

INTERNATIONAL MONETARY FUND

**Modernizing the Surveillance Mandate and Modalities**

Prepared by the Strategy, Policy, and Review Department and the Legal Department

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This paper discusses how the Fund might increase the value of its surveillance. It considers both the substance of surveillance (what it should do) and its modalities (how to do it). The main ideas focus on how the Fund can do more—and more sharply defined—multilateral surveillance, generate greater value and traction from bilateral surveillance, and integrate the two better.

To buttress multilateral surveillance, the Fund could:

- Do more analysis of outward spillovers, a need long recognized but by all accounts still only partially met. New reports covering such spillovers from countries whose policies or circumstances impact the overall system would be produced by cross-departmental teams in parallel with Article IV reports, bridging multilateral and bilateral perspectives.
- Hold multilateral consultations as needed on special topics to foster collaboration and collective action when these topics are not already being addressed (e.g. in the G-20 Mutual Assessment Process), and engage more with existing country groups.
- Strengthen financial sector surveillance by mapping interconnectedness across borders and sectors and the transmission channels of macro-financial instability, filling gaps in financial sector data, and collaborating with key entities involved in financial stability work.

The adoption of Multilateral Surveillance Decision could help support these ideas.

To increase the value and traction of bilateral surveillance, options include:

- Promote better cross-country understanding, with more thematic multi-country reports, clustering work on countries facing similar issues, and facilitating informal policy dialogue between policy makers from different countries facing similar challenges.
- Improve traction of surveillance by reaching audiences more effectively, e.g., producing more timely and topical reports, preparing occasional “staff country notes” when there are significant developments, and increasing outreach and engagement with stakeholders.

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**List of Acronyms**

CGER	Consultative Group on Exchange Rate Issues
EWE	Early Warning Exercise
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
FSI	Financial Soundness Indicator
FSS	Financial Sector Surveillance
G-20 MAP	G-20 Mutual Assessment Process
GFSR	Global Financial Stability Report
IEO	Independent Evaluation Office
IMFC	International Monetary and Financial Committee
LCFI	Large Complex Financial Institution
LOT	Lapse-of-Time
REO	Regional Economic Outlook
TSR	Triennial Surveillance Review
WEO	World Economic Outlook

*This paper is one in a series of follow-up papers on [The Fund's Mandate—An Overview](#) and [The Fund's Mandate—The Legal Framework](#) discussed by the Executive Board on February 22, 2010. It discusses the mandate and modalities of surveillance, without proposing Board decisions at this stage. A companion paper discusses [financial sector surveillance](#) issues in more depth.*

## I. THE NEED FOR CHANGE<sup>1</sup>

### A. Context

1. ***Changing world.*** The world has changed in important ways since the late 1970s when surveillance as we know it started: capital flows now dwarf trade flows; many members are now integrated into world capital markets and financial sectors have become more interconnected so crises can be transmitted rapidly across the globe even without affecting the balance of payments of the originating country; and the speed of information flows has increased, allowing shocks to spread faster. Yet, the way the Fund undertakes surveillance has not changed very much and is pretty much the same for all members, systemic and non-systemic. Although a changing world does not in itself mean that surveillance has to be reformed, the increasing financial interconnectedness of countries, as demonstrated by the recent crisis which originated in advanced systemic countries, has implications for surveillance—both substance (what surveillance should do) and modalities (how to do it). In addition, other developments have had a bearing on surveillance. Importantly, the G-20 Mutual Assessment Process (MAP) launched in 2009 is an ambitious attempt at economic policy collaboration among G-20 countries. Although not Fund surveillance, the initiative complements it and offers the Fund a way to strengthen its engagement with G-20 members, while providing some lessons and insights for the Fund's thinking on surveillance reform.

2. ***Rationale for surveillance.*** What, if anything, does Fund surveillance do that the market and sovereign states operating in isolation cannot achieve? First and foremost, by virtue of its universal membership, the Fund is uniquely placed to monitor and assess economic and policy spillovers across countries, advise on how to achieve global economic and financial stability (a global public good), and serve as a forum where members discuss each others' policies and collaborate. Indeed, the Fund is the only institution where 186 countries have regular opportunities to comment on each others' economic policies. Second, Fund's surveillance, by providing comprehensive medium-term perspectives on members' economic policies, can help reinforce discipline and credibility for members' policies (i.e., help counterbalance any tendency for policy makers to focus on immediate policy challenges and consequences).

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3. ***The focus of surveillance.*** Surveillance is mandated to examine the international monetary system and members' exchange rates. In order to fulfill this mandate, the range of issues that the Fund must focus on is broad. In bilateral surveillance, the Fund must examine not only the member's exchange rate policies but also its domestic economic and financial sector policies. In multilateral surveillance, the Fund must oversee the international monetary system to ensure its effective operation and, for this purpose, must examine a broad range of issues that are relevant for its effective operation. As discussed later, while the meaning and scope of bilateral surveillance are well articulated and understood, those of multilateral surveillance are not.

4. ***Surveillance priorities.*** At the time of the [2008 Triennial Surveillance Review](#) (TSR), which reviewed surveillance in the run up to the financial crisis, the Executive Board adopted four operational priorities for surveillance (bilateral and multilateral), in areas where the Board expected improvements: (i) risk assessments; (ii) financial sector surveillance and real-financial linkages; (iii) analysis of exchange rate risks and external stability risks; and (iv) multilateral perspective (comprising cross-country experiences and inward and outward spillovers). Concrete actions have been taken to help ensure progress on the first three of these priorities, but less so on the fourth one (Box 1).

## **B. Gaps and Challenges**

5. ***Focus on global stability and outward spillovers.*** For the Fund to be able to promote global stability (a shorthand for the stability of the international monetary system), it needs to pay much more attention to outward spillovers from country policies that impact the system. This is not a new concern—it was, for instance, already explicitly identified as a priority in the 1999 [External Evaluation of IMF Surveillance](#). In its 2006 [Report on Multilateral Surveillance](#), the Independent Evaluation Office (IEO) noted that the absence of an overall strategy for multilateral surveillance and the silo structure of the Fund had resulted in outputs that give too much weight to providing information on economic developments and prospects (dominant “bottom-up” approach), and too little weight to analyzing economic policy linkages and proactively identifying the scope for collective action. Also, the IEO's 2009 report on [IMF Interactions with Member Countries](#) noted that majorities of *all* country groups both wanted a greater Fund presence in international policy coordination and spillover analysis (except for the large advanced economies) and gave the Fund low marks for effectiveness in this area. Overall, the evolutionary approach to multilateral surveillance does not appear to be meeting the membership's expectations.

