

Evaluation Summary

# Multilateral Surveillance



Evaluation Report

# Multilateral Surveillance



Independent Evaluation Office of the IMF • 2006

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Production: IMF Multimedia Services Division

Typesetting: Alicia Etchebarne-Bourdin

Figures: Jason Soleil

**Cataloging-in-Publication Data**

Multilateral surveillance/[prepared by a team headed by Shinji Takagi and including Thomas Reichmann . . . [et al.]—[Washington, D.C.]: Independent Evaluation Office, IMF, 2006—(Evaluation report).

ISBN 1-58906-553-0

Includes bibliographical references.

1. International Monetary Fund—Evaluation. 2. Economic policy. I. Takagi, Shinji, 1953– II. Reichmann, Tomás. III. Series: Evaluation report (International Monetary Fund).

HG3881.5.I58M8 2006

Price: US\$25.00

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The following conventions are used in this publication:

- In tables, ellipsis points (. . .) indicate “not available” and 0 or 0.0 indicates “zero” or “negligible.” Minor discrepancies between sums of constituent figures and totals are due to rounding.
- An en dash (–) between years or months (for example, 2005–06 or January–June) indicates the years or months covered, including the beginning and ending years or months; a slash or virgule (/) between years or months (for example, 2006/06) indicates a fiscal or financial year, as does the abbreviation FY (for example, FY2006).
- “Billion” means a thousand million; “trillion” means a thousand billion.
- “Basis points” refer to hundredths of 1 percentage point (for example, 25 basis points are equivalent to ¼ of 1 percentage point).

As used in this publication, the term “country” does not in all cases refer to territorial entity that is a state as understood by international law and practice. As used here, the term also covers some territorial entities that are not states but for which statistical data are maintained on a separate and independent basis.

Some of the documents cited and referenced in this report were not available to the public at the time of publication of this report. Under the current policy on public access to the IMF’s archives, some of these documents will become available five years after their issuance. They may be referenced as EBS/YY/NN and SM/YY/NN, where EBS and SM indicate the series and YY indicates the year of issue. Certain other documents are to become available 10 or 20 years after their issuance, depending on the series.

# Foreword

Surveillance is one of the most important activities of the IMF, and is central to its efforts to promote global financial stability through international monetary cooperation. Multilateral surveillance can identify economic linkages and policy spillovers between countries, as well as international economic and market developments. It can complement bilateral surveillance by adding global and cross-country perspectives to the analysis of developments in individual countries and in so doing, it can enhance the quality and relevance of the IMF's policy advice.

What is special about the IMF's role is that its near-universal membership gives it a uniquely broad perspective, and that all IMF member governments have committed themselves to be part of its system of peer review and oversight. However, to be influential in this environment, multilateral surveillance must bring to bear analytical rigor, clear policy prescriptions, and an active engagement with senior national policymakers and relevant international forums.

Given the substantial cost to the IMF of its multilateral surveillance activities, and the key role that the IMF has in ensuring a more stable world economy, the Independent Evaluation Office conducted an evaluation of the IMF's multilateral surveillance activities for the period 2000–05. The evaluation separated issues concerning content and quality from issues of use, delivery, and ultimate effectiveness, and evaluated both using data gathered from desk studies of outputs, surveys of stakeholders, and interviews of government officials. This evaluation report recognizes the analytical quality of many individual components of multilateral surveillance. However, it sees considerable scope for improvement, in particular through better integration of financial and macroeconomic dimensions, as well as bilateral and multilateral analysis and policy prescriptions.

The report recommends that the IMF strengthen its role at the center of a more robust global peer review system by establishing a more proactive engagement with relevant intergovernmental groups; enhance the roles of the Executive Board and the International Monetary and Financial Committee in multilateral surveillance; streamline and better focus the products of multilateral surveillance, present shorter and clearer messages, and deliver them more strategically to target groups; and define more clearly the goals of multilateral surveillance and the mechanisms to achieve them.



Thomas A. Bernes  
*Director*  
*Independent Evaluation Office*

### **Multilateral Surveillance**

This evaluation report was prepared by a team headed by Shinji Takagi and including Thomas Reichmann, Nils Bjorksten, Halim Kucur, and Ramya Ghosh. Additional contributions were received from David Peretz and Misa Takebe. The report was approved by Thomas A. Bernes, Director of the Independent Evaluation Office. Chapters of the report benefited from inputs from David Goldsbrough and Marcelo Selowsky. Administrative support by Arun Bhatnagar, Annette Canizares, and Maria Gutierrez is gratefully acknowledged, as is editorial assistance from David Cheney and Esha Ray.

# Abbreviations and Acronyms

AfDB	African Development Bank
AFR	African Department (IMF)
AsDB	Asian Development Bank
APD	Asia and Pacific Department (IMF)
APEC	Asia-Pacific Economic Cooperation Council
<i>BAR</i>	<i>BIS Annual Report</i>
BEL	Bond, Equities, and Loans database (IMF)
BIS	Bank for International Settlements
CEE	Central and Eastern Europe
CEMAC	Central African Economic and Monetary Union
CGER	Coordinating Group on Exchange Rate Issues (IMF)
CGFS	Committee on the Global Financial System
CIS	Commonwealth of Independent States
CVU	Corporate vulnerability utility (IMF)
ECB	European Central Bank
ECCU	Eastern Caribbean Currency Union
ECLAC	Economic Commission for Latin America and the Caribbean (United Nations)
Ecofin	Economic and Financial Affairs (EU)
EFC	Economic and Financial Committee (EU)
EPC	Economic Policy Committee (OECD)
EU	European Union
EUR	European Department (IMF)
EXR	External Relations Department (IMF)
FAD	Fiscal Affairs Department (IMF)
FATF	Financial Action Task Force
FDI	Foreign direct investment
FIN	Finance Department (IMF)
FMU	Financial Market Update (IMF)
FSF	Financial Stability Forum
<i>FSR</i>	<i>Financial Stability Review</i> (Bank of England)
FST	Financial Systems Trends (IMF)
FY	Fiscal or financial year
G-3	Group of Three
G-5	Group of Five
G-7	Group of Seven
G-10	Group of Ten
G-20	Group of Twenty
GAB	General Arrangements to Borrow
GAO	Government Accountability Office (United States) <sup>1</sup>
GDP	Gross domestic product
GDS	Global Data Source database (IMF)

<sup>1</sup> Until July 6, 2004, known as General Accounting Office.

GEE	Global Economic Environment data (IMF)
GEM	Global Economy Model (IMF)
GFM	Global Fiscal Model (IMF)
<i>GFSR</i>	<i>Global Financial Stability Report</i> (IMF)
GMM	<i>Global Markets Monitor</i> (IMF)
GTAP	Global Trade Analysis Project
HIPC	Heavily Indebted Poor Countries Initiative (IMF and World Bank)
IAIS	International Association of Insurance Supervisors
ICM	International Capital Markets Department (IMF)
<i>ICMR</i>	<i>International Capital Markets Report</i> (IMF)
IEO	Independent Evaluation Office (IMF)
IFI	International financial institution
IMF	International Monetary Fund
IMFC	International Monetary and Financial Committee (IMF)
IOSCO	International Organization of Securities Commissions
IT	Information technology
LIBOR	London interbank offered rate
MAE	Mean absolute error
MCD	Middle East and Central Asia Department (IMF)
MDG	Millennium Development Goals (United Nations)
ME	Mean error
MERM	Multilateral Exchange Rate Model (IMF)
MFD	Monetary and Financial Systems Department (IMF)
MULTIMOD	Multi-Region Econometric Model (IMF)
OECD	Organization for Economic Cooperation and Development
OEO	<i>OECD Economic Outlook</i>
PDR	Policy Development and Review Department (IMF)
PIN	Public Information Notice (IMF)
PPP	Purchasing power parity
RES	Research Department (IMF)
RMSE	Root mean squared error
ROSC	Report on the Observance of Standards and Codes (IMF)
SEC	Secretary's Department (IMF)
UFR	Use of Fund resources (IMF)
VAR	Vector autoregression
VE	Vulnerability exercise (IMF)
WAEMU	West African Economic and Monetary Union
WEMD	World Economic and Market Developments (IMF)
<i>WEO</i>	<i>World Economic Outlook</i> (IMF)
WHD	Western Hemisphere Department (IMF)
WP1	Working Party 1 (OECD)
WP3	Working Party 3 (OECD)
WTM	World Trade Model (IMF)

# Summary of Findings and Recommendations

**S**urveillance is a core function of the IMF, a critical element of its toolkit to promote global financial stability through international monetary cooperation. Multilateral surveillance brings into analysis economic linkages and policy spillovers between countries, as well as international economic and market developments. It complements bilateral surveillance by adding global and cross-country perspectives to the analysis of developments in individual countries. And by exploring options to deal with policy spillovers in a global context, it can enhance the policy advice that the IMF gives to its members.

The IMF is not alone in providing analysis of the world economy. What is special about the IMF is that all governments that belong to the organization have committed themselves to be part of a system of peer review and oversight. The near universal membership of the IMF gives it a unique perspective. At the same time, a number of other government bodies and private sector entities are engaged in surveillance-type activities. For the IMF to have preeminent impact in this environment, it must bring to bear analytical rigor, clear policy prescriptions, and an active engagement with senior national policy-makers and relevant forums.

The ultimate test of the effectiveness of multilateral surveillance is its impact on policies in member countries. Are such policies ever modified as a result of IMF advice about linkages and spillover effects, or as a result of discussions or peer pressure in international forums to which the IMF provides analysis and advice? Such an assessment is difficult for several reasons, including the multiple factors that influence a country's policies. The main focus of the evaluation is therefore more on the content and quality of multilateral surveillance and how effectively policy implications are drawn and communicated.

Among the questions we address are: (1) Do the issues analyzed correspond to the IMF's unique perspective with respect to economic linkages between countries? (2) Are the issues examined relevant and timely? (3) Does multilateral surveillance enhance the policy advice provided by bilateral surveillance? (4) How well are macroeconomic and capital market surveillance combined in the analysis of relevant

issues? (5) Are the messages of multilateral surveillance reaching the intended audience? (6) Are the messages being presented in a way that maximizes their impact?

## Overall Assessment

IMF multilateral surveillance is carried out by various departments and interdepartmental committees. IMF staff uses a wide range of vehicles to analyze economic developments, and the resulting policy messages are conveyed in a wide range of outputs or products (see box). Most of the individual components of the final products are well crafted and feature high-quality analysis; they are useful to particular audiences and fulfill particular needs. The *World Economic Outlook (WEO)* is especially well regarded. This evaluation, however, finds that a clear and comprehensive strategy is lacking to guide the integration of the components and the delivery of outputs. As a result, multilateral surveillance is not achieving its full potential.

The absence of an overall strategy has meant that the IMF's multilateral surveillance as a whole is less than the sum of its parts. Outputs give too much weight to providing information on economic developments and prospects, for which the IMF is increasingly only one of many providers. And they give too little weight to analyzing economic policy linkages, in which the IMF has a comparative advantage, and proactively identifying scope for collective action. The current setup for involving the Executive Board limits its contribution to multilateral surveillance. The failure to clarify the operational goals and define the mechanisms to best meet them has resulted in:

- a predominantly “bottom-up,” or country-based, approach to policy advice;
- a “silo” structure (in which different IMF departments produce different outputs without adequate coordination) that hinders the fuller integration of macroeconomic and capital market approaches;

### The Main Outputs of IMF Multilateral Surveillance

IMF multilateral surveillance is disseminated to various audiences through a number of outputs, described in greater detail in Background Documents (pp. 9–20).<sup>1</sup> These outputs include:

- Semiannual “flagship” reports: the *World Economic Outlook (WEO)* and the *Global Financial Stability Report (GFSR)*;
- Regional outlooks produced by four of the IMF area departments;
- Regular contributions to intergovernmental forums and committees, such as the Group of Seven (G-7), the Group of Twenty (G-20), and the Financial Stability Forum (FSF);
- Confidential analyses of periodic IMF-internal exercises: the Coordinating Group on Exchange Rate Issues, the vulnerability exercise, and World Economic and Market Developments (WEMD); and
- Internal reports: the semiannual *Financial Systems Trends*, the semiannual *Financial Market Update*, and the daily *Global Markets Monitor*.

<sup>1</sup>The background documents are available at [www.imf.org/ieo](http://www.imf.org/ieo).

- a proliferation of publications that lack focus; and
- an insufficiently proactive engagement with various high-level groups of national policymakers.

## Major Findings

### Content and quality

*Selection of issues for analysis.* The products of multilateral surveillance—especially the *WEO*—have been largely successful in selecting for analysis issues that reflect the IMF’s comparative advantage. The *WEO* gives roughly equal weight to issues that deal with the spillovers of policies in individual countries and to analyzing and comparing the experience of different countries. Dedicated analysis of exchange rate issues and related spillover effects, however, does not appear frequently—which is surprising given the IMF’s mandate to oversee the international monetary system and the exchange rate policies of its member countries.

*Timely identification of relevant issues and global risks.* The *WEO* has also largely succeeded in identi-

fying in a timely way relevant issues for analysis, as measured against the issues subsequently picked up by G-7 and G-20 agendas. In terms of identifying relevant global macroeconomic and financial risks, both the *WEO* and the *Global Financial Stability Report (GFSR)* also compare favorably with similar publications of other international and national bodies. This assessment, however, is based on evidence gathered during the relatively calm period of 2000–05, when no major crisis tested the IMF’s “early warning” mechanisms.

*Integration of multilateral and bilateral surveillance.* The evaluation confirms the findings of the 1999 external evaluation of surveillance that the IMF’s surveillance has a strong bilateral (or country) orientation, so that policy advice and economic forecasts predominantly reflect the views of IMF area departments (the departments—grouped by geographic region—that carry out bilateral surveillance). As a result of this country orientation, multilateral surveillance has not sufficiently explored options to deal with policy spillovers in a global context; the language of multilateral advice is no more based on explicit consideration of economic linkages and policy spillovers than that of bilateral advice. In addition, the dominant bottom-up (or individual country) approach also tends to yield consistently optimistic macroeconomic forecasts for certain regions.

*Integration of macroeconomic and capital market analysis.* The IEO evaluation notes the insufficient integration between the *WEO* and the *GFSR*, a point also emphasized by the recent McDonough Report.<sup>1</sup> The evaluation identifies areas where integration could have been desirable but did not take place, largely owing to the “silo” structure of multilateral surveillance.

### Use and delivery

*Use of the WEO in bilateral surveillance.* There is substantial scope for IMF staff to increase its use of multilateral surveillance outputs in bilateral surveillance work. The evaluation finds that most area department economists do not make much use of the *WEO* in their country work (other than the *WEO*’s quantitative forecasts of major economic variables). Indeed, only 14 percent of the senior staff surveyed said that *WEO* topics were discussed with national authorities.

<sup>1</sup>An external review that provided the IMF with an independent perspective on how it should organize its financial sector and capital market analysis and surveillance activities. The review was led by U.S. Public Company Accounting Oversight Board Chairman William J. McDonough, former President of the New York Federal Reserve Bank.

*Use of the GFSR in bilateral surveillance.* Few area department economists use the *GFSR* on a regular basis (only 4 percent of the survey respondents used it “regularly” in their country work). Although the *GFSR* has raised some important longer-term issues, it has not in practice added value to bilateral surveillance beyond the information already available in the markets. It has not adequately distilled the implications of market developments for the IMF’s day-to-day country work.

*Presenting the message.* Given the variety of tasks assigned to multilateral surveillance products, the documents have tended to be too long and to lack focus. In the case of the main surveillance chapter of the *WEO* (Chapter I), for example, each component of the analysis may be useful to a particular audience or meet a particular need, but the efforts to meet all the varying demands have expanded the chapter unduly. Indeed, the full *WEO* document could benefit from considerable streamlining so that its critical messages were more clearly highlighted. As to surveillance notes, they should concentrate on spelling out the consequences of policy spillovers and objectively presenting options for dealing with them.

*Reaching the intended audience.* Attempts to reach multiple audiences through the same publications have complicated the task of communicating the messages effectively. The wide press coverage enjoyed, particularly by the *WEO*, indicates that IMF multilateral surveillance messages have a significant potential for influencing public debate. Yet, we were struck by the low readership (both internally and externally) of the *WEO* itself. Most readers rely on summaries rather than read the document itself. This underscores the need for the products of IMF multilateral surveillance to have a more explicit “customer” focus, with a range of well-communicated products aimed at meeting the diverse needs of various audiences.

*Potential for peer pressure.* The potential for multilateral surveillance to exert peer pressure on individual country policies is not fully exploited. First, the IMF is not proactively engaged with the G-7, the G-20, or other forums to which it has unique access. Second, the current structure for involving the Executive Board limits the contributions that it (and the International Monetary and Financial Committee, IMFC) can make to multilateral surveillance.

## Recommendations

**Recommendation 1.** *Strengthen the IMF’s role at the center of a more robust global peer review system by establishing a more proactive engagement with relevant intergovernmental groups.*

*The IMF should become more proactive with respect to intergovernmental groups, particularly the G-7 and the G-20.* The emergence of these and other government bodies (e.g., the Organization for Economic Cooperation and Development (OECD) and the Financial Stability Forum (FSF)) and regional groupings (e.g., the euro area, the Asia-Pacific Economic Cooperation Council (APEC), and Western Hemisphere Finance Ministers), as well as increasingly sophisticated officials in capitals, have fundamentally altered the context in which the IMF must act. Increasingly, the IMF must draw on its strength (near-universal membership) and comparative advantage to provide leadership to this global system; it must also draw upon the global system’s collective output to strengthen its own policy advice. The IMF has unique access to the G-7, the G-20 (which includes key emerging market economies), and other global and regional forums of senior national policymakers. Because these forums meet frequently, have limited attendance, and involve actual decision makers, they may provide opportunities for a more frank discussion of policy spillovers and possible responses, and for more effective peer pressure than is possible in larger meetings or at meetings of less senior officials. Rather than seeing such groups as competitors, it is critical that the IMF expand its ties to these groups, while at the same time enhancing the involvement of the IMFC.

