

INTERNATIONAL MONETARY FUND

**2011 Triennial Surveillance Review and Review of the 2007 Decision:
Concept Note**

Prepared by the Strategy Policy and Review Department

In consultation with the other departments

Approved by Reza Moghadam

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I. INTRODUCTION

1. **Context:** Over the past three years, the Fund has worked to assist members in addressing the repercussions of the global financial crisis while also tackling gaps in its surveillance framework that the crisis laid bare. This reform agenda has drawn extensively from the recommendations of the 2008 Triennial Surveillance Review (TSR), as well as subsequent Fund and IEO reviews of the Fund's performance in the run-up to the crisis.¹ This TSR provides an opportunity to take stock of the steps taken and to assess recent experience with surveillance.
2. **Key objectives:** The primary objective of the TSR is to support the Fund's ability to contribute to both country-level and global stability through its surveillance. The TSR's diagnosis and recommendations will take into account recent reforms to strengthen the Fund's detection and communication of the spectrum of risks and transmission channels, inter alia to and from the financial sector, and will consider how effectively and efficiently the Fund is ensuring consistency and comprehensiveness across the various levels of surveillance (from bilateral to multilateral). The review will also assess the candor and evenhandedness of Fund surveillance and, building on the recent findings of the IEO, consider possible recommendations.
3. **Scope:** The review will focus on the period from late 2008 and the escalation of the global crisis, drawing upon the findings of the extensive existing work by the Fund and the IEO on the pre-crisis period and looking back directly on specific issues only if needed. Whereas earlier reviews concentrated on bilateral surveillance, the 2011 TSR will additionally cover multilateral surveillance (including both global and cross-country) and related products (e.g., Regional Economic Outlooks; Cross-Cutting Thematic Reports and analytical inputs for other key fora for surveillance—e.g., the G-20). It will also make a preliminary assessment of the

¹ See: [IMF Performance in the Run Up to the Economic and Financial Crisis, IEO](#), (1/10/2011), [2008 Triennial Surveillance Review](#) (09/02/2008), [Initial Lessons of the Crisis](#) (2/6/2009), [Financial Sector and Bilateral Surveillance—Toward Further Integration](#) (8/31/2009), [The Fund's Mandate—An Overview](#) (1/22/2010), [Review of the Fund's Mandate—Modernizing the Surveillance Mandate and Modalities](#) (03/29/2010), [Financial Sector Surveillance and the Mandate of the Fund](#) (3/29/2010), [Review of the Fund's Mandate—Follow-Up on Modernizing Surveillance](#) (7/30/2010).

consequences of the Fund’s changing relationship with the G-20, the Financial Stability Board (FSB), and other outside fora for its surveillance with both systemic and non-systemic members. Recourse to outside expertise will be stepped up for this review through the use of an external advisory group.

4. ***The Legal Framework for Surveillance:*** Based on the findings of the TSR, and building further on the discussions of the mandate and the Fund’s role in addressing capital flows, the legal framework for surveillance will be reviewed to assess whether it provides an effective framework to support international monetary stability in the current global context.² Further feedback on options for reform would also be sought.

II. PREVIOUS SURVEILLANCE REVIEWS: FINDINGS AND RECOMMENDATIONS

5. ***Building from previous reviews:*** The 2008 TSR—and subsequent reviews by both the IMF and IEO—highlighted the need for the Fund to improve its capacity to think the unthinkable, connect the dots between global and country-level risks, and highlight concerns forcefully. The 2008 TSR identified four key areas as a high priority for greater attention over the three-year review period: risk assessment, integration of macroeconomic and financial sector surveillance, integration of multilateral and bilateral surveillance, and strengthened exchange rate assessment (Figure 1). As detailed in Box 1, more recent reviews of the pre-crisis period