6. ***Constraints on the analysis of spillovers.*** One reason for the lack of progress in analyzing outward spillovers is the dominance of bilateral surveillance in the Fund's surveillance activities, which itself stems from a legal and operational framework heavily tilted toward it (see the table in Box 2). Several factors contribute to this:

### Box 1. The Operational Priorities of Surveillance—Actions and Progress

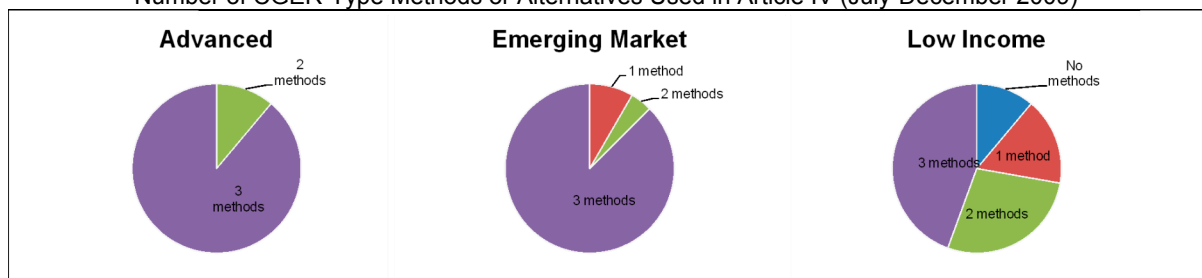
In October 2008, the Board adopted four [operational priorities](#) to guide surveillance through 2011: (i) risk assessments; (ii) financial sector and real-financial linkages; (iii) analysis of exchange rate and external stability risks; and (iv) multilateral perspective (cross-country experiences and inward and outward spillovers). Important actions have been taken to foster progress on these priorities. The next TSR in 2011 will provide a fuller assessment, but there is already some evidence of progress, with the exception of the coverage of outward spillovers where bolder supporting actions seem warranted.

**Risk assessments.** To complement the Vulnerability Exercise for Emerging Markets, the Fund has developed the Early Warning Exercise (EWE), done jointly with the FSB, and Vulnerability Analysis for Advanced Countries. These exercises provide systemic and thorough analysis of major risks to baseline projections and their policy implications, and provide early warning to members.

**Financial sector surveillance and real-financial linkages.** A number of initiatives have been launched, as discussed in [Financial Sector and Bilateral Surveillance—Toward Further Integration](#). In 2009, the Executive Board revamped the Financial Sector Assessment Program (FSAP) to make it more nimble and better integrated with surveillance. At that time, Directors noted the progress in focus on financial sector issues in bilateral surveillance, multilateral analyses of macro-financial linkages, particularly the EWE, and data coverage and availability. For example, analysis and coverage of financial sector issues in staff reports have been strengthened, and the integration of the core messages of the WEO and the GFSR, and the Fund's various vulnerability exercises into bilateral surveillance has improved. Many REOs have covered in depth financial sector issues and staff has also put out its views and research on specific financial sector topics through Staff Position Notes and Working Papers. At the same time, the collection, dissemination, and quality of existing data have improved, with new internal and external websites, dissemination of financial soundness indicators (FSIs) via the Fund's FSI website, and the establishment of an Inter-Agency Group on Economic and Financial Statistics (chaired by the Fund).

**Assessments of exchange rates and external stability risks.** Since the 2007 Decision was adopted, the coverage and quality of exchange rate analysis has improved significantly. The [2008 TSR](#) reviewed early evidence of this improvement—most staff reports at that time described the de facto exchange rate regime adequately, with advice on any recommended changes generally well supported. In addition, nearly all reports provided a clear assessment of the exchange rate level, based on multiple indicators and techniques in most cases. More recent evidence shows further progress. For example, the vast majority of Article IV staff reports issued during July–December 2009 included Consultative Group on Exchange Rate Issues (CGER)-type approaches to exchange rate assessments (the few exceptions were mainly for low-income countries where data availability is a constraint, see chart). Almost all of these reports included quantitative range estimates of the deviation of the exchange rate from equilibrium. There are also indications that clarity and candor in exchange rate assessments have improved after the 2007 Decision, despite labeling concerns. For example, the share of staff reports that uses well-established expressions such as undervaluation, overvaluation, or in equilibrium has increased significantly since before the 2007 Decision. (Based on a random sample of 40 countries, 100 percent of staff reports included such expressions in 2009, compared with 60 percent in 2006). And there was at least one case where a member did not consent to publication of the staff report because of the report's exchange rate assessment.

Number of CGER-Type Methods or Alternatives Used in Article IV (July–December 2009)



*Continuation of Box 1*

**Multilateral perspective.** There has been less progress on delivering on multilateral perspectives, in particular on analysis of outward spillovers, and with fewer concrete supporting actions. The report on *Cross-Cutting Themes in Major Article IV Consultations* is one notable example of an effort to look at countries from a multilateral perspective. Article IV staff reports appear to be handling *inward* spillovers well. As for *outward* spillovers, although a comparison of staff reports for a group of systemically important countries before and after 2008 shows an increase in the coverage and depth of outward spillovers, the coverage nonetheless tends to remain fairly narrow, and the issue is typically treated in a box with little connection to the rest of the staff report and with little, if any, link to policy dialogue. An informal survey of systemically important country teams suggests that by and large outward spillovers did not figure prominently, if at all, in discussion with policy makers. While staff often presented its findings on outward spillovers to the authorities, there was no substantive policy dialogue based on these findings. Table 1 summarizes the treatment of outward spillovers in recent Article IV staff reports for selected countries.