Management and the Board could consider a number of possible approaches, such as:

- establishing a unit dedicated to maintaining constant contact with the relevant officials of systemically important countries, particularly the chairpersons that guide the work of these groups;
- giving more attention to the continuity of IMF representations at these meetings to allow it to foster personal relationships of trust; and
- focusing surveillance notes on policy spillovers and options for addressing them. The review of recent developments and prospects could be made into an appendix to the note. A one-page, double-spaced summary should accompany these notes, directly targeted at the senior national policymakers.

**Recommendation 2.** *Enhance the roles of the Executive Board and the IMFC in multilateral surveillance.*

- Executive Directors play many roles in multilateral surveillance, including as conduits for information to the national authorities and in helping prepare the IMFC discussions. The Board’s primary multilateral surveillance discussions

currently center on draft *WEO* and *GFSR* documents, each of which is too large to serve as the basis for meaningful policy discussions (particularly within a tight time frame). As a result, the Board's attention is inevitably focused on factual clarifications and drafting suggestions. To address this weakness, the Board could:

- focus its surveillance discussions on a few issues of critical importance, so as to promote free and open discussion. It might identify and agree on key issues for ministers to focus on at the upcoming IMFC meeting;
  - endorse, every six months (say, in summer and winter) in the context of a World Economic and Market Developments (WEMD) session, a short statement on the state of the world economy. This statement should be communicated to the public, including through a Public Information Notice (PIN),<sup>2</sup> similar to what is done with respect to Article IV consultations with individual countries;
  - consider setting up a standing committee to monitor progress on strengthening the IMF's and the Board's surveillance activities.
- *The IMFC should focus on issues related to policy spillovers and scenarios for collective action.* To encourage a more frank and focused consideration of these issues, the Executive Board could prepare, ahead of an IMFC meeting, a short statement of the critical issues facing the global economy and their implications for senior policymakers. This statement could be presented to capitals sufficiently ahead of the meeting to allow time for consideration.

**Recommendation 3.** *Improve the content and form of multilateral surveillance outputs through streamlining and more focus on key issues.*

- *To heighten their impact on the global policy debate, IMF multilateral surveillance products should present a much shorter and more focused message, coupled with a more strategic communications policy to better deliver key messages to target groups.* In a world with numerous analyses of global macroeconomic developments and prospects, and in which the IMF's informational advantage has diminished, the IMF cannot expect to affect the policy debate unless it can clearly articulate and skillfully present its messages on the global situation and on the risks and

<sup>2</sup>PINs provide background information and Executive Board summing up on Board discussions of Article IV reports, surveillance developments, or general policy matters.

policy implications it poses. Although multilateral surveillance contributes useful pieces to the global policy debate, the lack of clearly stated objectives has led to multiple publications; multitasking by each of these publications, with a resultant loss of focus; and the absence of an institution-wide communications strategy to coordinate the timing and delivery of clearly articulated and critical messages. In our view, the IMF needs to review and reorient its major multilateral surveillance publications. In this connection, the report on the "Macroeconomics of Globalization" recently proposed by the Managing Director provides an opportunity to rethink and, if necessary, streamline or consolidate some of the existing publications.<sup>3</sup> It is not our intent to recommend a specific approach as many variations are possible. But the following possibilities might be considered:

- The special topics chapters of the *WEO* and the *GFSR* that deal with long-term issues could be separated and included in a new globalization report;
- The *WEO* could be streamlined and focused on areas where the IMF can provide the greatest value added over information available elsewhere;
- The current Chapter II of the *GFSR* (which reviews recent developments and potential vulnerabilities) could be absorbed in a more macrorelevant way into what is now Chapter I of the *WEO*;
- The *WEO* could make wider use of scenario analysis and cite the results of such analysis more openly in the main text, drawing pointed policy implications where feasible. It could explore integrating emerging methodologies of scenario analysis into the IMF's existing global economic models;
- A short note should accompany each *WEO*, assessing critical global economic issues and drawing out their policy implications in a way that would be helpful and accessible to senior national policymakers;
- The timing of publications could be better sequenced to allow the intended audiences suf-

<sup>3</sup>In August 2005, the Managing Director proposed to the Executive Board that a "Report on the Macroeconomics of Globalization" should be launched to complement the *WEO* and the *GFSR*. He noted that such a report could focus on long-term aspects of globalization "in greater depth than is currently possible in the six-monthly time frame of the *WEO* and *GFSR*." See "Draft Report of the Managing Director on the Fund's Medium-Term Strategy," SM/05/332, August 2005.

ficient time to absorb them. At present, the *WEO* and *GFSR*—which consist of about 500 typeset pages—are delivered almost simultaneously for the spring and fall meetings of the IMFC.

- *The Executive Board should clarify the scope of regional surveillance.* IMF staff has taken various initiatives in recent years with respect to its regional work, partly responding to the call of some Executive Directors. In addition to the surveillance of common currency areas, which has become more formalized, most area departments have begun to produce regional economic outlooks. A large portion of these reports, however, describes recent economic developments and prospects, information which is available elsewhere. While regional outreach has been well received, it is not clear that regional outlooks effectively serve a regional surveillance function—which would require them to concentrate on regional economic interlinkages and policy spillovers. The Board’s clarification should cover the following issues:
  - the role of regional outlook publications in the IMF’s overall publications policy;
  - whether it makes more sense to reorient some regional studies on the basis of analytical constructs (such as stage of development, small island economies, or some other element of commonality), rather than on the basis of geography defined by the jurisdiction of an area department. If so, the Board should assign responsibility for initiating and producing such cross-country studies;
  - whether analytical chapters of regional outlooks—which deal with topical issues—might also be included in the proposed globalization report.

***Recommendation 4.*** *Strengthen the structure of multilateral surveillance by clarifying operational goals and defining organizational strategies and accountabilities.*

- *The IMF should clarify the operational goals of multilateral surveillance and define the strategies and mechanisms to achieve these goals,* including, for each output, the purpose, the intended audience, who is accountable, and how to measure effectiveness. The lack of clearly stated goals has led to differing views of these goals and their meaning and to an inability to measure effectiveness.
- *The IMF needs to strengthen the multilateral dimension of surveillance, particularly for “systemically important” countries* (that is, countries that have an impact on global financial stability). The need to better integrate bilateral and multilateral surveillance has long been recognized. However, despite all efforts, including repeated Board directives, Policy Development and Review Department (PDR) guidance notes, and the IMF’s internal review process, integration has not been achieved. Although one is tempted to say “just do it,” the failure of earlier efforts over at least the last six years must give reason for pause. There is a need for serious reflection on why the existing incentive structure within the institution has thwarted progress on this front. At a minimum, benchmarks need to be established to measure progress on the integration of financial sector and capital markets work with macroeconomic work, and on the integration of multilateral and bilateral surveillance. Success in meeting these benchmarks should then be a key component of the scheduled 2008 Biennial Review of Surveillance.
- To achieve this goal may require more fundamental organizational changes. Such change can be disruptive and should not be undertaken lightly. Many considerations are relevant and the IEO is not in a position to make specific recommendations. However, a number of possible options, ranging from major structural change to a reallocation of accountabilities within the existing organizational structure, have been identified and are worth considering:
  - Given the centrality of surveillance, the IMF could establish a Surveillance Department by combining the existing multilateral surveillance functions of the Research Department (RES) and the surveillance functions of the PDR.
  - For each systemically important country, the IMF’s Economic Counsellor (and head of RES) could prepare a one-page assessment of the key policy measures that would contribute toward resolving core global surveillance challenges prior to the Article IV consultation discussion at the Board.
  - Give sign-off authority to RES—in addition to PDR—on the briefing papers and staff reports for Article IV consultations with systemically important countries, and promote RES’s more active participation in country work. This may call for the creation of a

global surveillance division responsible for integrating all aspects of IMF surveillance.

- Make greater use of the internal Surveillance Committee, chaired by management, to form institutional positions on systemically important issues, including exchange rates, and to contribute to management’s accountability to the Board.
- *As already recognized within the IMF, the work of the International Capital Markets Department, ICM (soon to be merged with the Monetary and Financial Systems Department, MFD) should be reoriented toward informing IMF economists of the macroeconomic implications of market developments and unfolding risks. The evaluation confirms the findings of previous evaluations, as well as the recent McDough Report, that capital market surveillance is not well integrated into the work of the rest*

of the IMF. The following steps could thus be considered:<sup>4</sup>

- The new department to be created by merging ICM and MFD could make greater efforts to distill the macroeconomic implications of its capital market analysis, speak the language of macroeconomists, avoid excessive use of market jargon, and collaborate better with other departments.
- The new department should seek a more cost-effective and targeted way to deliver to its audiences the results of its research and analyses on capital market topics.

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<sup>4</sup>The recent decision by management to restructure the IMF’s financial sector and capital markets work addresses this same issue. The steps suggested here are additional measures that could be considered.

# Introduction

**T**he IMF has three core functions: surveillance over the policies of its member countries, financing in support of IMF-backed adjustment programs, and technical assistance. Of these three core functions, surveillance is the most important and has the broadest implications. Given this importance, the International Monetary and Financial Committee (IMFC), the Executive Board, and the Managing Director have called surveillance a critical area in need of strengthening.<sup>1</sup>

This report presents the findings of an evaluation of the IMF's multilateral surveillance. The evaluation has two goals: contributing to transparency by showing how multilateral surveillance works in practice, and identifying areas where improvement can be made to enhance its effectiveness and impact. The evaluation pays particular attention to the key outputs and procedures involved, seeking to assess how and how well these contribute to the IMF's overall objective in multilateral surveillance of global financial stability. Although IMF surveillance has been extensively assessed in the past, this is the first evaluation that focuses exclusively on multilateral surveillance.<sup>2</sup>

While the legal basis of IMF surveillance is established in the IMF Articles of Agreement (Box 1.1), its precise operational meaning has yet to be explicitly stated in IMF documents. What is clear is that it is a multidimensional concept that involves "all aspects of the Fund's analysis of, scrutiny over, and advice concerning, member countries' economic situations, policies, and prospects."<sup>3</sup> While the IMF conducts surveillance, it is also a participant in a broader process of multilateral surveillance involving other organizations and country groups.

<sup>1</sup>Initiatives to strengthen surveillance are currently under way, including the recently announced decision by management to restructure financial sector and capital markets work in the IMF. This report also hopes to contribute to this process.

<sup>2</sup>See Background Documents, pp. 3–8, for a summary of the references made in previous reviews to multilateral surveillance. The Background Documents are available via the Internet at [www.imf.org/ieo](http://www.imf.org/ieo).

<sup>3</sup>"External Evaluation of IMF Surveillance—Report by a Group of Independent Experts" (EBAP/99/86), July 15, 1999. Hereafter referred to as the Crow Report. Published as IMF (1999).

In IMF terminology, it has been customary to use the expressions *bilateral* and *multilateral* to characterize the two broad categories of surveillance activities.<sup>4</sup> Bilateral surveillance refers to the IMF's surveillance over the policies of individual countries. It is typically conducted through periodic Article IV consultations with all member countries. Multilateral surveillance refers to the surveillance of economic linkages and policy spillovers between countries as well as international economic and market developments. It can complement bilateral surveillance by bringing into the analysis global and cross-country perspectives. And it contributes to the overall objectives of IMF surveillance, which are to promote policies that are consistent with "the continuing development of the orderly underlying conditions that are necessary for financial stability," as specified in Article IV of the IMF Articles of Agreement.

The rest of this chapter makes the concept of multilateral surveillance operational for the purpose of this evaluation, presents a brief description of how multilateral surveillance is conducted in the IMF, and describes the scope and methodology of the IEO evaluation. Chapter 2 then assesses the content and quality of the IMF's multilateral surveillance outputs and Chapter 3 discusses their use and delivery. The Background Documents contain supplementary and other supporting information, including evidence for the statements we make in the report. (The Background Documents are available via the Internet at [www.imf.org/ieo](http://www.imf.org/ieo).)

## Characteristics of Multilateral Surveillance

In making the concept of multilateral surveillance operational for the evaluation, we emphasize the

<sup>4</sup>Alternatively, surveillance activities can be classified into country, regional, and global surveillance. What we call multilateral surveillance may to some extent overlap with global surveillance, but it also involves the analysis of linkage-related and cross-country issues more broadly, including some aspects of regional surveillance.

### Box I.1. The Legal Basis for IMF Surveillance

Under Article I of the IMF Articles of Agreement, among the purposes of the IMF is to “promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.” In order to achieve this mandate, surveillance was introduced into the Articles at the time of the Second Amendment in 1978, which formally eliminated the par value system and permitted each member country to choose an exchange rate arrangement of its own liking. With this amendment, “the responsibilities of the IMF changed from those of a guardian of member countries’ observance of exchange rate rules to those of an overseer of individual country exchange rate policy” (Gutián, 1992). Surveillance thus became “a central pillar of IMF activities and responsibilities in the modern era” (Boughton, 2001; also Mussa, 1997).<sup>1</sup>

Article IV of the amended Articles of Agreement endowed the IMF with the responsibility to “oversee the international monetary system in order to ensure its effective operation.” This is the basis for multilateral surveillance under the IMF’s Articles. Moreover, the amended Articles also require the IMF to oversee the compliance of each member with its obligations respecting exchange rate policies and economic and financial regarding policies under Article IV, Section 1

<sup>1</sup>Boughton (2001) further notes that the term surveillance was used for the first time in an IMF document in 1974.

and to exercise firm surveillance over the exchange rate policies of members. This is the basis for bilateral surveillance under the IMF’s Articles.

In 1977, the Executive Board adopted a decision on the “Surveillance over Exchange Rate Policies” (Decision No. 5392, as amended), which took effect when the Second Amendment entered into force in 1978, as a means of providing guidance to members with respect to their exchange rate policies and of implementing the IMF’s surveillance responsibilities over those policies:

“The Fund’s appraisal of a member’s exchange rate policies . . . shall be made within the framework of a comprehensive analysis of the general economic situation and economic policy strategy of the member, and shall recognize that domestic as well as external policies can contribute to timely adjustment of the balance of payments. The appraisal shall take into account the extent to which the policies of the member, including its exchange rate policies, serve the objectives of the continuing development of the orderly underlying conditions that are necessary for financial stability, the promotion of sustained sound economic growth, and reasonable levels of employment.”

Thus, the scope of IMF surveillance can be broad, but it derives from the IMF’s more narrow responsibility to oversee the international monetary system and to exercise surveillance over the exchange rate policies of members under Article IV.

characteristics of multilateral surveillance that differentiate it from bilateral surveillance. In our view, multilateral surveillance has at least four distinguishing characteristics. First, its value added cannot just be the sum of bilateral surveillance across all member countries. Multilateral surveillance must bring to bear the perspectives that cannot be obtained from bilateral surveillance alone. These are the implications of economic linkages and policy spillovers across countries, as well as the analysis of global economic and market developments that may constrain the pursuit of economic policies globally or by individual countries.

Second, multilateral surveillance is more asymmetric than bilateral surveillance. In the surveillance of the global economy, not all countries are equally important. Larger economies inevitably exert greater impact on the rest of the world than smaller ones; even economies of the same size may have different systemic consequences for the world economy, depending on the degree of integration with the rest of the world. The systemically more important economies should receive greater attention in multilateral surveillance. In large measure, multilateral

surveillance is concerned with the analysis of economic linkages among the systemically more important economies and the impact of their policies on the rest of the world. This analysis should in turn feed into the bilateral surveillance of systemically less important economies.

Third, the peer review (or collective discussion) aspect of IMF surveillance is more prominent in multilateral surveillance than in bilateral surveillance. All IMF surveillance activities, including Article IV consultations, involve an element of peer review as their outputs are discussed by the Executive Board. Given its focus on economic linkages and policy spillovers, however, multilateral surveillance can identify potential opportunities for cooperative or collective action and thereby increase the relevance of peer review. The effectiveness of multilateral surveillance in bringing about a measure of policy cooperation or coordination critically depends on the extent to which it can bring peer pressure to bear.

Finally, the IMF is only one of many players in multilateral surveillance. A number of other institutions and country groups are active in addressing the different aspects of global cooperation on monetary

### Box 1.2. Principal Institutions and Country Groups Engaged in Global Cooperation on Monetary and Financial Issues

#### Institutions

- *The IMF* occupies a special place in the international financial system because of its near universal membership. It has an associated ministerial steering committee that meets twice a year—the International Monetary and Financial Committee (IMFC)—to discuss policy issues.
- *The BIS*, based in Basel, Switzerland, is an international organization established to foster cooperation among the central banks of industrial countries. In recent years, the BIS’s membership has expanded to include a number of emerging market countries.
- *The OECD* regularly brings together, for an exchange of views on policy issues, a group of industrial country finance ministry and central bank deputies in Working Party 3 of its Economic Policy Committee.

#### Country groups

- *The Group of Seven (G-7)* superseded in the mid-1980s the Group of Five (G-5) finance ministers and central bank governors (from the United States, Japan, Germany, France, and the United Kingdom) by including the counterparts from Canada and Italy. From early on, discussions focused on exchange rates and economic policy coordination. More recently, however, discussions have focused on such other issues as global financial stability and the role of international financial institutions (IFIs).

- *The Group of Ten (G-10)* includes 11 industrial countries that are parties to the General Arrangements to Borrow (GAB), established in 1961 to lend to the IMF in the event of insufficient liquidity.
- *The Group of Twenty (G-20)* was created in 1999 as a forum of finance ministers and central bank governors from the major emerging market countries as well as the G-7 and Australia. The IMF participates as an ex officio member. The G-20’s current agenda covers all the key aspects of global financial stability and economic cooperation.
- *The Financial Stability Forum (FSF)* was also created in 1999 explicitly to promote global financial stability. Members include representatives of national authorities responsible for financial stability from the G-7, Australia, the Netherlands, Singapore, and Hong Kong SAR, along with representatives of international financial institutions and regulatory bodies, including the IMF. It meets twice a year and is serviced by a small secretariat based at the BIS.

#### Others

- The various Basel-based committees, including the Basel Committee on Banking Supervision.
- A wide range of regional forums exist to bring senior policymakers together in different regions, including meetings of the Asia Pacific Economic Cooperation Council (APEC), Western Hemisphere, and European Union (EU) Finance Ministers.

and financial issues (see Box 1.2 for a partial list). When the IMF was established, it was in some respects a monopoly or near-monopoly supplier of analysis and advice on international financial and monetary issues. This is no longer the case. The IMF’s effectiveness now depends in part on how well it interacts with these other institutions, and how far it builds on and exploits its areas of comparative advantage. The IMF’s role in multilateral surveillance thus needs to be seen in the context of this wider global effort.

