Executive Summary

This evaluation assesses the performance of IMF surveillance in the run-up to the global financial and economic crisis and offers recommendations on how to strengthen the IMF's ability to discern risks and vulnerabilities and to warn the membership in the future. It finds that the IMF provided few clear warnings about the risks and vulnerabilities associated with the impending crisis before its outbreak. The banner message was one of continued optimism after more than a decade of benign economic conditions and low macroeconomic volatility. The IMF, in its bilateral surveillance of the United States and the United Kingdom, largely endorsed policies and financial practices that were seen as fostering rapid innovation and growth. The belief that financial markets were fundamentally sound and that large financial institutions could weather any likely problem lessened the sense of urgency to address risks or to worry about possible severe adverse outcomes. Surveillance also paid insufficient attention to risks of contagion or spillovers from a crisis in advanced economies. Advanced economies were not included in the Vulnerability Exercise launched after the Asian crisis, despite internal discussions and calls to this effect from Board members and others.

Some of the risks that subsequently materialized were identified at different times in the *Global Financial Stability Report*, but these were presented in general terms, without an assessment of the scale of the problems, and were undermined by the accompanying sanguine overall outlook. These risks were not reflected in the *World Economic Outlook* or in the IMF's public declarations. The IMF did appropriately stress the urgency of addressing large global current account imbalances that, in the IMF's view, risked triggering a rapid and sharp decline in the dollar that could set off a global recession. But the IMF did not link these imbalances to the systemic risks building up in financial systems.

The IMF's ability to detect important vulnerabilities and risks and alert the membership was undermined by a complex interaction of factors, many of which had been flagged before but had not been fully addressed. The IMF's ability to correctly identify the mounting risks was hindered by a high degree of groupthink, intellectual capture, a general mindset that a major financial crisis in large advanced economies was unlikely, and inadequate analytical approaches. Weak internal governance, lack of incentives to work across units and raise contrarian views, and a review process that did not "connect the dots" or ensure follow-up also played an important role, while political constraints may have also had some impact.

The IMF has already taken steps to address some of these factors, but to enhance the effectiveness of surveillance it is critical to clarify the roles and responsibilities of the Board, Management, and senior staff, and to establish a clear accountability framework. Looking forward, the IMF needs to (i) create an environment that encourages candor and considers dissenting views; (ii) modify incentives to "speak truth to power;" (iii) better integrate macroeconomic and financial sector issues; (iv) overcome the silo mentality and insular culture; and (v) deliver a clear, consistent message on the global outlook and risks.