**Table 1. Coverage of Outward Spillovers in Recent Article IV Reports of Selected Large Economies**

Country/region	Spillovers covered	Reach of spillovers	Extent of coverage	Discussion w/ authorities	Quantification
Canada - 2009	Remittances, trade (tourism in caribbean), financial	Broad (remittances, financial), Caribbean (trade)	One Box with supporting charts	On mission (banking)	Yes
Euro Area - 2009	Growth, financial	Within Europe	Spread across the report	Yes	No
France - 2009	Limited spillover effects outside euro area	...	One sentence	No	No
Germany - 2008	Growth, consumption, financial	Within Europe	One page with supporting graphs	Yes	Yes
India - 2009	Monetary policy, growth, fiscal policy	Global, regional	Two paragraphs	No	No
Italy - 2008	Financial	Central and Eastern Europe	One paragraph	Yes	No
Japan - 2009	Financial	Sample of BIS reporting countries	Box and supporting graphs	No	Yes
Russia - 2009	Trade, financial, remittances	Central Asia and Caucuses	One paragraph	No	No
South Africa - 2009	None	N/A	N/A	On mission (growth)	N/A
United Kingdom - 2009	Financial	World	One box	No	Yes
United States - 2009	Growth, trade, financial, remittances, global imbalance	World	One Box and one para with supporting graphs	Yes (global imbalance)	Yes

Source: Strategy, Policy, and Review Department.

### Box 2. Units of Analysis and Channels of Influence

**Units of Analysis.** Effective surveillance must focus on countries, regions, and the world (the natural geographical units of analysis), but also on themes, sectors, and institutions as needed (within and across countries) to capture entities such as large financial institutions and groups of interconnected countries. Bilateral and multilateral analyses should complement each other. While bilateral surveillance would assess individual countries, thematic issues, and specific private sectors/institutions (financial sector) important for individual country stability, multilateral surveillance would deal with regions, networks of financial interconnectedness, and private sectors/institutions important for global stability.

**Channels of Influence.** The agents to be influenced are ultimately the world’s economic and financial decision-makers—i.e., the authorities of individual countries and formal grouping of countries (e.g., euro area). Channels for traction with these agents include: direct communication between them and the Fund; peer pressure and collaboration among members; and indirect communication through other stakeholders (markets, individual institutions, media, civil society, etc.).

The table below illustrates the vehicles the Fund currently uses to analyze the relevant units (e.g., country, regions, sectors, etc.) and the vehicles used to influence policy makers. It highlights the dominance of Article IVs in Fund surveillance activities, the need to better coordinate data collection, and the large gap in vehicles to exchange views and have direct communication with policy makers at the level of regions, groups of interconnected countries, Large Complex Financial Institutions (LCFIs), and the globe.

	Vehicles Used to Conduct the Analysis			Vehicles Used in the Various Channels of Influence		
	Data Collection	Data Analysis	Exchange of Views	Direct communication	Peer Pressure	Other stakeholders
<b>Countries/Currency Unions</b>	A-IV	A-IV	A-IV	A-IV	A-IV	A-IV
<b>In-Country Themes/ Sectors</b>	A-IV FSAP	A-IV FSAP	A-IV FSAP	A-IV FSAP	A-IV FSAP	A-IV FSAP
<b>Cross-Country Themes/ Sectors</b>	AIV/WEO/GFSR EWE/VEs	AIV/WEO/GFSR EWE/VEs	A-IV	A-IV	A-IV WEO/GFSR EWE	AIV/WEO/GFSR
<b>Regions</b>	n/a	REO	-	-	-	REO
<b>Groups of interconnected countries</b>	Incomplete data	-	<b>GAP</b>			-
<b>LCFI network</b>	Incomplete data	-				-
<b>Globe</b>	n/a	WEO/GFSR	-	-	WEO/GFSR	WEO/GFSR

n/a indicates no need to collect data at this level, as the data are individual country data.

- *The lack of a comprehensive framework for multilateral surveillance.* Legally, bilateral surveillance is well defined, first in Article IV itself and further in the 2007 Decision. However, for multilateral surveillance, the Fund’s mandate is not as fully developed. While the legal basis for multilateral surveillance is clearly laid out in Article IV, Section 3(a) (i.e., the Fund “shall oversee the international monetary system to ensure its effective operation”), the Fund has not adopted a comprehensive decision to give content to this provision. Operationally, bilateral surveillance is based on a dialogue with policy makers, with a well-defined output—the Article IV staff



reports. Current multilateral surveillance reports—the WEO and GFSR—focus on systemic issues and broad policy recommendations but have little policy dialogue.

- *Bilateral surveillance cannot capture all outward spillovers well.* While bilateral surveillance assesses how members’ policies promote systemic stability, its perspective on spillovers is limited in two important respects. First, the current legal framework for bilateral surveillance requires the Fund to examine outward spillovers arising from a member’s policies only when they are transmitted through the member’s balance of payments, implicitly leaving outward spillovers transmitted through other channels outside of its scope. Second, with respect to members’ domestic policies, each member is required to promote systemic stability only by promoting its own domestic stability.
- *Organizational challenges.* Even if bilateral surveillance could assess all outward spillovers, it would be ill-placed to do so as it is undertaken mainly by *individual country* teams. While it is natural for these teams to assess how exogenously given policies in other countries affect the country they work on (inward spillovers), it is harder for them to assess how this country affects the rest of the world (outward spillovers). Also, the analysis and policy recommendations in the context of bilateral surveillance tend to take developments in the rest of the world as given, while the reality is that the world is made up of dynamic feedback loops that require a bird’s-eye view to analyze. While the WEO and GFSR look at systemic outcomes, they tend to rely on the country analysis from the Article IV process to generate (add up) their multilateral perspective. Also, and no less importantly, because there is no dialogue with all of the relevant policy makers, these vehicles tend to focus less on identifying spillovers and advising on policies and their mutual consistency than on trends and outlook.

7. ***The need for multilateral engagement with top policy makers.*** Experience has shown that the close engagement of top policy makers to discuss shared problems is crucial for the promotion of collective action. The Fund’s Executive Board and the International Monetary and Financial Committee (IMFC) provide fora for a multilateral discussion on systemic economic issues, but neither is an ideal place for policy collaboration: the Board because Executive Directors are typically not in a position to make policy commitments on behalf of countries; the IMFC because of the limited time for and long gaps between its meetings. The G-20 MAP goes a long way in addressing this need, and it would not make sense to duplicate this work. However, many special topics affecting groups of countries that may include non-G-20 members or only a few of the G-20 members will remain uncovered.

