

## I. PREVIOUS REVIEWS ON MULTILATERAL SURVEILLANCE

Surveillance may well be the most frequently assessed activity within the IMF. It has been under virtually continuous review since the adoption of the 1977 Surveillance Decision, through both regular and ad hoc processes, including periodic (initially annual, now biennial) reviews mandated by the 1977 decision, frequent internal discussions among the staff, and the 1999 external evaluation (the Crow Report).<sup>1</sup> To help define the parameters of this evaluation, it is useful to establish what previous reviews of surveillance have said about multilateral surveillance in the IMF.

Although the IMF has been involved in multilateral surveillance almost from the beginning, its focus has historically remained on bilateral surveillance.<sup>2</sup> This in part reflects the legal origin of bilateral consultations, which derived from Article XIV of the IMF Articles of Agreement that authorized member countries to maintain exchange restrictions subject to the requirement that they held regular consultations with the IMF. Although the scope of multilateral surveillance has expanded over time in response to the increasing globalization of economic activities, it has still received far less resources than bilateral surveillance and, as expected, previous reviews of surveillance have said far more about bilateral surveillance, and multilateral surveillance as such has received rather limited attention.

While different reviews have emphasized different aspects of multilateral surveillance, it is striking that there is a common set of issues which virtually every previous review has addressed. In 1999, for example, the Chairman's Summing Up of the Executive Board discussion of the Crow Report noted "the substantial common ground between the evaluators' report and the Fund's own internal evaluations," which included the need to "(ii) give more explicit attention to international aspects of a country's macroeconomic policies and spillover issues; (iii) focus more on cross-country comparisons and regional developments;.....and (v) give more emphasis to financial sector and capital account issues." Five years later, in 2004, the internal Biennial Review still noted the need to strengthen the treatment of global spillover, regional developments, and global capital markets issues.

The key findings and recommendations of previous evaluations, including internal staff assessments, fall broadly under the following three headings:

- Integration of multilateral and bilateral surveillance;

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<sup>1</sup> In addition, other stakeholders have also commented on how to strengthen IMF surveillance at various times. Crockett and Goldstein (1987), for example, review the reports issued in 1985 by the Deputies of the Group of Ten and the Deputies of the Group of Twenty-Four on international financial architecture issues, including IMF surveillance.

<sup>2</sup> For example, the flagship vehicle of multilateral surveillance, the *World Economic Outlook*, originated as late as June 1969 (Boughton, 2001).

- Regional surveillance; and
- Capital market surveillance.

The fact that these are recurring themes suggests the inherent difficulty of addressing these issues, but can also mean that, in some cases, staff has not been provided with clear guidance on how to prioritize different surveillance activities. We highlight below the main findings and recommendations on these issues, as found in the four most recent external or internal reviews of surveillance: the 1999 Crow Report; and the 2000, 2002, and 2004 Biennial Reviews (Table 1.1).<sup>3</sup>

### **Integration of multilateral and bilateral surveillance**

The Crow Report emphasized the need to focus surveillance on the international aspects of a country's policies, the linkages across countries, and the lessons countries could learn from the experience of others, and stated that a broad shortcoming of IMF surveillance was the lack of integration of multilateral and bilateral surveillance. It further observed that the forecasting exercise for the WEO was too much of a "bottom-up" process (in which inputs were provided by area departments) and thus suggested that the Research Department should be given ultimate responsibility for the WEO forecast in order to strengthen the "top-down" element.

Much of the 2000 and 2002 Biennial Reviews, while recognizing that there was still room for improvement, described how the IMF had responded to the call for better integration of multilateral and bilateral surveillance. The 2000 review, for example, stated that cross-country themes had appeared more frequently in bilateral surveillance since the Asian crisis. Likewise, the 2002 review stated that the integration of multilateral and bilateral surveillance had "evolved significantly," with the establishment in 2001 of a vulnerability exercise in which information from multilateral surveillance plays a critical role. These reviews understandably reflected the period they covered, when the frequency and global nature of financial distress affected many member countries, and the institution responded by addressing the perceived deficiencies in surveillance instruments.

