



July 30, 2014

2014 TRIENNIAL SURVEILLANCE REVIEW—OVERVIEW PAPER

EXECUTIVE SUMMARY

The 2014 Triennial Surveillance Review takes place at a pivotal time. The crisis may have abated, but the complexity of policymaking has not. Countries are grappling with the painful legacies of the crisis—large debts, high unemployment and lackluster recoveries. Policymakers share a common goal of securing resilient and job-rich growth. They also face some common constraints. With limited policy space, countries are relying more on non-traditional macroeconomic and financial policies, or difficult structural reforms. Global interconnections continue to shape domestic policy choices, as countries look to shield against adverse spillovers and seize opportunities to harness the benefits of globalization.

The crisis raised the bar for Fund surveillance. The Fund has undertaken major steps to overhaul its surveillance toolkit and update its legal framework. This, together with the current confluence of challenges, raises the question: where to next for surveillance?

- In large part, the central task is to effectively embed recent innovations into the practice of surveillance. These innovations can also be refined, drawing on the lessons from early experience. These aspects of implementation are a major focus of this review.
- At the same time, Fund surveillance must continue to adapt to emerging challenges. Given the sweeping scope of recent changes, the answer is not to layer on more innovations. The other main pillar of this review is how to deliver 'smarter' surveillance—analysis and expert advice that is tailored to country circumstances, and that is enriched and has greater impact through continuous dialogue with member countries.

In that spirit, this surveillance review focuses on three broad fronts:

1) Integrating and deepening risk and spillovers analysis. Risks and spillovers remain first-order issues for the world economy and should be central to Fund surveillance. Recent reforms have made surveillance more risk-based, helping to better capture global interconnections. However, there is still significant scope to exploit more effectively the synergies between bilateral and multilateral surveillance. Experience so far also points to the need to build a deeper understanding of how risks map across countries, and how spillovers can quickly spread across sectors to expose domestic vulnerabilities. In this regard, two important steps forward would be reviving and adapting balance sheet analysis, and fully embedding macro-financial analysis in Article IV surveillance.

2) More tailored and expert policy advice. Given the ongoing complexity of policymaking, the Fund faces an equally complex task in providing useful policy advice. The answer is not for surveillance to cover all bases in all countries, but to tailor advice to country circumstances. The Fund should continue to build its understanding of macroprudential policy and its interactions with other policies. The Fund will also have to grapple with structural issues given their increasing importance for macroeconomic stability and growth. Surveillance should always highlight the implications of macro-critical structural reforms for the economy, but be more selective in where it offers policy advice. The Fund will add greatest value if it provides a cohesive package of analysis and advice, and better leverages its institutional knowledge of cross-country policy experiences.

3) Achieving greater impact. Analytical improvements alone will not be enough to improve the effectiveness of surveillance. This requires adapting the way surveillance is conducted based on a deeper understanding of country perspectives. The Fund has made good strides in this direction, but there is still room for more client-focused, yet candid, communication. This would help build a reinforcing cycle of well-tailored and influential analysis and advice. At the multilateral level, a clear and streamlined set of key messages will help strengthen the Fund's influence on global policy dialogue. Effective surveillance also hinges on the legitimacy of advice, underscoring the importance of evenhandedness, particularly in a world where countries often have a stake in advice to other countries. In a highly interconnected world, getting traction means not just encouraging but convincing global policymakers to work together. This raises questions about whether the Fund's mandate is adequate to support a stronger Fund role in global cooperation.

Putting these proposals into action will require a detailed implementation plan. Following consideration by the Board, the Managing Director will prepare an action plan to take this forward. It will be supported by a revised surveillance guidance note. As implementation will take some time, staff proposes moving comprehensive surveillance reviews to a five year cycle (next due in 2019), complemented by an interim progress report after 2½–3 years.

Approved By
Siddharth Tiwari

Prepared by Strategy, Policy, and Review Department

CONTENTS

ACRONYMS	4
CONTRIBUTORS	5
INTRODUCTION	6
ENHANCING RISK AND SPILLOVER ANALYSIS	8
A. Further Integrating Analysis	9
B. Deepening Analysis	12
SUPPORTING RESILIENCE AND SUSTAINABLE GROWTH	16
A. Beyond Orthodoxy: More Tailored Policy Advice	17
B. Beyond Ordinary: Value-Added Policy Advice	24
ACHIEVING GREATER IMPACT	27
A. Two-Way Candid and Clear Communication	27
B. Evenhandedness	30
C. Global Cooperation	31
OTHER ISSUES	32
A. Surveillance Review Cycle	32
B. Resource Implications	32
C. Operational Priorities for 2014–19	33
ISSUES FOR DISCUSSION	33
BOXES	
1. Summary of Stakeholders' Perspectives	8
2. Tools to Support Balance Sheet Analysis	14
3. The IMF's Policy Compass	18
4. An Input-Based Approach to Evenhandedness	30
FIGURES	
1. Progress Since the 2011 TSR	6
2. Inputs for the 2014 TSR	7
3. Timeline of IMF Fiscal Policy Pronouncements Mapped Against Global GDP Growth by Income Group	21
ANNEX	
I. 2014 TSR Recommendations	34

Acronyms

CD	Capacity Development
CSOs	Civil Society Organizations
CGER	Consultative Group on Exchange Rate Issues
EBA	External Balance Assessment
FSAP	Financial Stability Assessment Program
G-20 MAP	G-20 Mutual Assessment Process
GFF	Global Flow of Funds
GFSR	Global Financial Stability Report
GPA	Global Policy Agenda
G-RAM	Global Risk Assessment Matrix
GSIB	Global Systemically Important Banks
IEO	Independent Evaluation Office
ILO	International Labor Organization
ISD	Integrated Surveillance Decision
LICs	Low-Income Countries
Pilot ESR	Pilot External Sector Report
RAM	Risk Assessment Matrix
REO	Regional Economic Outlook
TA	Technical Assistance
TSR	Triennial Surveillance Review
WEO	World Economic Outlook

Contributors

TSR Team—Overview and Background Studies: Peter Allum, Myrvin Anthony, Zsofia Arvai, Tamim Bayoumi, Hugh Bredenkamp, R. Sean Craig, Mame Astou Diouf, Lawrence Dwight, Gilda Fernandez, Mark Flanagan, Gavin Gray, Vera Kehayova, Jung Kim, Kalpana Kochhar, Taline Koranchelian, Xavier Maret, David Marston, Nicolas Million, Masato Miyazaki, David Moore, Gillian Nkhata, Sean Nolan, Jean Frederic Noah Ndela Ntsama, Ceyda Oner, Karen Ongley, Rania Papageorgiou, Michael Perks, Perry Perone, Jiemin Ren, Ranil Salgado, Veronique Salins, Sarah Sanya, Andrew Tiffin, Di Wang, Hans Weisfeld, Yi Xiong (all SPR); Lars Engstrom, Carla Macario and Aleksandra Zdzienicka (all AFR); Neil Saker, Ding Ding (both APD); Pelin Berkmen, Julia Bersch, Qianying Chen, Kazuko Shirono (all EUR); Bernardin Akitoby, Serhan Cevik, Carolina Correa Caro, Luc Eyraud, Kerstin Gerling, Martine Guerguil (all FAD); Serkan Arslanalp, Patrick Imam, Silvia Iorgova, Paul Mathieu, Hiroko Oura, Francis Vitek (all MCM); Eugenio Cerutti, Ayhan Kose, Esteban Vesperoni (all RES), Evrim Bese Goksu, Noriaki Kinoshita, Manik Shrestha (all STA).

Commentaries: Montek S. Ahluwalia, Paul Krugman, and Martin Wolf.

External Studies: Kenneth Rogoff (Integrating Bilateral and Multilateral Surveillance on a Continuing Basis); David Daokui Li and Paul Tucker (Risks and Spillovers); Malcolm Knight and Guillermo Ortiz (Multilateral Surveillance: Ensuring a Focus on Key Risks to Global Stability); Paul Acquah, Alan Ahearne, and Paul Collier (Structural Policies in Fund Surveillance); and Michael Callaghan (Evenhandedness of Fund Surveillance).

Interviews with Stakeholders: Jack Boorman and Teresa Ter-Minassian.

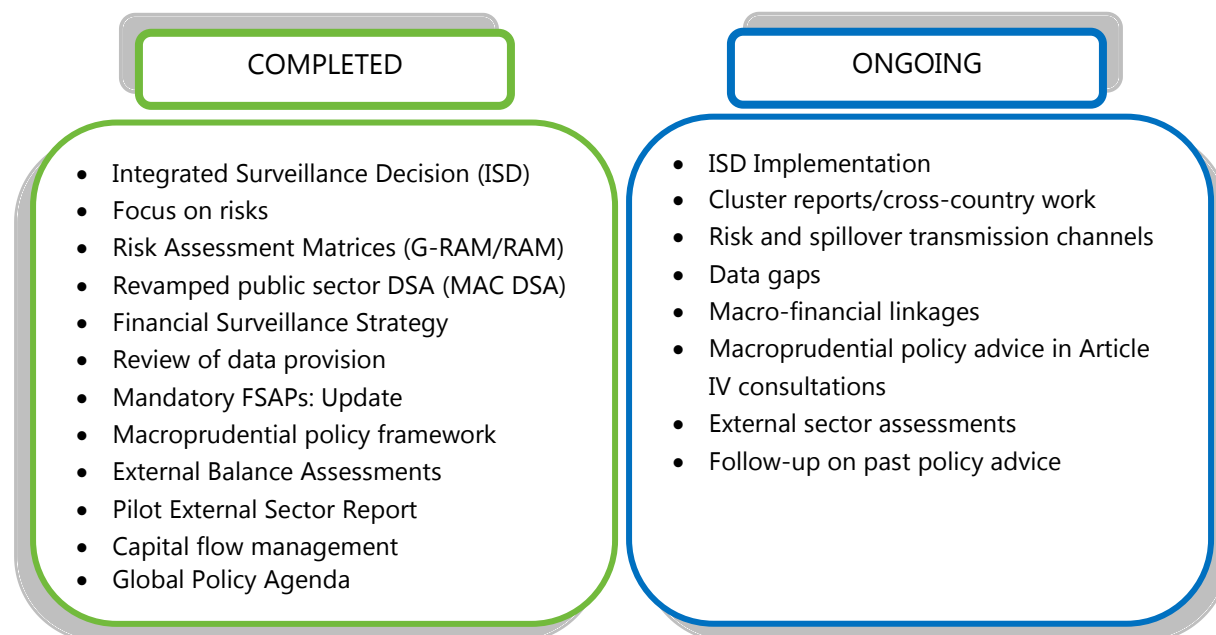
External Advisory Group: Paul Collier; Kemal Dervis; Salam Fayyad; Takatoshi Ito; Malcolm Knight; Anne Krueger; Alexei Kudrin; Xavier Musca; Guillermo Ortiz; Maria Ramos; Andrew Sheng; Paul Tucker; Ngaire Woods; and Martin Wolf.

Interdepartmental Contact Group: Christina Daseking; Anne-Marie Gulde-Wolf; Laure Redifer (all AFR); Isabelle Mateos y Lago; Jerald Schiff (both APD); William Murray (COM); Helge Berger; Kenneth Kang (both EUR); Martine Guerguil; Sanjeev Gupta (both FAD); Matthew Fisher; Donal McGettigan (both FIN); Dominique Desruelle; John Green (both ICD); Ross Leckow; Nadia Rendak (both LEG); Jeffrey Franks; Alfred Kammer; Martin Sommer (all MCD); James Morsink; Christopher Towe (both MCM); Hassan Al-Atrash (SEC); Jonathan Ostry (RES); Robert Heath; Robert York (both STA); Ulric Erickson von Allmen (WHD).

