study on IMF and Global Financial Stability

An [external study](#) suggests that the Fund has the potential to carry out the overarching role of monitoring and safeguarding global systemic stability, consistent with its mandate for stability of the international monetary system. While the financial stability field is crowded, the Fund has distinct comparative advantages, with its universal membership and existing expertise in macroeconomic and financial surveillance.

The authors note that the Fund already plays such a role, producing high quality analysis and working co-operatively with other financial stability actors. But they see scope for improvement:

- Multilateral surveillance products do not always reach key decision makers directly because they are too voluminous.
- Much of the Fund’s surveillance is carried out in subject-area silos, which may impede the Fund’s ability to connect the dots.
- Because of structural impediments—such as being too close to officials or too far from markets—or the institutional constraint of having to produce peer-reviewed work rather than speedy analysis, not to mention the potential for conflict between the its lending and surveillance roles, the Fund tends to be behind the curve and has difficulties being a candid truth-teller.
- Thoroughness of analysis and extensive review weigh on the ability to monitor fast moving events and develop contingency plans and solutions for potential tail risks.
- The Fund’s culture and traditions are such that it approaches issues from a conceptual macroeconomic framework which may impede its ability to spot financial sector and tail risks.

The study proposes five broad recommendations:

1. Strengthen analytics and flexibility to encourage “out-of-the-box” thinking. Specific proposals include: setting up a separate team to uncover tail risks complementing the EWE; charging ad hoc working groups to study such risks in greater depth; and creating a new, timely, and frequent summary report for top public and private decision-makers.
2. Tailor products to target audiences in order to generate traction.
3. Work more effectively with the FSB by supporting its initiatives and commenting independently on its effectiveness.
4. Adopt a three-fold strategy on the resolution of data issues, including an active role in the G-20 data gaps initiative (while involving non-G-20 members at appropriate times), continuing working with existing data from published and proprietary sources with more analysis of interconnectedness, and calling for more extensive public disclosure of existing data.
5. Strengthening the legal foundation of surveillance to give the Fund more explicit authority to take on an expanded and overarching financial stability role.

- *Data.* As highlighted in the mission chief surveys, the availability of data remains a constraint to better financial sector analysis. The background study—*Financial Sector Analysis in Bilateral Surveillance* found that while there is scope to improve analysis with the currently available data, there are also constraints. While some data do exist, they may not be always available to staff (e.g., some stress test results). Other data, notably related to the shadow banking sector, are not available. Recent initiatives to identify and address data gaps exposed by the crisis, including in coordination with FSB, should help to some

extent. But legal limitations on sharing existing individual data remain a continuing challenge (see also companion legal paper). Moreover, despite the mission chiefs' concern about insufficient data, the background study found that Article IV reports rarely note financial sector data weaknesses—only in 5 out of 50 cases was there a mention of data gaps. Reporting on data limitations that impede financial stability assessments in Article IVs should be strengthened. More generally, efforts to address data gaps could be enhanced by bringing forward the next *Review of Data Provision for Surveillance Purposes* to 2012.⁵

- *Real-financial linkages.* Interviewees saw scope for further progress in the analysis of two-way transmission channels between financial and real sectors and advice on macro-prudential policies. This is consistent with the background study *Financial Sector Analysis in Bilateral Surveillance*, which found that the treatment of macro-financial linkages in staff reports was particularly patchy—there was sufficient analysis to identify whether the financial sector was a potential source of macro vulnerability in only 6 out of 17 cases.
- *FSAPs.* Integration of FSAPs in Article IVs remains insufficient. Country authorities felt more could be done to integrate the findings of FSAPs and other technical assistance on financial sector issues into regular bilateral surveillance. While progress must be made in ensuring better integration of financial stability analysis in bilateral surveillance in general (see below), FSAPs provide an opportunity for more in-depth analysis. In this respect, the introduction of mandatory FSAPs for 25 economies with systemically important financial sectors represents progress, but their frequency—every 5 years—is low when compared with the pace of financial developments.⁶
- *LICs.* Surveillance in LICs needs to better account for the interplay between financial sector development and stability. The background study on LICs found that financial sector coverage in LICs pays insufficient attention to the impact of underdeveloped/shallow financial markets on the effectiveness of macroeconomic policies, the economy's ability to absorb shocks, and to support strong, durable growth. While financial deepening and greater integration into global financial markets pose new risks that should be monitored closely, the study found that weak data render difficult standard quantitative analysis using Financial Soundness Indicators and stress testing.⁷

⁵ The next review of data provision is currently scheduled for 2013. [The Acting Chair's Summing Up—Review of Data Provision to the Fund for Surveillance Purposes, May 2, 2008.](#)

⁶ In 2010, staff recommended that the frequency of mandatory FSAPs for economies with systemic financial sectors should be targeted at 3 years (see [Integrating Stability Assessments Under the Financial Sector Assessment Program into Article IV Surveillance](#)). The Executive Board did not agree with the proposed frequency for the assessments, and instead endorsed targeting a frequency of every five years.