8. ***Financial sector surveillance.*** The global financial crisis and its complex transmission channels naturally lead to the question whether ongoing improvements to the Fund’s financial sector surveillance go far enough. The companion paper on financial sector surveillance discusses in greater detail the case for changes to strengthen financial sector surveillance by mapping the transmission channels of macro-financial instability, and

promoting deeper engagement with key entities involved in financial stability work (e.g., FSB, see Box 3). A key issue will be to fill data gaps—in collaboration with other international institutions—on risks in the financial sector, international network connections, and sector balance sheets.

### **Box 3. Key Messages on Financial Sector Surveillance**

Financial sector surveillance issues are discussed in greater depth in the companion paper, *Financial Sector Surveillance and the Mandate of the Fund*. The main themes and messages are:

**Assessing risks better.** Fund surveillance needs to adapt to better capture the marked increase in financial interdependencies across countries. To assess properly the risks of transmission of macro-financial instability across borders, Fund surveillance needs to better “map” the transmission process through global financial networks. This would involve tracing financial flows and exposures across asset classes, maturities, and countries to improve the Fund’s capacity to assess how changes in policies, or shocks, in one country can propagate through the system. It would also assess how the functioning of the network might be impaired as the systemic institutions with key intermediation roles in the networks come under stress. Doing this would require more structured engagement with these institutions and closer collaboration with their home supervisors.

**Filling data gaps.** To map global financial networks, the Fund will need access to the necessary data, both aggregate data on the operation of the networks and on key institutions. The Interagency Group on Economic and Financial Statistics (established at end-2008, the Fund chairs this group) represents a promising start to improve data availability for global network analysis.

**Collaboration with standard setters.** Going forward, the Fund could play a more systematic role in the standard setting process, building on its enhanced analysis of macro-financial linkages and global financial networks. More systematic analysis of global regulatory efficiency and its implications for stability could provide value added to the standard-setting process, and the Fund is uniquely placed to provide this.

**Mandatory FSAPs.** The FSAP is formally a technical assistance program that cannot be done unless requested by a country. Fund surveillance could be strengthened by making FSAPs mandatory, at least for countries with systemically important financial systems. Many Executive Directors have expressed support for this option and it seems appropriate to reexamine it in the context of a review of the Fund’s surveillance mandate. FSAPs could be made mandatory by making FSAP part of surveillance. Key questions include: would FSAPs be mandatory on a set schedule (say every five years) or when the Fund considers that an FSAP is warranted? How would “systemically important financial systems” be defined? What would be the role of the World Bank? What are the resource implications?

**Collaboration with the FSB.** The Fund and the FSB already collaborate very closely with each other, for example on the EWE and in the context of the FSB’s peer review process. To avoid excessive duplication as the collaboration between the Fund and the FSB deepens, there may be merit in clarifying further the areas and activities that each body should primarily focus on. The Fund’s comparative advantage is in surveillance of the global financial system and analysis of macro-financial stability issues. The FSB should lead on micro-prudential issues (e.g. elaboration of international financial sector supervisory and regulatory policies and standards, and coordination across the various standard-setting bodies) with input and support from the Fund. At the same time, in practice, some overlap will be inevitable, and having two, complementary perspectives on issues should be useful to policy makers. The Board will have the opportunity to discuss issues related to the FSB as it considers whether the Fund should formally become a member.

9. ***Traction/Impact of Fund advice.*** As an institution seeking to promote global stability, the Fund faces a fundamental challenge in that it seems to have least value and traction with those members—large advanced and large emerging market economies—that matter most for global stability, while traction and value is high for other (e.g., low-income and small emerging market) members (TSR, 2008; IEO, 2009).

10. ***Moving forward.*** Placing more emphasis on multilateral surveillance and greater focus on outward spillovers can allow the Fund to be more effective in promoting global stability—a common good—and can help the Fund to improve the traction of its surveillance. At the same time, bilateral surveillance should remain a pillar of the Fund’s activities and actions will be required to increase its value and traction.

## II. BUTTRESSING MULTILATERAL SURVEILLANCE

11. ***Overview.*** This section discusses how the Fund could place greater emphasis on multilateral surveillance. It lays out ideas for new products and procedures, makes the case for a Multilateral Surveillance Decision, and identifies what its key building blocks might be. The new products are meant to supplement, not substitute for, existing ones and provide a bridge between multilateral and bilateral surveillance. The WEO and GFSR are well-respected and established products that provide an independent source of staff analysis of global economic and financial developments, trends, and risks, as well as broad policy ideas. In addition, last year, the Fund launched its EWE, jointly prepared with the FSB, to assess the risks of unlikely, but plausible downside scenarios. Multilateral surveillance is also buttressed by the semi-annual Fiscal Monitor, which analyzes the state of public finances around the world.

### A. Products and Procedures: Filling the Gaps

#### Spillover reports

12. ***What and why.*** Spillover reports would be prepared for countries whose policies or circumstances significantly impact the system. They would be thematic in nature and assess the impact of outward spillovers from the policies in a country or group of countries (or contagion from a shock originating in the country) on global stability, regions, and members. The reports would leverage the analysis in the WEO, GFSR and REOs, as relevant, but would drill deeper into specific topics. They would complement the Article IV reports for these countries, providing a bridge between bilateral and multilateral surveillance and reinforcing the peer-review mechanism.

13. ***Key operational questions:***

- *How would they relate to the Article IV consultations?* Spillover reports would be part of multilateral surveillance, while informing and complementing bilateral surveillance, as the scope of the outward spillovers covered by them would be wider than those that are formally the subject of bilateral surveillance—i.e., the assessment of members’

compliance with their obligations under Article IV—(see second bullet of paragraph 6 and Box 4). The modalities and timing of spillover reports will require careful consideration and, to ensure that these reports deliver value, their content and format will be adjusted as experience is gained. One possibility would be to prepare a draft in advance of the Article IV consultation so that its findings could be discussed with the member concerned during the Article IV mission. This structure would allow for synergy between the Article IV and the spillover reports and would also minimize the burden on the authorities. The spillover report would be issued separately, but at the same time as the Article IV report so the Board could discuss both together. To the extent that spillover reports overlap with the coverage of bilateral surveillance, they would be incorporated into Article IV reports by reference. This would allow the Board to have a comprehensive view of the member’s policies and their effects on the stability of the member itself and on the rest of the world.