INTRODUCTION

1. **The 2014 TSR takes place against the backdrop of a sluggish global recovery and limited policy space.** Policymakers around the world face the common goal of moving beyond the modest and fragile recovery to stronger, more inclusive job-rich growth. At the same time, they find themselves with limited policy space to do so. Arguably, advanced economy policymakers are most constrained. Emerging market and low-income economies have also seen a decline in policy space as a result of efforts to mitigate the effects of the crisis, waning pre-crisis tailwinds and recent market pressures. These constraints are likely to continue for the foreseeable future, leading countries to rely on non-traditional macroeconomic policies and difficult structural reforms that will take time to pay-off.
2. **Meanwhile, policymakers are continuing to adapt to a highly interconnected world.** More and more countries will benefit from these interconnections as they grow, converge and integrate more deeply into the global economy. But they will also be exposed to risks and shocks that propagate across borders and will need to build the resilience to cope with them.
3. **Fund surveillance responded actively to the crisis, adapting to the realities of an interconnected global economy.** Policy advice has evolved at the institutional level (e.g., fiscal policy, unconventional monetary policy, management of capital flows, and macroprudential policy). The Fund has also modernized its legal framework to integrate bilateral and multilateral surveillance, introduced a number of initiatives (e.g., Financial Surveillance Strategy, Pilot External Sector Report), and sharpened its focus on risks and spillovers (Figure 1).

Figure 1. Progress Since the 2011 TSR



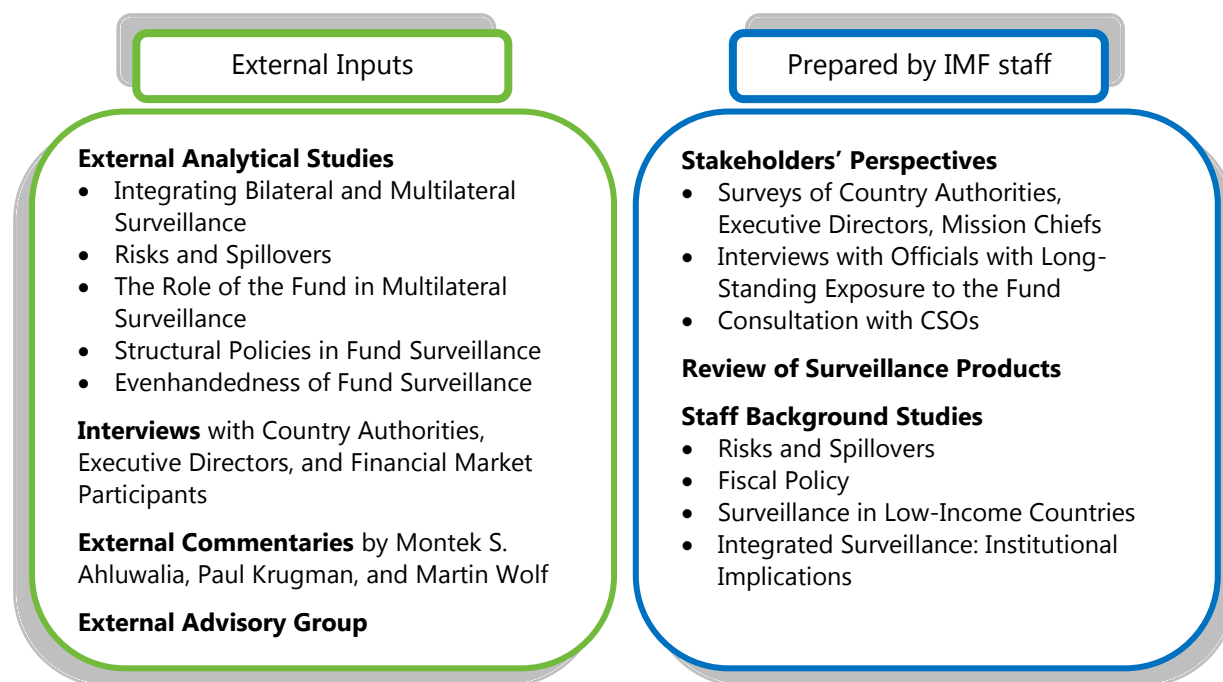
4. Yet, surveillance needs to continue to evolve to respond to countries’ needs.

Understanding the complexities of global economic and financial interlinkages, and integrating them in our practice of surveillance takes time. In this context, 2011–14 was a period of innovation. The focus now should be on integrating and embedding these innovations in the Fund’s day-to-day surveillance work, as well as adapting policy advice to emerging new challenges.

5. The overarching theme of this review is how to tailor surveillance to support sustainable growth in a still deeply interconnected post-crisis world. The next section assesses how to enhance further risk and spillover analysis, taking forward progress in implementing the key priorities from the 2011 TSR. The subsequent section focuses on the broader context of how to shape policy advice to help countries build resilience against shocks and support sustainable growth. Building on improvements in analysis and advice, the paper then considers how clear and candid communication, closer attention to evenhandedness, and stronger global cooperation could improve the effectiveness of surveillance.

6. This review was informed by a wide-range of inputs (Figure 2). These include stakeholder surveys (Box 1), a review of recent surveillance products, staff background studies, extensive external inputs—analytical studies, commentaries, interviews with stakeholders, consultation with civil society organizations (CSOs)—and an independent review by an External Advisory Group. These inputs have provided a rich discussion, and diverse perspectives and analyses, helping to formulate the findings and recommendations of this review.

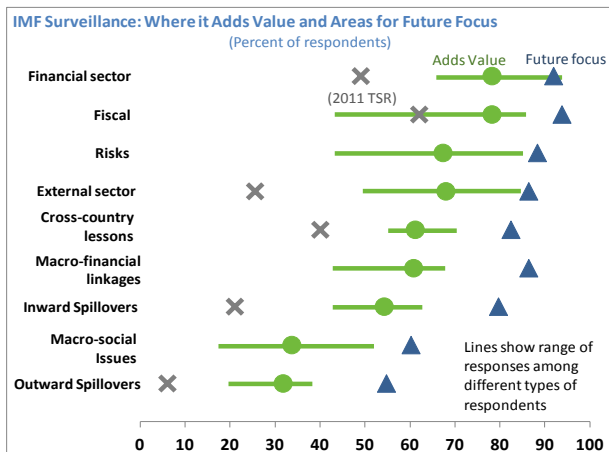
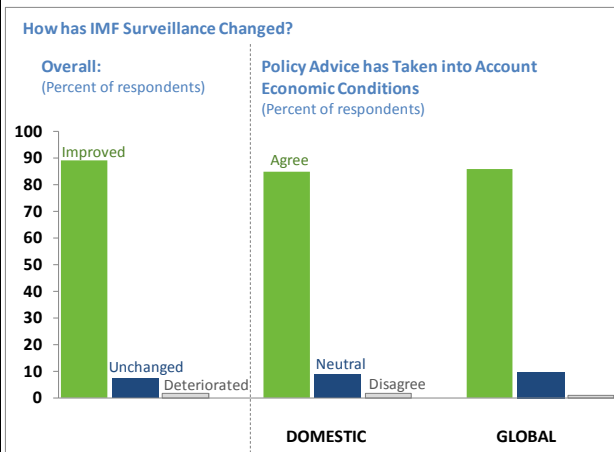
Figure 2. Inputs for the 2014 TSR



Box 1. Summary of Stakeholders' Perspectives

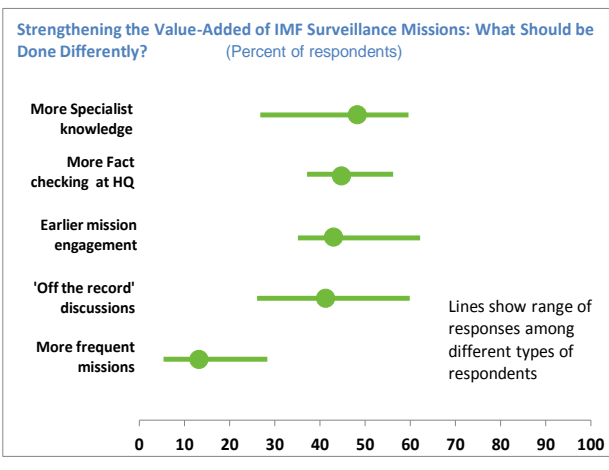
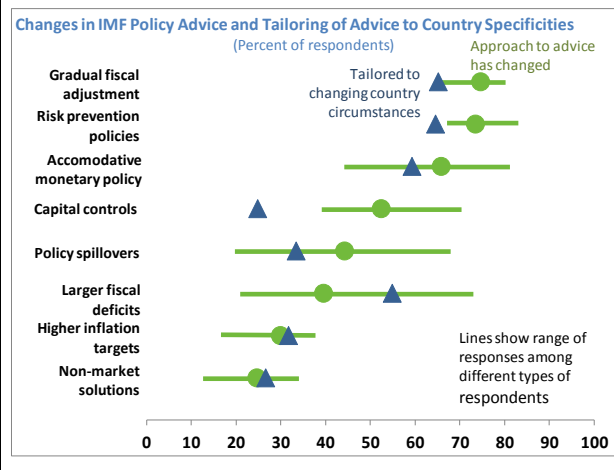
Country authorities believe that IMF surveillance has improved since 2011, taking into account changing economic conditions...

...adding most value in the financial, fiscal and external sectors, as well as on risk assessments; while macro-financial and spillover analysis lag behind.



The Fund's approach has evolved, tailoring advice to country specificities: more so on the pace of fiscal adjustment and less so on capital flow management.

Going forward, countries would like more expert advice, backed by cross-country policy experiences.



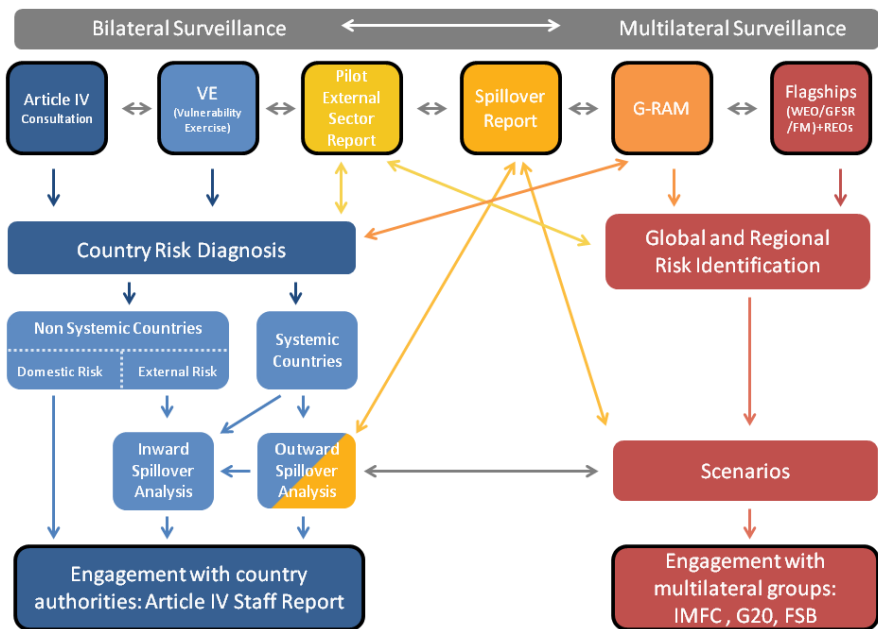
ENHANCING RISK AND SPILLOVER ANALYSIS

Risks and spillovers remain first-order issues for the world economy—and they should be central to Fund surveillance. In response to the crisis, the Fund overhauled its surveillance to make it more risk-based and better reflect global interconnections. Advancing this agenda will take time. This means continued efforts to integrate bilateral and multilateral surveillance, and capitalize more fully on the Fund's enhanced analytical toolkit. It also means incorporating new tools to further deepen the Fund's analysis of the transmission of risks across countries, and how spillovers can quickly spread across sectors to expose domestic vulnerabilities.