⁷ See [Financial Sector and Bilateral Surveillance—Toward Further Integration](#), Box 7.

22. **Financial stability analysis needs to be better integrated into Article IVs.** A key question is how best to build up financial sector capacity in Article IV mission teams. Possible avenues could entail ensuring continuous financial expert support for systemic cases (necessary for in depth discussions on specialized topics); stepping up training for “generalist” economists to strengthen financial stability analysis capacity across the Fund; and greater collaboration across country teams (e.g., through networks of staff for countries that have strong financial links). Furthermore, while the analytical toolkit for financial sector surveillance has expanded in recent years, improving its accessibility and dissemination would also help mainstream financial stability analyses.

Recommendation 3. Bolster the effectiveness of financial sector surveillance.

- Adopt at the Executive Board, and endorse at the IMFC, a strategic work plan for financial sector surveillance. This would cover financial sector risks, macro-financial linkages, and macroprudential policies.
- Promote work on financial interconnections, including through better access to key data.
- Strengthen financial stability analysis in the Article IV process. Different avenues could be considered: stepping up training, disseminating vetted financial sector tools, and supplementing existing guidance on LIC specific issues.
- Establish more frequent (every three years) financial stability assessments under the FSAP for economies with systemically important financial sectors.

V. EXTERNAL STABILITY

Despite technical improvements in the Fund’s exchange rate assessments, there is considerable dissatisfaction among stakeholders with the Fund’s external stability analysis and policy advice. This section discusses the need to ensure appropriate coverage, consistency, and transparency of external stability assessments.

23. **Surveys and interviews revealed a troubling dissatisfaction with the Fund’s exchange rate assessments.** Despite wider use of standard exchange rate assessment methods (as part of the CGER efforts) and substantial work by country teams to improve the analyses, surveys and interviews suggest that continued discontent with exchange rate assessments. In interviews, a number of officials expressed concern about the 2007 Decision, saying it focused excessively on exchange rates, distracting from a broader analysis of external stability. Some interviewees also called for sharper and more candid assessments, in particular for countries with persistent, large current account surpluses. These concerns need to be addressed; issues related to the legal framework for surveillance are dealt with in the companion paper.

24. **Transparency and consistency in the use of methods are important to dispel concerns about lack of evenhandedness.** The review of staff reports undertaken for the background study on [Exchange Rate and External Stability Assessments](#) found that broadly similar technical methods were used for a large number of countries and qualitative bottom-line assessments were generally consistent with quantitative estimates. Adjustments to the common methodology were often made to take into account country-specific circumstances, as allowed under existing guidance, but these were not always clearly explained. Furthermore, in a few cases, countries in similar circumstances received different treatment and consistent methods were not used over time. Continued efforts should be made to improve exchange rate assessments, but without the need for new initiatives. Separately, insufficient transparency around the analytical underpinnings of the Fund’s work on the multilateral CGER exercise remains a source of frustration for some parts of the membership.

25. **Importantly, external stability assessments should not be limited to the assessment of equilibrium exchange rates.** Nearly two-fifths of Executive Directors felt that a significant share of staff reports had insufficient coverage of capital flows and reserve adequacy issues, also relevant for assessing external stability. Indeed, the review of staff reports showed that the analysis of risks to external stability focused primarily on exchange rate levels. Contrary to guidance, only a quarter of staff reports examined factors relevant for assessing risks to the capital and financial account, such as capital flows, balance sheets, or reserve adequacy. Concerns also remain with the integration of external stability risks into overall policy discussions. Only a third of Executive Directors thought that staff reports met their expectations in this regard. The review of staff reports also indicated that reports insufficiently traced out the role of the overall mix of policies in contributing to vulnerabilities. Thus, there is need to re-emphasize guidance that external stability assessments have a broad focus and should be well integrated into overall policy discussions.