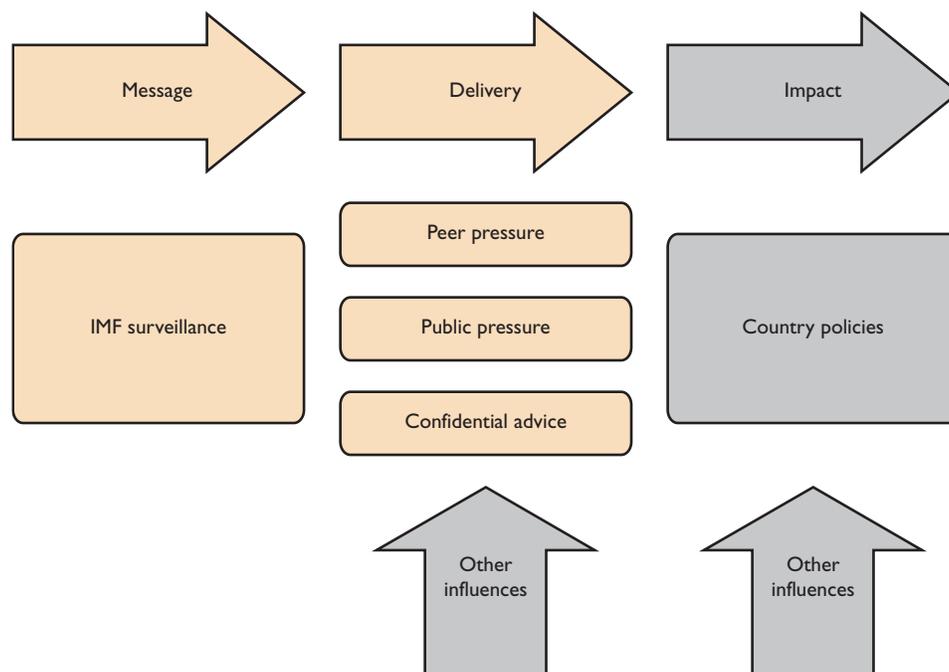
To assess multilateral surveillance, we consider four channels through which it seeks to achieve its objectives:

- at the global level, by directly interacting with international groups of national policymakers;
- by informing and helping shape public debate across the membership, which in turn can influence policy decisions;

- at the national level, by transmitting advice through bilateral surveillance to individual countries, particularly the major economies whose policies have the largest global economic impact; and
- by informing internal decision making within the IMF.

We may call the dominant forms of influence that operate through the three “external” channels as “peer pressure,” “public pressure,” and “confidential advice,” respectively, though in practice each could work in varying degrees through all three channels.

Evaluating surveillance is easier to grasp if it is viewed in terms of a results chain, namely, “message,” “delivery,” and “impact” (Figure 1.1). Effectiveness can then be measured at each of these stages. However, it should be acknowledged at the outset that the impact of multilateral surveillance on member countries’ policies is particularly difficult to

**Figure I.1. The Results Chain of IMF Surveillance**

assess for a number of reasons, not the least of which is the presence of multiple influences.

### Multilateral Surveillance in the IMF

Multilateral and bilateral surveillance are closely linked concepts. Multilateral surveillance often draws on the country-specific information obtained from bilateral surveillance. At the same time, the global and cross-country perspectives obtained from multilateral surveillance ideally feed back into discussions with individual countries in the context of bilateral surveillance. Although the IMF carries out clearly distinctive *multilateral* and *bilateral* surveillance activities, a simple demarcation between the two is not always possible. In some cases, the same vehicle may serve both multilateral and bilateral surveillance functions, thus making them joint products. With this caveat, we review below the organization and resource costs of multilateral surveillance in the IMF.

#### Organization of multilateral surveillance

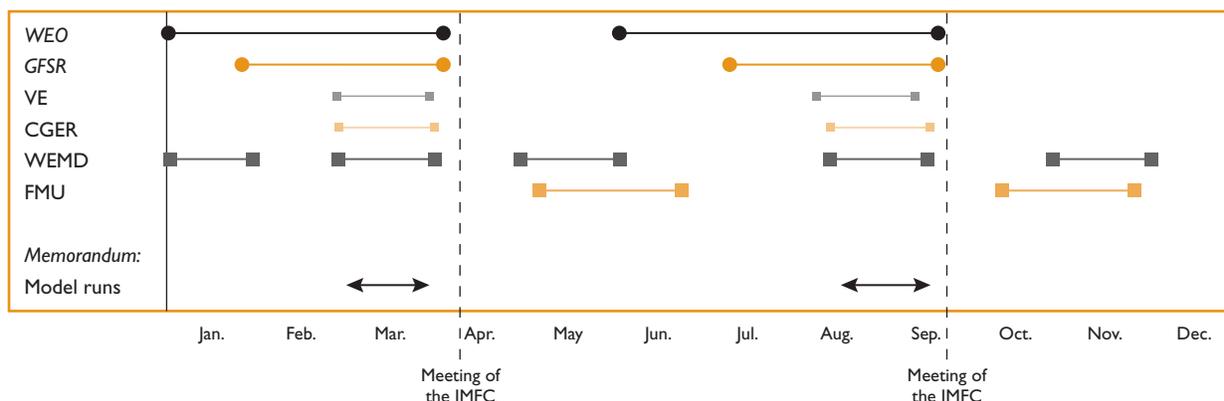
The IMF's multilateral surveillance works through a number of established outputs and procedures that include reports and internal exercises. Except for the production of regional outlooks, in which area departments take the lead, most of the

other multilateral-surveillance-related outputs and procedures are either produced or coordinated by functional departments, notably the Research Department (RES), the International Capital Markets Department (ICM), and the Policy Development and Review Department (PDR). Many of the internal exercises, including model runs, are timed to provide quantitative inputs into the production process of the *World Economic Outlook (WEO)* document and, to a much lesser extent, the *Global Financial Stability Report (GFSR)* document. In this sense, the *WEO* occupies a special place in the IMF's multilateral surveillance (Figure 1.2).

The *WEO* is both an output and a process. As an output, it is prepared twice a year by RES to communicate the views of IMF staff on global economic developments, prospects, and risks, as well as to present analysis of selected economic policy issues. The report is submitted to, and discussed by, the Executive Board, but it is published as a staff document, along with the Summing Up of the Board discussion. As a process, the *WEO* is almost continuous and involves the entire institution. Although RES takes the lead in its production, RES interacts extensively with other IMF departments; country-specific forecasts are provided by area departments.

The *GFSR*, prepared twice a year, to date by ICM, is designed to identify vulnerabilities in the global financial system. Like the *WEO*, it is submitted to, and discussed by, the Board and is published as a

Figure I.2. Approximate Cycles of Key Outputs and Procedures



staff document, along with the Summing Up of the Board discussion. In contrast with the interactive approach of the *WEO*, the *GFSR* uses relatively little input from other departments. Even input on banking sector issues from the Monetary and Financial Systems Department (MFD) has been limited, largely confined to self-contained blocks. ICM staff does interact early on with RES, however, to ensure that the selection of topics for the *GFSR* and the *WEO* is coordinated. Inputs to the *GFSR* are more likely to come from outside the IMF, through extensive ICM consultations with regulators and market participants.

The internal exercises also provide inputs to the *WEO* and the *GFSR*. The vulnerability exercise takes place semiannually and results in a report prepared by PDR that identifies underlying vulnerabilities and crisis risks in about 50 emerging market economies.<sup>5</sup> The report is submitted to management following clearance from RES and ICM. The Coordinating Group on Exchange Rate Issues (CGER), an interdepartmental group of IMF economists, prepares a semiannual report on the likely medium-term paths of industrial country currencies. After clearance from RES and PDR, the report is submitted to management, with a major portion of it also circulated to the Executive Board for information.

The World Economic and Market Developments (WEMD) exercise is a vehicle by which the IMF's Economic Counselor provides the Executive Board with up-to-date information on the global economy. The Board's WEMD sessions normally take place five times a year. Sessions in March and August are combined with *WEO* discussions, while sessions in June and November are coordinated with ICM, which si-

<sup>5</sup>Crisis risks in a subset of countries, however, are assessed on a quarterly basis.

multaneously prepares a Financial Market Update (FMU) as input into the discussion. The update consists of a short note that summarizes global financial market developments following each *GFSR*.

Surveillance notes prepared by RES for various intergovernmental groups—notably the G-7 and the G-20—are derivatives of these intellectual efforts within the IMF. The production of these notes, coordinated by a single senior staff member in RES, often involves an update of the latest *WEO* or WEMD material, subject to the usual interdepartmental review process.

Regardless of which department is actually responsible for production, area departments exert critical influence on any judgment expressed about individual member countries. Even in such an internal exercise as the vulnerability exercise, the final judgment on a particular country's crisis vulnerability rests with the relevant area department. Views expressed in the *WEO* or surveillance notes on individual countries must also be explicitly or implicitly endorsed by the area departments. The production process of the *WEO*, moreover, involves an aggregation of country desk inputs (albeit shaped by common global assumptions); this assures the *WEO*'s consistency with bilateral surveillance.

### The resource costs of multilateral surveillance

Because multilateral and bilateral surveillance are closely linked, it is difficult to agree on a precise estimate of the allocation of resources and time between them and between other IMF activities. Even so, multilateral surveillance claims a relatively small share of the IMF's budgetary and human resources, relative to bilateral surveillance or the use of IMF resources (that is, financing provided to member countries under IMF-supported adjustment programs). About 260

**Table I.1. Human Resource Cost of Multilateral Surveillance Activities, FY2005<sup>1</sup>**

	Staff-Years (As percent of IMF total)
<i>WEO</i> and <i>GFSR</i>	60.2 (2.0)
Research and policy on the international monetary system	115.2 (3.8)
Regional surveillance	47.5 (1.6)
Others <sup>2</sup>	37.3 (1.2)
Total	260.2 (8.5)
Memorandum items	
Bilateral surveillance	885.9 (28.9)
Use of Fund resources	883.0 (28.8)

Source: IMF, Office of Budget and Planning, Time Reporting System and Budget Reporting System.

<sup>1</sup>Includes a prorated distribution of the time attributed to IMF-wide management and administration activities.

<sup>2</sup>Includes participation in the IMFC and other forums, surveillance over exchange rate regimes, and the vulnerability exercise.

**Table I.2. Executive Board Meetings on Multilateral Surveillance, 2003–05<sup>1</sup>**

	2003		2004		2005 <sup>2</sup>	
	Number	Hours	Number	Hours	Number	Hours
Multilateral surveillance <sup>3</sup>	14 (3.3)	28 (4.7)	14 (3.1)	20 (4.1)	13 (3.4)	18 (4.6)
Total	422	596	453	487	386	394
Memorandum items						
Stand-alone Article IV	94 (22.3)	144 (24.2)	93 (20.5)	106 (21.8)	89 (23.1)	81 (20.6)
Use of Fund resources (UFR)	86 (20.4)	130 (21.8)	87 (19.2)	122 (25.1)	53 (13.7)	60 (15.2)
Combined Article IV/UFR	28 (6.6)	51 (8.6)	28 (6.2)	40 (8.2)	31 (8.0)	34 (8.6)

Source: IMF, Secretary's Department, Operations Division.

<sup>1</sup>Percent of total in parentheses.

<sup>2</sup>Through October.

<sup>3</sup>Includes *WEO*, *GFSR*, *WEMD*, and regional surveillance.

staff-years were used for multilateral surveillance (including regional surveillance) in financial year 2005 (May 1, 2004, to April 30, 2005), accounting for 9 percent of the IMF's total staff resources (Table 1.1). This is no small sum, even though it represents less than a third of the resource costs of bilateral surveillance or use of IMF resources.<sup>6</sup>

Multilateral surveillance claims an even smaller share of Executive Board time, reflecting both the bilateral orientation of the IMF's work and the fact that multilateral surveillance involves some internal procedures and outputs that are not shared with the Board, let alone made public. In recent years, the

Board has typically held about 14 meetings on multilateral surveillance issues (including regional surveillance) a year,<sup>7</sup> spending an average of about 20 hours each year (Table 1.2).<sup>8</sup> These represent no more than 4–5 percent of total Board time.

### Scope and Methodology of the Evaluation

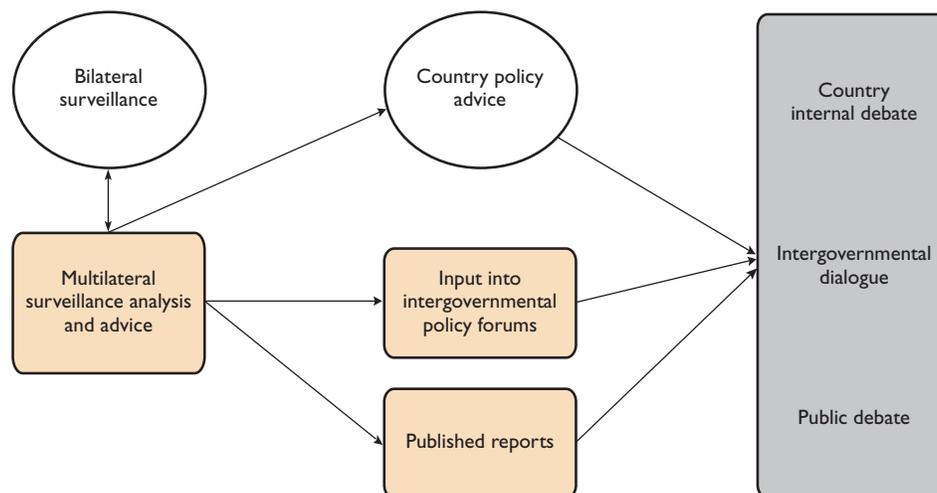
Because multilateral surveillance is conducted through various vehicles, our evaluation must necessarily assess the effectiveness of specific outputs and procedures, some of which may well have dual

<sup>6</sup>This may well overestimate the actual cost of multilateral surveillance proper, as the IMF's Time Reporting System combines multilateral surveillance, policy development, and operation of the international monetary system together in one category. Additional inaccuracies may have resulted from the transition from the Budget Reporting System to the Time Reporting System, which took place in FY2005.

<sup>7</sup>This includes the Article IV consultation with the euro area but excludes informal seminars.

<sup>8</sup>The increasing use of "gray" statements (prepared statements submitted for minutes instead of verbal interventions) in recent years has further reduced the length of Board meetings.

Figure I.3. Linkages in Multilateral Surveillance



multilateral-bilateral surveillance functions. Although many IMF analytical activities have a multilateral surveillance dimension, for the purpose of this evaluation, we focus on four types of outputs and procedures:

- published reports: the *WEO* and the *GFSR*;
- internal exercises: the vulnerability exercise (VE), the Coordinating Group on Exchange Rate Issues (CGER), and World Economic and Market Developments (WEMD);
- G-7 and G-20 surveillance notes; and
- regional outlooks.

We consider regional outlooks because regional considerations, with a focus that transcends country-specific issues, have a multilateral character. Although regional work by area departments takes many forms (such as cross-country analytical work and regional policy discussions with national authorities), regional outlooks are the most visible part and deserve special attention.

These outputs and procedures have multiple audiences and objectives. Internal procedures (e.g., the vulnerability exercise and WEMD) address IMF staff, management, or the Executive Board. Some outputs (e.g., G-7 and G-20 surveillance notes) are directed at a single external audience, such as senior policymakers of major member countries. Yet others (e.g., the *WEO*) are targeted at several different audiences simultaneously, including IMF staff, the Executive Board, member country authorities, the press, and the public at large.

The evaluation is based on a desk study of published and internal documents, which were selected primarily from the 2000–05 period (following the 1999 external evaluation). In examining the integration of multilateral and bilateral surveillance, we pay particular attention to a sample of staff reports for Article IV consultations issued during 2004–05.<sup>9</sup>

To supplement the desk study, the evaluation team sent out questionnaire surveys to users of the IMF’s multilateral surveillance outputs, and also interviewed a large number of IMF staff; all 24 Executive Directors (or their alternates); senior policymakers, especially in the finance ministries and central banks of major countries; officials of regional and international organizations; and relevant representatives of the public, including key market participants and the press.

We developed and applied several criteria to assess the content of multilateral surveillance outputs and the effectiveness of delivering the multilateral surveillance message. The two areas of focus in the report—“content” and “delivery”—can be depicted schematically (Figure 1.3). Content refers to what is inside the box on the left-hand side—multilateral surveillance analysis and advice. Delivery involves the arrows going from “multilateral surveillance analysis and advice” to the circle above and the two boxes on the right.

<sup>9</sup>We chose this period because the 2004 Biennial Surveillance Review examined the staff reports for Article IV consultations concluded through early 2004.

## Content and Quality

We now turn to our evaluation of the content and quality of the IMF's multilateral surveillance outputs. We begin by discussing the selection of issues analyzed as part of multilateral surveillance, showing how they reflect the IMF's comparative advantage. We then consider the relevance and timeliness of the issues selected for analysis by using as a benchmark the importance attached by national policymakers in the G-7 and G-20 process. We likewise assess the relevance and timeliness of the risks identified in multilateral surveillance by comparing them to the risks identified by other international and national bodies. We look at the integration of multilateral and bilateral surveillance by analyzing the IMF's policy advice and macroeconomic forecasts. And we assess the integration of macroeconomic and capital market analysis by identifying how multilateral surveillance combines these alternative approaches to analyze relevant issues.