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<sup>3</sup> "Biennial Review of the Implementation of the Fund's Surveillance and the 1977 Surveillance Decision" (SM/00/40), February 18, 2000; "Biennial Review of the Implementation of the Fund's Surveillance and the 1977 Surveillance Decision" (SM/02/82), March 14, 2002; and "Biennial Review of the Implementation of the Fund's Surveillance and the 1977 Surveillance Decision" (SM/04/212), July 2, 2004.

Table 1.1. Key Findings and Recommendations of Previous Reviews on Multilateral Surveillance

	1999 Crow Report	2000 Biennial Review	2002 Biennial Review	2004 Biennial Review
Integration of multilateral and bilateral surveillance	There is a lack of integration between multilateral and bilateral surveillance; there is a need for more multilateral and cross-country analyses in bilateral surveillance; RES should be given ultimate responsibility for the WEO forecast in order to increase the “top-down” element of multilateral surveillance.	Cross-country perspectives are frequently found in bilateral surveillance, but key themes from multilateral surveillance are rarely found.	Significantly greater integration has been achieved by the introduction of a vulnerability assessment framework in which information from multilateral surveillance plays a critical role.	Integration is satisfactory in terms of quantitative macroeconomic analysis, but substantial room remains for strengthening the analysis of global spillovers and for discussing the impact of global economic conditions and risks in Article IV reports.
Regional surveillance	Surveillance of the euro area should center around the ECB and other EU institutions, with reduced emphasis on bilateral surveillance; there is a need to bring regional spillover issues directly into country consultations and Board discussions	The modality for euro area surveillance has been successful, and similar arrangements are being made for other currency unions; the IMF has been providing intellectual and analytical support to other regional initiatives, including through the establishment of the Office for Asia and the Pacific.	Contacts between staff and regional economic institutions have intensified.	Despite some recent regional surveillance initiatives by area departments, regional spillovers are seldom covered in Article IV reports. Annual Board discussion of regional developments, and a further formalization of surveillance in currency unions outside the euro area, are called for.
Capital market surveillance	Greater attention should be paid to the forces driving the capital account in order to better appreciate the macroeconomic effects of international capital flows.	There has been deeper discussion of the composition of capital flows and more assessment of the risk that these flows could pose for financial intermediaries and the economy at large. Even so, staff reports would benefit from more description of the capital account policy regime and an assessment of the influences of capital flows on the macroeconomy and the financial sector	Capital market surveillance has been improved by intensified information gathering and greater interactions with market participants, which was made possible by the establishment of ICM and the Capital Markets Consultative Group. However, it is still not well integrated with macroeconomic surveillance.	There is a near absence of references to global capital markets in Article IV reports.

The 2004 review duly recognized the progress achieved through these initiatives, but observed that there was “substantial room to strengthen the analysis of regional and global spillovers.” It noted the progress made in integrating the quantitative aspects of bilateral and multilateral analysis—with country data bases feeding into WEO projections and country desks making use of WEO forecasts. Yet, the staff reports for Article IV consultations contained very little discussion of the impact of global economic conditions and risks; and there was almost no reference to global capital markets in the Article IV reports. This is a criticism of bilateral surveillance, but we can also consider this as a criticism of the way multilateral surveillance is put to use within the IMF.

### **Regional surveillance**

There are two aspects to regional surveillance. One is how to adapt the modality of bilateral surveillance to a group of countries under a currency union that share a common monetary policy, and the other relates to the need to incorporate regional spillovers and linkages in surveillance work. The Crow Report addressed both of these issues by recommending that surveillance of the euro area center around the European Central Bank (ECB) and other European Union (EU) bodies, and that regional spillover issues should be directly brought into country consultations and Board discussions.

The 2000 and 2002 reviews devoted much of their discussion to describing the progress made in implementing the recommendations of the Crow Report. The 2000 review, for example, stated that the IMF had paid increasing attention to regional issues from an institutional perspective—there had been more reporting of regional developments to the Board; and the IMF had provided analytical and technical support to regional forums, including through the establishment of the Office for Asia and the Pacific. Likewise, the 2002 review noted that contacts between IMF staff and regional economic institutions had intensified, particularly in the case of currency unions.