Figure 1: Findings and Recommendations of the 2008 TSR

	Findings	Recommendations
Risk Assessment	<ul style="list-style-type: none"> • Star struck by good performance • Too little attention paid to risks 	<ul style="list-style-type: none"> • More systematic risk assessment • Emphasis on tail events • Use WEO/GFSR/regional risks
Macro-Financial Linkages	<ul style="list-style-type: none"> • More two way analysis of transmission real /financial sector • Greater specificity of advice 	<ul style="list-style-type: none"> • Clarify organizing framework • Continue developing the toolkit • Build up macro-financial expertise
Multilateral Perspective	<ul style="list-style-type: none"> • Large unmet demand for spillover analysis + cross-country analysis 	<ul style="list-style-type: none"> • Better leverage WEO/ GFSR • Improve information sharing • Reward cross-country analysis for value added to policy discussion
Exchange Rate Assessment	<ul style="list-style-type: none"> • Needs better integration in macroeconomic assessment • More transparent presentation • Improve methodology • Greater candor +evenhandedness 	<ul style="list-style-type: none"> • Operational Guidance was under review: further progress expected without the need for new initiatives
Other Areas for Attention	<ul style="list-style-type: none"> • Repetition among bilateral surveillance products (Concluding Statement, PIN, Report, SIPs) was counterproductive • Ensure even quality • Preserve existing strengths (fiscal) 	<ul style="list-style-type: none"> • Improve brevity, timeliness, clarity, and strategic delivery of key communications messages

² Prior to 2008, reviews of the decision on Bilateral Surveillance and reviews of surveillance were joint. The 2008 TSR Issues Note indicated that the 2011 TSR would resume the tradition of joint reviews.

stressed the need for fundamental reforms to strengthen the risk focus of Fund surveillance, more effective identification of financial-sector-driven risks, better integration of systemic and country-level surveillance, steps to increase the traction of Fund surveillance, and creation of an environment that encourages candor and diverse views and strengthens incentives to “speak truth to power.”

Box 1. Recent Findings and Recommendations on IMF Surveillance

Lessons on the Run-Up to the Crisis

Initial Lessons from the Crisis (February 6, 2009). IMF analysis highlighted that the Fund did not provide strong or focused warnings prior to the crisis—warnings were too scattered and unspecific 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. The recommendations from this report resulted in the establishment of the Vulnerabilities Exercise for Advanced Economies (VEA) and the Early Warning Exercise (EWE), and greater attention to financial sector surveillance.

IEO Report on the Run-Up to the Global Economic and Financial Crisis (January 10, 2011) found that the Fund provided few clear warnings about the buildup of vulnerabilities and risks in the global financial system. Furthermore, there was a sense of a lack of urgency about addressing financial sector risks or considering possible severe adverse outcomes. Surveillance also paid insufficient attention to risks of contagion or spillovers from a crisis in advanced economies. The IEO found that groupthink, intellectual capture, and governance that discourage contrarian views hindered the Fund’s performance. They proposed five general recommendations to improve the setting for surveillance: to create an environment that encourages candor and diverse/dissenting views; strengthen incentives to “speak truth to power”; to better integrate financial sector issues into macroeconomic assessments; to overcome silo behavior and mentality; and to deliver a clear, consistent message on the global outlook and risks.

Surveillance Modalities

IEO Report on the IMF’s Interactions with Member Countries (November 30, 2009) noted that majorities of all country groups wanted a 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 thus far to improve surveillance traction—this remained a work in progress. Interactions with authorities were undermanaged, although some individuals managed particular interactions very well.

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 surveillance and lending at the country level. 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.

Modernizing the Surveillance Mandate and Modalities (March 29, 2010) illustrated the lack of progress in adopting a more multilateral perspective in surveillance and analyzing outward spillovers. Moreover, 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.