### Comparative Advantage and Topic Selection

#### The IMF's comparative advantage

A broadly defined multilateral surveillance output can conceivably include the analysis of different types of issues, with each addressed to a particular audience or intended to satisfy a recognized need. These issues might include:

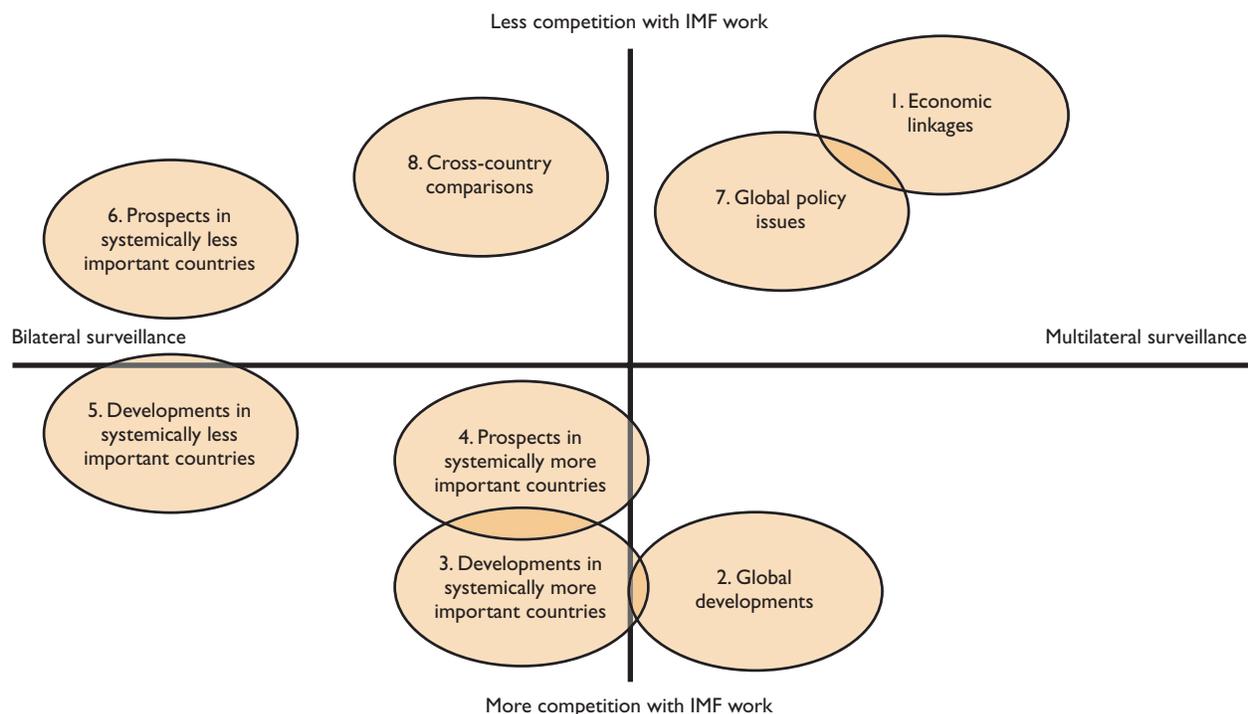
- (1) economic linkages, policy spillovers, and global risks;
- (2) global economic and market developments;
- (3) developments in systemically more important economies;
- (4) prospects in systemically more important economies;
- (5) developments in systemically less important economies;
- (6) prospects in systemically less important economies;
- (7) emerging global policy issues; and
- (8) cross-country comparisons of policy experiences.

Some of these issues are uniquely multilateral surveillance in nature, in that information on them cannot be obtained simply by aggregating information from bilateral surveillance. Others have a multilateral-surveillance orientation even if the information is obtainable from bilateral surveillance, given their relevance for the global economy or their cross-country focus. Still other issues have their roots largely in bilateral surveillance. With some issues, including those rooted in bilateral surveillance, the IMF may be better positioned than other institutions to provide information because of its greater analytical resources; with other issues, information may be plentiful and the IMF would be just one of many providers.

In light of these considerations, the categories of issues listed above can be depicted in a diagram in which the "multilateral/bilateral surveillance" scale is drawn as the horizontal axis and the "less/more competition from others" scale as the vertical axis (Figure 2.1). In this diagram, the IMF's contribution to multilateral surveillance increases as one moves from the south-west corner toward the north-east. While these are all legitimate topics of analysis, given the scarce resources, it would make more sense for the IMF to give comparatively more attention to those topics on which it could better contribute to the goals of multilateral surveillance. A trade-off may be involved in choosing topics. For example, the IMF is uniquely positioned to do cross-country comparisons but these have a bilateral (country-specific) focus. Global economic and market developments are an important topic of multilateral surveillance, but equally good information is readily available elsewhere.

What is useful to one audience may not be useful to another; thus, usefulness does not by itself establish the IMF's comparative advantage. For example, with regard to a question on the components of the *WEO*, about half of the national authorities surveyed considered the review of recent economic develop-

Figure 2.1. Potential Topics for Multilateral Surveillance Outputs



ments—on which information is readily available elsewhere—to be most useful, about the same as those who considered the discussion of prospective policy issues as most useful (when the sample is restricted to industrial countries, the percentage was less than 25 percent; for the G-7 countries only, no respondent considered the review of recent economic developments to be most useful). With regard to capital market surveillance, although almost 80 percent of respondents considered the *GFSR*'s review of recent market developments to be most useful, a number of market participants interviewed by the IEO stated that the *GFSR* offered little new market-related information.

### Selection of topics for the *WEO*

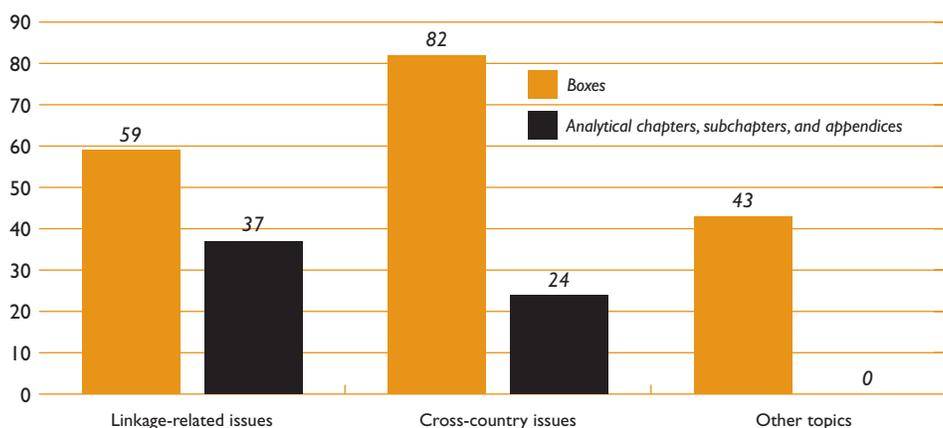
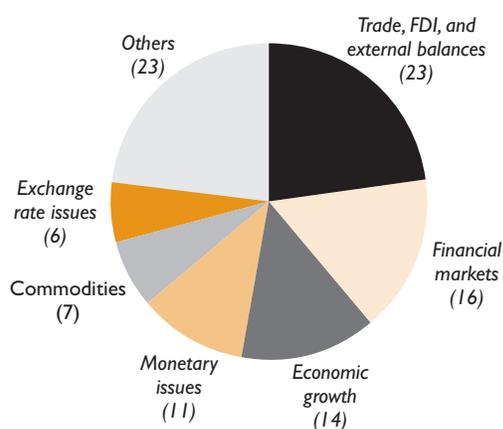
With this background, the IEO evaluation team assessed the selection of topics for the *WEO*. A close look at the *WEO* is particularly warranted because it forms the intellectual foundation for much of the IMF's other multilateral surveillance work.

In discussing topic selection in the *WEO*, it bears noting that Chapter I differs quite a bit from the rest of the report. Chapter I traditionally presents an overview of economic developments and prospects across major groupings of IMF member countries. Chapter II addresses a topical issue of current inter-

est, such as the house price boom or the role of remittances, while Chapter III analyzes an issue of more medium-term importance, such as population aging. In addition, five or so boxes typically included in Chapter I also discuss topical issues, albeit much more succinctly. Because the Chapter I topics are standard and recurring, we focus initially on topics in the boxes and analytical chapters.

As expected, the *WEO*'s analytical chapters (including appendices and subchapters) and boxes address a variety of topics, but the overwhelming majority reflect the two areas of the IMF's greatest comparative advantage: linkage-related and cross-country issues (Figure 2.2). Of the 245 topics covered in the analytical chapters and boxes during 2000–05, 96 topics were related to economic linkages across countries, 106 related to cross-country themes, and the remaining 43 related to other issues. Thus, the *WEO*'s analytical sections seem to serve two purposes: to present analyses of issues that have implications for economic linkages across countries, and to present analyses of cross-country themes that draw on the experiences of different countries. We consider the selection of these topics to be broadly appropriate.

A more detailed breakdown indicates that almost a quarter of the 96 linkage-related topics were concerned with trade, foreign direct investment (FDI), and external balances (Figure 2.3). The second most

**Figure 2.2. The Composition of WEO Topics, 2000–05****Figure 2.3. The Breakdown of WEO Linkage-Related Topics, 2000–05**  
(In percent)

frequent multilateral surveillance theme in the *WEO* related to financial markets (16 percent). Compared with the *GFSR*, however, many of the financial market issues discussed in the *WEO* had a macroeconomic focus and were often covered in a text box, rather than a full chapter or appendix. Other important themes were economic growth (14 percent) and broadly defined monetary issues (11 percent), which included interest rate policy, inflation, and deflation. Strikingly rare was dedicated coverage of exchange rate issues, with only six observations over six years.<sup>1</sup>

<sup>1</sup>In addition, there were 6 cross-country analyses on exchange rate issues, so that the total number of exchange-rate-related topics in the *WEO* was 12.

For example, conspicuously missing was an analysis of China's exchange rate, which in recent years has figured prominently in international policy debate. The issue was discussed in Article IV consultations with China, but the IMF did not use the *WEO* to discuss whether the renminbi (or any other Asian currency for that matter) was undervalued and, if so, what the alternative paths to adjustment might be and their implications for the adjustment of global imbalances.<sup>2</sup> The omission is all the more striking when one considers that the *WEO* in 2004 included such topics as "China's Emergence and Its Impact on the Global Economy" and "Learning to Float: The Experience of Emerging Market Countries Since the Early 1990s."

### Selection of topics for the *GFSR*

The format of the *GFSR* was fixed in 2003, when the publication became semiannual. The report opens with an overview (Chapter I), which is followed by a review of recent developments and prospective risks in mature and major emerging markets (Chapter II) and then by a discussion of structural topics of medium-term nature in its two analytical chapters (Chapters III and IV).<sup>3</sup> Chapter II includes several boxes on special themes and may also occasionally include a section on structural issues of current interest. In assessing the selection of topics for the *GFSR*, we concentrate below on the boxes included in the

<sup>2</sup>Following the renminbi exchange rate reform in July 2005, the September 2005 *WEO* discussed the economic impact of greater exchange rate flexibility in emerging Asia accompanied by a decline in the rate of foreign exchange reserve accumulation.

<sup>3</sup>In the April 2003 issue only, developments and risks were reviewed separately for mature markets (Chapter II) and emerging markets (Chapter III), and a structural topic was covered in one chapter (Chapter IV).

review chapters and the topics discussed in the analytical chapters.

We find that, unlike the *WEO*, virtually every topic in the *GFSR* was related to economic linkages in a broad sense.<sup>4</sup> This is to be expected, given its focus on global financial market developments that affect the volume and direction, as well as the risks associated with international capital flows. Much space is devoted to discussing developments and risks in individual countries, including some smaller emerging markets; some discussions have a specific geographic focus. Yet, clear implications are drawn from these for capital inflows or outflows, international linkage of interest rates, and other international transmission channels.

During 2002–05, roughly one-third of *GFSR* topics related to advanced markets, another third to emerging markets, and the remaining third to other issues with no clear geographic focus, including crisis resolution issues. As to the breakdown of topics by subject, 37 percent involved risk-related issues (e.g., risk transfers and risk management), 32 percent related to the development of market institutions, and 22 percent to capital flows (Figure 2.4). Many boxes had pedagogical functions, explaining methodological issues involved in monitoring financial markets (see also Table 3.1).

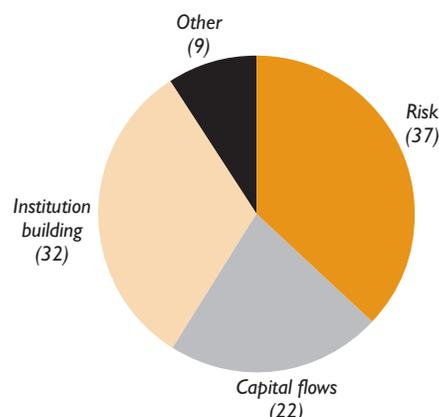
### Selection of topics in regional outlooks

Partly responding to direction from the Executive Board, IMF staff has recently intensified its efforts to incorporate regional surveillance and cross-country analysis in its country work. The most prominent of these initiatives is the publication of regional outlooks by three area departments—the African Department (AFR), the Asia and Pacific Department (APD), and the Middle East and Central Asia Department (MCD).<sup>5</sup> Because these regional outlooks, in their current public format, are relatively new and may still be evolving, our assessment is only tentative.

<sup>4</sup>The selection of topics for the *GFSR* is guided by an explicit objective stated in the preface that appears in every issue: “The *Global Financial Stability Report (GFSR)* assesses global financial market developments with a view to identifying potential systemic weaknesses. By calling attention to potential fault lines in the global financial system, the report seeks to play a role in preventing crises, thereby contributing to global financial stability and to sustained economic growth of the IMF’s member countries.”

<sup>5</sup>The Western Hemisphere Department (WHD) also prepares a regional outlook, but it is available only through the department’s website and is generally used as material for presentations by senior staff. Consequently, its publication does not involve the IMF’s internal review process. The European Department (EUR) does not prepare a regional outlook of any kind, but organizes its regional surveillance work along subgroups of countries, including the European Union (EU).

**Figure 2.4. The Breakdown of *GFSR* Topics, 2002–05**  
(In percent)



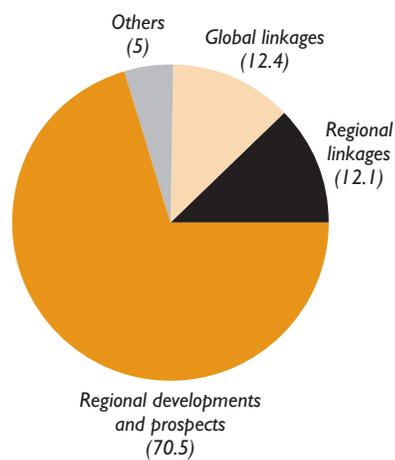
The three regional outlooks published in 2005 included overviews of the regional economic picture and a few analytical pieces on policy issues of regional relevance. Some of these pieces were of high quality. At least one of them (Chapter II of the Middle East and Central Asia outlook on “Responding to Higher Oil Prices”) received wide international press coverage and contributed to public debate. Aside from these analytical contributions, the bulk of the outlooks (more than 70 percent) were largely descriptive accounts of regional economic developments obtained from Article IV reports on individual countries (Figure 2.5). The weight of descriptive material, however, differed considerably across the three outlooks.

Regional outlooks seem to offer some value to most people, but the perception of their usefulness differs between industrial and developing countries, as well as between B-level staff and A-level staff at the IMF (Figure 2.6).<sup>6</sup> Surveys reveal that the authorities of industrial countries and B-level staff are much less inclined to view regional outlooks as “very useful” as opposed to “somewhat useful,” while the reverse holds for the authorities of other countries and A-level staff.<sup>7</sup>

<sup>6</sup>Within the IMF, B-level staff refers to senior staff (Directors, Deputy Directors, Senior Advisors, Advisors, and Division Chiefs), while A-level staff refers to Economists and Senior Economists.

<sup>7</sup>“Somewhat useful” combines “useful, but more resources are not needed” and “marginally useful” in the staff survey and corresponds to “useful, but value-added is small” in the authorities’ survey. A further breakdown (not reported in the figure) indicates that the share of national authorities who considered regional outlooks to be “highly helpful” exceeded 90 percent in MCD countries, about 80 percent in AFR countries, 60 percent in APD countries, more than 50 percent in EUR countries, and less than 50 percent in WHD countries.

**Figure 2.5. The Composition of Topics in Regional Outlooks**  
(In percent)



Source: Based on regional outlooks for sub-Saharan Africa (AFR, May 2005), Asia and Pacific (APD, August 2005), and the Middle East and Central Asia (MCD, September 2005).

## Relevance and Timeliness

Another aspect of the content of the products of multilateral surveillance concerns the relevance and timeliness of the issues and risks identified. In this section, we first examine whether the topics discussed in the *WEO* have subsequently influenced the discussion agendas of the G-7 and G-20.<sup>8</sup> We then compare the risks identified in the *WEO* and the *GFSR* to those cited in the OECD's *Economic Outlook (OEO)*, the BIS's *Annual Report (BAR)*, and the Bank of England's *Financial Stability Review (FSR)*. (We selected the *FSR* because it is the oldest and most established national publication.)

### Issues analyzed by the *WEO*

We assess the relevance and timeliness of the topics analyzed in the *WEO* by using the topics discussed by the G-7 and G-20 as a benchmark. We focus on the *WEO*, even though the IMF's G-7 and G-20 surveillance notes can also include special, and directly relevant, analytical pieces on policy issues. These pieces, however, are often prepared at the request of meeting organizers and do not provide insight into whether the IMF has proactively identified those topics. We rely on all the issues of the *WEO* and the G-7 and G-20 communiqués for the 2000–05 period.

<sup>8</sup>The *GFSR* focuses more narrowly on a few issues, and its intersection with the G-7 or G-20 tends to be limited. The IEO evaluation found that the *GFSR* discussed only four emerging policy issues subsequently raised in G-7 communiqués.

