ANNEX 7 How Did Country Authorities View the IMF's Performance?[36]

The country authorities who were interviewed were almost unanimous in the view that the Fund failed to warn sufficiently about the risks and vulnerabilities that led to the crisis.[37] However, few of them blamed the Fund or the individual mission teams for this failing. They admitted that most observers (including themselves and their fellow authorities) had also been overly comforted by the prolonged benign global environment. As one interviewee put it, "Neither we nor the IMF staff exercised imagination." The few outside voices that had expressed grave concerns (William White and Nouriel Roubini were among the most frequently cited) were typically not heeded in this seemingly "new paradigm" of a more stable global financial system, underpinned by innovation and risk dispersion.

Despite the Fund's failure to warn of the impending crisis, country authorities, in most cases, had much positive to say about the Fund and the bilateral surveillance process. Among the positives were a high general regard for Fund staff competency and analysis. The authorities felt that discussions with mission teams were usually candid, constructive, and of high quality, bringing useful and independent third-party views to the policy debate. Furthermore, most of those interviewed believed that the Fund's financial sector analysis had improved significantly over the years, and they had a generally high regard for the Financial Sector Assessment Program (FSAP) in particular. FSAPs had often been the catalyst to strengthen countries' financial sector policies, including spurring countries to do their own stress testing and move toward international best practices in supervision and regulation.

At the same time, country authorities provided many criticisms regarding the Fund's performance prior to the crisis. The subjects ranged from analytical weaknesses to political biases, the surveillance process, and organizational problems.

On the analytical front:

- The Fund's *general mindset that markets know best* and financial innovation reduces risks would have made it difficult for the staff to see the buildup of systemic risks.
- Bilateral surveillance typically *focused primarily on domestic policies* and vulnerabilities, offering little analysis of spillovers and contagion (even in the case of small, open economies).[38] Where there was some discussion on spillovers or contagion, the Fund usually saw the problems as arising from emerging markets, not from the advanced economies.
- Notwithstanding improvements over the past decade, *the Fund still had not adequately linked macroeconomic with financial sector analysis.* This inadequacy was reflected in the heavy reliance on models that to date have been unable to adequately capture macro-financial linkages.[39]
- *Balance sheet analysis* was infrequently employed. Furthermore, when it was used, it was sometimes done incorrectly.
- While the IMF had performed no worse than others in foreseeing the crisis, it *had not used its*

[36] The views expressed here are based on interviews with country authorities as well as some regional and international institutions.

[37] The results from the survey undertaken for IEO's evaluation of *IMF Interactions with Member Countries* (IEO, 2009) indicate that only a minority of advanced and emerging market officials thought the IMF did a good job of alerting member countries about imminent external risks. While a majority of the country authorities rated the IMF's performance highly on various aspects of interactions, two areas stood out in which only a minority thought the IMF had performed well: (i) presenting alternative scenarios and addressing "what if?" questions and (ii) bringing quickly to the authorities' attention the implications of changing external conditions.

[38] Similarly, in the IEO evaluation of *IMF Interactions with Member Countries* (IEO, 2009) a majority of respondents to a survey of country authorities wanted a greater IMF contribution to spillover analyses, yet did not rate the IMF highly for its effectiveness in this area.

[39] The survey of country authorities undertaken for the IEO's evaluation of IMF research (IEO, 2011, forthcoming) found that while a majority of country authorities thought that IMF selected issues papers were somewhat or very useful in informing the policymaking process, in those instances where they were not deemed "very useful," the most frequently cited reasons were that the analytical framework was not suited to the realities of the country or that the research was too theoretical with little practical applicability.

comparative advantage in analyzing cross-cutting global issues and identifying risks.

- More use of *cross-country analysis* (particularly on countries that were facing similar issues) might have helped in identifying common vulnerabilities.

On political biases:

- A repeated theme was the apparent *lack of even-handedness* in how the Fund treats its largest shareholders versus all others. Many country authorities believed that the Fund offered much more hard-hitting critiques of the policies of emerging markets and smaller advanced countries. Meanwhile, even when there were obvious commonalities in vulnerabilities with smaller countries, the large advanced countries were given the benefit of the doubt that their policymakers, supervisors, and regulators would be able to steer their economies through any rough patches. The 2007 Decision on Bilateral Surveillance only heightened this sense of unequal treatment. This perception also came out clearly in the survey of country authorities for the IEO's evaluation of *IMF Interactions with Member Countries*; for example, 86 percent of survey respondents from large emerging markets said that surveillance was in the interest of the "largest IMF shareholders." In particular, some felt that the IMF was insufficiently critical of the policies of a major shareholder.

On the surveillance process itself:

- A number of country authorities recognized that the Fund had identified many of the risks and vulnerabilities but typically presented these in a "laundry list of warnings, with no prioritization." That is, all Fund staff reports had the usual economist approach of "on the one hand (with list of economic positives first—which sets the tone), followed by on the other hand (with list of downside risks)." They asked how one should respond to such a wide-ranging list of risks, listed with no sense of probabilities nor urgency.
- Policy recommendations were often obvious (e.g., tighten fiscal policy, pursue a credible and sound monetary policy, or strengthen supervision) but lacked specificity about how to implement them. According to one interviewee, "interactions on the Article IV often feel like just any other meeting I have with all those international institutions, too formulaic."
- As for the value added by the Executive Board to bilateral surveillance, nearly all felt this was minimal at best, as the Board's contributions were usually very belated (coming months after the mission team's concluding statement had been presented to the country authorities) and often superficial (e.g., Summings Up were typically a fairly generic reiteration of the staff report).

On organizational problems:

- The high turnover of staff on mission teams was often cited. This implied a considerable loss of country knowledge and a constant training of new mission members to understand country specifics, history, and culture, all of which are very important for providing relevant policy advice and gaining traction.
- The turnover problem was worsened by the IMF's restructuring exercise, which was conducted precisely when the crisis was taking hold. In some cases, the restructuring caused countries to experience a complete turnover of mission members or even periods with no mission chief.
- Finally, the more general issue of staff resources was also reflected in the very infrequent FSAP updates. More continuous follow-up on financial sector issues might have better illuminated the problems ahead of time.

Interviewees also raised some issues that could be interpreted as having aspects which were both positive and negative regarding the Fund's performance:

- In almost everyone's view, the Fund must *walk a very fine line between highlighting the risks of a crisis and actually precipitating one*. For this reason, more sensitive messages would sometimes be communicated privately and orally to the authorities. However, on occasion, the authorities on the receiving end of such messages admitted that they did not remember what was said, because the only documented views of the mission were in the concluding statement.
- Many of the authorities agreed that the Fund teams clearly highlighted the domestic vulnerabilities and risks … but said that those were *obvious to everyone*.
- Finally, while the *WEO* and *GFSR*[40] pointed to many of the pertinent risks and vulnerabilities and were generally held in high regard, policymakers did not notice any warnings regarding an impending crisis. This was widely attributed to the *overall upbeat banner messages* that typified these documents in the run-up to the crisis.

[40] Many of the interviewees admitted that they only had time to read the documents' Executive Summaries. While many did not read the *GFSR* due to its more technical nature, those involved with financial stability issues did read it.