Recommendation 4. Publish an assessment of external balances, including exchange rate estimates from the multilateral CGER exercise. While methodological limitations and uncertainties in measurement should be candidly acknowledged, publishing a summary of external positions and vulnerabilities, and the results of the multilateral CGER exercise (in the WEO or a stand-alone document) would support greater accountability, candor, evenhandedness, and help inform the global debate on imbalances.

VI. INCREASING TRACTION

While traction is a nebulous concept, it can be understood as the extent to which the authorities engage with the Fund on its advice or the extent to which Fund advice translates into policy action. Background work for this TSR suggests that concerted efforts are required to generate greater traction of Fund advice, particularly with systemic countries. This section discusses why broadening participation in surveillance, while improving its quality, coverage, candor, and addressing concerns of evenhandedness, is essential for increasing traction.

26. The ability to influence policy making is the cornerstone of effective surveillance.

This involves high-quality analysis, the ability to bring in new perspectives, tailored but consistent advice, and—through these endeavors—trust building. The latter, in turn, requires that surveillance is—and is perceived to be—evenhanded across the membership. It requires candor to ensure that Fund’s views are clear and accountable. Effective communication with a broad range of audiences and engagement with other fora (e.g., the G-20, FSB, regional groups) could also help strengthen traction.

27. Surveys show that traction is uneven. Approximately 75 percent of country officials thought that Fund policy advice helped generate policy debate at least to some extent in their country, and 65 percent acknowledged that Fund advice led to a policy change. These headline figures, however, mask significant differences. Traction is higher for program than non-program countries, declines with income level, is particularly low in Asia, and is lower for G-20 than for non-G-20 countries—a source of concern given the more systemic nature of the former. A perception of weak traction with the euro area and the United States is also highlighted in the external report on the euro area and the contribution by Joseph Stiglitz.

28. Views differ on ways to best gain traction. Some have suggested radical changes in the Fund’s way of operating, including moving to stricter enforcement of policy obligations through the application of sanctions (see in particular *Truman*, 2010; and *Palais Royal Initiative*, 2011).⁸ But such radical steps are unlikely to appeal to a membership that has consistently revealed its preference for a cooperative approach.⁹ Traction, therefore, has to be earned.

A. Quality, Candor, and Evenhandedness

29. High quality analysis is key, but traction goes beyond the quality of surveillance.

The need for progress in the quality of analysis ranks high across the membership, in particular for the largest (G-20) countries. Indeed, gaining traction is more difficult in countries with ready access to a variety of analyses, including their own. In addition to preserving existing strengths (e.g., on fiscal issues), recommendations made in previous sections should help generate greater traction. For instance, drawing on other countries’ relevant experiences is seen as an important avenue for progress across the membership, with G-20 country officials highlighting this as yielding the highest relative value-added in the

⁸ [Palais Royal Initiative, Reform of the International Monetary System: a Cooperative Approach for the Twenty First Century](#) (Camdessus, Lamfalussy, Padoa-Schioppa and et al., January 2011), and [Strengthening IMF Surveillance: A Comprehensive Proposal](#) (Truman, December 2010). See also the companion legal paper.

⁹ The absence of any finding of breach of policy obligations under Article IV, Section I since the Second Amendment, and the difficulties encountered in seeking to apply labels in certain circumstances (e.g., fundamentally misaligned exchange rates in the framework of the 2007 Decision) are symptomatic of the limited appetite among the membership for moving away from the cooperative nature of the Fund.

surveillance area. However, traction goes well beyond the quality of surveillance. In Asia, the contribution of surveillance to the understandings of policy issues is similar to the rest of the membership, but perceived traction is much lower.

30. **A majority of country officials emphasized the need for more tailored policy advice.** Officials across most income levels and regions emphasized such advice as the most important area for progress, with the exception of those from the Americas – where greater consistency of advice was seen as the priority. Interviews confirm that officials, in particular from emerging and low-income countries, would like to see staff be more aware of, and sensitive to, their circumstances. In addition, interviewees generally indicated that staff kept a fluid dialogue with the authorities between Article IV consultations, and consulted them ahead of missions on the analytical issues for discussion. Nonetheless, some authorities indicated that staff could do more to solicit their views on analytical papers ahead of the consultation to ensure greater relevance to the policy issues confronting policy makers.