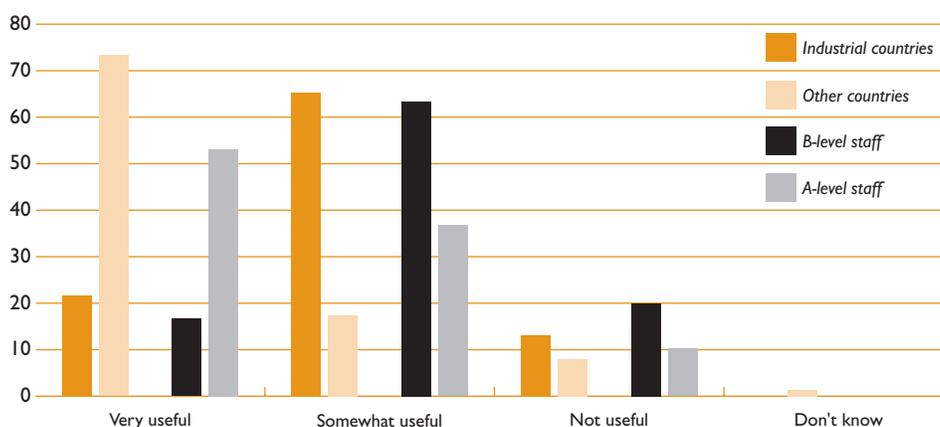
Here, we must cite a caveat. Because the G-7 and G-20 agendas cover various types of issues that are broader than the IMF's mandate, one cannot expect every agenda item to have been discussed in an immediately preceding *WEO*. The issues fall under three broad categories: “perennial” topics, unpredictable shocks, and emerging policy issues. Perennial topics are covered regularly by the *WEO* and the G-7 and G-20, while unpredictable shocks are also almost immediately taken up by all three. In these cases, it is not possible to say whether the appearance of such a topic in a G-7 or G-20 communiqué was prompted by the *WEO*'s discussion of it. In assessing the relevance of *WEO* topics, we focus on emerging policy issues.

A review of the documents suggests that about three-quarters of the items for discussion (140 out of 192) were perennial issues that had emerged before 2000 and were discussed regularly thereafter. These included the Heavily Indebted Poor Countries (HIPC) initiatives, reform of the international financial institutions, standards and codes of good practice, trade liberalization, and the Millennium Development Goals (MDGs). Two were related to shocks—namely, the Indian Ocean tsunami of 2004 and a post-September 11 Action Plan to combat the financing of terrorism.<sup>9</sup> This leaves 50 items of discussion that could be considered as emerging policy issues, such as the impact of higher oil prices, the impact of the information technology (IT) revolution, remittance flows, and regional issues of strategic interest. Of the 50 items, 36 items constituted separate issues, with at least ten of these (such as issues related to oil prices and the Doha round of multilateral trade negotiations) discussed on successive occasions, sometimes for more than a year. We compared the G-7 and G-20 communiqués with the *WEO* to see if the *WEO* discussion of these 36 issues preceded their appearance in the relevant communiqués (Figure 2.7).

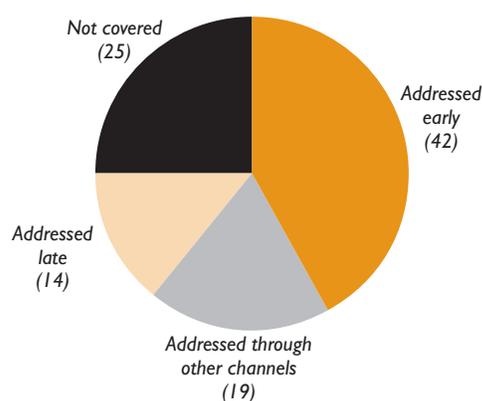
More than 40 percent of the emerging issues discussed by the G-7 and G-20 were addressed in IMF multilateral surveillance either prior to or around the same time as the G-7 and G-20 discussion (identified as “early” in the figure). This, however, understates the performance of IMF multilateral surveillance. About 20 percent of the emerging issues not covered—such as developments in Brazil and Turkey—were being addressed by the IMF through other channels, including bilateral surveillance (designated as “addressed through other channels”). Most of the other issues not covered—such as nuclear safety, an Education Action Plan, and security-related issues—were outside the expertise of the IMF. Only five issues (14 percent of total) were ad-

<sup>9</sup>The terrorism financing issue was discussed at many subsequent meetings and is thus considered to have become a perennial issue.

**Figure 2.6. National Authorities and Area Department Staff on Regional Outlooks**  
(In percent)



**Figure 2.7. G-7 and G-20 Emerging Policy Issues in IMF Multilateral Surveillance, 2000–05**  
(In percent)



ressed “late” by IMF multilateral surveillance. These included some financial-flows-related issues (such as remittances) and oil data transparency. All in all, IMF multilateral surveillance appears to have performed reasonably well in its timely selection of relevant topics; it successfully identified and analyzed emerging issues 75 percent of the time before they were taken up by the G-7 and G-20 forums.

#### Risks identified by the *WEO* and the *GFSR*

There is no absolute yardstick to assess whether IMF multilateral surveillance identified relevant global risks in a timely manner. Here, we compare the risks identified by the *WEO* and the *GFSR* during 2003–05 to those identified by similar publica-

tions—the *OEO*, the *BAR*, and the *FSR*—to assess how the IMF stacks up against other international and national bodies. We first compare the *WEO* with the *OEO* with regard to the identification of global macroeconomic risks, and then compare the *GFSR* with the *BAR* and the *FSR* for global financial risks.

#### The *WEO*

A desk review indicates that most of the risks identified in Chapter I of the *WEO* were downside risks related to external imbalances, sharp exchange rate corrections, adjustments in corporate and household balance sheets, oil market volatility, geopolitical uncertainties, and the like. The *WEO* and the *OEO* identified more or less the same vulnerabilities that could pose downside risks to the global economy. Occasionally, one institution was ahead of the other in identifying risks that subsequently became more widely recognized (e.g., the rise in long-term interest rates in the 2004 *WEO* or the failure of an investment pickup in the 2003 *OEO*). However, it is difficult to conclude that the overall performance of one was better than the other, even if the focus is on risks relevant to OECD countries.

The difference between the two institutions concerns nuance and emphasis. The OECD tends to analyze more deeply the causes of risks, and it understandably focuses more on OECD member countries. In contrast, the IMF tends to present risks in a more global context and to focus on international linkages. This is particularly true when external imbalances and cross-country growth differentials are addressed. The *WEO* covered not only developments and prospects in the G-7 countries but also in emerging Asia, and it considers the potential impact of different adjustment paths on emerging market economies.

More generally, the *WEO* has a wider geographical coverage that includes emerging market economies (although the coverage of these countries has diminished lately because of growing emphasis on external imbalances in industrial countries). For example, the *WEO* identifies risks related to fiscal positions in Eastern Europe and the Middle East, covers developments in Latin America and Turkey, and assesses the impact on Asia of a worldwide slump in the IT sector. The IEO assessment concludes that the *WEO* has been successful in identifying relevant global risks in a timely manner, at least relative to its main competing multilateral surveillance publication.

### The GFSR

A desk review suggests that the *GFSR* identified virtually all of the global risks cited by the *BAR* and the *FSR*. Such risks include the follow-on effects from oil and commodity price shocks, global external imbalances, and what it called excessive yield compression (or investor complacency to risk). While it is difficult to determine which publication was first to spot any given risk, each document featured discussions of the proximate causes of the main risks, as well as a series of derivative risks associated with the response of different macroeconomic and financial variables to an initial shock.

The various documents differed in some important ways. Relative to the *GFSR*, the *FSR* provides fuller information on bank balance sheet fragilities and is more likely to include associated vulnerabilities in its discussion of risks, especially regarding the United Kingdom. Understandably, its focus is more closely linked to those vulnerabilities that affected financial sector firms operating within its jurisdiction, such as potential fragilities in U.K. household and corporate balance sheets. The *BAR* takes a markedly more global view than the *FSR*, while at the same time also focusing on risk exposures contained in bank balance sheets. Consistent with the role of the Bank for International Settlements (BIS) in bringing together G-10 central bankers, the *BAR*'s starting point usually involves shocks to the real economy, carrying over into interest rates and then to asset prices.

The *GFSR* also has a distinctively global view but it focuses more on capital markets. For example, it frequently refers to potential shocks deriving from sudden changes in investor sentiment, and it is the only publication that lists geopolitical risks in emerging markets.<sup>10</sup> The *GFSR*'s weakness, relative to both

<sup>10</sup>Emerging market considerations were not absent from the other publications, but the discussion usually related more to cyclical developments (e.g., an economic slowdown in China) than to geopolitical effects on investor risk appetite.

the *FSR* and the *BAR*, has to do with its analysis of risks associated with bank balance sheets. This, however, is not a weakness of IMF multilateral surveillance more generally, as global banking sector risks are more fully covered in the Monetary and Financial Systems Department's semiannual *Financial Systems Trends*, an internal publication initiated in 2005. Integrating this publication more closely would have allowed the *GFSR* to provide a more balanced coverage of global financial risks.<sup>11</sup>

## Policy Advice and Forecasts

Multilateral surveillance provides value added when it goes beyond the simple aggregation of bilateral surveillance. In this section, we evaluate multilateral surveillance from this perspective. Specifically, we review below how policy advice compares between multilateral and bilateral surveillance and how the bilateral orientation of IMF surveillance affects the quality of forecasts.

### Policy advice

IMF surveillance has a strong bilateral orientation, given the dominant role played by area departments in forming judgments on country-related matters. This is clearly indicated by Table 2.1, which compares the IMF's policy advice for the United States, the euro area, Japan, and China given in the *WEO* and in Article IV consultation reports in 2004.<sup>12</sup> In general, IMF staff reports for Article IV consultations provide richer details and better context for the policy advice being offered. The advice offered in the *WEO*, on the other hand, is shorter and crisper. Undoubtedly, these differences reflect the fact that a staff country report can devote much more space to discussing policies in a particular country, whereas the space that can be devoted to a particular country in the *WEO* is rather limited. Other than this, the substance of the policy advice appears to be virtually identical between the *WEO* and the staff reports.<sup>13</sup>

<sup>11</sup>It is expected that the forthcoming merger of ICM and MFD will result in a better integration of capital market and financial sector surveillance.

<sup>12</sup>We chose 2004 for illustrative purposes only. Almost identical conclusions can be drawn for any year between 2001 and 2005.

<sup>13</sup>In contrast, the *GFSR* is not produced through a bottom-up process and seems to be less constrained by the views of area departments. In the April 2005 issue, for example, the *GFSR* noted: "a revaluation of the Chinese renminbi is seen as the key to a broadening of the adjustment process. A revaluation of the renminbi would probably create headroom for other Asian currencies to strengthen, and pressures on them to do so would intensify." At this time, the area department (along with the *WEO*) was publicly arguing for China's need to introduce greater exchange rate flexibility, and not for a revaluation of the Chinese currency.

**Table 2.1. Selected Policy Advice in Multilateral and Bilateral Surveillance, 2004**

Country or Area	September WEO <sup>1</sup>	Article IV Consultation
United States <sup>2</sup>	<ul style="list-style-type: none"> <li>• “[F]iscal policy should aim to bring the federal government budget back to balance . . . by the end of the decade. This is also important for the orderly resolution of global current account imbalances . . . the better-than-projected outcome for FY2004 . . . should be used to strengthen the targeted outcomes in the coming two years . . . tax revenues may also need to rise . . . consideration could be given to broadening the tax base, for example by cutting tax exemptions, and introducing a national indirect tax.”</li> <li>• “The challenge for monetary policy is to return interest rates to neutral . . . the Federal Reserve’s approach of ‘measured tightening’ appears generally appropriate, but . . . much will depend on the nature of the incoming data.”</li> </ul>	<ul style="list-style-type: none"> <li>• “Bringing the budget back to balance . . . within a reasonable period would leave the U.S. fiscal position much better placed. . . . The recovery provides a valuable opportunity for embarking upon the fiscal effort . . . emphasis could be laid on reforms to broaden and simplify the tax base, for example by cutting tax expenditures . . . or by introducing a national indirect tax. Although stronger growth abroad should play a key role in fostering the resolution of global current account imbalances, deter-mined efforts to strengthen the U.S. fiscal position would help boost national saving and ensure that the adjustment is orderly.”</li> <li>• “[T]he time has come to start removing stimulus. Although there appears scope for a measured tightening, recent statements by officials have helped market participants recognize that the withdrawal of monetary stimulus will not be unduly delayed.”</li> </ul>
Euro Area <sup>3</sup>	<ul style="list-style-type: none"> <li>• “[T]he long-term fiscal situation in many countries remains difficult . . . those countries with the weakest underlying positions should seek to reduce underlying deficits by at least ½ percent a year. . . . Reductions in tax burdens in many countries are also highly desirable, but . . . are a lower priority until a significant down-payment on fiscal adjustment is in place.”</li> <li>• “The widespread endorsement of the Lisbon reform agenda has not been matched by equally widespread implementation. . . . Progress has been greatest in centrally led reform, notably the Financial Services Action Plan and the Single Market; nationally sponsored reforms have lagged, particularly in labor markets . . . greater prioritization of the Lisbon Agenda, focused on the key issue of raising labor utilization, could be helpful. Renewed central initiatives for product market deregulation . . . might also add to incentives for national labor market reforms.”</li> </ul>	<ul style="list-style-type: none"> <li>• “[C]ountries should demonstrate a continued commitment to medium-term fiscal discipline . . . countries with weak budgetary positions should undertake measured but high-quality fiscal consolidation that improves the cyclically-adjusted deficit by at least ½ percent of GDP a year.”</li> <li>• “There has been measurable progress in, and toward, deregulating and integrating product and financial markets. While much remains to be done, the basic directions and steps to be taken have been agreed and instigated by area-wide institutions. . . . The greatest concern is over reform in areas where national competencies loom large. . . . The Lisbon reform agenda should be prioritized and focus on boosting work incentives. . . . Stepping up deregulation of goods and services markets . . . could provide additional momentum for labor market reform . . . peer pressure on governments could be strengthened, including by ‘naming and shaming’ cases of lagging structural reforms.”</li> </ul>
Japan <sup>4</sup>	<ul style="list-style-type: none"> <li>• “[T]he current monetary stance . . . should be maintained until inflation is firmly positive. If financial markets became concerned that the policy of quantitative easing might end too early, the Bank of Japan could increase the current account target to signal its resolve to maintain the framework until deflation is decisively subdued. . . . as the onset of inflation draws nearer, enhancements to the Bank of Japan’s communication strategy could help to focus inflation expectations, including by setting a suitably positive medium-term inflation objective and by publishing more of the Bank’s views on monetary policy and the inflation outlook.”</li> <li>• “[A]chieving savings in FY2004 relative to the budget would be desirable . . . options for consolidation include further cuts in capital spending, broadening the personal income tax base, and—in the medium term—raising the consumption tax. . . . stepped-up structural reforms could also improve Japan’s fiscal position by increasing potential output growth.”</li> </ul>	<ul style="list-style-type: none"> <li>• “The current monetary policy stance and strategy . . . should be maintained until inflation is firmly positive . . . further increases in the current account target could be considered, if needed, as a way of further signaling to markets the commitment to maintain the quantitative easing framework as long as necessary. . . . As the onset of inflation draws nearer, enhancements to the BoJ’s communications strategy could help to stabilize inflation expectations. This could include quantifying the BoJ’s inflation objective . . . [and] publish[ing] more details of its views on monetary policy and the inflation outlook.”</li> <li>• “[A]chieving savings in FY2004 relative to the budget would be desirable . . . options for consolidation could include further social security reforms . . . further cutting capital spending and broadening the personal income tax base, and (in the medium term) raising the consumption tax. . . . Front-loaded regulatory reforms . . . would help to unlock Japan’s economic potential.”</li> </ul>

Table 2.1 (concluded)

Country or Area	September WEO <sup>1</sup>	Article IV Consultation
China <sup>5</sup>	<ul style="list-style-type: none"> <li>• “[F]urther monetary tightening is likely to be needed, which would be aided . . . by greater exchange rate flexibility.”</li> <li>• “Fiscal policy also has a key role to play in cooling down the economy, including through saving revenue over-performance and reducing public investment at both central and local government levels.”</li> </ul>	<ul style="list-style-type: none"> <li>• “[A] further tightening of monetary policy would appear to be needed. . . . [This] would ensure that growth in monetary and credit aggregates comes down . . . in line with the central bank’s targets. . . . Increased flexibility of the exchange rate would also improve the effectiveness of monetary policy in containing domestic demand and price pressures.”</li> <li>• “Fiscal policy should play a more supportive role in achieving a soft landing of the economy. The authorities are urged to save the expected revenue overperformance . . . , reduce public investment . . . , and lower the deficit below the level targeted in the 2004 budget. . . . the authorities [should] aim to steadily reduce the fiscal deficit by ¼ to ½ percent of GDP per year over the medium term. . . . A number of measures are needed to address growing concerns over fiscal risks at the local government level.”</li> </ul>

<sup>1</sup>The WEO was discussed by the Executive Board on September 3, 2004.

<sup>2</sup>The Article IV consultation with the United States was concluded on July 23, 2004.

<sup>3</sup>The Executive Board discussion of the staff report on “Euro Area Policies” was held on July 26, 2004.

<sup>4</sup>The Article IV consultation with Japan was concluded on July 28, 2004.

<sup>5</sup>The Article IV consultation with China was concluded on July 28, 2004.

This means that, in terms of the content of policy advice, multilateral surveillance differs little from bilateral surveillance. To be sure, the institution’s policy advice must be consistent regardless of the channel of communication. Rather, the problem is that the language of multilateral advice is no more based on explicit consideration of economic linkages and policy spillovers than that of bilateral advice—and it offers no more insight into the possibilities for policy coordination or collective action. It appears that the national and regional sections of the WEO’s Chapter I are meant to reinforce the policy message of bilateral surveillance, not by setting it in an explicitly global context, but simply by repeating the same message.

This is not to suggest that the bottom-up procedure is necessarily a weakness of IMF multilateral surveillance. To the contrary, it can be considered to be its very foundation. According to a number of people interviewed by the IEO, it is the backing of the IMF’s familiarity with individual countries that gives credibility to what the IMF says about the global economy. The critical thing is that this strong country knowledge is appropriately complemented by multilateral perspectives, if the IMF is to play its role as the machinery for international monetary cooperation. For this, there must be an effective counterweight to the inherently bilateral orientation of IMF surveillance.

From the perspective of discussing economic linkages and policy spillovers, the real value added of the WEO seems to lie in the first several pages of

Chapter I, which precede the national and regional discussions. These first few pages discuss and analyze extensively such issues as (1) how external imbalances are distributed across countries or regions; (2) how global commodity market developments are related to growth performance in the world economy, and their likely global impact; (3) financial market and exchange rate developments (with cross references to the *GFSR*); and (4) how to manage potential risks and vulnerabilities in the world economy, including the path to an orderly adjustment of external imbalances. Although this section is rich in analysis, in most cases it does not offer clear and pointed policy advice.