#### **Box 4. Spillovers and the 2007 Decision**

It may be possible to address spillovers in bilateral surveillance more comprehensively than is presently the case. While the 2007 Decision focuses on a wide range of spillovers arising from a member’s policies – in particular, its exchange rate policies, it requires the Fund to take into account the impact of a member’s policies on other members only when they undermine the member’s own “external stability.” (The term “external stability” is established by the 2007 Decision as the central organizing principle of bilateral surveillance and is defined to mean “a balance of payments position that does not, and is not likely to, give rise to disruptive exchange rate movements”.) Where the member is in a state of external stability, the 2007 Decision precludes the Fund from taking into account the effects of the member’s domestic economic and financial policies on other members.

The scope of spillover analysis in bilateral surveillance could be expanded by amending the 2007 Decision to require the Fund to focus on spillovers arising from a member’s domestic economic and financial policies even when the member itself is “externally stable.” However, under Article IV, Section 1, a member is only required to ensure that its domestic policies are promoting its own domestic stability. Thus, to the extent that the member is promoting its domestic stability, the Fund cannot require the member to change its domestic policies to address their adverse effects on other members or the stability of the exchange rate system more generally. When a member’s domestic policies are undermining its own domestic stability, the Fund may only require the member change its policies in a manner that promotes its own domestic stability, regardless of the impact on other members. For the Fund to be able to require members to adjust their domestic policies to support the stability of the exchange rate system, it would be necessary to amend the Fund’s Articles to expand the scope of members’ obligations accordingly.

- *How often and about whom should they be prepared?* Spillover reports would be prepared annually for the handful of countries/regions that make up the bulk of global GDP or financial flows, and less frequently (either on a rotating basis, or as dictated by circumstances) for other countries whose policies or circumstances could have

systemic effects. Systemic is not only a matter of size (GDP, trade) or sectoral dominance (finance, oil), but state-dependent: in current post-crisis conditions, even a relatively small country such as Greece can have systemic effects. The selection of countries for spillover reports would be decided in consultation with the Board in the context of the work program. It would be informed by the findings of the WEO, GFSR and EWE. Resource constraints would also have to be taken into account in doing this selection.

- *Who should produce them?* For several reasons—logistics, global consistency, cross-country perspective—these reports should probably be prepared by special functional department staff teams, in close collaboration with the regular country teams. These special teams would hold discussions with the member concerned as well as with policy makers and institutions of affected countries, as relevant. An example of a spillover report would be one which explores how changes in financial sector regulations in one country affect capital flows to and from other countries. In this case, the Monetary and Capital Markets department could lead the team, which would also comprise staff from other departments with relevant expertise.
- *Should they be published?* The presumption should be that the report would be published with the consent of the relevant member(s).
- *Trial run.* To give the Board a more concrete idea of how spillover reports might work and evolve in practice, consideration could be given to producing some over the course of the year.

### **Multilateral consultations on special topics**

14. ***What and why.*** Multilateral consultations on special topics would be initiated by the Fund on an “as needed” basis when a problem arises in a policy area (e.g., financial regulation) or a region (e.g., a major crisis in a member country or group of countries that strongly affects its neighbors) that is important for the effective operation of the international monetary system, e.g., has systemic implications, and requires close collaboration among a group of members for an effective solution, and where effective collaboration is not already taking place elsewhere (for instance, in the context of the G-20 MAP).

15. ***Possible modalities.*** When a problem requires policy responses in several countries, there are typically several policy constellations across countries that can achieve the desired outcome, each with a different distribution of the burden of adjustment. In such cases, there would be no basis for the Fund to recommend any particular solution. Therefore, the Fund is more likely to play a productive role by helping *facilitate* a discussion among relevant members by providing analytical inputs and policy options. Specifically, the Fund would initiate a multilateral consultation and bring together senior policy makers for discussions (as in the 2006 multilateral consultation), but ultimately, agreement on specific policy actions would be left to the members (as in the G-20 MAP). This could help enhance ownership of the process and increase the chances of success. The Fund’s role would also be to analyze the

effects of any agreed policy response (or lack thereof), including on members that are not part of the multilateral consultation. Similar to spillover reports, the various inputs and reports would be prepared by a special staff team, in close consultation with the country teams. The involvement of the Board in the various stages of the process could build on the design of the 2006 multilateral consultation and the G-20 MAP (Appendix 1).

16. ***Key differences with the G-20 MAP.*** Multilateral consultations on special topics would be undertaken at the initiative of the Fund (the Managing Director would determine in consultation with the Board when circumstances call for a consultation, based on broad criteria). They would be on an “as needed” basis, rather than on a regular periodicity. Also, the group of members involved would depend on the problem at hand, and would not be a pre-defined group. The Fund would provide analysis based on Fund staff’s best estimates and projections, not strictly on the basis of inputs from the participants in the consultation.

### **Other possible vehicles**

17. ***Interaction with existing regional/country groups.*** The Fund could also explore, and seek to encourage, greater use of the Fund’s surveillance analysis and policy recommendations as a basis for policy discussions in existing regional and other groupings such as the Association of Southeast Asian Nations (ASEAN) or the European Union. It could do so by offering tailored repackaging of existing surveillance work to ensure maximum usefulness for the particular forum. Leveraging the Fund’s work more actively in these types of groupings—where discussions often take place at senior policy making levels—could be good way to enhance the traction of surveillance.

18. ***Make the Regional Economic Outlook (REOs) part of multilateral surveillance.*** All area departments prepare REOs, which have become an established vehicle for engagement with regions. One way to buttress multilateral surveillance could be to make area departments’ REOs a formal part of surveillance and better leverage them through increased outreach. This would increase the scope to include fresh analytical material in addition to the information derived from staff reports, including by drawing on closer engagement with policy makers. Greater synergies with WEO and GFSR would allow for more focused and less resource-intensive reports. The advantage of making more out of REOs is that they are already being produced and they cover all countries (even if to varying degrees). On the cost side, making them a formal part of surveillance would slow down the publication time (because they would first need to be discussed by the Board) which could reduce their outreach value. Moreover, REOs focus on regions which may often not be the most relevant unit of analysis (as opposed to groups of interconnected countries, or group of countries affected by a common problem) and some of the “regions” covered are not regions in an economic or geographic sense as much as they are artifacts of the Fund’s departmental structures. There may be scope to explore collaboration between REO teams on themes that cut across regions.