6. ***Ongoing reforms:*** The Fund has taken a number of steps since 2008 that respond to these findings. These include, inter alia, development of new vehicles to sharpen the focus on risks (the EWE, VEA, the forthcoming Vulnerabilities Exercise for Low-Income Countries, and the Fiscal Monitor) and on cross-country themes and spillovers (Cross-Cutting Thematic Reports, participation in the G-20 MAP, G-20 surveillance notes, and the forthcoming spillover reports for the five most systemically important economies), as well as better integration of existing products (mandatory FSAPs, WEO/GFSR foreword/MD statement). The interdepartmental review and collaboration processes have also been revamped, financial sector expertise and analysis increased, communications and outreach have been stepped up (including through use of Regional Advisory Groups), and innovative Article IV report formats are being introduced. The Review will take stock of experience with these changes, recognizing that only preliminary views will be possible for the most recent initiatives (including spillover reports, the vulnerability exercise for LICs, and mandatory FSAPs).

III. 2011 TSR APPROACH

7. ***Themes.*** Taking into account the priorities identified in the 2008 TSR³ and subsequent Fund and IEO analyses, and drawing from background studies on key developments in the review period (paragraph 8), the TSR will examine four key themes:

- ❖ ***Risk assessment:*** Drawing on the findings from the background studies, the TSR will assess progress in how risks are treated and communicated. Specific focus will be placed on the surveillance of systemic risks; including the tracking of risks and potential transmission channels of shocks. The review will consider the degree to which the Fund's analysis and communications distinguishes between plausible and tail risks. The contribution of new tools, including the EWE and vulnerabilities exercises, and the extent to which these analytics are integrated into Article IV reports and other surveillance products, will be reviewed.
- ❖ ***Financial sector risks and their propagation:*** The TSR will focus on the Fund's efforts to strengthen understanding of financial sector risks and of the two-way transmission between financial risks and the real economy, at the country and cross-country level. This will include reviewing progress in data sharing—in collaboration with other bodies such as the FSB—and in filling data gaps related to the financial sector and more broadly, including those identified by the G-20.
- ❖ ***Integrating multilateral and bilateral surveillance (to be led by an external expert):*** Effective surveillance requires bridging the gap across the various levels of surveillance (bilateral, cross country, and global) in particular by ensuring consistency and a proper identification of inwards and outwards spillovers across economies. The TSR will assess how various surveillance and related products fit together. The review will examine the

³ As stipulated in the [Statement of Surveillance Priorities](#), the TSR will report on progress in attaining the priorities identified in the statement; management's and staff's contributions, and factors that impeded progress.

extent to which new products are addressing identified gaps or contributing to overlaps—both on substance and in communication. In this context, it will look at recent reforms to support greater integration between the WEO and GFSR, as well as the introduction of the Fiscal Monitor, expanded vulnerability assessments, cross-cutting thematic reports and, recognizing that only initial impressions can be drawn, forthcoming spillover analyses. The implications of the Fund’s changing relationship with outside fora—including the G-20 and FSB—will also be reviewed. In this context, the TSR will review the Fund’s input into the G-20 Mutual Assessment Process.

- ❖ *Exchange rate assessments:* The TSR will assess the candor, evenhandedness and transparency of assessments, whether the exchange rate assessment is embedded in the staff’s analysis, and whether spillovers are adequately discussed. The interactions between staff and the authorities on exchange rate assessments will also be explored.
8. **Background Studies:** The TSR will examine the Fund’s contribution on four key issues related to developments in the review period, with two of these studies to be prepared by external experts:
- ❖ *Euro Area (to be prepared by an external expert):* Did bilateral surveillance in the run-up to the euro area crisis cover sovereign debt risks and financial sector vulnerabilities, particularly in countries hardest hit by the crisis? Were intra euro area developments, in particular current account imbalances, adequately considered? Were policy recommendations candid and timely? What lessons can be drawn from this experience for the Fund’s surveillance framework?
 - ❖ *Financial sector crisis strategy and response (to be prepared by an external expert):* has the Fund been effective in contributing timely, clear, analytically well grounded, and candid diagnosis and policy advice on financial sector crisis response? What have been the possible limiting factors, if any? What lessons can be drawn to reinforce the Fund’s ability to fulfill its mandate on global financial stability issues over the medium term?
 - ❖ *Stimulus and exit policies:* has the Fund’s policy advice in this area proved useful for country authorities? Has a consistent framework for analysis been applied across countries that takes into account both growth/employment and sustainability considerations? Has adequate consideration been given to risks, as well as outward and inward spillovers? Has Fund advice been candid and evenhanded? What lessons can be drawn?
 - ❖ *Low-Income Countries:* while surveillance of LICs will be integral to the broader issues under the review, a number of more specific questions also arise. Is Fund policy advice sufficiently tailored to these countries’ priorities and emerging needs?
9. **Effectiveness:** Building from the recent IEO recommendations, the review will look at several issues critical to the effectiveness of surveillance:

- ❖ *Candor*: the TSR will consider external, Board, and staff perceptions of Fund candor and possible constraints (e.g., pressures from members, “star-struck” deference to authorities, or internal incentives). It will also consider the inherent tension between, on the one hand, public candor and, on the other, the Fund’s role as a confidential adviser and the risk a public statement could precipitate a crisis.
- ❖ *Evenhandedness*: The review will seek to assess both evenhandedness and perceptions regarding evenhandedness across countries and groups of countries. In particular, the review will assess whether Fund advice is equally specific across the membership.
- ❖ *Encouraging a diversity of views*: The review will consider ways to include direct external inputs into surveillance (including routine input from eminent outside experts in surveillance of systemic cases) and examine measures that support a diversity of views across the staff.
- ❖ *Taking into account the political and social context*: The review will also consider the degree to which staff takes into account the political and social context (unemployment, inequality, and poverty) in surveillance.

10. ***Review of the legal framework.*** The TSR will also inform a review of the legal framework for surveillance, including the 2007 Decision on Bilateral Surveillance, which will be conducted concurrently. The review will build from the discussions that have already taken place in the context of the mandate discussions to consider the effectiveness of the current legal framework in supporting effective Fund surveillance and options for reform. Such reforms could, for example, support integration of bilateral and multilateral surveillance and provide clearer guidance on the conduct of the full range of members’ policies relevant for IMF surveillance building, for example, from ongoing discussions on managing capital flows.

IV. FRAMEWORK FOR THE 2011 REVIEW

11. ***Methodology for review.*** Drawing on the framework developed in the context of the 2008 TSR, the review will employ a range of tools:

- ❖ ***Review of staff reports.*** Recent Article IV reports on a 50-country sample representative of the membership will be reviewed to collect standardized qualitative information across a range of questions. Multilateral surveillance and related products will also be reviewed.
- ❖ ***Surveys*** will be used to gauge the views of country authorities; Executive Board members (as a proxy for the view of the international community); staff involved in bilateral (Article IV mission chiefs), cross country and multilateral surveillance (as producers); financial market participants; media/think tanks; and CSOs.
- ❖ ***External Experts*** are expected to contribute independent views on key issues covered by the review and to prepare reports based on structured interviews with country authorities. The findings of these studies will be provided to the Board in full.

- ❖ **Background Studies.** Specific background studies, involving cross-departmental teams, will provide an assessment of performance on key developments in the review period. The studies will review Article IV Staff Reports, multilateral and regional products, plus internal documents such as briefing papers, policy consultation notes, and back-to-office reports, together with outside analyses, and will draw upon interviews with mission chiefs and stakeholders.
- ❖ **Interviews/Outreach** will be used to dig into early findings in more depth.
- ❖ **Advisory Group.** Additional external input through an Advisory Group will provide an independent check on staff's analysis and recommendations. This group will have 10–12 representatives and will comprise of a diverse range of independent experts with broad regional representation and policy experience. Their views will be shared with the Board, and published as part of the TSR.

V. ISSUES FOR DISCUSSION

Do Directors agree that the overall objective and the proposed themes provide the basis for a useful review of the effectiveness of surveillance?

Do Directors agree with the methods that the review will employ?