31. **Comprehensive surveillance should include coverage of macro-social issues that may impact members' stability.** Some officials stressed the need for Fund surveillance to place greater emphasis on structural and social issues that are prominent in their policy agenda. This view is echoed by Joseph Stiglitz, who emphasized the importance of broadening the coverage of surveillance to encompass such issues as a way to enhance traction with systemic members (Box 7). In particular, he argued that surveillance should go beyond standard economic and financial criteria to ensure that social concerns (e.g., employment and inequality) are adequately taken into account—a point also emphasized by the EAG.

32. **Evenhandedness is a continuing source of concern.** While media and financial sector participants saw this as less of an issue, country officials expressed concern about evenhandedness. Surveys indicated that nearly a quarter of officials disagree that the Fund is evenhanded in its policy advice, with a majority of G-20 respondents sharing this view, and officials from the Americas and Europe being the most critical. In addition, some interviewees explicitly linked the acceptance of candid advice with greater evenhandedness on part of the Fund. Interviewees suggested that the Fund was insufficiently critical of the policies of its major shareholders. There were also calls to broaden the surveillance paradigm, with a number of interviewees calling for distance vis-à-vis a perceived Anglo-Saxon model. These views are echoed by Joseph Stiglitz and Martin Wolf, who argued that broadening the range of models underlying Fund analysis and challenging orthodox assumptions (e.g., self-regulating financial markets) are important for the credibility of Fund advice. Recent efforts to step up the scrutiny on large economies (e.g., through the VEA, mandatory FSAPs for systemic financial centers, and spillover reports) and governance reforms should go some way toward addressing this criticism. Efforts to increase the transparency and consistency of methods used (e.g., in exchange rate and financial stability analyses) could also contribute.

Box 7. Lessons from the Arab Spring for Fund Surveillance

The 2011 turbulence in the Middle East and North Africa has brought the coverage of social issues in IMF surveillance into focus. Over the past years, bilateral surveillance has concentrated on macroeconomic stability and market-based reforms. Issues such as unemployment, income distribution and inequality, inclusiveness, and accountability and governance, which contributed to the uprisings, were mentioned sporadically in some reports. For example, the 2007 Article IV report for Egypt expressed concern about the lack of inclusive growth, while the [October 2010 MCD Regional Economic Outlook](#) devoted attention to the problem.

To what extent should unemployment, inequality and poverty be taken up in IMF surveillance?

In answering this question, several considerations are important: (i) the purposes of the Fund, as defined in Article I of the Articles of Agreement, to contribute “to the promotion and maintenance of high levels of employment and real income”; (ii) the tension between the breadth and the depth of analysis—in this respect the 2004 TSR called for “*more discriminating coverage of issues outside the Fund’s traditional areas of expertise*”, and the 2008 TSR argued that “*recent gains—for example, in focus—should be preserved*”; (iii) other institutions have greater expertise on social issues, in particular on labor market issues. At the same time, it is clear that IMF surveillance must be comprehensive, i.e., should cover all policies that may impact members’ stability. Against this background, the 2009 [Bilateral Surveillance Guidance Note](#) stipulates that “Article IV reports should include information on political and social developments where they are relevant for analysis of economic policies”—although recognizing the necessity to leverage other institutions’ expertise on these issues. In addition, it points out that surveillance in LICs would generally be broader in scope, cover progress in poverty reduction, and, on occasion, income distribution issues.

A [think piece](#) prepared for this TSR by Joseph Stiglitz emphasizes the importance of broadening the coverage of surveillance. He argues that, since surveillance is aimed at assessing a country’s economic performance, the assessment should be based on the variables of ultimate interest to the well-being of the citizens of the country. Good indicators of inequality would therefore be desirable, recognizing that inequality may be of direct concern to shaping the nature of society as well as for economic stability. The fact that insufficient attention was given to these issues prior to the crisis meant that surveillance was “unbalanced,” thereby undermining its credibility. Stiglitz also calls for broadening participation in surveillance, noting that participation on the part of workers, businesses, and civil society could bring a change in perspectives and help garner greater support for surveillance.

33. **Views on candor are mixed, and surveillance may be erring excessively on the side of caution.** Similar to the 2008 TSR, a majority of officials considered the degree of candor in their own Article IV reports to be adequate. A third of them stated that more candid messages were frequently delivered outside of the staff report (mainly orally). Two thirds of mission chiefs saw themselves as largely candid in their dialogue with authorities. However, mission chiefs noted some degree of self censorship in the reports, with 1 in 7 stating that the need to preserve good relationships with authorities limited the candor of their report. In addition, while surveys did not find strong evidence of pressure from members on mission chiefs to temper their positions, a few mission chiefs reported instances of “very large pressure” from advanced and emerging economies. These findings echo concerns raised by

the IEO in its study on pre-crisis surveillance. External studies and advisors caution equally strongly against what they see as an excessively conservative bias on the part of the Fund — especially when dealing with economies that are subject to substantial scrutiny, including from markets.