A. Further Integrating Analysis

7. The Fund has made major analytical and operational changes so that surveillance delivers consistent, pointed, and targeted analysis of risk and spillovers.¹

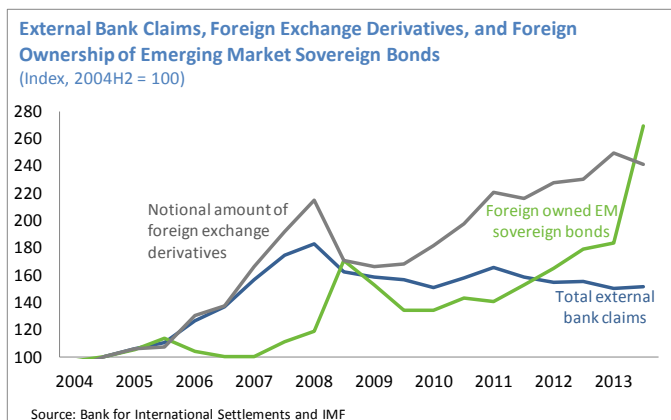
Bilateral and multilateral surveillance ran on separate tracks before the crisis. To better exploit the synergies between them, and tap into in-depth country knowledge, the Fund has put in place new processes and products that aim to draw the various threads together. The 2012 Integrated Surveillance Decision (ISD) clarified the scope of risk coverage and mainstreamed spillover analysis in Article IVs, supported by coverage of outward spillovers from systemic economies in the Spillover Report. An internal risk group helps



draw different perspectives together to form a staff view on the key global risks, summarized in a global risk assessment matrix (G-RAM) that is a basis for risk assessments in bilateral surveillance. Internal vulnerability exercises support this with rich, bottom-up evidence on risks for almost the entire membership. In parallel, the Fund has made major efforts to strengthen external sector surveillance through a new External Balance Assessment (EBA) methodology and the Pilot External Sector Report (Pilot ESR), which provides multilaterally consistent analysis of the external positions and policies of 29 systemic economies, in tandem with bilateral surveillance.

8. This agenda is even more relevant today.

Debt levels are still high, despite some deleveraging, and cross-border trade and financial linkages continue to deepen. Interconnectedness has many benefits, among them opportunities to boost growth and improve resource allocation. It also means that financial market shocks, such as the 2013 “taper tantrum,” will continue to



¹ Spillovers can arise from exogenous shocks or a country's policies.

have significant spillovers via both capital flows and shifts in risk positions. Over time more countries will enter this sphere as they grow, converge and become more financially integrated with the global economy; frontier low-income countries (LICs) exemplify this trend. Also, new dimensions to interconnectedness will continue to emerge. For example, some financial regulatory reforms and macroprudential policies have the potential to generate adverse spillovers in the short run even if their long-term goal is to support global stability. Strengthening this analysis will help improve Fund advice on policies to prevent risks, and mitigate their impact should they materialize.

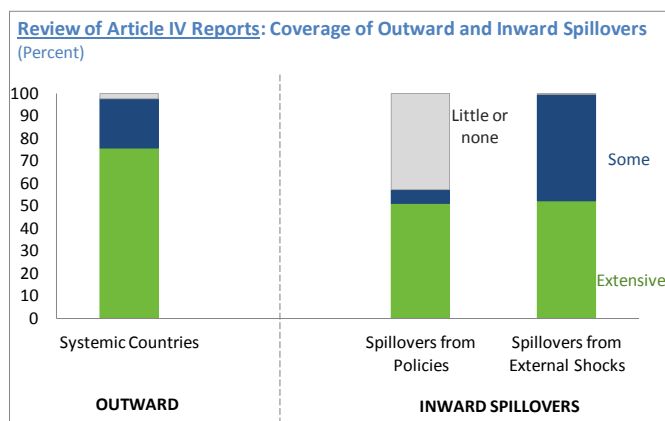
Continuing on the Path of Integrated Surveillance

9. While there has been good progress, continued efforts are needed to more fully integrate bilateral and multilateral surveillance. Staff and external studies found that surveillance messages are broadly consistent across bilateral and multilateral products. Nevertheless, multilateral surveillance could be used more systematically to inform country work, with regional economic outlooks (REOs) and cluster reports helping to bridge the gap. This would also support bilateral surveillance in drawing on cross-cutting work about major policy issues and financial market developments.

“For a policy institution, there is little point in the multilateral reports unless they affect policy on the ground.”

Li & Tucker

10. Further effort is needed to implement the Integrated Surveillance Decision (ISD) more systematically. Outward spillover analysis—which draws heavily on recently developed spillover models—is discussed in Article IV reports for large systemic economies. But reports vary in terms of the depth of analysis and the extent to which it is integrated into policy discussions. Staff also finds it hard to gain traction with this work, as policymakers are focused on domestic goals. Examining “spillbacks”—the risk of adverse feedback effects that systemic countries experience from their own outward spillovers—will enrich analysis and policy discussions, and could help build traction. However, the most powerful spillbacks—often those from tail risks—will not be captured by models and are best assessed through expert judgment.²



11. Analysis of inward spillovers should also be strengthened. Many Article IV reports discuss the implications of global risks, although they vary in the extent of supporting detailed or quantified analysis. To improve the rigor of analysis in countries where global risks may have high impact, reports could more systematically include alternative, quantified scenarios that spell out the

² There could also be instances where tail risks materialized and had outward spillovers without necessarily any spillback effects.

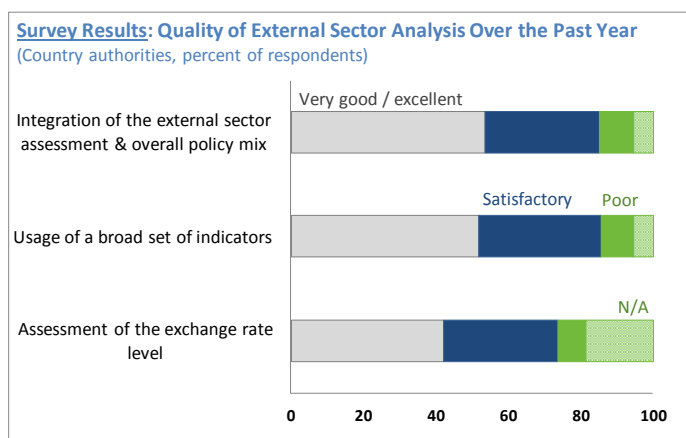
implications of a global adverse scenario. This would support qualitative discussions and help pinpoint possible policy responses and the trade-offs involved. More attention to inward spillovers from other countries' policies would further enrich policy discussions in both the source and recipient countries.

12. The Fund could also go further to explore spillovers among groups of countries that share similar characteristics or are exposed to common shocks. Cluster reports and REOs have already helped to draw policymakers' attention to spillovers, externalities and the potential gains from policy cooperation. So far, this work has focused on regional groupings, but it could also explore spillovers between countries in different regions whose characteristics make them subject to common shocks and opportunities.

Embedding External Sector Analysis

13. The Fund has taken important steps to strengthen its external analysis. The EBA and Pilot ESR are facilitating a more robust framework that includes a wider range of indicators to judge developments in the external sector. The EBA methodology has been tested and refined. While refinements should continue as for other models, this should not impede the gradual application of the main EBA concepts to a broader set of countries, although this would take time and depend on data availability.

14. External assessments should be embedded more fully in surveillance. Stakeholders are not fully convinced that external sector analysis has improved, or that it is adequately integrated into discussions of the policy mix. Article IV reports still regularly express the assessment narrowly (i.e., in terms of the exchange rate) rather than in terms of the broader external position. They also often fail to justify the bottom line assessment, and how it relates to different quantitative results and other indicators. Importantly, for countries with external imbalances, assessments are often not used to inform policy discussions. Moreover, reports for EBA countries often do not discuss the contribution of domestic policies to external imbalances nor refer to these results in formulating relevant policy advice. Country pages in the Pilot ESR provide a good model of integrated analysis of all relevant external sector indicators.

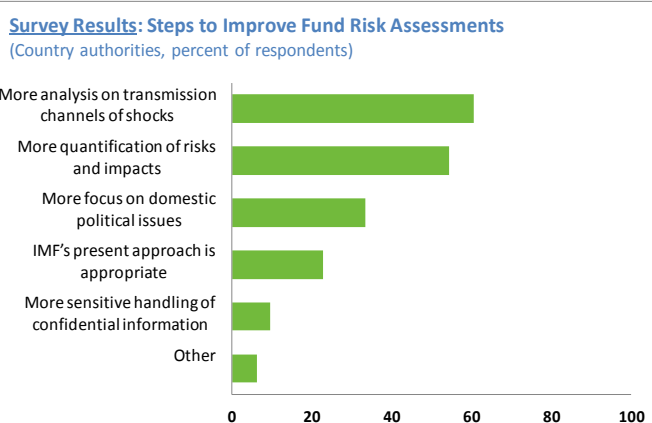


Recommendations:

- **Continue integration of bilateral and multilateral surveillance.** Bridge remaining gaps through REOs and cluster reports. Strengthen ISD implementation, with more systematic analysis of outward spillovers and spillbacks in systemic countries; greater quantification of the impact of spillovers on recipient countries, drawing on global risk scenarios; and discussion of policy implications.
- **Strengthen external sector assessment.** Gradually replace CGER with EBA for a broader set of countries, subject to data availability. Undertake a comprehensive assessment of the external position using a broader set of indicators than just the exchange rate. In countries where the EBA methodology is applied, discuss the contribution of domestic policies to external imbalances, and use these results in relevant policy discussions.

B. Deepening Analysis**15. Country authorities appreciate the improvements in analysis, but would like the Fund to delve further into how risks and spillovers are transmitted across borders and sectors.**

In particular, they would like more analysis of the transmission channels of shocks, greater quantification of risk assessments, and more in-depth discussion of the impact of systemic countries' policies on the rest of the world. A review of surveillance products identifies similar gaps in Article IV reports, including uneven coverage of intersectoral (particularly macro-financial) linkages and limited usage of quantitative analysis.

**16. A more holistic view of risks and spillovers will require an eclectic analytic approach.**

This involves the Fund drawing on a combination of its newly revamped analytical toolkit, judgment, and in-depth country knowledge.³ More broadly, to enhance the mapping of risks and spillovers, and identify the corresponding vulnerabilities, the Fund should revive and adapt analysis of balance sheets. This will also have the benefit of deepening macro-financial analysis. The external study on *Risks and Spillovers* highlights the importance of national balance sheet analysis in detecting risks and understanding how shocks are propagated. For this to happen, much more progress is needed from the membership to enhance data provision.⁴

"Models provide inputs but not mental crutches."
Li & Tucker

³The staff background paper on *Risks and Spillovers* lays out the Fund's toolkit for spillover analysis, includes DSGE models that incorporate financial linkages to varying degrees, global VARs and balance sheet models, and presents the conclusions of an academic seminar in April 2014, which found the Fund's models to be cutting edge.

⁴ More than five years after the collapse of Lehman Brothers, the Fund still lacks even aggregated information on global systemically important banks (GSIBs), and access to aggregated cross-border banking data is restricted.

The Balance Sheet Approach 2.0

17. The crisis and developments since are a reminder of the importance of balance sheets for identifying sources of vulnerability and the transmission of shocks. This was an important lesson of the Asian crisis, which led the Fund to develop a *Balance Sheet Approach*.⁵ This was initially applied to emerging markets but has since fallen into abeyance. Applying the same principles to advanced markets before the global financial crisis might have helped detect risks associated with European banks' reliance on U.S. wholesale funding to finance structured products. Balance sheet effects are likely to remain powerful in a world where advanced economies are deleveraging, and all economies are becoming more interconnected.

18. Reviving and adapting the balance sheet approach will help the Fund to better tailor risk and spillover analysis to country circumstances. In particular, it would allow surveillance to better capture major risks stemming from gross flows as well as domestic vulnerabilities (such as leverage, currency or liquidity mismatches). This would provide a stronger basis for an in-depth view of how global and domestic shocks affect individual economies and propagate across sectors. Matrices showing assets and liabilities, their maturity, and currency composition, for each sector are a powerful tool to support this analysis (Box 2). Balance sheet effects are also slowly being incorporated into more formal models including the Fund's spillover models.

19. Going forward, there is scope to build on the national balance sheet approach to better analyze cross-border linkages, particularly financial linkages. Two tools can support this:

- **Developing a global flow of funds (GFF)** would provide a more granular picture of potential spillover channels. For example, it would help to link a country's liabilities to asset holders in other countries. In this regard, work is at an early stage to develop a GFF that would supplement existing matrices with external linkages—in terms of geography and type of asset or liability.
- **Extending the external debt sustainability analysis (DSA) to cover external liquidity risks.** This could be derived from an analysis of how gross balance of payments flows are likely to respond in downside scenarios. It would thus help pinpoint which elements of the external balance sheet are most likely to come under strain.