The lack of policy content in this uniquely multilateral section may reflect some understandable factors. Economics is still unable to offer an unambiguous picture of exactly how different policies affect different variables and how different economies interact with each other; there is no clear consensus on how to define what is sustainable and what is not. All in all, the problem of uncertainty is a fact of life in economic policymaking, but it is compounded many times when dealing with global economic linkages and policy spillovers. To be more useful to policymakers, the WEO could get around this problem by spelling out these uncertainties more explicitly—for example, by indicating possible ways in which economic interactions may play out. It could also make greater use of scenario analysis to bring policy content to an area where concrete policy prescription is not possible. WEO authors have done

**Table 2.2. WEO Forecast Errors, 1991–2003<sup>1</sup>**

	GDP Growth		Inflation	
	Mean	z-stat	Mean	z-stat
Current year				
Industrial	–0.26	–2.53	0.17	2.71
Emerging Asia	–1.07	–0.88	–1.07	–1.61
Latin America	0.54	3.71	–6.02	–2.09
Transition <sup>2</sup>	0.80	2.36	–10.58	–1.75
Middle East	–0.07	–0.06	2.50	2.07
Africa	1.45	5.85	–3.79	–6.39
One year ahead				
Industrial	0.07	0.58	0.25	3.46
Emerging Asia	0.00	–0.01	–1.38	–1.65
Latin America	1.08	6.34	–1.95	–0.22
Transition <sup>2</sup>	1.41	3.35	–13.81	–1.02
Middle East	–0.16	–0.27	3.38	2.33
Africa	1.37	5.10	–5.65	–7.77

<sup>1</sup>A positive number indicates that the *WEO* forecast overpredicted the variable concerned (i.e., a positive number for growth and a negative number for inflation represent optimistic bias). For inflation in Latin America and transition countries, the samples start in 1992 and 1996, respectively, in order to remove extreme values.

<sup>2</sup>Also includes some nontransition EU accession countries.

this over the years, but usually not in the main text of Chapter I (see also Chapter 3, section on “Presenting the Message,” and Table 3.3).

### WEO forecasts

The optimistic bias of *WEO* forecasts has been documented by a number of econometric studies. The early work of Artis (1997) found that, between 1973 and 1994, the *WEO*’s one-year-ahead forecasts for industrial countries and current-year forecasts for developing countries had an optimistic bias. More recent studies have reaffirmed the tendency of *WEO* forecasts to have optimistic bias for developing countries (e.g., Timmermann, 2006).<sup>14</sup> These results are replicated by the IEO’s own calculations of the forecast errors of the *WEO*’s recent current-year and year-ahead forecasts for different regions (Table 2.2).

Table 2.2 indicates that, for the period 1991–2003, the accuracy of *WEO* forecasts differed from region to region. Current-year forecasts significantly underpredicted growth and overpredicted inflation for industrial countries; for one-year-ahead forecasts, the pessimistic bias remained for inflation but not for growth. On the other hand, the *WEO*’s current-year forecasts significantly overpredicted growth for Latin America, the countries in transition, and Africa, while they significantly underpredicted inflation for

these countries; the optimistic bias for growth remained for one-year-ahead forecasts for these regions. The optimistic bias for African growth was both statistically significant and numerically relatively large during 1991–2003.

Part of the bias in *WEO* forecasts may be the inevitable result of their conditional character. Every issue of the *WEO* spells out the assumption that “established policies of national authorities will be maintained.” In this respect, the forecasts defer to the *intentions* of national authorities, as opposed to their *likely behavior*, suggesting a possible built-in optimistic bias. The optimistic bias recently observed, however, relates almost exclusively to those regions with relatively small economies, so that the bias does not materially distort the IMF’s view of the overall global economy.

In fact, in terms of root mean squared errors (RMSEs),<sup>15</sup> *WEO* forecasts on growth and inflation compared favorably to the corresponding Consensus forecasts for the G-7, Europe, and emerging Asia during 1991–2003 (Table 2.3).<sup>16</sup> For the G-7 and Europe, in particular, the *WEO* forecast errors (both

<sup>15</sup>The RMSE is the most widely used measure of forecast accuracy and is given by:

$$\text{RMSE} = \sqrt{(\sum_t (F_t - R_t)^2)/n},$$

where  $F_t$  and  $R_t$  are, respectively, the forecast and realized values of the variable in question,  $t$  is a time subscript, and  $n$  is the number of observations.

<sup>16</sup>Consensus forecasts represent the means of representative private sector forecasts compiled by Consensus Economics, a private U.K.-based data provider.

<sup>14</sup>Timmermann (2006) found that, between 1990 and 2003, the IMF tended to overpredict growth and underpredict inflation in current year forecasts for several regions, especially Africa, Central and Eastern Europe, and the Commonwealth of Independent States.

**Table 2.3. WEO and Consensus Forecast Errors, 1991–2003<sup>1</sup>**

	GDP Growth		Inflation	
	WEO	Consensus	WEO	Consensus
Current year				
G-7	1.39	1.36	0.53	0.48
Europe	1.35	1.39	0.94	0.94
Emerging Asia	2.14	1.97	2.23	2.30
Eastern Europe	3.99	3.31	21.36	17.55
Latin America	2.91	2.48	47.34	43.01
One year ahead				
G-7	1.54	1.49	0.77	0.77
Europe	1.71	1.75	1.21	1.29
Emerging Asia	3.09	2.87	3.55	4.29
Eastern Europe	4.47	4.01	61.63	60.42
Latin America	4.06	3.75	84.26	56.53

<sup>1</sup>Root mean squared errors. The country groupings correspond to the Consensus regions. Data are not available for Africa.

current-year and year-ahead) were extremely close to the Consensus forecast errors.<sup>17</sup> The *WEO* forecast errors for Eastern Europe and Latin America appeared to be numerically larger than those of the corresponding Consensus forecasts. This most likely reflected the optimistic bias of the *WEO* forecasts observed in Table 2.2.

The IEO believes that part of the consistent bias observed for Africa (and, to a lesser extent, other regions) relates to how the forecasting exercise is conducted. While the Research Department coordinates the process, the growth forecasts provided by area departments for most countries are rarely adjusted. This allows the optimistic bias of country desks to come through.<sup>18</sup> The lack of optimistic bias for the industrial countries supports this conjecture. The evaluation team has learned that RES interacts far more extensively with major country desks at various stages of preparation, so that global consistency is better incorporated into major country forecasts. Also, the greater availability of public information (including competing forecasts by Consensus Economics and other institutions) may place discipline on the area departments' forecasts for these countries.

Forecasts are never perfect, but the fact that some are biased in one direction, year in and year out, may already have undermined the credibility of IMF surveillance. About twice as many of the national author-

ities surveyed replied that they agreed with the statement that “*WEO* forecasts are optimistic,” compared with those who disagreed.<sup>19</sup> In addition, all of the forecasters at regional development banks interviewed by the evaluation team felt that *WEO* growth forecasts for their respective regions were almost always more optimistic than their own.<sup>20</sup> *WEO* forecasts, however, seem to enjoy considerable influence in the public and private sectors. A number of national officials and market participants explained to the IEO that, even when they disagreed with *WEO* forecasts, they still considered them as a benchmark—for example, to evaluate their own assessments. Less biased forecasts probably would make an even better benchmark.

### Integration of Capital Market and Macroeconomic Analysis

The IMF has made considerable efforts to build up its capital market expertise, but capital market analysis has yet to be integrated in the IMF's core macroeconomic work, in the view of outside experts.<sup>21</sup> Part of the lack of sufficient integration be-

<sup>17</sup>Country groupings in Table 2.3 correspond to the Consensus regions and do not exactly match the *WEO* groupings used in Table 2.2. Insufficient coverage of Africa in Consensus forecasts precludes a similar comparison for that region.

<sup>18</sup>For example, U.S. General Accounting Office (2003) found that, between 1990 and 2001, *WEO* forecasts for growth and inflation were optimistically biased for 57 countries under IMF-supported programs (see also Timmermann, 2006). Ghosh and others (2005), however, cite evidence that optimistic bias is no greater in program countries than in nonprogram countries.

<sup>19</sup>About 40 percent of the private sector experts surveyed agreed with the statement that *WEO* forecasts were optimistic, while another 40 percent stated that they neither agreed or disagreed.

<sup>20</sup>A formal test would show, however, that these impressions are not supported by actual data. The IMF's growth forecasts have in fact been less optimistic than those of some other multilateral institutions for relevant regions.

<sup>21</sup>As recently as November 2005, the McDonough Report cited the need to “foster effective cross-fertilization between area and functional departments and ensure that available financial expertise is fully and efficiently brought to bear in the Fund's bilateral and multilateral work.” See Report of the Review Group on the Organization of Financial Sector and Capital Markets Work at the Fund, November 2005.

### Box 2.1. Macroeconomic and Capital Market Surveillance: Corporate Accounting Scandals of 2001–02

The series of accounting scandals in 2001–02 involving financial misrepresentations by major corporations in the United States and elsewhere represented a global financial shock with potential real economic consequences. Both the *WEO* and the *GFSR* covered this event.

*WEO coverage.* The April 2002 *WEO* stressed the emerging signs of global economic recovery, but dedicated only a single paragraph to the risk that financial markets might be optimistic about earnings expectations. This paragraph included a brief mention of weaknesses in the accounting and auditing framework revealed by the recent scandals, and referred the reader to the *GFSR*. Separately, the *WEO* contained an analytical chapter entitled “Three Essays on How Financial Markets Affect Real Activity.” Half a year later, the September *WEO* expressed concerns about the pace and stability of the recovery, following the weakening of financial markets and the deterioration of financing conditions for emerging markets. The *WEO* analyzed in some detail the impact on the short-term outlook of recent equity market declines and cited the risk that any new accounting scandals might set off further declines in equity markets. The *GFSR*’s call for strengthening corporate governance and transparency (see below) was cited several times. Yet, the *WEO* was upbeat by noting positive indicators for sustained recovery over the medium term, albeit at a slower pace than previously expected.

*GFSR coverage.*<sup>1</sup> The discussion in the March 2002 *GFSR* was largely descriptive of the recent scandals and the channels through which the markets had already reacted. The June *GFSR*, however, identified the quality of corporate profits in mature markets as the main source of uncertainty, with attendant risks to the balance sheets of insurance companies in the event of substantial equity market declines—declines that mate-

rialized just one week later. The September *GFSR* noted the apparent resilience of markets but also highlighted the risk that investor confidence might continue to erode to the point of withdrawing en masse from risk taking, with further equity price corrections cascading across markets to trigger liquidity events. A related risk identified in the *GFSR* was that the capital positions of financial institutions were being impaired to the point of causing systemic problems. Recommendations were longer-term in nature, including increased vigilance by supervisors and participation in the IMF’s initiatives on standards and codes. By December, the confidence shock triggered by the collapse of Enron was essentially over. The December *GFSR* noted that the risks to international financial market stability remained limited and manageable, thanks in part to U.S. monetary policy action and key regulatory measures to restore investor confidence in corporate accounting.<sup>2</sup>

*Comparing the WEO and the GFSR.* Although the *WEO* and the *GFSR* covered the same event, their approaches differed in two ways. First, the *GFSR* adopted a short time horizon in monitoring market sentiment and market positions, whereas the *WEO* applied analytical tools to the incoming data—drawing conclusions more germane to resolving starting point uncertainty of the real economy and its prospects over the medium term. Second, the September *GFSR*’s mostly intuitive discussion of systemic risks to financial systems did not feature in the *WEO*, while the data-intensive analytical work of the *WEO* on assessing bubbles, balance sheets, consumption, and investment more broadly did not feature in any *GFSR*. The *WEO* and the *GFSR* cited each other, however, thus giving the reader an alternative point of reference.

<sup>2</sup>The Sarbanes-Oxley Act strengthening oversight of accounting was passed on July 30, and a key August 14 deadline for the executives of selected listed U.S. companies to certify their financial accounts passed uneventfully.

<sup>1</sup>The *GFSR* was published quarterly in 2002.

tween macroeconomic and capital market analysis is that integration is difficult—or may even be unnecessary—in some areas. Many of the issues and risks discussed in the *GFSR*’s Chapter II fall in this category; for example, the April 2005 *GFSR* noted:

“At some point, markets may become impatient with the pace of change, and asset prices will start to play a more forceful role in bringing about the needed adjustments. In that event, U.S. government bond yields and credit spreads on corporate bonds would likely increase sharply . . . contributing to a deterioration of the external financing environment for emerging markets” (p. 21).

This possible event is cast in such a hypothetical way that it does not elicit a need for response. Likewise, the analytical chapters of both the *GFSR* and the *WEO* have also included many issues that do not allow for easy integration of the macroeconomic and capital market approaches—such as risk management practices, fiscal policy, and labor market institutions.

With respect to a number of issues, however, integration between the *GFSR* and the *WEO* would have been both feasible and desirable but did not take place. Examples from the analytical chapters include the following:

- In September 2003, the *WEO* discussed reserve accumulation in Asia and the impact of ex-

change rate volatility on emerging markets, while the *GFSR* analyzed the volatility of private capital flows to emerging markets. Both addressed crisis vulnerabilities but they did not even cite each other. A year later, in September 2004, the *GFSR* featured a chapter on emerging markets as net capital exporters and discussed reserve accumulation in this context, but it made only a passing reference to the September 2003 *WEO* discussion of the macroeconomic aspects of the same topic.

- The September 2004 *WEO* briefly discussed the impact of population aging on financial markets and public pension plans. This discussion, however, did not draw on the *GFSR* analysis that also appeared in the same month of the longer-term issues for the pension fund industry.
- The September 2004 *WEO* discussed the global house price boom, analyzing why the structure of mortgage contracts differed across countries. Six months later, the April 2005 *GFSR* discussed mortgage contracts from a household risk management perspective but made only a footnoted reference to the September 2004 *WEO*.

These analyses were stand-alone pieces that did not necessarily require the support of an alternative analytical approach to be complete. Still, better integration of the macroeconomic and capital market approaches would have provided additional insights.

Similar examples can also be found in the review chapters (i.e., Chapter I of the *WEO* and Chapter II of the *GFSR*). These chapters in the two publications follow standard templates that cover financial market issues without overlapping each other, but where one stops and the other begins appears largely arbitrary. When the *GFSR* and the *WEO* deal with the same issues (including energy market developments recently), they do not seem to go much beyond making cross references to each other (Box 2.1). The overall tone could also be different. For example, in April 2005, the *WEO* struck a cautionary note on the outlook in light of diverging patterns of growth and growing external imbalances. The *GFSR* was more sanguine, however, seeing “no particular reason to believe that this benign scenario might come to an end anytime soon.” These examples demonstrate the so-called “silo” problem of the IMF’s internal organization.

## Use and Delivery

We now consider issues related to the use and delivery of the IMF's multilateral surveillance products. We look first at how multilateral surveillance informs bilateral surveillance. We then discuss whether the multilateral surveillance message is reaching the intended external audience, including how well the delivery of the message is exploiting the potential for peer pressure. We consider whether the presentation of surveillance products is sufficiently focused on areas where the IMF can offer the greatest value added and is done in a way that maximizes its impact. We then offer a few observations on the ultimate impact of IMF multilateral surveillance on policies adopted in major countries.

### Informing Bilateral Surveillance

To assess the extent to which multilateral surveillance provides global perspectives to bilateral surveillance, we paid particular attention to the two most recent staff reports (issued through December 2005) for Article IV consultations with a sample of 36 countries,<sup>1</sup> as well as evidence collected from surveys and interviews. We review below (1) how the staff reports cover the linkages between domestic macroeconomic issues and global economic conditions; (2) how area department staff incorporates global capital market perspectives in its country work; and (3) how the IMF is trying to promote the integration of multilateral perspectives in bilateral surveillance.<sup>2</sup>

<sup>1</sup>In addition to the 19 G-20 countries (Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, the United Kingdom, and the United States), the sample was expanded to include a broad cross section of the IMF's membership: Algeria, Cameroon, Chile, Colombia, Egypt, Israel, Kenya, Malaysia, Namibia, the Netherlands, Nigeria, Pakistan, the Philippines, Poland, Singapore, Spain, and Ukraine. As a reference, we also looked at the staff reports (and accompanying selected issues papers) for euro area policies.

<sup>2</sup>Integration of multilateral and bilateral surveillance is a high-priority item in the latest Surveillance Guidance Note (issued in May 2005), which suggests that Article IV reports should highlight

### Macroeconomic surveillance

While the staff reports we reviewed all make some reference to global linkages, in many cases the analysis was not central to the overall discussion, with hardly a paragraph devoted to them. In some reports, the references were limited to recent world oil price developments, but this was an event difficult to ignore for any country (Box 3.1). Additional references to global and regional spillovers were found in a few accompanying selected issues papers, but the IEO's overall assessment does not change.<sup>3</sup> The global or regional ramifications of domestic policies were discussed only for China in 2004, the United States in 2004 and 2005, and Japan in 2005. Even for Germany or Russia, there was virtually no discussion of the regional (let alone global) spillover effects of their policies (for the euro area as well, discussion of global and regional issues was found to be more inward-looking).

Why such limited coverage of global and regional linkages? At least three interpretations are possible. First, linkage issues may be discussed with the authorities but not written up in staff reports. Interviews with area department staff have suggested this possibility. Second, the absence of discussion of global or regional linkages in staff reports may only suggest that these issues are not pertinent to policy discussions in a particular context. A third interpretation, of course, is that multilateral surveillance fails to affect the conduct of bilateral surveillance.

These interpretations are not mutually exclusive, but the last possibility is implied by the IEO surveys of senior area department staff and national authorities (Figure 3.1). Focusing specifically on the *WEO*, only 7 percent of the IMF's senior staff and 10 percent of the authorities surveyed "strongly agreed" with the statement that "*WEO* topics are discussed

the domestic consequences of global developments and that surveillance in large countries should pay close attention to the systemic impact of their policies. Guidance Notes are issued by PDR to provide operational guidance to staff on various topics.

<sup>3</sup>Selected issues papers frequently included some analyses of cross-country issues.

### Box 3.1. Global Linkages and Spillovers in Individual Country Reports, 2004–05

References to global linkages and spillovers vary across Article IV staff reports. Some reports—specifically those on Algeria, Israel, Namibia, the Netherlands, Nigeria, Pakistan, and Spain—made few or no references to global linkages beyond the implications of oil price developments. By contrast, the country reports for Chile, China, Mexico, Singapore, Turkey, and the United States offer numerous references and detailed analysis of global linkages.