34. **Reporting on the follow up to past surveillance advice should be strengthened to increase candor and accountability.** Despite current guidance requiring Article IV reports to follow up on previous policy advice, fewer than half of the staff reports reviewed contained such an assessment. In the recent past, dramatic changes in the global economy could have rendered previous policy recommendations out of date. But, as suggested by Martin Wolf and the external study on the euro area, the lack of follow-up could be symptomatic of a wider problem (e.g., lack of candor or consistency in policy advice) which needs to be addressed. Current guidance needs to be reinforced and applied consistently—a view shared by the EAG—to increase accountability on the part of the member country and the Fund alike.

Recommendation 5. Generate greater traction of Fund surveillance:

- Systematically bring external views into surveillance to increase candor. This could include external ex-post assessments of Fund surveillance in systemic countries, covering surveillance over a number of years, conducted independently or in the context of future TSRs. More debate in Article IV consultations could be encouraged by referring to minority views in staff reports and seeking external views on concluding statements/reports (e.g., by facilitating web debates).
- Ensure coverage of social issues that are important for members' stability in Article IV consultations, leveraging effectively other institutions' expertise (e.g., World Bank and ILO).
- Consistently elicit members' views ahead of Article IV consultations on key issues, while preserving candor and independence.

B. Communicating Effectively

35. **The ability to effectively communicate, including to broader audiences, is an important element of traction.** In general, stakeholders viewed the communication of surveillance favorably (Box 8). Executive Directors and financial market participants also gave high marks to the clarity of messages in IMF surveillance products. Interviewees praised efforts to increase outreach in bilateral surveillance, a step encouraged by Joseph Stiglitz and by CSOs. In his contribution, Martin Wolf also stressed the need to systematically reach out to outsiders, including financial market analysts and trade unions, in order to bring in a diversity of views. Some interviewees, however, noted that staff sometimes lacked the political savvy to get traction with policy makers, parliamentarians, CSOs, and the public.

Box 8. Surveillance and Communications

Since 2008, the Fund has employed new communications vehicles and reached out to a more diverse audience to communicate surveillance messages more effectively.

- **New communications vehicles.** *Press briefings* and [video interviews](#) have been used increasingly to convey key findings of surveillance. A new Multimedia Center enables broadcasters from all over the world to interview IMF staff. IMF video content is distributed widely, through [imf.org](#), [YouTube](#), and online broadcast distribution services. The IMF's global economy blog, [iMFdirect](#), has received around half a million views since its launch in August 2009 and reaches a wider readership via coverage in other prominent blogs. There is also a Spanish blog, [Diálogo a fondo](#), and a new Arabic blog is planned for later in 2011. Surveillance content is also distributed through [podcasts](#), in a range of languages. The IMF's [Twitter](#) account issues advisories of new publications to over 20,000 followers, and through [Sina](#), it reaches over 45,000 Chinese followers. Re-tweets allow the IMF to reach an audience in the millions.
- **Reaching a more diverse audience.** IMF opinion research has found that the more people know about the Fund, the more they support the institution's objectives. The IMF has stepped up its engagement with academia, civil society organizations, labor unions, parliamentarians, and youth. To increase the reach of multilateral surveillance, the IMF now launches Updates of the [WEO](#), the [GFSR](#), and [Fiscal Monitor](#) outside the U.S.—for example, in Johannesburg and Sao Paulo in 2011. The fact that surveillance-related material is available in a range of languages is critical to reaching a wider global audience.

The IMF's multilateral surveillance products continue to have the largest impact overall. The [WEO](#) and [GFSR](#) remain the most successful, with their website averaging about 100,000 and 55,000 visits, respectively, during the first week after the release of the reports (April 2008–April 2011). Country authorities find these products to be the most helpful in sharpening their views on economic developments. The impact of [REOs](#) has varied; hits are fewer than for multilateral publications.

A number of best practices have emerged from the Fund's recent experience.