"The IMF could benefit from a better understanding of the dynamics of global liquidity and its channels of transmission in order to advise on a coordinated response to such circumstances to mitigate systemic risk."
Knight & Ortiz

20. Pressing ahead with balance sheet analysis requires simultaneous efforts to address related data gaps. Comprehensive data are available only for a subset of countries, but the Fund can make significant progress by analyzing partial data sets more thoroughly. Staff and national authorities should also work together to fill the gaps, particularly of household and corporate balance sheets.

⁵ See Mark Allen, Christoph Rosenberg, Christian Keller, Brad Setser, and Nouriel Roubini, [A Balance Sheet Approach to Financial Crises](#), IMF Working Paper WP/02/210.

21. Fully understanding the significance of balance sheets requires more than analytical tools. For example, tools may not capture the extent to which derivative positions alter relationships between sectors, shadow banking obscures liabilities, or vulnerabilities in non-financial assets or liabilities, such as real estate, influences private-sector solvency. Applying judgment is equally important.

Box 2. Tools to Support Balance Sheet Analysis

The Fund’s workhorse tool for balance sheet analysis is a matrix showing asset and liability positions in and between key sectors—government, financial, non-financial and external—with breakdowns by maturity and currency. It has several uses:

- First, it generates indicators of maturity and currency mismatches for the three domestic sectors, which have been the catalyst for many financial crises.
- Second, it provides the *national balance sheet*, a country’s position vis-à-vis the rest of the world, showing its aggregate vulnerability to changes in exchange rates, foreign interest rates, and external financing.
- Third, the bilateral linkages between sectors in the matrix illustrate how shocks might propagate across sectors, including the potential for feedback effects that magnify their initial impact. For instance, the figure shows how the recognition of contingent liabilities on a government balance sheet that is financed by domestic banks could crowd out lending to the non-financial sector, with the potential for adverse feedback loop if government borrowing costs were to rise.

Balance Sheet Matrix

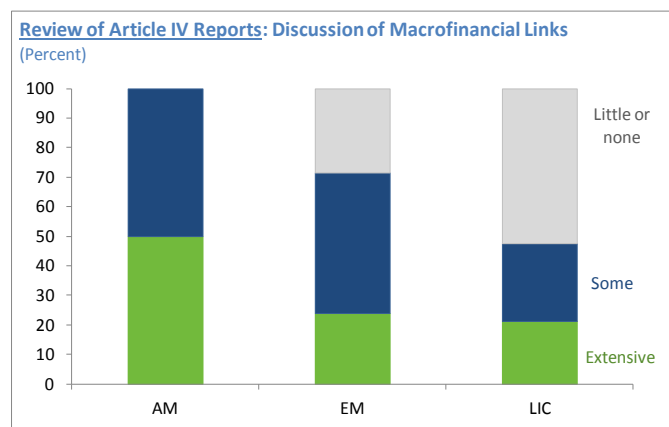
		Holder of the Liability (Creditor Sector)										
		Government		Financial Sector (incl. Central Bank)		Other Non-Financial Sectors		External		TOTAL		
		Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	
Issuer of the Liability (Debtor Sector)	Government											
	<i>In domestic currency</i>											
	ST											
	LT											
	<i>In foreign currency</i>											
	ST											
	LT											
	Financial Sector (incl. Central Bank)											
	<i>In domestic currency</i>											
	ST											
	LT											
	<i>In foreign currency</i>											
	ST											
	LT											
	Other Non-Financial Sectors											
<i>In domestic currency</i>												
ST												
LT												
<i>In foreign currency</i>												
ST												
LT												
External												
<i>In domestic currency</i>												
ST												
LT												
<i>In foreign currency</i>												
ST												
LT												
TOTAL												
<i>In domestic currency</i>												
<i>In foreign currency</i>												

The matrix should be seen as a starting point for balance sheet analysis. The government and financial balance sheets can be disaggregated to enable deeper analysis (e.g., bank and non-bank sectors). The external balance sheet can be supplemented with more granular data on bilateral bank, portfolio and FDI exposures to other countries, allowing richer analysis of the channels through which external shocks can impact the country. IMF non-financial balance sheet data can also be used with national source data on household and corporate balance sheets to explore risks in those sectors in greater depth.

It's Mostly Macro-Financial

22. The Fund has made progress in strengthening financial surveillance, but this work is not yet sufficiently incorporated into its core macroeconomic analysis.

The Financial Surveillance Strategy identified ways and upgraded the instruments to enable a more integrated assessment of financial risks. FSAPs are better integrated in Article IV consultations. However, financial and macroeconomic analyses remain fragmented. In part, this reflects a longstanding tendency for the “generalist” macroeconomic perspective to be largely divorced from the “specialist” financial perspective. This is reinforced by the absence of a unified model that links macro and financial variables, although there is a selection of tools that could help with this analysis. Analysis drawn from FSAPs has not closed the gap because it has been skewed towards institutional and microprudential issues, and not conducted frequently enough—especially in non-systemic countries—to support higher-frequency surveillance of macroeconomic issues. This fragmentation impedes the Fund’s effort to understand the macro-relevance of financial sector developments and the implications of other sectors on financial stability. Surveys indicate that country authorities are moderately satisfied with progress on macro-financial linkages; and less so for Executive Directors.



23. Deeper macro-financial analysis would be a springboard for better understanding links between sectors, and the transmission of shocks.

In many countries, the financial sector is the fastest and most powerful transmitter of both external and domestic shocks, with feedback effects often magnifying the initial impact. More broadly, the structure and functioning of the financial sector may support or undermine macroeconomic stability. Understanding these relationships is a prerequisite for effective risk and spillover analysis, and developing a balanced policy mix.

24. Macro-financial analysis should focus on a few questions:

- **Baseline.** Forming a view on the relationship between output and financial variables, especially credit, in the baseline scenario will help shed light on the credibility of projections and on risks that could build up over time. This will require an in-depth understanding of the key drivers of macroeconomic and financial trends, and the ways in which they interact.
- **Risks around the baseline.** Examining risks, including tail risks, around the baseline could point to the underlying sources of vulnerability (i.e., the key financial factors affecting macroeconomic stability and whether the financial sector acts as a conduit/absorber of shocks). This will help inform the choice/mix of macroeconomic, macroprudential, microprudential, and structural policies to mitigate these risks.

25. Advancing this agenda requires cultural and organizational changes, as well as better tools and steps to address data gaps. Recognizing the financial sector as an essential element of the macro landscape necessitates that macro-financial analysis becomes an integral part of Article IV consultations. Doing so would put new demands on area departments, who need to be firmly in the driver’s seat for financial surveillance, as well as on functional departments that support them. This will take some time and require concerted efforts on several fronts to support staff in meeting these new demands: providing better tools (e.g., simple, portable tools for financial sector risk assessment, stress testing, and incorporating financial sector variables into standard macro analysis); gradually shifting the profile of Fund economists to ensure they have adequate *macro-financial skills* through training and personnel policies; and changing work practices to generate incentives and opportunities for individual *staff to acquire and use* the needed skills. Addressing gaps in financial sector data, such as on GSIBs, is important for making good progress on this work.⁶

Recommendations:

- **Integrated analysis of risks and spillovers** to understand how vulnerable a country is to shocks and how they will be transmitted. Revive and modernize the balance sheet analyses; develop a GFF; and extend external debt sustainability analyses to cover external flows.
- **Mainstream macro-financial surveillance.** This could be achieved through better tools and new practices, as well as a shift in the profile of Fund economists.
- **Address data gaps.** Implement the G-20 Data Gap Initiative.

SUPPORTING RESILIENCE AND SUSTAINABLE GROWTH

The crisis was a resounding demonstration of why global interconnections increasingly shape domestic policy choices. And today’s policymakers face an added complexity. Countries are grappling with the lingering effects of the crisis—how to build resilience against shocks and ensure more durable and job-rich growth, with less policy space.

The Fund faces an equally complex task providing policy advice that helps countries navigate these challenges. The answer is not for surveillance to cover all bases in all countries, but to tailor advice to country circumstances. The focus here is on those policies where Fund surveillance should be fine-tuned to better support country tailoring. It will be equally important for the analysis and policy mix to be internally consistent, and to draw more effectively on the institutional knowledge of cross-country policy experiences.

⁶ The ongoing Review of the FSAP will provide suggestions to strengthen tools and change practices.

A. Beyond Orthodoxy: More Tailored Policy Advice

26. The efficacy of orthodox policy frameworks has been hotly debated since the crisis. In part, this reflects the confluence of crisis conditions and the still substantial task of addressing the legacies—heavy public debt burdens, weaker growth potential, high unemployment, and latent financial vulnerabilities. The added complication of intensifying cross-border and intersectoral ties makes it increasingly necessary to look beyond simple policy solutions.

27. The Fund has been an active player in this debate and has adapted its policy advice (Box 3). Multilateral surveillance and policy research have been instrumental in reorienting policy frameworks, particularly in the areas of fiscal policy, capital flow management and macroprudential policies. Although this work has progressed at different rates, Fund-wide efforts have helped new thinking gain ground and better supported bilateral policy advice. While the Fund’s stakeholders have recognized this shift, staying relevant is a moving target and differs from country to country.

Taking the Macroprudential Policy Plunge

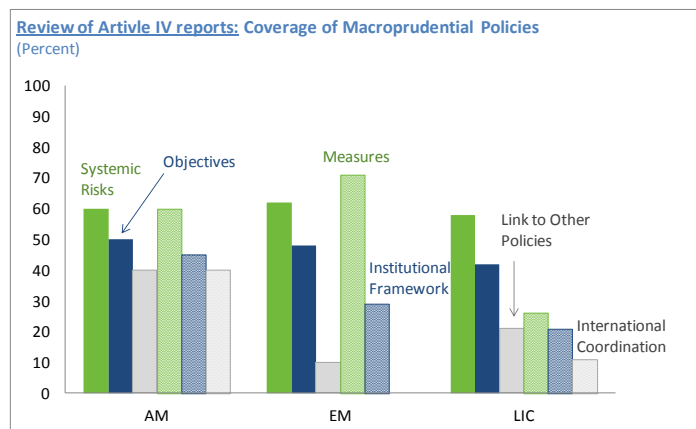
28. Macroprudential policies have gained prominence as a vehicle to help ensure financial stability, plugging an important gap in the policy toolkit. The centrality of macro-financial fault lines during the crisis underscored the potentially macroeconomically destabilizing costs of system-wide financial risks. Coupled with the recognition that monetary and fiscal policies are not always the best instruments through which to preserve financial stability, policymakers are making progress in developing macroprudential measures to promote resilience to financial system risks.

“The Fund’s focus should be on macroprudential policy as a means of guarding against major threats to stability rather than as a tool for trying to fine-tune the credit cycle.”

Li & Tucker

29. This promises to be a critical step forward for the Fund’s oversight of global stability. The use of, and advice on, macroprudential policy in advanced and emerging market economies with systemic financial sectors can help guard against threats to global stability. Macroprudential policies can be deployed in response to both internally generated and external threats to stability, and thus can be a useful tool in all economies. However, the Fund’s thinking on macroprudential policies—when and how to deploy them and their interactions with other policies—is still evolving.

30. The Fund’s evolving thinking on macroprudential policy is not yet well embedded in bilateral surveillance. This is the case even for advanced and emerging market economies. The discussion of macroprudential policies is also not linked to other policies and the wider macroeconomic implications. At the same time, the differing coverage across income groups suggests that there is already some country tailoring. To help move this forward,



Box 3. The IMF's Policy Compass

The global economic and financial crisis raised fundamental questions about macroeconomic policy. The Fund has played a role in fostering the global debate amongst policymakers and academics to reassess principles and policy frameworks.^{1/}

At the same time, it has needed to adjust its advice in real time, as the global economy and member countries have moved through uncharted territory. There is still some way to go before reaching consensus, but important theoretical and empirical progress has been made and new policy frameworks are emerging. The major areas of debate and their implications for the Fund's "policy compass" are as follows:

Fiscal policy^{2/}

Before the crisis, there was broad agreement that fiscal policy had a limited role as a short-term stabilization tool, reflecting inconclusive evidence regarding the sign and magnitude of fiscal multipliers, and lags in policy design and implementation.