The 2004 review, while acknowledging that area departments had made significant efforts to strengthen regional surveillance (through the preparation of regional outlooks, occasional seminars and research papers), noted that regional spillover issues were still rarely discussed in the staff reports for Article IV consultations and, in the case of currency unions outside the euro area, called for a greater formalization of regional surveillance. It further suggested that the results of ongoing regional analysis should regularly be communicated to the Board; annual meetings be organized to discuss economic and market developments in different regions; and the timing of Article IV consultations of neighboring countries could possibly be coordinated in order to promote discussions of regional economic interactions.

### **Capital market surveillance**

The IMF has considerably strengthened its capacity to conduct financial sector and capital market surveillance since the Asian crisis. Of these, financial sector surveillance relates more specifically to bilateral surveillance, for example, within the framework of the Financial Sector Assessment Program (FSAP) jointly administered by the IMF and the World Bank

(see IEO, 2006). In this evaluation of multilateral surveillance, our focus is more on capital market surveillance, including the surveillance of global financial linkages and international capital movements.

Following the Crow Report, which called for greater attention to the forces driving the capital account, the 2000 and 2002 reviews observed the progress made. The 2000 review noted that there had been deeper discussion of the composition of capital flows as well as more assessment of the risk that these flows could pose for financial intermediaries and the economy at large. Likewise, the 2002 review observed the extensive coverage these issues had recently received in the WEO and the GFSR, and the establishment of ICM and the Capital Markets Consultative Group designed to improve the flow of capital market information to the IMF.

Neither of these reports was complacent. The 2000 review, while stating that key capital account topics were covered in the majority of the staff reports reviewed, suggested that there should be an assessment of the influences of capital flows on the macroeconomy and the financial sector. The 2002 review noted that, despite the improvement in capital market surveillance, capital market and macroeconomic surveillance were still not well integrated. These observations are echoed by the 2004 review, which noted the near absence of references to conditions in global capital markets in Article IV reports. In particular, it stated that “less than 10 percent of all Article IV reports linked domestic financial conditions to movements in world interest rates; only about a quarter of emerging market reports referred to the impact of past or prospective capital market conditions for emerging markets; and less than 20 percent of advanced country reports mentioned the effects of movements on global equity markets.”

### **The role of the Executive Board**

In addition to the three recurring themes discussed above, the role of the Executive Board has also received occasional attention in previous reviews. The Executive Board plays various roles in the IMF’s surveillance. It authorizes the release of surveillance outputs to the public; it provides guidance to the staff on how to prioritize surveillance activities; and it is the Board’s discussion, and the summing up thereof, that expresses the IMF’s official views. It therefore comes as no surprise that the role of the Board has also been discussed in the past in the context of multilateral surveillance.

The Crow Report, for example, noted that Executive Directors tended to “lean more heavily on the staff to modify judgments of policies in their respective countries than is healthy for the long-run reputation” of surveillance publications, and called for a simplified Board clearance procedure and the presumption that the staff drafts of multilateral surveillance reports be published as they stood. The IMF’s transparency policy (under which most country documents are now released to the public), however, has made this less of an issue in more recent years.

More fundamental to the role and effectiveness of the IMF in multilateral surveillance is the emergence, over the years, of multiple channels for global policy debate. Kenen et al. (2004), for example, argue that strategic direction for the IMF has directly been provided by the G-7 in recent years and that the Executive Board has not been “the forum for debating the principal issues of international financial policy.” In part responsible for this outcome were advancements in transportation and telecommunications, which allowed policymakers in national capitals to have direct inputs into the deliberations of the Executive Board (as well as other multilateral forums) and thereby diminished “the freedom of action of Executive Directors.” For the IMF’s multilateral surveillance to have impact, staff memorandums have noted the need to participate in the G-7 and other intergovernmental processes where key policy decisions are discussed.