## B. Key Building Blocks of a Multilateral Surveillance Decision

19. ***The case for a Multilateral Surveillance Decision.*** The issues identified above could be addressed in a new Executive Board Decision on multilateral surveillance. The case for such a decision rests on three main arguments. It would:

- Create clear expectations—for staff, management, and the world at large—about the Fund’s role in conducting multilateral surveillance and analyzing spillovers (i.e., provide an institutional process that supports analysis of spillovers);
- Create an environment in which to discuss spillovers without new substantive obligations; and
- Provide a framework to engage with policy makers across countries.

20. ***Key building blocks.*** A Multilateral Surveillance Decision could include the following building blocks:

- *The scope of multilateral surveillance.* The new decision would clarify the range of issues the Fund would examine in the context of multilateral surveillance. Under Article IV, Section 3 (a), the Fund is required to “oversee the international monetary system in order to ensure its effective operation.” The decision would provide guidance on the meaning of the “international monetary system” and explain that, while this concept has a fairly narrow and specific meaning, the range of issues that the Fund would need to examine to ensure its “effective operation” is potentially broader, and would, in particular, encompass global economic and financial stability;
- *Analysis under multilateral surveillance.* The Decision would clarify what type of analysis Fund staff would be expected to produce and report to the Board. This would include analysis of global trends, outlook, and risks (which would be expected to continue to be produced primarily in the context of the WEO, GFSR, and EWE). It would also include detailed analysis of the effects that the policies of certain systemic member countries have on the global stability or the stability of other members (to be done, for instance, through dedicated individual *spillover reports*). The Decision would provide broad guidance on how countries would be selected for such assessments of outward spillovers and clarify that members would be required to make themselves available for discussions with Fund staff for the conduct of such analysis;
- *Multilateral Consultations.* The Decision would explicitly empower the Fund to initiate multilateral consultations with a group of members when global or multi-country issues require collaboration or collective action. The Decision would provide broad guidance on how the Fund would determine when an issue warrants a multilateral discussion (see paragraph 14). The guidance would need to be flexible to allow for changing circumstances. The Decision would also clarify the main modalities for such consultations (as described in paragraph 15). It would explain that

members would be required to participate in a multilateral consultation when called on to do so by the Fund;

- *Foster the provision of necessary information.* Under Article VIII, Section 5, the Fund may require, subject to certain limitations, a member to report any information the Fund deems necessary for its activities, including multilateral surveillance. While Article VIII, Section 5 (b) makes it clear that members are under no obligation to furnish information in such detail as to disclose the affairs of individuals or corporations, Section 5 (c) permits the Fund to obtain key financial sector information through voluntary agreements with members. The Decision could provide a platform to encourage members to enter into such voluntary agreements; and
- *Provide a review clause.* The Decision would include a provision indicating that the Decision should be reviewed after a given period (e.g., 3-5 years).

### **C. Relation between the Multilateral Surveillance Decision and the 2007 Decision**

21. *The 2007 Decision would not need to be revised.* As per paragraph 6, and assuming the above ideas go forward, there would be no need to change the 2007 Decision to capture explicitly the outward spillovers that are currently left outside the scope of bilateral surveillance, as these would in any case be better analyzed in a multilateral setting under the Multilateral Surveillance Decision. The latter would not entail any new policy obligations for members. For the Fund to have the power to require changes in members' domestic policies when these negatively affect the system as whole but not their own domestic stability, a change in the Articles of Agreement would be required (Box 4).

22. *One or two surveillance decisions?* A more technical question is whether the 2007 Decision should be merged with the new Multilateral Surveillance Decision to form a single Surveillance Decision. There may be political attractiveness to the idea as it could eliminate the contentiousness that still lingers about the passage of the 2007 Decision. However, in practice, this would only amount to an alternative format, as the substance of the two components would be the same as when laid out under two separate Decisions.

### **III. INCREASING THE VALUE AND TRACTION OF BILATERAL SURVEILLANCE**

23. *Bilateral surveillance should remain as a key pillar of Fund activities.* Rebalancing surveillance activities to allow more multilateral surveillance should not be at the expense of the quality of bilateral surveillance. Bilateral surveillance is a key source of country knowledge, as well as an obligation of the Fund vis-à-vis its members. As such, it should remain central to the Fund's engagement with its members. While improved multilateral surveillance should benefit the quality of bilateral surveillance, there is also scope to enhance the value and traction of bilateral surveillance (as noted by the [IEO \(2009\)](#) and the [2008 TSR](#)) including by better leveraging cross-country analysis and experience. This section discusses possible reforms that could help address these issues.



### A. Promoting Better Cross-Country Understanding

24. **Options.** The Fund’s analysis and knowledge of individual members provides the foundation for the institution’s unique and extensive cross-country knowledge. This cross-country experience and analysis should be leveraged better to add value to bilateral surveillance. The following options, not mutually exclusive, could help do this.

- *Produce more thematic multi-country reports.* Article IV consultations could be enriched with multi-country reports for countries such as mineral or oil exporters, aid-dependent countries, and countries with large reserves cushions. Recent examples include the 2009 paper on *Cross-Cutting Themes in Major Article IV Consultations*.
- *Cluster work on similar countries or countries facing similar problems.* Scheduling Board meetings on similar countries or countries facing similar problems around the same time would enable the Board to form a better view of issues affecting several members. This is already done to some extent (e.g., G-7 members and for some currency unions), but could be explored more broadly, keeping in mind staffing and logistical constraints to clustering.
- *Facilitate engagement between policy makers.* The Fund could also do more to facilitate informal policy dialogue between small groups of policy makers from different countries facing similar challenges (e.g. countries facing large fiscal adjustments), e.g., at the margins of the Spring and Annual meetings.
- *Provide better internal support for cross-country analysis.* The Fund has enormous experience from across the world, but it is a challenge for country teams to make sure all this experience and knowledge is brought to bear in relevant cases. This is largely because the information is not easily accessible to all staff. The Fund could consider investing in technical “back-office support” which would provide mission chiefs and reviewers with relevant information on experience in other countries. Furthermore, the Fund has a wealth of statistical information, but there is scope for improved data management in the Fund to ensure the use of high-quality and comparable data.