However, almost all advanced economies deployed some fiscal stimulus during the crisis, demonstrating the growing sense that fiscal policy is an appropriate countercyclical tool when faced with a severe downturn, limited monetary policy space and poorly functioning credit channels. Subsequent research suggests that fiscal multipliers can be much larger in these conditions. Given high sovereign debt levels and protracted low growth, this has spurred an intense debate about the optimal pace of fiscal adjustment. More broadly, the enormity of the shock to advanced economies, particularly via sovereign-bank feedback loops, has prompted a reassessment of what constitutes a "safe" level of debt.

Fund advice has evolved with these changing economic conditions and emerging evidence (Figure 2). In the depths of the crisis, it called for coordinated and front-loaded fiscal stimulus, with clear plans for normalizing in the medium-term. With signs of economic recovery, the Fund pivoted to focus on exit and medium-term consolidation. Although the Fund cautioned against abrupt front-loaded tightening to avoid stalling the recovery, in retrospect the shift back to consolidation may, in some cases, have come too soon. In general, advice has become more pragmatic and flexible, better balancing short and long-term considerations. There is more attention on the pace and composition of adjustment (including the implications for sustainability, growth, efficiency and equity) and a renewed focus on the design of institutional frameworks to underpin effective policies.

Monetary policy^{3/}

The crisis challenged the notion that price stability alone is sufficient for macroeconomic stability. It demonstrated that dangerous imbalances can develop even under conditions of low inflation and stable output gaps. The advanced economy policy response also marked a departure from traditional thinking. With short-term interest rates at the zero lower bound, central banks moved beyond the one-target-one-instrument approach, relying instead on unconventional monetary policies (UMP) to restore the functioning of financial markets and support economic activity.

The Fund has analyzed unconventional monetary policies in depth –from definitions to mapping transmission channels and estimating their impact. Analysis and advice has generally been supportive of UMP in a number of advanced markets, recognizing that they have so far been beneficial on net for UMP countries and on a global basis. However, the Fund has increasingly focused on the risks and adverse spillovers associated with UMP and "exit". In the context of risks to domestic and global stability, the Fund also embraced the case for a new financial stability lever to deal with asset-price and credit bubbles (see macroprudential policy).

The Fund is heavily involved in global discussions on the future shape of monetary policy—the post-crisis "new normal". Key issues include how to reduce the likelihood of hitting the zero lower bound and whether there are merits in using unconventional tools during normal times. It is likely to be some time before the debate on these issues is settled.

Box 3. The IMF's Policy Compass (concluded)

Macprudential policy^{4/}

The crisis revealed a glaring gap in the policy toolkit. The traditional mix of macroeconomic policies and microprudential measures aimed at individual financial institutions could not identify and address systemic financial risks. Advanced and emerging economies alike have responded by rapidly developing and deploying macroprudential policy as a new lever to curb systemic financial risks. While it is still early days, policymakers are rapidly gaining experience.

The Fund has synthesized lessons from international experience and staff research to develop an institutional framework for macroprudential policy. The Fund's preliminary thinking so far covers: the definition and scope of the policy; the measurement of systemic risk; interactions with other macroeconomic and financial policies; operational and institutional arrangements; and multilateral perspectives.

Nevertheless, the thinking and practice in this area is a work in progress. Although a number of emerging market economies were using these policies before the crisis, evidence on their effectiveness is mixed, and we are some way from knowing how to measure and use them reliably. More research and analysis needed on the costs and benefits^{4/} of macroprudential policy, as well as to understand its interaction with other macroeconomic and financial policies. This is particularly true of the relative roles and effects of macroprudential and monetary policies, and how they coordinate. There is also little consensus on questions of institutional governance.

Capital flows^{5/}

Capital flows to emerging economies accelerated following the crisis, reflecting a combination of push-pull factors, including their improved fundamentals and growth prospects, as well as balance sheet vulnerabilities and loose monetary policies in advanced economies. Some responded by complementing macroeconomic policies with capital flow management and prudential measures. These realities on the ground forced a reexamination of traditional policy prescriptions for the liberalization and management of capital flows.

The IMF responded by developing a new institutional view that explains the policy trade-offs between the benefits of capital mobility and the risks, including sudden capital flow reversals and the associated sharp currency depreciation and balance sheet dislocations.

The institutional view clarifies that liberalization needs to be well-planned, timed and sequenced and that it is not necessarily an appropriate goal for all countries at all times. It also recognizes that capital flow management measures, while not a substitute for warranted macroeconomic adjustment, can be useful in certain circumstances. The main challenge ahead is to understand how to combine the various policies. Lastly, it notes that policymakers in all countries, including those that generate large flows, need to take account of how their policies affect global economic and financial stability.

^{1/} For example, [Rethinking Macroeconomic Policy I](#) (February 2010) and [Rethinking Macroeconomic Policy II](#) (April 2013).

^{2/} For example, [Reassessing the Role and Modalities of Fiscal Policies in Advanced Economies](#) (September 2013).

^{3/} For example, [Global Impact and Challenges of Unconventional Monetary Policies](#) (September 2013).

^{4/} For example, [Key Aspects of Macroprudential Policy](#) (June 2013).

^{5/} For example, [Institutional View on the Liberalization and Management of Capital Flows](#) (November 2012).

the Fund is developing operational guidance, building on analytical work so far. The Fund will also need to position itself to offer more expert support to strengthen practices, regimes and institutions.

Fiscal Policy Advice through a New Lens

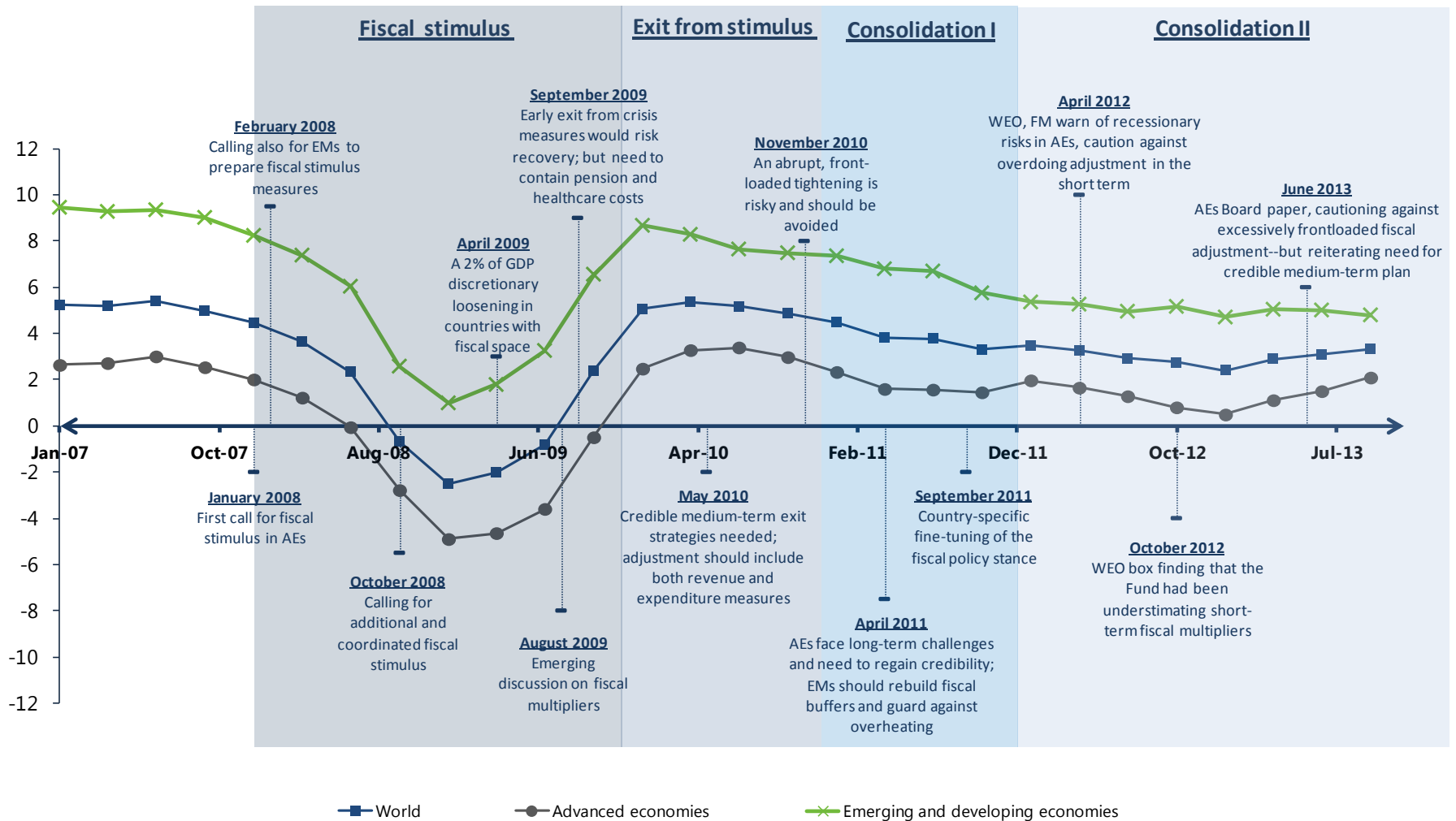
31. Fiscal policy advice is still the ‘bread and butter’ of surveillance. Country authorities continue to see the greatest value-added from the Fund’s work on fiscal developments and policy. Stakeholders also see the Fund’s propensity to recommend more gradual fiscal adjustment attuned to the pace of the recovery and financing constraints—a factor also borne out in recent Article IV reports—as a positive development.

32. Reflecting the early lessons of the crisis, the Fund’s fiscal advice now better accounts for the growth and sustainability implications. Fund-wide analysis and policy messages have been important in guiding this more nuanced approach (Box 3 and Figure 3), with a corresponding shift in bilateral surveillance. Fiscal policy advice generally had a stronger cyclical component, particularly early in the crisis, and was grounded in structural balances where feasible. There has also been more attention paid to the pace of adjustment and composition of measures. At the same time, a surprising number of reports do not clearly identify or quantify a country-specific medium-term anchor for fiscal policy.

33. With many countries facing an extended period of low growth and high debt, the Fund’s fiscal policy advice will need to continue this balancing act. Staff’s background study on the *Review of Fiscal Policy Advice* sets out a number of options that could help reinforce this approach. Fund-wide analytical work would strengthen the basis for estimating structural balances providing well-grounded advice on expenditure measures. A clear, well-justified—and country-specific—anchor⁷ could help articulate more concretely how fiscal advice reflects both short-term cyclical and medium-term sustainability objectives. Continued progress toward a more comprehensive assessment of fiscal risks, including contingent liabilities, intersectoral risks, and long-term challenges, would further enrich fiscal advice. To support this, the Fund’s standards and codes provide the basis for strengthening public balance sheet analysis over time.

⁷ A fiscal anchor could be specified either in terms of levels (e.g., fiscal balance, debt stock) or changes (e.g., a recommended amount of adjustment).