- *Clear, concise messages*—together with *consistency of messages* across surveillance documents (bilateral, regional, and multilateral)—is essential to get key points across effectively.
- *Proactive and deliberate outreach*, targeting the most relevant audiences, is equally important. Outreach should be tailored to local conditions, drawing on the range of communications options. Resident representatives have played a vital role in such outreach.

Survey findings suggest that stakeholders' rate communication of IMF surveillance favorably.

Over two thirds of survey respondents in the media and 40 percent of CSOs considered the Fund's communications on surveillance as "somewhat or much better" than that of other international financial institutions, government agencies and think tanks. However, more could be done to increase the candor of messages and to reach a wider audience. Although the clarity of the Fund's communications on surveillance is generally evaluated favorably, some respondents still considered the language in IMF surveillance too technical. Use of "plain English" messaging via new communications vehicles could help address this concern. In terms of outreach, upcoming efforts should consider more systematic engagement with a wider audience, especially during bilateral surveillance.

36. **While the Fund's multilateral products are valued, there is a risk that key policy messages are diffused.** It is a challenge for any audience to absorb the current volume of multilateral surveillance publications (around 2300 pages annually, in addition to 3200 pages

for bilateral surveillance). This also raises risks of overlap, inconsistency, excessive segmentation of messages, and inefficient work practices (e.g., internal review fatigue). On the other hand, survey results suggest that different surveillance vehicles, including REOs (particularly for Sub Saharan Africa), are overall held in high regard by diverse stakeholders. As such, the trade-off between tailoring products and risking excessive segmentation is a difficult one to resolve. On balance, staff agrees with external reviewers who did not see a compelling case for a radical merger of the main multilateral products—in particular the WEO, GFSR, and Fiscal Monitor (see *TSR External Study—IMF Surveillance: Coverage, Consistency, and Coherence*).

37. **Drawing top-line messages for senior policymakers is important for ensuring the consistency and coherence of the Fund’s messages.** In light of the multitude of multilateral products, external reviewers and interviewees called for a succinct and candid overarching document that consolidates the main messages on the global outlook and risks and includes top-line policy recommendations. Work is already underway to develop a consolidated multilateral surveillance report (CMSR) requested by the IMFC in April 2011. This report will distill the key messages from the WEO, GFSR, Fiscal Monitor, and other surveillance products (e.g., spillover reports and the early warning exercise). This has the potential to increase traction, and strengthen the intra-institution dialogue on key issues and policies.

C. Engaging with Others

38. **IMF surveillance operates in an institutional landscape that has changed significantly since the last TSR, bringing new opportunities and challenges in its wake.** A number of government-based multilateral fora are now carrying out self-assessments of members’ economies and policies at the regional (the European Union/the euro area, ASEAN+3) and multilateral (G-20, and FSB) levels.

39. **Interviews revealed sharply different views about the legitimacy and effectiveness of the G-20, and the proper role of the Fund in this context.** For instance, one interviewee suggested the Fund “...could make its reputation...” on surveillance through its work with the G-20, while others were concerned that the Fund’s work with the G-20 risked effectively taking surveillance of the largest member countries out of the Fund. Similarly, there were differences of view on the implications of the increased role of the G-20 for Fund governance. Some expressed concerns, while others suggested integrating the G-20 ministers group with the IMFC, with a possible activation of the Council.

40. **Staff views the engagement with other fora as potentially increasing the effectiveness of surveillance.** Staff’s recent [Review of the Fund’s Role in the G-20 MAP](#) suggests that Fund’s engagement with the G-20 provides an additional opportunity to generate traction for its advice by opening up new channels of communications to decision makers (Box 9). More broadly, the *Coverage, Consistency and Coherence* study emphasizes the importance of engaging with supranational groupings, such as ASEAN+3. The euro area

study cautions that in engaging with other bodies, Fund advice has to be able to step back from their agenda. While in its involvement the Fund has to remain mindful of keeping a broad and independent perspective, this kind of dialogue is important as it provides the Fund with avenues to inform and influence national policies. In addition, in engaging with other fora, there is a need for a clear process to ensure that other members (e.g., non-G-20 members) are heard on issues of broader implications to the membership.