### B. Improving Traction

25. **Options.** To increase the value of surveillance, including with large advanced and emerging market countries, the Fund could consider the following reforms to reach these audiences more effectively and motivate members to engage in surveillance:

- *More topical and timely reports.* For staff reports to bring value and have traction they must revolve much more around cross-country perspectives than is currently the case. For many large advanced and emerging market members, the real value in the Article IV is to learn how events and trends in the global economy affect them and how policy issues they grapple with have been tackled by other countries. Of course, the Article IV report must also focus on economic developments and outlook, risks, and policies (domestic and external). Moreover, to ensure that staff’s analysis is

“fresh”, ongoing efforts to reduce the lag between surveillance missions and publication of staff reports should be built on;

- *More continuous communication.* Article IV staff reports provide comprehensive assessments of members’ economic performance, prospects, and policies. Executive Directors might be briefed in informal country matters sessions on developments in between Article IVs. But unless the member has a Fund-supported program, there is no report—to the Board or the public—even if there are major developments in the country. As part of ensuring more continuous surveillance and engagement on countries, and improving traction, one possibility would be for staff to prepare occasional “*staff country notes*” when there are significant economic and policy developments. The idea would not be to provide high-frequency commentary (à la investment banks) on the latest economic data, but rather to provide a staff view on important policy developments or events. The report would be sent to the Board for information and would be presumed to be published subject to the member’s consent;
- *Increased communication on surveillance.* Increasing pre- and post-mission engagement with other stakeholders (e.g., CSOs, parliamentarians, etc.), and contributing to media (including local media) outlets would help widen the reach of Fund messages. Conducting outreach on multilateral and regional issues even in the context of bilateral surveillance is also important; and
- *Regional advisory groups.* The Fund could build on its experience with establishing regional advisory group of eminent persons to foster high-level two-way communication on surveillance issues and priorities.
- *“Pre-qualifying” members to use Fund resources using Article IV assessments.* This could help increase the predictability of access to Fund resources and would ensure sharper assessments in Article IV reports. At the same time, the advantage of this predictability needs to be weighed against the potential market consequences and political sensitivities about “rating” and possibly “labeling” members. These issues are further discussed in the [Future Financing Role of the Fund](#).

### C. Tailoring the Frequency of Engagement

26. *Options.* Bilateral surveillance relies heavily on the Article IV consultation for analysis and interaction with members, and for reporting to the Board and the rest of the world. Over 90 percent of members hold Article IV consultations on a cycle of 12- to 15-month intervals. There are advantages to such close and regular engagement. The annual rhythm of consultations is well-known by members and the public and it mirrors many members’ annual budget cycles. Also, consultations at the same frequency for most members avoid the risk of negative signaling stemming from a frequency reflecting the member’s vulnerability. At the same time, with more multilateral surveillance products, and more thematic reports that cover country developments, there is scope to consider greater flexibility in how bilateral surveillance is undertaken, bearing in mind the need to ensure that

consultations are held with *all* members within a reasonable cycle. To tailor surveillance better to country circumstances, the following options could be explored:

- *Increased use of LOT procedures.* Article IV consultations, as well as program reviews, can be completed on an LOT basis.<sup>2</sup> LOTs have typically not been used in the past for Article IV consultations to avoid the impression of something less than a full peer review. However, there may be growing acceptance at the Board of concluding Article IV consultations on an LOT basis—since January 2009, the Board has concluded eight Article IV consultations on LOT basis, and many other consultations are being concluded in very short Board meetings. In 2009, a fifth of all consultations was concluded in less than 30 minutes (including the reading out of the summing-up). Consideration could be given to establishing procedures or criteria that would encourage greater use of LOT procedures. While greater use of LOT procedures could free up Board time for discussion of multilateral surveillance and surveillance of countries with systemic impact, it would only involve marginal efficiencies in staff resources;
- *More variable cycles.* There are established criteria for using cycles longer than the standard 12 month, and there seems to be scope for greater use of longer cycles within these criteria, perhaps for currency union members.<sup>3</sup> Moving countries to cycles up to 24 months when there are no major concerns or policy issues would free up both staff and Board resources to do more cross-country work in support of bilateral surveillance (e.g., the recent paper on [Cross-Cutting Themes in Economies with Large Banking Systems](#)). Staff would still be monitoring and visiting the country between Board discussions (and prepare “staff country notes”), including in the context of thematic or multi-country reports (e.g. regional reports). Moreover, there may be circumstances where members or the Fund would find more frequent engagement and reporting to the Board to be desirable (e.g. rising vulnerabilities, important policy reforms are being undertaken). Such monitoring has been done in the past at the request of members, e.g., in 2004-05 with “intensified surveillance” in Jamaica, Lebanon, and Nigeria, but with some reluctance on the part of the Fund to use that specific term. The Fund could consider a policy on intensified surveillance in such circumstances.

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<sup>2</sup> There are no strict criteria for the use of LOT consideration for Article IVs. In practice, the justification in past LOT cases has been along the lines of favorable economic conditions, satisfactory performance, and unchanged policy requirements.

<sup>3</sup> Countries can be considered for extended consultation cycles if they do not meet any of the following criteria: (i) systemic or regional importance; (ii) completion of a Fund arrangement in the past year; (iii) outstanding Fund credit above 25 percent of quota; and (iv) perception of some risk because of policy imbalances or exogenous developments, or identification of pressing policy issues of broad interest to the Fund membership. (Members that receive financial assistance from the Fund or that are under the Policy Support Instrument are automatically on longer cycles). Countries that qualify can be moved to a longer cycle (i) upon consent of the authorities and (ii) following a consultation with the country's Executive Director.

27. ***Ensuring that surveillance takes place.*** Article IV surveillance is mandatory for *both* the Fund and its members. Members are required under Article IV to consult with the Fund on their domestic and exchange rate policies.<sup>4</sup> However, there is, at present, no legal obligation on the part of members to comply with the deadlines that are established for the completion of periodic Article IV consultations. Rather, Fund policy has always established these deadlines as “expectations” with no consequence flowing from the failure to meet them. In practice, unless a member voluntarily engages with the Fund, Article IV consultations can be delayed for extensive periods of time. For instance, two large members have not had a consultation in more than three years. This undermines the Fund’s capacity to discharge its surveillance mandate. A forthcoming Board paper will clarify the legal framework governing obligations of members to consult with the Fund under Article IV, and put forward ideas for how to address this issue.

#### IV. CONCLUSION

28. ***Challenges.*** Fund surveillance has not changed much over the past decades and is pretty much the same for all members. At the same time the world has changed dramatically, and Fund surveillance has lost traction with its largest members—those that matter for global economic and financial stability.