Figure 3. Timeline of IMF Fiscal Policy Pronouncements Mapped Against Global GDP Growth by Income Group
(Year-on-year percentage change)



Source: IMF staff

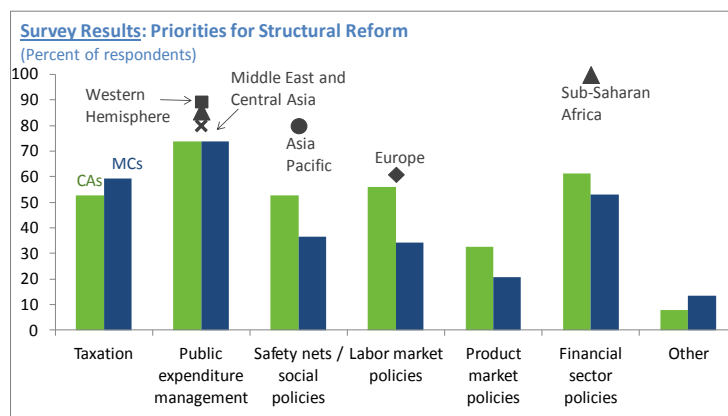
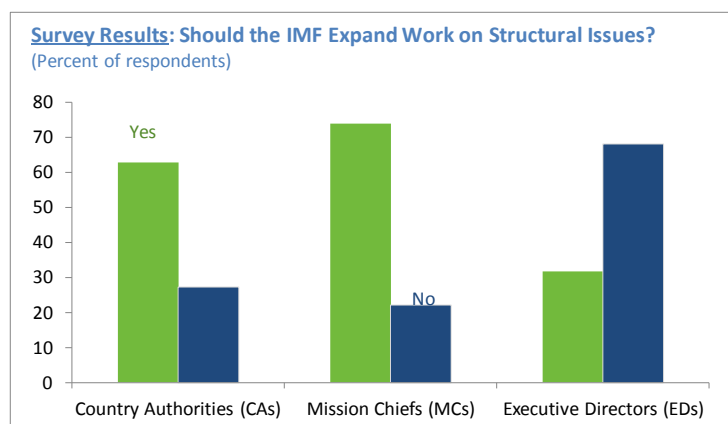
The Possibility Frontier for Structural Policies

34. Views are deeply divided on the Fund’s role on structural issues. While country

authorities would like to see the Fund engage more in structural issues, Executive Directors seem to be more skeptical. Opinions also differ on the types of structural policies on which the Fund should focus, largely reflecting country circumstances. For example, labor market and fiscal reforms top the list of priorities for advanced economies that need to boost growth and restore sustainability, whereas public expenditure management and financial deepening are priorities for LICs.⁸

35. To help countries ensure stability and sustain growth, the Fund will inevitably need to grapple with structural issues. Even on a relatively narrow interpretation of the Fund’s core responsibility for safeguarding macroeconomic stability, many structural policies are relevant. And, in a

climate where generating more durable, job-rich and inclusive growth is at the top of the policy agenda, particularly in LICs,⁹ structural issues are an increasingly central element of the macro-toolkit. The question is which issues and to what extent. The external study on *Structural Policies in Fund Surveillance* suggests that the Fund should cautiously take on some new areas based on the following three criteria: macro-criticality; underemphasis by others, and reasonable proximity to Fund expertise. While staff sees merit in establishing principles, it has reservations about the ‘underemphasis’ criterion. This could, for instance, imply the Fund withdrawing from areas of core competence (e.g., public expenditure management, which is also covered by others). Moreover, using these criteria, the study recommends focusing on areas such as utility regulation and rent seeking, while the Fund currently has little expertise beyond the fiscal and financial aspects of rent-seeking.

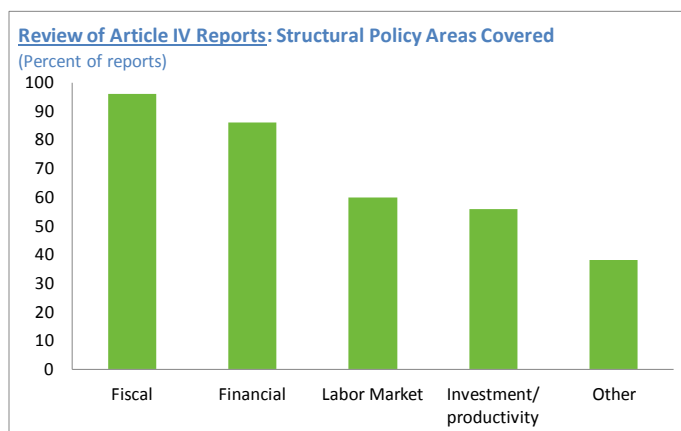


“...five specific structural policies that would be appropriate for enhanced Fund surveillance: curtailment of rent-seeking; reform of public sector accounting; utility regulation; tax reform; and pension reform.”
Acquah, Ahearne & Collier

⁸ The staff background study on [Scope of Surveillance in Low-Income Countries](#) also makes a case for the Fund to provide advice on the taxation of natural resource revenues.

⁹ See the staff background study on [Scope of Surveillance in Low-Income Countries](#).

36. Fund surveillance already covers a wide range of structural issues, albeit in varying degree. Most often this focuses on fiscal and financial reforms in the Fund’s traditional areas of expertise. However, these are followed closely by labor market reforms, and to a less extent by structural issues related to investment and productivity (e.g., infrastructure investment or regulatory frameworks), reflecting the importance of these issues in many countries. Surveillance of these latter two areas does not always contain the same depth of analysis and knowledge, which may reflect lack of expertise or engagement with other agencies.



37. Establishing clearer principles for engagement would help avoid an ad-hoc focus on structural issues. Principles or ‘filters’ could also help delineate the depth of the Fund’s involvement, namely when and when not to offer specific policy advice.

- **Macro-critical:** The first filter should continue to be macro-criticality.¹⁰ Given the Fund’s mandate, surveillance should always identify all macro-critical structural issues that need to be addressed and discuss their macroeconomic implications. Yet, the Fund need not be the expert advisor in all areas. This single filter could imply a massive expansion of the Fund’s advice on specific structural issues, some of which fall beyond its expertise. Thus, macro-criticality is a necessary but not sufficient condition for determining when the Fund’s involvement should go beyond acknowledging the macroeconomic implications to providing detailed policy advice.
- **In-house expertise:** In core areas where the Fund has in-house expertise (i.e., fiscal and financial reforms), surveillance should leverage as much as possible the technical assistance it provides and its cross-country institutional knowledge of policy experiences. Where the Fund does not have expertise, this filter should help gauge if it will borrow or build expertise.
 - Where other agencies have expertise, the Fund should typically ‘borrow’ expertise to inform its surveillance through building stronger partnerships, rather than ‘reinventing the wheel’. This could follow the model for collaboration between the Fund and World Bank.¹¹

¹⁰ The ISD already requires that macroeconomically relevant structural aspects of monetary, fiscal and financial sector policies always be subject of bilateral surveillance.

¹¹ There is a well established framework for collaboration between the Fund and the World Bank. As laid out in the 1989 IMF-World Bank Concordat and the 2007 Joint Management Action Plan on Bank-Fund Collaboration, this collaboration follows a lead-agency model. The model provides that the Fund has the primary responsibility to provide short-term macroeconomic analysis and related policy advice, while the Bank has the primary responsibility to advise on development strategies, sectoral policies, public expenditure priorities, and poverty reduction. In addition, there are areas of shared responsibility, for example, in public financial management.

- However, where a ‘critical mass’ of member countries have a macroeconomic interest, as seems to be the case with financial deepening and labor market reforms, there would be merit in building further staff expertise. This could help supplement, rather than supplant, the dialogue with other agencies. In other words, where available, staff should continue to leverage other expertise at an individual country level.

Recommendations

- **Strengthen surveillance of macroprudential policies** as a complement to other macroeconomic policies in advanced countries and integrated emerging markets.
- **Continue accounting for growth and sustainability implications in fiscal advice.** Undertake institutional analysis to strengthen the basis for structural fiscal balances; present fiscal advice in terms of a clear and well-justified anchor.
- **Be selective in advising on structural policies.** Recognize all macro-critical structural issues and their implications on an economy; follow principles to determine where to provide advice: macro-criticality, and Fund expertise or interest from ‘critical mass’ of the membership (e.g., financial deepening and labor market issues); in other areas, leverage advice from other international organizations.

B. Beyond Ordinary: Value-Added Policy Advice

38. Value-added surveillance requires more than top-notch analysis in discrete policy areas. This is particularly true given the complexities of today’s global economy and the emergence of new policy challenges. Country authorities are looking to the Fund to provide more concrete and actionable advice, based on cross-country and expert knowledge, with greater attention to on-the-ground conditions. This requires policy analysis and advice that is formulated—and communicated—in a cohesive way paying attention to the interconnections between countries and sectors, and the interactions between policies.

Putting the ‘Policy Advice’ Puzzle Together

39. For newer policy tools, it will take time to understand fully their practical application and interactions with other policies. For instance, we still have relatively limited experience with and knowledge of the effectiveness of macroprudential policies, the interactions between the various tools, or their interactions with monetary and microprudential policies.

40. In areas where the depth of analysis is improving, this could be used more effectively to guide policy advice. There has been considerable progress over the past years to strengthen the analytical underpinnings for surveillance, including on risk and spillover analysis, external sector assessments, and financial stability analysis. Yet, this analysis still tends to be confined within each sector and is not fully used to inform policy advice. For example, risk analysis is not used extensively in policy advice (either to prevent risks materializing or mitigate their impact) in as many as half of the Article IV reports reviewed for the TSR. As noted earlier, reports for EBA countries also do not yet effectively use the resulting policy gaps in providing policy advice.

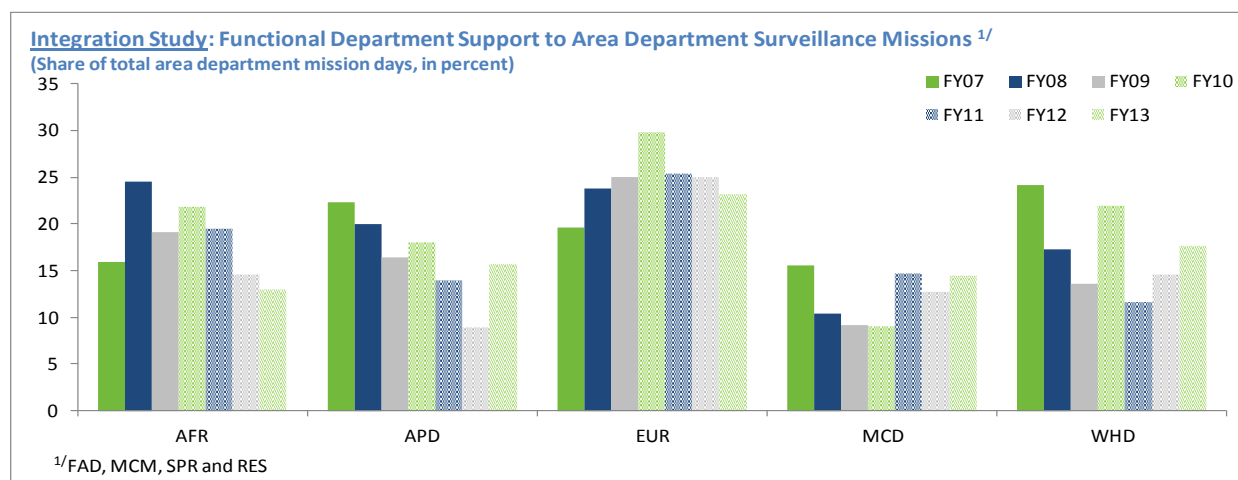
41. More broadly, surveillance could do a better job of providing a ‘whole of economy’ picture of the policy mix or policy interactions. Staff reports do not often analyze the underlying policy interactions in much depth, except in the more traditional area of fiscal-monetary. In this regard, around half the reports sampled for this TSR did not include an in-depth discussion of the policy mix and as many as one third of reports did not discuss it at all. This may in part reflect the traditional formulation of Article IV reports along sectoral lines, which may not be the most conducive to thinking in an interactive way. The external study on *Integrating Bilateral and Multilateral Surveillance on a Continuing Basis* raises similar issues.

“...given that the initial impulse of Abenomics was a large depreciation in the yen, should the Fund have placed even greater emphasis on “third arrow” structural reforms?”
Rogoff

42. The critical issue will be to digest and pull together analysis in a way that delivers a cohesive package of policy advice. Surveillance need not cover all bases in all countries, but should draw out the interactions between policies. More broadly, attention to intersectoral linkages will serve as a diagnostic for the overall mix of policies. The driving principle should be to ensure that the whole is more than the sum of the parts. Article IV reports that are structured around economic goals or themes, rather than sector-by-sector, may help do this more effectively. In systemic countries, a more cohesive approach would also help identify alternative policy combinations that may mitigate adverse spillovers.