Box 9. Lessons from Fund Engagement with the G-20

Experience to date suggests substantial benefits to IMF input in the G-20 process given the strong engagement by G-20 members. A direct dialogue with groupings of policy makers who can influence each other provides the Fund with another avenue to inform and influence national policies and, increase traction of Fund advice. The formation of the G-20 also provides a clear signal about key issues that, at a minimum, a sizable portion of the membership considers important. In this context the G-20 MAP process provides a number of important lessons for Fund surveillance. The following characteristics are particularly relevant:

- The G-20 MAP is located at the boundary with bilateral and multilateral surveillance, it is focused on cross-country connections and spillovers, and makes thematic connections across countries;
- The broad-based, multilaterally consistent, framing of issues relevant to global imbalances suggests that there was unmet demand in this area;
- Interviews undertaken with country authorities suggest that the G-20's cooperative, country-led structure, as well as their use of objective, non-punitive norms, is seen by the participants as a plus of the G-20 process;
- The G-20 has a unique governance structure, with a direct line to Leaders, giving the process the potential for real traction.

VII. OTHER ISSUES: THE MAKING OF SURVEILLANCE

While making specific organizational recommendations goes beyond the scope of this review, this section briefly considers the type of changes that could support effective surveillance, and discusses resource implications.

41. Organizational changes could facilitate a more integrated and candid surveillance. Background studies suggest a number of steps in support of these:

- *Putting in place mechanisms to further strengthen inter-departmental collaboration.* Weekly cross-departmental surveillance meetings led by the economic and financial counselors and surveillance meetings led by management have improved cross-departmental information sharing and consultation, as have a number of inter-department groups such as the Low-Income Country Consultative Group, Financial Surveillance Group, and the Capital Inflows Group. However, external studies, interviews, and the recent IEO study on pre-crisis surveillance, point to the persistence of a “silo” mentality within the Fund. The *Coverage, Consistency and Coherence Study* stresses the need for management to send clear messages about the value the organization places on inter-departmental collaboration, and set out incentives to encourage it.

- *Encouraging mobility.* Sufficient tenure of staff in country teams is important. However, mobility, in particular across departments, has a role to play in encouraging broader thinking, dissemination of skills, and collaboration, as highlighted in the euro area study.
- *Promoting openness to diverse external views and creating internal incentives for candor.* Creating an internal culture that is tolerant of dissenting views and rewards questioning by staff—as emphasized by Martin Wolf and the IEO—could enhance the candor of surveillance. As noted by the EAG, there is also a need to “be more open to external dissenting views and to avoid a “one way or no way” dogma”— a point also made by Martin Wolf and Joseph Stiglitz.

Resources

42. **Gross budgetary implications of this paper’s recommendations would not be neutral.** Total expenditures on surveillance (service delivery and travel for all of multilateral, regional and bilateral surveillance) were cut back during the downsizing but have increased since. At \$250 million, they represented a quarter of the Fund’s total service delivery and travel expenditure in fiscal year 2010.¹⁰ Many of the recommendations made in this TSR could be implemented within the existing budget envelope. There are, however, significant resource costs attached to others, in particular if the decision was taken to: increase the frequency of financial stability assessments for systemic countries and financial sector training; regularize spillover reports; and increase the use of external experts. A discussion on what surveillance—or the Fund—should do less of might be warranted in light of evolving institutional priorities. Following the Board discussion, staff would need to follow up on those recommendations endorsed by Directors and present a fully costed proposal in the context of budget discussions.

VIII. PRIORITIES FOR 2011–14 AND ISSUES FOR DISCUSSION

A. Operational Priorities for 2011–14

43. **A review of progress against the Statement of Surveillance Priorities (SSP) has been conducted as part of this TSR.** The SSP was adopted by the Executive Board in 2008 to guide surveillance over the next three years.¹¹ This included *economic* and *operational* priorities, intended to steer the IMF’s work in order to deliver better surveillance to members.

¹⁰ This figure includes multilateral, bilateral, and regional surveillance (monetary unions and regional economic outlooks) and FSAPs. It excludes oversight of the international monetary system, inputs to the G-20 or other regional groupings, data collection, and general research. The cost of overhead and governance was approximately two-thirds of service delivery and travel in FY2010. Excluding these, FY2010 expenditure on surveillance was about \$148 million.

¹¹ The [SSP](#) was designed to help the IMF deliver on its mandate to promote international monetary stability and to lay a clear basis for monitoring and accountability. Progress towards the identified priorities was to be assessed through regular reports from the Managing Director, and in the context of the TSRs.

While the exercise has been useful for articulating surveillance priorities, the instrument itself got limited traction. In this context, staff recommends updating priorities as an integral part of the TSR framework, rather than in an SSP as a separate instrument.