The staff report for Chile, for example, mentions that robust growth in the global economy has helped boost the price of copper. It also points out that Chile’s real GDP growth was aided, among other things, by low world interest rates. Chile’s trade links with China are also discussed in detail. The report refers to regional developments—such as Argentina’s decision to reduce natural gas exports—forcing Chilean electricity generation to switch to more costly coal- and diesel-generated power. It also discusses the possible effects of a sharp rise in world oil prices.

The Article IV report for China discusses the possible regional impact of a slowdown in that country. It

also looks at greater exchange rate flexibility and its impact on the domestic economy. Analysis of the prospects for higher U.S. interest rates is featured in some sections of the report.

Economic links with the United States are discussed in great detail in the Article IV report for Mexico, which also discusses the increased Chinese exports to the United States and its effect on Mexico’s export share.

The U.S. Article IV report analyzes the effect on domestic activity of an increase in oil prices and discusses the implications of the large current account deficit and associated risks of market disruption. The report points out that the low U.S. national saving rate could be a significant drain on global saving as the world recovery matures, potentially dampening global investment and growth. As to the resolution of global current account imbalances, the report discusses the importance of stronger growth abroad and the need for a stronger U.S. fiscal position; it also analyzes the spillover effects of U.S. economic policies on global investment.

during Article IV discussions,”<sup>4</sup> although there may be a considerable variation across the area departments.<sup>5</sup> The split views of the staff and the authorities in the next two categories (“agree” and “neutral”) may mean that limited time is spent discussing global issues during Article IV consultations (thus leading to divergent assessments). Although progress may have been made in terms of references to economic-linkage-related issues in Article IV staff reports, there is obvious scope for bringing global perspectives further into bilateral surveillance.

#### Capital market surveillance

Most IMF area department economists appear to be paying attention to international capital market issues. According to the survey of area department staff, more than 70 percent of respondents said they were either “very familiar” or “familiar” with the Global Markets Monitor, a daily summary of market developments produced by the International Capital

Markets Department. Indeed, more than half of them said that they used it “frequently.” The review of the staff reports for our sample of 36 countries also indicates that the reports for 25 of them included some discussion of the implications of global capital market developments for the economies concerned. The countries for which no mention of global capital market developments was made mostly included countries with relatively limited access to international capital markets, such as Cameroon, Kenya, and Namibia.

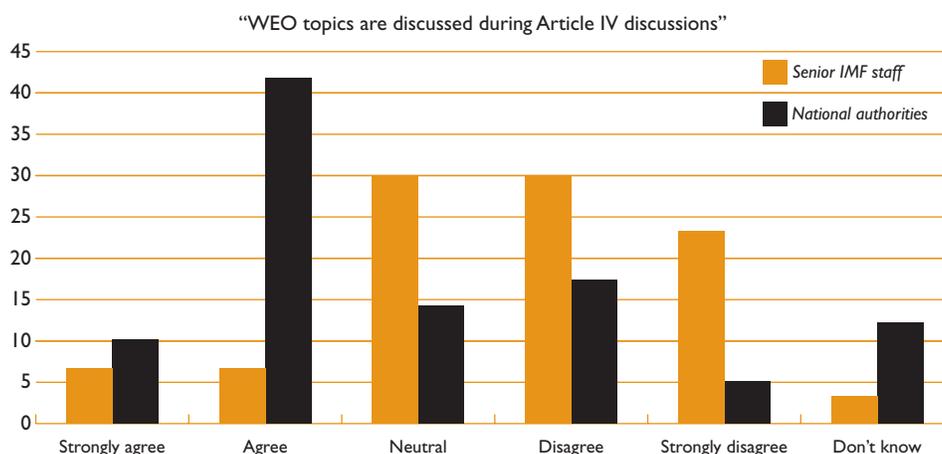
In almost all cases where references to international capital market issues were made, however, they were limited to a few lines; rather surprisingly, no mention of global market developments was made in the staff reports for the Netherlands, Singapore, and Spain. The references were mostly related to capital flows or interest rates, issues that are readily translatable into macroeconomic terms. The frequent absence of references to global capital market developments in staff reports, and the terseness of the references that are made, may partly reflect the relative paucity of global capital market issues that have immediate macroeconomic consequences.

Turning to the use of the *GFSR*, most members of the IMF staff and the Executive Board interviewed by the IEO had a generally negative view of the *GFSR*, mainly because of what they consider its excessive length and overuse of market jargon. The views expressed by national authorities were more positive. More than 80 percent of respondents con-

<sup>4</sup>Although not shown in the figure, only 15 percent of senior area department staff surveyed “strongly agreed” that “the *WEO* provides effective support to Article IV consultations.” Another 15 percent “agreed” with the statement.

<sup>5</sup>In commenting on the draft report, the European Department indicated that the *WEO* more regularly informed bilateral surveillance in that department. Note that the statistical margin of error (at the 95 percent level) for the senior staff survey was about 16 percent.

**Figure 3.1. Senior Area Department Staff and National Authorities on the WEO**  
(In percent)



sidered the analytical rigor of the *GFSR* as either “completely adequate” or “adequate.” Somewhat fewer respondents gave such high marks to the *GFSR* in such other categories as timeliness and identification of vulnerabilities, but the outside perception of the *GFSR* was considerably better than that of those within the IMF.

How do we reconcile this generally positive assessment of the *GFSR* by national authorities with the generally negative view held by those within the IMF? We believe it can be explained by the relatively small readership of the *GFSR*, as revealed by interviews with IMF staff, market participants, and member country officials. According to our survey, only 4 percent of area department staff uses the *GFSR* in its country work “regularly” (and hardly anybody uses it “frequently”); 76 percent said that they seldom read the document. But those in member countries who responded to the surveys actually read the *GFSR*. We suspect that when the surveys reached the finance ministries and central banks concerned, the task of responding to the survey was assigned to those who actually read it.

The limited audience for the *GFSR* within the IMF has much to do with the nature of the issues that the publication has dealt with in recent years (Table 3.1). Discussion of recent market developments in the review chapter of the *GFSR* offers little new information to most IMF staff members, beyond what is already available from the financial press and other routine market intelligence. Likewise, the analytical chapters have almost exclusively covered issues related to the transfer of risks across sectors and medium-term institutional development issues. These issues have little immediate consequence for the IMF’s routine Article IV country work. Outside

the IMF, some of these chapters have been highly appreciated by those who read them. A senior major country official responsible for financial stability explained to the IEO team that risk-related issues covered in the *GFSR* were critically important, but only to a relatively small group of risk managers in the public and private sectors.

These considerations suggest that if the *GFSR* is to offer greater value added to those within the IMF and also to a wider audience outside, its authors must better exploit their comparative advantage. Indeed, IMF staff has a unique position that corresponds to: (1) its ability to analyze market developments from a perspective that is detached from the marketplace; (2) its neutrality characterized by the absence of a profit motive; and (3) its access to the IMF’s extensive global macroeconomic information. This underscores the need for a more collaborative approach to producing the *GFSR*, seeking greater inputs from various IMF departments at different stages.

At the same time, the *GFSR* should aim to provide IMF staff with an analytical view of market developments that identifies the implications of these developments for the IMF’s country work, including short-term risks and vulnerabilities in the global financial system. The more specialized studies on medium-term risk transfer and institution-building issues could be redesigned to target the relatively small group of interested specialists and could be featured in a separate publication.

### Bringing more multilateral perspectives into bilateral surveillance

The IMF has several mechanisms in place to bring multilateral perspectives into bilateral surveil-

**Table 3.1. Major GFSR Topics, 2003–05**

Issue	Developments and Prospects <sup>1</sup>	Analytical Chapters <sup>2</sup>
March 2003	<ul style="list-style-type: none"> <li>• Developments and risks in mature and emerging markets.</li> <li>• Analysis of portfolio shift from risky assets to cash in mature markets and its implications for financial stability.</li> </ul>	<ul style="list-style-type: none"> <li>• “Local securities and derivatives markets in emerging markets”—developments and policy measures to promote their further development.</li> </ul>
September 2003	<ul style="list-style-type: none"> <li>• Developments and risks in mature and emerging markets.</li> <li>• Possible risks posed by Fannie Mae and Freddie Mac for financial stability, given their size.</li> <li>• How hedging in the mortgage market can amplify interest rate movements.</li> <li>• Implications of the prospect of rising U.S. interest rates for emerging markets.</li> </ul>	<ul style="list-style-type: none"> <li>• “Financial asset price volatility”—how to control factors that amplify asset price volatility, including enhanced transparency, better risk management, and improved market infrastructure.</li> <li>• “Volatility of private capital flows to emerging markets”—determinants of the pattern and volatility of capital flows and the policy responses that followed the Asian crisis.</li> </ul>
April 2004	<ul style="list-style-type: none"> <li>• Developments and risks in mature and emerging markets, with a focus on whether asset price levels are justified by fundamentals, and also including corporate governance.</li> </ul>	<ul style="list-style-type: none"> <li>• “Risk transfer and the insurance industry”—the transfer of risk from banks to insurance companies in major countries, and its implications for risk management in the insurance sector.</li> <li>• “Institutional investors in emerging markets”—analysis of how various nonbank institutional investors make asset allocation decisions vis-à-vis emerging market securities, and its implications for the volatility of capital flows to emerging markets.</li> </ul>
September 2004	<ul style="list-style-type: none"> <li>• Developments and risks in mature and emerging markets, including an update on the insurance industry, the hedge fund industry, and energy trading markets.</li> <li>• “Financing flows and global imbalances.”</li> </ul>	<ul style="list-style-type: none"> <li>• “Risk management and the pension fund industry”—the challenges faced by pension funds in major countries, measures to enhance their risk management practices, and the implications for the transfer of risk to the household sector.</li> <li>• “Emerging markets as net capital exporters”—the associated accumulation of net international reserves and how this facilitated the financing of large U.S. current account deficits.</li> </ul>
April 2005	<ul style="list-style-type: none"> <li>• Developments and risks in mature and emerging markets, including global imbalance issues, energy markets, and an update on the insurance industry and hedge funds.</li> <li>• Possible impact on emerging markets of a rise in U.S. interest rates.</li> </ul>	<ul style="list-style-type: none"> <li>• “Household balance sheets”—greater assumption of risks by the household sector and its implications for risk management and the need to educate the public.</li> <li>• “Corporate finance in emerging markets”—the rise of capital market financing in emerging markets, remaining obstacles to more diversified funding, and the associated vulnerabilities.</li> </ul>
September 2005	<ul style="list-style-type: none"> <li>• Developments and risks in mature and emerging markets.</li> </ul>	<ul style="list-style-type: none"> <li>• “Aspects of global asset allocation”—factors that determine asset allocation, the behavior and strategy of different types of institutional investors, growing complexity of investment funds, and how home bias has disappeared.</li> <li>• “Development of corporate bond markets in emerging market countries.”</li> </ul>

<sup>1</sup>Chapters II and III for the March 2003 GFSR; Chapter II for all others. These chapters follow a largely standard template that includes developments and issues related to bond and equity markets, the banking sector, exchange rate movements, capital flows and emerging market financing, and sectoral balance sheet developments. Only a few topics of special interest are highlighted in the table.

<sup>2</sup>Chapter IV for the March 2003 GFSR; Chapters III and IV for all others.

lance. In recent years, it has taken steps to strengthen these mechanisms and develop new instruments for this purpose. We highlight below the recent modifications of the vulnerability exercise (VE); a prospective enhancement of the work of the Coordinating

Group on Exchange Rate Issues (CGER); and the increasing use of global economic models in bilateral surveillance. We also review the participation of RES and ICM staff in area department missions in recent years.

First, the IMF substantially modified the vulnerability exercise in mid-2005, to strengthen its top-down element. The primary objective was to enhance the analytical underpinning of vulnerability assessments. The modification also included a new mechanism to select countries on the basis of objective criteria, so as to ensure that all systemically important countries are covered regardless of the judgments of area departments. The final assessment of vulnerability still rests with area departments. Although most area department staff does not seem to find much value added in the exercise, the indicator-based rating scheme at least imposes discipline on the process, with any major differences of view communicated to management.

Second, work is under way to expand the coverage of the CGER to include emerging market economies, in order to increase the multilateral aspect of the exercise and its usefulness in bilateral surveillance. Considerable data collection work is required before the methodological approaches can become operational. When the work is completed, CGER assessments will provide additional multilateral inputs into exchange rate surveillance by country teams for a much larger set of countries.

Third, multilateral perspectives can be brought into bilateral surveillance by using global economic models. Two models, GEM and MULTIMOD, have been used by IMF staff in some bilateral surveillance situations.<sup>6</sup> By the very nature of these models, their use, at least in their multicountry versions, implies that economic linkages across countries are explicitly incorporated in the analysis. The models have often been applied to relevant policy issues and have helped draw some sharp policy implications. An IEO review of recent staff reports indicates that, especially with the development of GEM, model-based simulations have become an increasingly frequent feature of bilateral surveillance. Whereas staff used only a handful of global model-based simulations each year during 2000–04, they were used in at least 10 cases in 2005.<sup>7</sup> We may see greater use of global models as GEM develops further and as more area department staff members become familiar with using its framework.

Finally, although not a formal process, the participation of RES and ICM staff in area department missions could potentially contribute to bringing more

multilateral perspectives into the IMF's bilateral surveillance work. Over the six-year period FY2000–05, 88 RES and ICM economists (52 for RES and 36 for ICM) participated in Article IV consultation missions.<sup>8</sup> ICM participation appears to have picked up in 2005, largely because of its increased participation in missions to emerging markets, particularly WHD countries.<sup>9</sup> RES participation in industrial country missions has been largely limited to a few countries, notably, Belgium, Australia, Germany, and Japan. On the whole, participation by RES and ICM staff in the IMF's country mission work is limited, and considerable scope may exist to promote the integration of multilateral and bilateral surveillance through this channel.

## Reaching the Intended Audience

### Identifying the intended audience

The external products of IMF multilateral surveillance—particularly the *WEO* and *GFSR*—have multiple audiences in the public and private sectors. The *WEO* receives a particularly wide press coverage, which has grown over the years (Figure 3.2).<sup>10</sup> Notable growth appears to have taken place in non-English language outlets, where citations have more than quadrupled, even as English language citations have grown by 50 percent.<sup>11</sup> The coverage of the *WEO* is particularly extensive around the time of its release: over a 12-day period following the release, the *WEO* typically receives close to 600 references in the press throughout the world.<sup>12</sup> There is clearly media interest in IMF forecasts, implying that effectively communicated multilateral surveillance messages can potentially have substantial impact on public debate.

Although the private sector is an increasingly important audience, interviews with staff members

<sup>6</sup>MULTIMOD is a dynamic multicountry macroeconomic model of the world economy designed to study the transmission of shocks across countries as well as the short-run and medium-run consequences of alternative monetary and fiscal policies. GEM is a new multicountry model with firmer microeconomic underpinnings.

<sup>7</sup>See Background Documents, pp. 43–44; available via the Internet at [www.imf.org/ieo](http://www.imf.org/ieo).

<sup>8</sup>See Background Documents, p. 45; available via the Internet at [www.imf.org/ieo](http://www.imf.org/ieo).

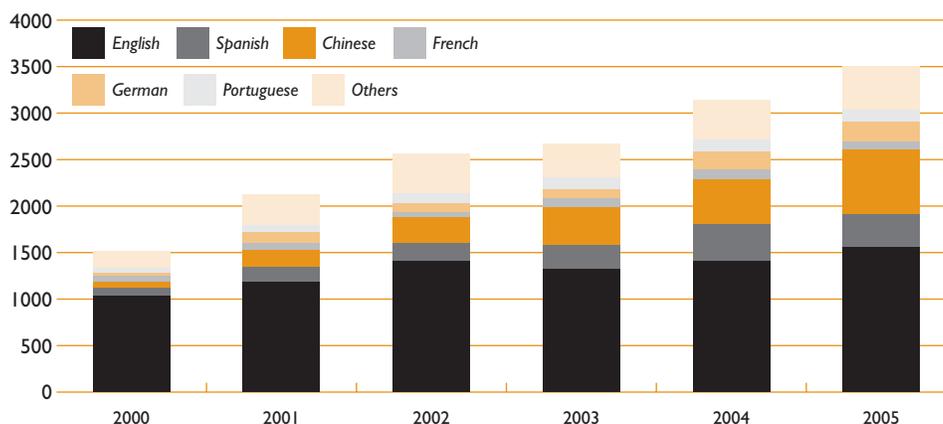
<sup>9</sup>Barbados, Brazil, Chile, the Dominican Republic, Mexico, and Venezuela.

<sup>10</sup>By comparison, the coverage of the *GFSR* is much more modest. For example, there were just over 400 press references to the *GFSR* during 2005, though this may be an underestimation of the actual press coverage. The term *GFSR* (or its full title) is not as firmly established as the *WEO* and consequently the Factiva search may not have caught all the relevant references to the publication, especially in non-English languages.

<sup>11</sup>It should be noted that the Factiva database, from which the EXR data are taken, has grown from about 7,000 sources in 2001 to over 9,000 in 2005. The database covers sources in 21 languages.