Better Leveraging Expert Analysis and Advice

43. Countries are increasingly looking to the Fund for expert advice. Many member countries are looking to the Fund for advice and guidance in embryonic policy areas. At the same time, as countries build their own institutional capacity, they have less need for the Fund’s general macroeconomic advice. In contrast, the participation of experts in bilateral surveillance to some regions has diminished in recent years, and the profile of staff teams is now tilted more towards macroeconomists who typically do not have specialty knowledge.

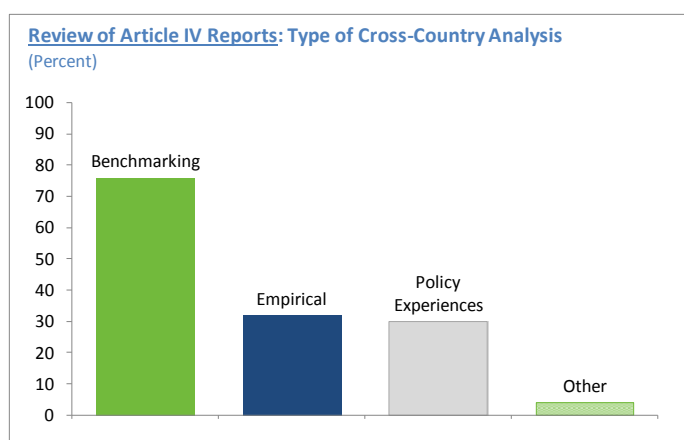


44. The Fund can better leverage its significant in-house expertise for surveillance.

Currently capacity development represents around one quarter of the Fund’s activities. Country authorities who have used Fund technical assistance (TA) feel that subsequent advice in Article IV consultations has been more persuasive. This is reflected in the experience of the Fund’s top ten users of TA. This is also particularly relevant for LICs, where the Fund deploys significant resources to strengthen institutional capacity. To take full advantage of this, surveillance could also better inform TA priorities, where practices in Africa and the Middle East are leading the way.

45. The Fund’s cross-country policy knowledge offers a vast pool of ready-made expert advice.

Countries see cross-country experience on practical policy issues as a main value-added to Fund surveillance. Despite long-standing interest, they feel that this remains an untapped resource that is not leveraged effectively in policy advice. While most Article IV reports include some cross-country analysis, this most often includes benchmarking against common indicators for peer countries. There is much less use of in-depth analysis of policy experiences. Drawing more systematically on cross-country policy insights—as suggested in the staff background study on *Integrated*



Surveillance—could both add depth to country-specific policy advice and ensure greater consistency of policy advice across countries. A good example is the cross-departmental work that is underway on natural resource management, which provides the basis for embedding this practice Fund-wide. Achieving a sea change in this regard will require more concerted efforts through better knowledge management, adequate incentives, and enhanced interdepartmental collaboration.

46. Of course, none of this is to say that the Fund should rely solely on developing its own expertise, particularly when strong expertise exists in other agencies.

In a budget-neutral environment and with the gamut of potentially macro-critical structural policies expanding, it will be essential for the Fund to build more effective partnerships with other organizations. While countries’ expert needs may vary, having in place broader institutional mechanisms for collaboration would help engage with other technical partners and embed that expertise within Fund surveillance. This could include working more closely with the ILO, OECD or World Bank on labor market issues and other structural policies (e.g., via cross-agency task forces on specific issues).

Recommendations:

- **Provide more cohesive policy advice in Article IVs** either by discussing the policy mix explicitly or structuring Article IVs reports around economic goals or themes to better capture policy interactions.
- **Better leverage expert analysis and advice.** Concerted efforts to draw on cross-country policy experiences; strengthen TA integration in surveillance; enhance collaboration with other organizations in specific areas.

ACHIEVING GREATER IMPACT

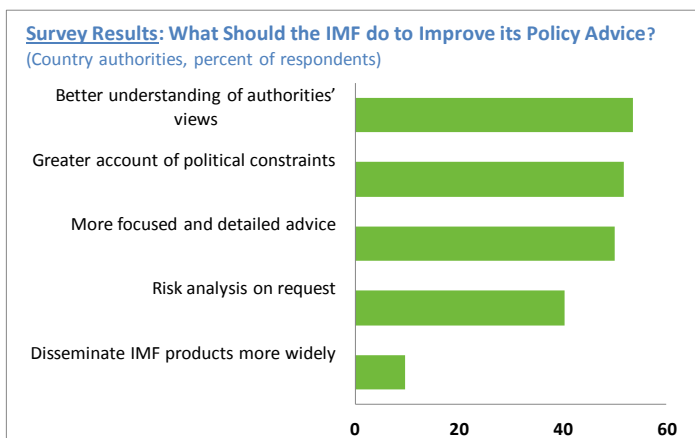
Analytical improvements alone will not be enough to enhance the effectiveness of surveillance. Achieving greater impact also requires a more client-focused approach based on deeper dialogue and clear and candid communication. Effective surveillance also hinges on the legitimacy of advice, underscoring the importance of evenhandedness in an interconnected world where countries often have a stake in advice to other countries. In a similar vein, a strong role for the Fund in supporting global cooperation is essential if surveillance is ultimately to translate into better global outcomes.

A. Two-Way Candid and Clear Communication

47. Communication has long been recognized as an essential ingredient for effective Fund surveillance. However, it has traditionally been framed in narrow terms of how the Fund conveys its messages to its members and other key stakeholders, rather than as a two-way dialogue. External experts suggest that the Fund should consider the broader role of communication throughout the whole surveillance process, including the importance of a candid policy dialogue to understand members' views, needs and concerns, and to deliver clear policy advice.

Strengthen the Policy Dialogue

48. Fund engagement with members has improved. A large share of the membership sees the Fund as their key external advisor on macro-policy decisions, noting a recent improvement in the policy dialogue. In general, country authorities feel that the Fund has become a more collaborative institution. Staff is credited with being more open and responsive to country needs, helping to build trust and increase the relevance of bilateral advice. Members also feel that the Fund has become less dogmatic, pointing to the evolution of policy advice at the institutional level. These messages were also emphasized in the recently updated *Fund Communication Strategy*.¹²



49. However, there is room to build stronger long-term relationships with member countries. Country authorities emphasize that the Fund needs to work harder to listen to their views, particularly their constraints, and requests for specific analysis and advice. The External Advisory Group suggests a fundamental shift towards more “client-focused” surveillance, with “communication at the start and not the end of the surveillance process.” Earlier engagement and more informal discussions are key ways to achieve this and ensure that surveillance is as relevant as

¹² [Review of the IMF's Communication Strategy](#) (August 2014).

possible. The report by the Independent Evaluation Office on the *Role of the IMF as Trusted Advisor* also highlights this point and country authorities' interest in using the Fund as an informal "sounding board" on policy options.¹³ More regular feedback from countries would allow the Fund to keep track of the quality of the policy dialogue and overall engagement. Country authorities appreciate that Article IV reports include follow-up on implementation of past policy advice, and would value an expanded two-way accountability tool that also reports on changes in Fund advice.

Deliver Candid Advice

50. The Fund should not shy away from delivering difficult messages. Balancing the roles of "trusted advisor" and "ruthless truth-teller" is a perennial challenge for the Fund. Listening to members and improving the policy dialogue does not mean that the Fund should be in the business of telling them what they want to hear. Rather, enhanced engagement should build trust and stronger relationships that will improve the influence of surveillance, making it less difficult to convey challenging messages, both privately and publically. Moreover, integrated surveillance means that listening to, and understanding, the needs and concerns of a particular member should feed into surveillance of the wider membership.

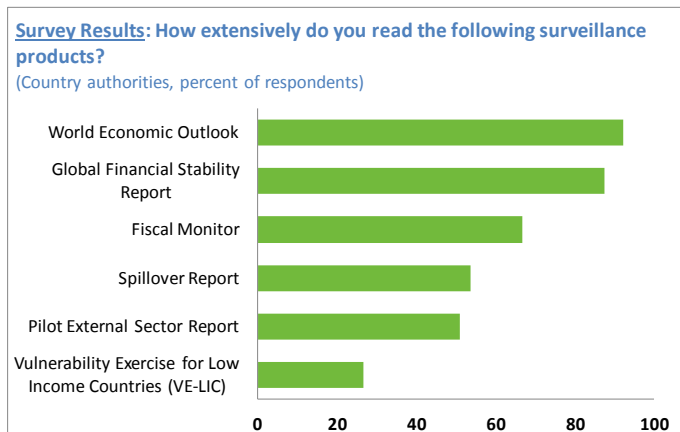
"The Fund should be more relaxed about covering in publications those tail events which participants in international financial markets and commentators are already talking about."
Li & Tucker

51. Evidence suggests that Fund surveillance needs to be more candid, particularly for systemic economies. Although more forceful language in reports generally reflects the depth of economic difficulties faced by countries, the background studies found some evidence that the candor of messages for larger economies does not always reflect their systemic implications. For instance, key messages, including on spillovers, are sometimes buried deep in reports. External studies and interviews suggest that this may reflect additional internal pressure and scrutiny associated with surveillance of systemic economies. Therefore, the Fund needs to ensure that the candor of surveillance for systemic economies, particularly on risks and spillovers, is beyond doubt.

"... sometimes key issues are somewhat buried deep in reports... or in less prominent publications, thereby having the effect of downplaying them."
Rogoff

Convey Clear and Coherent Messages

52. The Fund's multilateral surveillance products are highly valued. Surveys and interviews with country authorities and market observers indicate that the flagships have established



¹³ See IMF Independent Evaluation Office, [The Role of the IMF as a Trusted Advisor](#), (2013).

audiences and are held in very high regard. Opinions on the newer products like the Spillover Report and Pilot ESR are more mixed—in part because they are still building their reader bases—but their *raison d'être* has broad support.

53. The expanded suite of multilateral products presents significant communication challenges. Stakeholders find it difficult to digest and absorb the key messages, a finding echoed by external experts. Although messaging across products is broadly consistent, the sheer volume of reports is “overloading” the “bandwidth” of policymakers. Feedback also suggests that technical language used in Fund reports continues to inhibit understanding, even for the more technically proficient audience. Two of the external studies—on *Multilateral Surveillance* and on *Integrating Bilateral and Multilateral Surveillance on a Continuing Basis*—see streamlining as an option to address this. However, the external study on *Risks and Spillovers* argues for preserving a standalone Spillover Report.

54. On balance, staff believes it would be premature to consider merging products. The Pilot ESR and Spillover Report serve an important role in placing stronger emphasis on the institution’s work and focus on interconnections. Moreover, the underlying processes are facilitating more integrated surveillance and interdepartmental collaboration. There is also an operational constraint. The analysis and preparation of these products is timed to inform and be informed by the Article IV consultations of large systemic economies. Any realignment in the schedules (e.g., aligning them with the WEO and GFSR timetables) risks losing important synergies. Over time, and once these products have matured and more become firmly embedded in bilateral surveillance, the Fund could reconsider a broader streamlining of multilateral surveillance products.

55. Nevertheless, there is still significant scope to streamline key surveillance messages. In this regard, a single product is needed to synthesize the key surveillance messages into a consistent and coherent whole. While the Global Policy Agenda (GPA) already goes some way toward serving this role, it could do so more effectively by adding a dedicated section that succinctly pulls together the surveillance messages from the full range of products. At the same time, to further enhance consistency, the messages from the Spillover Report and Pilot ESR should be reflected substantively in the WEO and GFSR. This should be complemented with more targeted outreach to relevant officials to ensure that they are better equipped to digest and absorb Fund products and their underlying analyses.

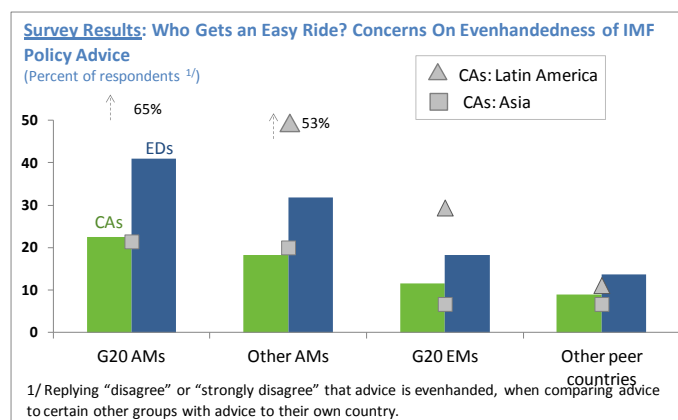
“The proliferation of [multilateral] reports raises important communication challenges.”
Rogoff

Recommendations:

- **Strengthen the policy dialogue.** Expand “follow-up” on past policy advice beyond implementation to include a reporting on changes in Fund advice; monitor the quality of engagement and policy dialogue through targeted periodic surveys.
- **Ensure clear and candid surveillance messages,** particularly on spillovers from systemic economies; integrate key messages from the Spillover Report and the Pilot ESR into the WEO and GFSR; synthesize key Fund policy messages in the GPA; undertake more targeted communications with relevant stakeholders on the underlying analysis.