44. **Staff recommends that the economic priorities for the period ahead be discussed in the new multilateral surveillance report (CMSR).** The economic priorities in the 2008 TSR were defined based on discussions of the fall 2008 WEO and GFSR, and revised in 2009 in response to significant changes in the global environment. With hindsight, staff's assessment is that economic priorities tend to evolve faster than over a three-year cycle, and are implicitly defined in multilateral surveillance. Therefore, staff recommends that economic priorities be dropped from the SSP going forward. Instead, the CMSR would flag the key economic priorities for the Fund and should serve as a useful tool for engaging members, particularly in the context of IMFC discussions.

45. **To make surveillance as interconnected as the global economy and ensure a risk-focus, staff proposes revising the operational priorities for 2011–14.** The operational priorities have served as a touchstone for [surveillance guidance](#) during the review period. While substantial progress has been made in addressing these, most remain relevant. Staff, therefore, recommends the following updated operational priorities:

Operational priorities for 2011-14¹²

- *Interconnections.* Bring a multilateral perspective to surveillance. Regularize spillover analysis and promote more cross-country work and thinking.
- *Risk assessment.* Ensure systematic coverage and in-depth discussion of risks in bilateral and multilateral surveillance. Deepen understanding of risk transmission channels and their policy implications.
- *Financial stability.* Adopt a strategic agenda for the Fund's financial sector surveillance. Take further steps to mainstream financial stability analysis in bilateral surveillance. Strengthen understanding of financial interconnectedness and continue to address data gaps.
- *External stability.* Improve consistency and transparency of exchange rate analysis and ensure discussions of external stability in staff reports extend beyond exchange rates.
- *Traction.* Strengthen candor and evenhandedness of surveillance, ensure adequate coverage of macro-critical issues, and improve the effectiveness of communication. Encourage regular dialogue with members and engagement with other fora.

¹² Progress against these priorities is to be assessed in 2014.

B. Issues for Discussion

- Do Directors agree with the main findings and key themes emerging from this TSR?
- Do Directors agree that the SSP economic priorities should be discussed in the new multilateral surveillance report?
- Do Directors endorse the operational priorities set out in this report for 2011–14, with progress to be assessed in the 2014 TSR?
- Do Directors consider that the specific recommendations laid out in this paper and in staff’s background papers would help make progress on the broader priorities?
- Do Directors have other suggestions to enhance the effectiveness of surveillance?
- Recognizing that a number of staff’s recommendations would have resource implications, do Directors see scope to do less of certain surveillance—or other—activities, and if so which ones?

ANNEX 1. RECENT REFORMS TO IMF SURVEILLANCE

Since the beginning of the crisis, the Fund has developed new vehicles to sharpen the focus on risks, cross-country themes, and spillovers. These include:

The [Early Warning Exercise \(EWE\)](#) assesses low probability but high impact risks to the global economy and identifies policies to mitigate them. It integrates macroeconomic and financial perspectives on systemic risks, drawing on a range of quantitative tools and broad-based consultations.

The **Vulnerability Exercise for Advanced and Emerging Market Countries (VEA, VEE)** provide the basis for the EWE's quantitative results, with the model outcomes being aggregated first by sector (e.g., external, fiscal, etc.), and then across sectors to arrive at overall country risk ratings. A similar exercise (VE-LIC) was launched in 2011 for LICs.

The [Fiscal Monitor](#) was launched in 2009 to survey and analyze the latest public finance developments, update fiscal implications of the crisis and medium-term fiscal projections, and assess policies to put public finances on a sustainable footing.

The [G-20 Mutual Assessment Process \(MAP\)](#) is a multilateral exercise through which G-20 countries identify objectives for the global economy and the policies needed to reach them. The Fund provides the technical analysis for the “mutual assessment” of the progress towards meeting these shared objectives. The Fund also provides tailored surveillance notes for the G-20.

Thematic multi-country reports are now regularly being prepared. For example, the report on [Cross-Cutting Themes in Employment Experiences during the Crisis](#) was discussed by the Board during an informal seminar in November 2010.

[Spillover Reports](#) have been undertaken on a pilot basis for the 5 largest economic countries/ zones. They examine outward spillovers from countries whose policies or circumstances may significantly affect the stability of the system.

[Financial Stability Assessments](#) under the Financial Sector Assessment Program (FSAP) for systemic countries are now compulsory every five years for countries with systemically important financial centers.