29. ***Vision.*** This paper lays out a vision for the Fund’s surveillance activities that would tailor surveillance better to members’ specific characteristics and which would provide for closer scrutiny of members that are critical for global stability. The vision includes more multilateral surveillance, while also increasing the value and traction of bilateral surveillance—a pillar of the Fund’s activities. The paper puts forward many ideas –not “proposals”—for discussion. In the staff’s own views, the ideas that seem most important to support progress in surveillance are: spillover reports (even more than the multilateral consultations on special topics), enhanced financial sector surveillance (stressing data collaboration and work with the FSB to expose threats to systemic—as opposed to institution specific—stability), thematic multi-country reports and country staff notes, and greater flexibility in surveillance cycles. An evolutionary approach that focuses on modifying existing products and modalities could be considered, but would not respond to repeated calls for better analysis of spillovers and interconnectedness by successive IEO reports, wise persons groups, Board reviews, and IMFC communiqués for over a decade. While new procedures in themselves won’t increase the traction of surveillance, they would set the Fund on a path to better meet the needs of the membership.

30. ***Resource implications.*** The increased emphasis on multilateral surveillance, combined with only limited changes in bilateral surveillance, would have resource and organizational implications. It is difficult to say how large they would be without some

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<sup>4</sup> See [The Fund’s Mandate—The Legal Framework](#).

experience. While these resource costs should not be downplayed, equally they should not be exaggerated. A rough estimate for a spillover report is that it would involve 1-2 staff years to produce, so a handful of spillover reports a year could require up to ten additional staff-years. There would also be costs—perhaps much larger—from the ideas in the financial sector and data areas. At the same time, there should be synergies between all these new activities and existing ones, and it should be possible to accommodate some of these resource demands as the intense crisis program work is winding down and with somewhat greater use of longer consultation cycles. Were there net additional resource implications, these would need to be considered in the medium-term budget strategy. The delivery of new surveillance products such as spillover reports may also involve organizational changes to facilitate teams that specialize in such analysis but equally could be achieved under the existing structure (e.g., via formation of standing cross-department teams). All of these issues can be tackled once there is a clearer idea of the scope of overall change in the mandate and modalities of surveillance.

31. *Next steps.* The ultimate product of the Board's numerous reflections on the mandate is a Board report to the IMFC in September 2010. Following the discussion of the current papers, follow-up papers may be required. But in any event, staff plans to prepare follow-up papers on capital flows, mandatory FSAP, members' obligations to consult under Article IV, and FSB membership.

## **Appendix 1: Examples of Experience with Multilateral Coordination**

### **The “Global Strategy” Attempt of 1979**

In 1979, against the backdrop of the breakdown of the par value system and adoption of the 1977 Surveillance Decision, the US Treasury Secretary suggested that the Fund could assess the performance of individual countries against an agreed global strategy for growth, adjustment, and price stability. Staff proposed focusing on G-7 countries:

- (i) G-7 countries would give the Fund a quantified statement on the economic and financial policies they intend to pursue in the year ahead;
- (ii) these statements could be coordinated through regular Article IV consultations;
- (iii) the policies would be those of the member only and would in no sense have been agreed;
- (iv) Fund staff would assess the statements and present them to the Board against the context of the WEO;
- (v) the Fund would monitor performance against the implied standard in these statements; and
- (vi) members should explain the reasons for departures from the statements.

Many Executive Directors expressed doubt on the proposal on the following grounds: (i) practical difficulty on how to arrive at an agreed global strategy; (ii) questions on the Fund’s technical ability to set a global strategy properly; (iii) Fund could infringe upon countries’ sovereignty; and (iv) focusing too much on G-7 could divert attention from other countries. However, the Board did agree in 1980 that in principle, it would be helpful to bunch the consultations with the G-7 countries as close together as possible, so that these countries could be considered in relation to one another and discussed in a consistent manner.

### **The Multilateral Consultation in 2006/07**

The Fund conducted a multilateral consultation with China, the Euro Area, Japan, Saudi Arabia, and the United States. The purpose was to have an action-oriented debate and, ultimately, policy actions by participants that could make a significant contribution toward global rebalancing. The consultation began with staff visits to the five participants in July and August 2006, followed by three multilateral meetings between September 2006 and March 2007, chaired by Fund management. In the last meeting, participants prepared detailed policy intentions, which were discussed in some depth.

The Executive Board was briefed on the results of the process and the main elements of the participants’ report, which was still being finalized, in early April 2007. The report was circulated to the IMFC and discussed at its breakfast later in April 2007. A staff report,

including five sets of one-pagers on each country's policy progress and plans to reduce global imbalances, was issued for Board discussion in July 2007. The Executive Board concluded the process by reviewing and taking stock of the [results](#).

The experience with this process has generally not been considered a success, however. For example, Edwin Truman noted already at the time that “the content and timetable of these consultations are insufficiently ambitious”.<sup>5</sup> Later, in discussing the staff report on the Multilateral Consultation several Executive Directors pointed out that the policy package in the Multilateral Consultation report was less ambitious than that recommended in the WEO or Article IV consultations. Other directors raised concerns about the lack of a framework to effectively monitor the implementation of policy commitments made by the five economies in this multilateral consultation.

### **The G-20 MAP**

In 2009, the G-20 launched a mutual assessment process (MAP) to achieve the objective of “strong, sustained, and balanced growth”. The Fund was asked assist this process by providing “*analysis of how the G-20's respective national and regional policy frameworks fit together*” and “*a forward-looking analysis of whether policies pursued by individual G-20 countries are collectively consistent with more sustainable and balanced trajectories for the global economy.*”

The MAP consists of a two-stage process where Fund staff draft a preliminary assessment report in the first stage (based on G-20 member countries' medium-term policy frameworks, plans, and projections covering the next 3-5 years) and the G-20 undertakes their mutual assessment in the second stage, using Fund staff's analyses and assessments as inputs. Although Fund staff's assistance to the G-20 is separate and distinct from Fund surveillance, the two activities will benefit each other: Fund staff's analytical input to the G-20 members will complement surveillance, by offering scope for additional insights into members' policy plans, and by providing a channel to increase traction.

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<sup>5</sup> See [Time is running out to rebuild the Fund](#), FT.com, July 11, 2006.