B. Evenhandedness

56. Evenhandedness is a cornerstone of a cooperative institution like the Fund. Effective surveillance relies on the legitimacy and credibility of analysis and advice, both of which can be undermined by an actual or perceived lack of evenhandedness. The consistency or fairness of surveillance will likely be scrutinized even more in an interconnected world. Where the fates of members are intertwined, the scale and impact of spillovers mean that systemic and non-systemic economies alike have a larger stake in the surveillance of others.



57. Evenhandedness continues to be a source of concern for some parts of the membership. A significant minority of members believe the Fund is not evenhanded in its advice, particularly with respect to the treatment of large advanced economies. The external study on *Evenhandedness of Fund Surveillance* finds little evidence that surveillance is systematically biased, although there are instances of differences. These alone may not be evidence of actual lack of evenhandedness, but they can reinforce entrenched perceptions.

58. The lack of clarity on what is meant by “evenhandedness” remains a key impediment to tackling the issue. Most concerns about evenhandedness are framed in terms of the “outputs” of surveillance, particularly the policy advice and the way it is presented. However, differences in output are not necessarily evidence of a lack of evenhandedness; in fact, they should differ if surveillance is tailored to country circumstances. The external study suggests that it would be more appropriate to assess evenhandedness on the way surveillance is conducted—effectively the “inputs” to surveillance (Box 4). That is not to say the “outcomes” of surveillance are not relevant to evenhandedness. To the contrary, assessing the “inputs” would help provide an objective basis on which to assess whether different “outputs” are appropriately calibrated to country circumstances.

Box 4: An Input-Based Approach to Evenhandedness

The external study on *Evenhandedness of Fund Surveillance* proposes a new approach to assessing evenhandedness based on the “inputs” or the way surveillance is conducted, rather than simply the “outcomes” from surveillance.

Inputs to surveillance should be based on the principle of “uniformity of treatment.” These include:

- *Resources:* Decisions on the number and experience of staff working on surveillance should be well founded and free of bias. The number and experience of staff working on each country could vary depending on the issues to be covered (needs-based approach) and judgments about the risk level of a country or its systemic importance.
- *Depth of analysis:* Each country would receive the same sound, objective, analytical input into every decision taken regarding the conduct of surveillance and the policy advice provided.

59. Establishing a clearer understanding of how to gauge the “evenhandedness of Fund surveillance” would be an important step forward in tackling the problem. This could provide a benchmark against which to assess and address concerns transparently. Evenhandedness is embedded in the Fund’s principle of uniformity of treatment. Respecting this principle does not imply a one-size fits all approach to surveillance. Instead, decisions about surveillance “inputs” should be well founded and free of bias. They should also reflect the need for the Fund to take a wider risk-management approach. For example, the allocation of resources and expertise, or the choice of analytical tools should be based on judgments about domestic and systemic risks. By establishing that decisions should reflect the need for equal risk-adjusted inputs to surveillance, the Fund and its members could have a clearer barometer to gauge whether surveillance lacks evenhandedness. To this end, the Fund should establish a mechanism for country authorities to report concerns (either unequal inputs or unjustified differences in output), and deal with identified issues transparently.

“All decisions in the surveillance process should be free from bias, and based on sound, robust and objective considerations.” Callaghan

Recommendations:

- Establish a clearer understanding of how to gauge “evenhandedness of surveillance” by using equal risk-adjusted ‘inputs’ to bilateral surveillance (in keeping with the Fund’s principle of uniformity of treatment), where ‘inputs’ are calibrated to country circumstances based on domestic and cross-country risks.
- Establish a mechanism for country authorities to report concerns, and deal with identified issues transparently.

C. Global Cooperation

60. For surveillance to be effective, it needs to have an impact across countries. Given the depth and range of connections among countries, even effective, well-communicated and evenhanded analysis may not be enough to deliver better global outcomes. Effective, risk-based surveillance on a global scale means the Fund increasingly needs to generate multilateral traction that influences and persuades policymakers across multiple countries.

61. There is a growing sense that cooperation is even more important today, yet it may be harder to achieve. The benefits of cooperation are less apparent during the “good times” than during the “bad times”. With policymakers less focused on crisis management, the challenge is now to move their attention to mitigating adverse spillovers. Moreover, they are accountable to domestic constituencies for their policy actions.

62. For surveillance to deliver global stability, the Fund should play a central role in fostering global cooperation. This is not a new issue for the Fund—cooperation is the *raison d’être* of the institution. At a minimum, the Fund needs to encourage global policymakers to work together and be more conscious of the spillovers of their policies. The ISD allows the Fund to hold, and be part of, the conversation between members. Through its support to the G-20 Mutual Assessment Process (MAP), the Fund has also found an additional channel to use its analysis and advice to facilitate and influence global policy discussions.

63. However, questions remain about whether the Fund’s role needs to be strengthened.

- The ISD can only take the Fund so far without a formal obligation for members to take account of spillovers to other countries, and the world as a whole, when formulating their own policies. Furthermore, as the background studies suggest, there are signs that confidence in the G-20 MAP, and cooperation more generally, have declined in recent years.
- The external study on *Multilateral Surveillance: Ensuring a Focus on Key Risks to Global Stability* encourages the Fund to explore whether changes to its structures and mandate could be made as a clear commitment on the part of Fund members to support a more cooperative approach to global growth and risk management.

“In the medium-term, a strong case can be made for giving the Fund an explicit capital account remit.” Knight & Ortiz

Recommendation:

- Appoint an expert group to explore how to strengthen the Fund’s role in global cooperation, including the adequacy of its mandate for ensuring global economic and financial stability.

OTHER ISSUES

A. Surveillance Review Cycle

64. Moving to a longer cycle would allow for a comprehensive, but cost-effective, surveillance review. Embedding reforms to Fund surveillance, and reflecting on experience with their implementation, takes time. At the same time, it is important that the Fund periodically takes a ‘step back’ to assess surveillance more holistically, particularly given the evolving nature of the global economy, member countries and their macroeconomic policy priorities. A longer surveillance review cycle could better serve both objectives. Accordingly, staff recommends moving to a five year cycle for a comprehensive review of surveillance (a quinquennial or five-yearly surveillance review), in line with the standard five-year cycle of policy papers. However, this would be complemented by a smaller scale interim report after 2½-3 years that would assess implementation, identify any emerging pressure points, and help shape the subsequent review.

B. Resource Implications

65. Taken together, the recommendations of this review would not be budget neutral. Most recommendations require changing the way surveillance is conducted and thus could be implemented within the existing budget envelope. Nevertheless, some proposals will require additional resources, particularly if the Fund were to: revive national balance sheet analysis; mainstream macro-financial surveillance; make progress on cross-country policy experiences; and cover labor market issues in more depth. Following the Board discussion, staff will follow up on those recommendations endorsed by Directors and present fully-costed proposals in the context of budget discussions.

C. Operational Priorities for 2014–19

66. To ensure that Fund surveillance supports sustainable growth in a post-crisis interconnected world, staff proposes the following operational priorities for 2014–19:

Risks and Spillovers. Integrate bilateral and multilateral surveillance, include alternative risk scenarios in Article IV consultations as relevant, and revive national balance sheet analyses.

Macro-Financial Surveillance. Make macro-financial analysis an integral part of Article IVs, and step up advice on macro-prudential policy to address financial risks, particularly in integrated economies.

Structural Policy Advice. Recognize all macro-critical structural issues and their macroeconomic implications; and follow principles for advice: macro-criticality, and Fund expertise or interest in a ‘critical mass’ of the membership.

Cohesive and expert policy advice. Move towards thematic Article IV staff reports, build advice on cross-country policy experiences, strengthen TA integration in surveillance, and enhance collaboration with other international organizations in specific areas.

Client-focused approach. Monitor engagement; and expand the coverage of follow-up on past policy advice in Article IV staff reports.

ISSUES FOR DISCUSSION

67. We would welcome Directors’ views on the following questions:

- Do Directors agree with the main findings and key themes emerging from this TSR?
- Do Directors endorse the operational priorities set out in this report?
- Do Directors consider that the specific recommendations would effectively support 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 in some areas of surveillance and, if so, which ones?
- Do Directors agree to extend the cycle of the surveillance review to five years, complemented by an interim assessment of implementation?

Annex. 2014 TSR Recommendations

Further Integrating Risk and Spillover Analysis:

- **Continue integration of bilateral and multilateral surveillance.** Bridge remaining gaps through REOs and cluster reports. Strengthen ISD implementation, with more systematic analysis of outward spillovers and spillbacks in systemic countries; greater quantification of the impact of spillovers on recipient countries, drawing on global risk scenarios; and discussion of policy implications.
- **Strengthen external sector assessment.** Gradually replace CGER with EBA for a broader set of countries, subject to data availability. Undertake a comprehensive assessment of the external position using a broader set of indicators than just the exchange rate. In countries where the EBA methodology is applied, discuss the contribution of domestic policies to external imbalances, and use these results in relevant policy discussions.

Deepening Risk and Spillover Analysis:

- **Integrated analysis of risks and spillovers** to understand how vulnerable a country is to shocks and how they will be transmitted. Revive and modernize the balance sheet analyses; develop a GFF; and extend external debt sustainability analyses to cover external flows.
- **Mainstream macro-financial surveillance.** This could be achieved through better tools and new practices, as well as a shift in the profile of Fund economists.
- **Address data gaps.** Implement the G-20 Data Gap Initiative.

More Tailored Policy Advice:

- **Strengthen surveillance of macroprudential policies** as a complement to other macroeconomic policies in advanced countries and integrated emerging markets.
- **Continue accounting for growth and sustainability implications in fiscal advice.** Undertake institutional analysis to strengthen the basis for structural fiscal balances; present fiscal advice in terms of a clear and well-justified anchor.
- **Be selective in advising on structural policies.** Recognize all macro-critical structural issues and their implications on an economy; follow principles to determine where to provide advice: macro-criticality, and Fund expertise or interest from ‘critical mass’ of the membership (e.g., financial deepening and labor market issues); in other areas, leverage advice from other international organizations.

Value-Added Policy Advice:

- **Provide more cohesive policy advice in Article IVs** either by discussing the policy mix explicitly or structuring Article IVs reports around economic goals or themes to better capture policy interactions.
- **Better leverage expert analysis and advice.** Concerted efforts to draw on cross-country policy experiences; strengthen TA integration in surveillance; enhance collaboration with other organizations in specific areas.

Two-way Candid and Clear Communication:

- **Strengthen the policy dialogue.** Expand “follow-up” on past policy advice beyond implementation to include a reporting on changes in Fund advice; monitor the quality of engagement and policy dialogue through targeted periodic surveys.
- **Ensure clear and candid surveillance messages,** particularly on spillovers from systemic economies; integrate key messages from the Spillover Report and the Pilot ESR into the WEO and GFSR; synthesize key Fund policy messages in the GPA; undertake more targeted communications with relevant stakeholders on the underlying analysis.

Evenhandedness:

- Establish a clearer understanding of how to gauge “evenhandedness of surveillance” by using equal risk-adjusted ‘inputs’ to bilateral surveillance (in keeping with the Fund’s principle of uniformity of treatment), where ‘inputs’ are calibrated to country circumstances based on domestic and cross-country risks.”
- Establish a mechanism for country authorities to report concerns, and deal with identified issues transparently.

Global Cooperation:

- Appoint an expert group to explore how to strengthen the Fund’s role in global cooperation, including the adequacy of its mandate for ensuring global economic and financial stability.