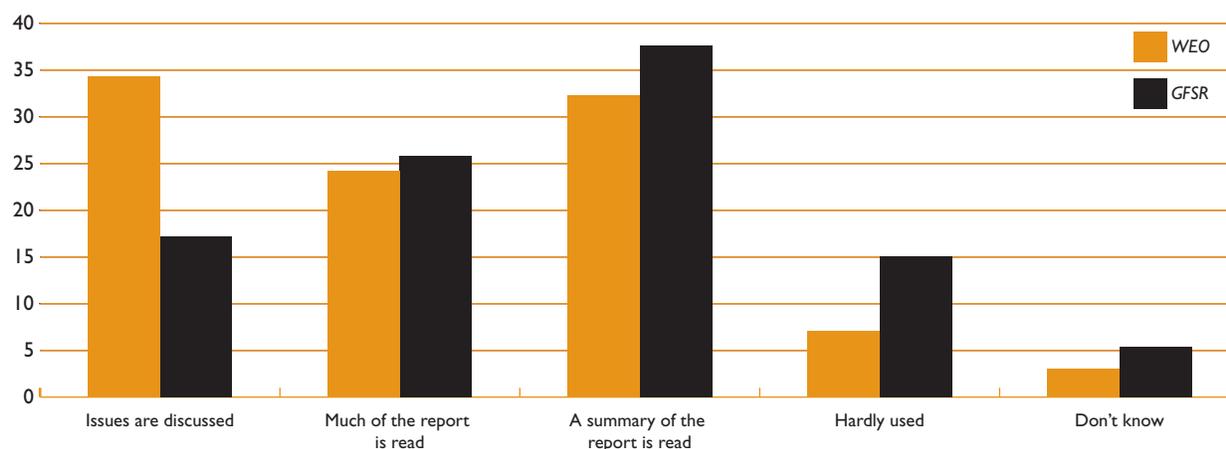
<sup>12</sup>For example, in the fall of 2005, there were 554 press references to the *WEO* (compared with 382 references over a similar period for the OECD's *Economic Outlook* released in December of the same year).

**Figure 3.2. The Press Coverage of the WEO, 2000–05**  
(Total references to the WEO)



Source: IMF, External Relations Department.

**Figure 3.3. How Multilateral Surveillance Is Used by National Authorities**  
(In percent)



suggest that many seem to consider the policymakers of member countries as the primary audience of multilateral surveillance outputs. National authorities also seem to see themselves as the main audience. More than 90 percent of respondents said that the audience for the *WEO* and *GFSR* was “policymakers and public sector economists,” while about 50 percent also considered academics and research institutes to be an audience. In contrast, the overwhelming majority of respondents did not consider the media or the private sector (including the markets) as the primary audience of these publications. Given the acknowledged importance within the IMF of informing the public, this is a rather surprising result.

Interviews with senior officials of IMF member countries indicate that the “message” of these publications does reach the relevant officials in finance ministries and central banks. Given the time constraints of senior officials and the length (and sometimes complexity) of these documents, however, those who actually read them are more likely to be “working level” officials assigned to prepare short summaries for their superiors. According to the survey, about 25 percent of respondents replied that “senior policymakers” read much of the *WEO* and the *GFSR* (Figure 3.3). The meaning of “senior policymakers” was not clearly specified in the survey. On the basis of interviews with officials of major countries, the IEO evaluation team believes that

much less than 25 percent of ministers and of governors and their deputies actually read the *WEO* or the *GFSR*.<sup>13</sup>

### Is the Executive Board effective as a peer pressure group?

The Executive Board's role in multilateral surveillance has three dimensions. First, members of the Board represent their national authorities and, as such, the Board itself can serve as a vehicle of peer pressure. Second, the Board processes the information it receives on global economic and market developments (e.g., through WEMD sessions) for its oversight of bilateral surveillance work.<sup>14</sup> The Board can thus serve as an additional mechanism for integrating multilateral and bilateral surveillance. Finally, the Board reviews the multilateral surveillance documents it receives (the *WEO* and *GFSR*) for factual accuracy and, possibly, also for its political sensitivities prior to the reports' publication.<sup>15</sup> We focus here on the role of the Board as a peer pressure group.

As a forum for peer pressure, the Executive Board's contribution to multilateral surveillance may be limited by the current setup for its involvement. When Executive Directors meet to discuss the *WEO* twice a year, in March and August, virtually all of their initial interventions are prepared statements that are circulated before the meeting and entered into the official minutes.<sup>16</sup> These written statements—called “grays” in IMF jargon—are useful because they often incorporate the carefully articulated and drafted views of national authorities. But these statements have not facilitated an active, free exchange of views on the substance of policy issues, and a number of senior officials in capitals maintain that whatever discussion does take place at the Board has not fed into their policy discussions.

<sup>13</sup>In our survey, none of the G-7 countries reported that senior policymakers read the *WEO* and only one country reported that senior policymakers read the *GFSR*. The interview results are more in line with these survey results for the G-7 countries.

<sup>14</sup>Such information is also communicated to capitals. However, WEMD sessions are informal, and no Board decision or Summing Up is produced.

<sup>15</sup>Whereas in the past the Executive Board may have exercised an unwritten prerogative to suggest that certain politically sensitive information be deleted before publication, the IMF's more recent transparency policy has transformed the role of the Board in the review process. RES staff indicated to the evaluation team that it now considers Board comments—which are more focused on facts and interpretations, rather than on excising politically sensitive material—to be helpful in ensuring the production of an accurate and well-balanced document.

<sup>16</sup>This is a widespread practice aimed at limiting the length of meetings and is not limited to Board discussions of the *WEO*.

The limited role played by the Executive Board under the current setup of multilateral surveillance is illustrated by examining the minutes of Board discussions on the *WEO*. We found that, during 2000–05, about three-quarters of the additional interventions by Executive Directors concerned factual clarifications, drafting suggestions, and other procedural comments (such as content and future topics). Indeed, Board members had only a limited exchange of views on an average of four topics, resulting in 10–12 additional interventions by Executive Directors (Table 3.2). The Summing Up of the Board discussion—appended to the *WEO* report—does not receive much press coverage, because the press conference that follows the Board discussion focuses on the *WEO* as a staff document. The table indicates a similar story for the Executive Board meetings on the *GFSR*.

### Contact with intergovernmental groups

Given their share of the global economy, the G-7 (accounting for about 65 percent of world GDP) and the G-20 (about 80 percent of world GDP) represent the most important policy forums to which the IMF has access.<sup>17</sup> These are the forums of systemically important countries where policymakers (including ministers and central bank governors and their deputies) meet to discuss policy issues of mutual interest. The limited number of attendees permitted at these meetings can facilitate frank exchanges of views among the most senior policymakers, and peer pressure can thus be exerted. The effectiveness of IMF multilateral surveillance, therefore, depends critically on the effectiveness with which the institution interacts with these major intergovernmental groups. Within the IMF, however, there is ambivalence toward these groups, which are seen more as competitors than as allies.

This ambivalence is partly reflected in a lack of continuity in institutional representation and in a poor infrastructure to support the IMF's inputs into these and other similar groups. While the Managing Director attends the meetings of these intergovernmental groups at the ministerial level, the First Deputy Managing Director and other senior officials have represented the IMF at the various meetings of the deputies. Surveillance notes for the G-7 and the G-20 have typically been prepared by a single B-level staff member in the Research Department.<sup>18</sup>

<sup>17</sup>The figures come from the *WEO* database. G-20 GDP does not include those EU member countries that are represented at the forum through the European Commission.

<sup>18</sup>Only in 2005 was one-half staff year of dedicated support allocated to this senior staff member.

**Table 3.2. Executive Board Meetings on the WEO and the GFSR, 2000–05<sup>1</sup>**

	2000–01 <sup>2</sup>		2002–03 <sup>2</sup>		2004–05 <sup>2</sup>	
	WEO	GFSR	WEO	GFSR	WEO	GFSR
Number of meetings	4	n.a.	4	6	4	4
Length	3 hours and 46 minutes		3 hours and 11 minutes	2 hours and 40 minutes	2 hours and 50 minutes	1 hour and 38 minutes
Number of “grays” issued	18	n.a.	18	18	24	24
Number of interactions on policy issues <sup>3</sup>	3 (12)	n.a.	4 (12)	1 (4)	4 (10)	0 (0)
Factual clarification or drafting suggestions <sup>4</sup>	65	n.a.	59	69	67	66
Other procedural comments <sup>3</sup>	12	n.a.	15	16	11	18

Source: Official minutes of relevant Board meetings.

Note: n.a. = not applicable; publication of the GFSR began in 2002.

<sup>1</sup>Averages for each meeting.

<sup>2</sup>Includes only regular spring and fall sessions.

<sup>3</sup>The average number of topics on which some exchange of views took place among Executive Directors (number of such interventions in parentheses).

<sup>4</sup>Percent of total Board discussion.

As a result, the IMF has not proactively engaged with these intergovernmental groups; only highly standardized surveillance notes containing an updated summary of the latest *WEO* are routinely prepared at the request of a country holding the chairmanship. Occasionally staff has found itself overstretched when a last-minute request for a special thematic piece is made. If more resources were allocated to these activities, not only could such requests be welcomed as a possible opportunity to help shape the policy debate, but the IMF could also initiate new analysis as an input into these forums. The lack of leadership, focus, and resources has precluded pursuing creative ways of engaging with these groups of senior policymakers.

When sufficient attention and resources are committed to intergovernmental group issues, a more proactive engagement can indeed be expected. This is illustrated by the preparation of a special note on “Adjustment of Global Imbalances” by an interdepartmental group of staff from the Asia and Pacific Department (APD), European Department (EUR), Western Hemisphere Department (WHD), ICM, PDR, and RES in January 2004, ahead of the G-7 meetings in February. Responding to a request from management, this team quickly prepared a highly technical note that analyzed: (1) how large external imbalances were creating divergent changes in net foreign asset positions across countries; (2) how much the U.S. dollar would need to adjust over time to accommodate these changes; and (3) the impact of such an exchange rate adjustment. This was in the end packaged as a five-page supplement to the surveillance note.

### Regional outreach

Regional outreach is another channel through which the IMF can communicate the products of its

multilateral and regional surveillance to targeted audiences. In mid-2005, area departments initiated efforts to deliver the key messages of the *WEO* to various regions. These regional outreach initiatives have generally been well received. Area departments can also take advantage of the access they have to regional forums of senior policymakers, including meetings of the Asia Pacific Economic Cooperation Council (APEC) and Western Hemisphere Finance Ministers. While it is not possible to assess these efforts in detail, the experience of the European Department’s engagement with EU institutions in recent years suggests the potential to increase the impact of IMF multilateral surveillance through these channels.

Within the EU, the IMF has enjoyed extraordinary access to policy discussions between senior national policymakers in the framework of the Economic and Financial Committee (EFC) of the Council for Economic and Financial Affairs (Ecofin Council).<sup>19</sup> The Director of the IMF’s European Department has regularly been invited to attend the Eurogroup and Eurogroup Working Party meetings through an informal arrangement.<sup>20</sup> Some senior European officials indicated to the IEO that the IMF was the only outside entity to be invited to the Eurogroup Working Party, and the IMF’s interventions

<sup>19</sup>The EFC has reportedly been increasingly successful in generating common EU positions on economic issues over the past 10 years.

<sup>20</sup>The Eurogroup is an informal group of Ecofin Finance Ministers, established in 1997. The Eurogroup Working Party is the Eurogroup’s counterpart to the Ecofin Council’s EFC. The ministers are accompanied by one EFC member each. Currently, the Eurogroup has 12 member countries represented. One senior official in Brussels noted that the Ecofin Council (with 25 member countries) was large and that more frank discussion took place in the Eurogroup.

were appreciated and sometimes sparked subsequent policy debate.

The reasons for the success of regional outreach in Europe may or may not apply to other regions. First, European governance structures and institutions have been undergoing rapid change. This has helped increase policymakers' interest in the views of the IMF, as a global organization with a politically dispassionate perspective. Second, the IMF has been able to focus selectively on key issues and to deliver views constructively. This has helped secure its access to ministerial discussions. Finally, IMF analysis is considered by many officials to be both analytically stronger and more forward-looking than similar analyses done by others.

### Presenting the Message

In a world in which the informational advantage of the IMF has declined and there are competing sources of analysis, the IMF cannot expect to affect the policy debate unless it has a clearly articulated message that is skillfully delivered through an effective communications strategy. An effective message must provide value added but this is not sufficient in itself. The message must also be packaged in such a way that it is quickly understood and absorbed. Interviews with senior policymakers and journalists in the elite financial press strongly suggest that the IMF's multilateral surveillance outputs would benefit from greater focus and pointedness. In this section we discuss these issues for the *WEO* and the G-7 and G-20 surveillance notes.<sup>21</sup>

### The *WEO*

The *WEO* is highly regarded and virtually all those interviewed by the IEO held positive views about its quality. Yet, only a small number actually read a major portion of the report. As noted earlier, the key messages do reach senior policymakers but only through a summary prepared by working-level officials. Outside the public sector, only a small minority in the financial press and academia seems to be reading much of the document. A leading journalist in the elite financial press told the evaluation team that he considered his role to be “deciphering” what the *WEO* said and to communicate that message to the public. Many interviewed by the evaluation team considered the *WEO* to be too “dense” and too long to excite their interest.

<sup>21</sup>We do not consider the *GFSR* here for two reasons. First, its review chapters, while useful to some, do not offer much value added. Second, its analytical chapters, in the current format, have been of interest mostly to a small group of specialists.

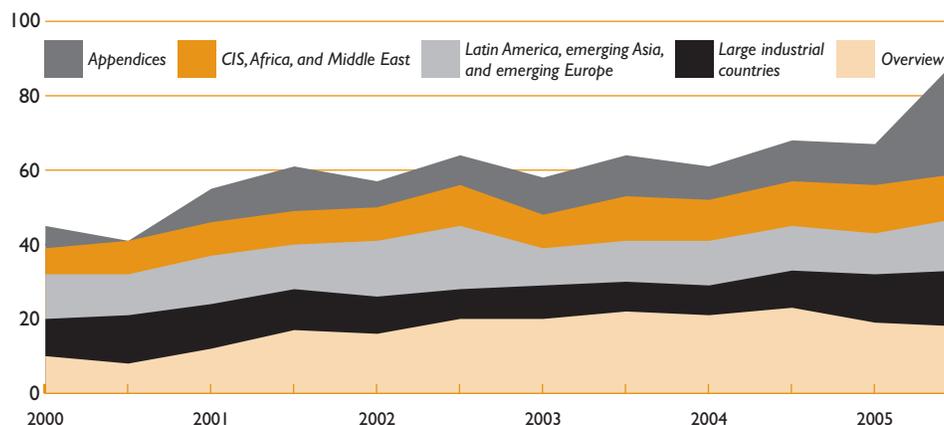
Undoubtedly, each of the individual topics discussed in the *WEO* is useful to a particular audience. But the fact that some topic is useful to somebody does not necessarily mean that it should receive heavy coverage, even if the IMF is the most efficient producer of information on that topic. A publication that tries to satisfy the needs of every segment of the broader audience tends to expand in volume and length over time. It thus risks losing focus and its appeal to potential readers.

For example, the *WEO*'s review chapter (Chapter I) expanded from 40 pages in 2000 to 60 pages (or 90 pages with appendices) in 2005, owing partly to the greater attention paid to economic developments in emerging and other developing countries (Figure 3.4). While this may have increased the *WEO*'s appeal to a wider geographical readership, it may also have contributed to the widely voiced reservations about its length. Although the overall length of the *WEO* has remained roughly the same, the key multilateral surveillance chapter (Chapter I) gets the most attention. There is thus considerable scope to streamline this chapter by narrowing its focus.

Model-based scenario analysis is a resource-intensive exercise that cannot easily be replicated by other institutions. It may thus deserve a more prominent place in the *WEO*, which many feel should focus more on prospects and risks. To be sure, global models were used for policy simulation purposes in every issue of the *WEO* during 2000–05 (Table 3.3), but the results were rarely cited in the main body of Chapter I; they appeared instead in an appendix, a text box, or in a section of the analytical chapters. Most of these simulations were designed to calculate the impact of various shocks on growth, inflation, and exchange rates in industrial countries. Global imbalances, the sustainability of U.S. external deficits, and the impact of changes in U.S. fiscal deficits have figured prominently as topics, and pointed policy recommendations were occasionally spelled out. More prominent treatment of these simulation results would have increased the *WEO*'s value added.

The staff's reluctance to give more prominent treatment to simulation results is understandable, as such results are specific not only to the particular model but also to the particular set of parameter values. In order to increase the general appeal of such model-based scenario analysis, IMF staff should include more parameter values and consider explicitly the implications of model uncertainty for policymakers. Decision-making tools to deal with these aspects of uncertainty are currently being developed and applied for various long-term planning purposes. If scenario analysis is to become a more central part of the *WEO* exercise, consideration could be

**Figure 3.4. Evolution of WEO Chapter I**  
(Number of pages)



given to combining the IMF's existing models with such emerging methodologies.<sup>22</sup>

At the same time, in order to reach a wide range of audiences with diverse needs, a variety of products may be needed. For busy senior policymakers, for example, a concise summary of the *WEO* might be helpful. Similar types of summaries are currently provided to journalists when the document is released. But most important, the IMF's multilateral surveillance products should have a "customer" focus. Each product must be designed for a specific purpose and with a specific audience in mind. Although the press and working-level officials play useful roles in disseminating information, the IMF should not count entirely on them to "decipher" the *WEO*'s messages.

### G-7 and G-20 surveillance notes

In assessing how G-7 and G-20 notes are presented to their audiences, we relied on interviews with senior officials of several G-7 and G-20 governments, as well as on our review of a number of surveillance notes prepared during 2003–05. At present, G-7 surveillance notes are prepared by IMF staff four times a year, and G-20 notes three times a year. Each note is transmitted to the relevant authorities ahead of the meetings of ministers and governors and their deputies. G-7 and G-20 surveillance notes are very similar. When G-7 and G-20 notes are prepared at about the same time, the two are almost identical. The only difference is that the G-20 note includes a summary of economic developments in a larger group of countries and may also include an

annex prepared at the request of the G-20 secretariat. We focus below on the G-7 notes, but almost identical points can be made for the G-20 notes.

A G-7 surveillance note is an 8–15 page, single-spaced summary of global prospects, financial and commodities market developments, and developments in individual G-7 member and major non-member countries. Often, but not always, one or two short pieces on current policy issues are attached to the note. These annexes can be as short as two pages or as long as seven. Sometimes, they are prepared at the request of the country holding the chairmanship. Recent annexes have included topics related to tax policy, oil market developments, and global imbalances. Text boxes in the main surveillance note have occasionally discussed policy issues.

The summary of prospects and developments constitutes the surveillance note per se. It presents an overview of key prospects and developments succinctly but with sufficient detail. A number of people interviewed by the IEO who had read these notes and participated in subsequent ministerial or deputies' meetings viewed them as technically competent and useful for providing background for subsequent discussions. The summary is descriptive, however, and largely devoid of policy discussion or implications. IMF staff seems to believe that its primary role is to provide such a summary and is reluctant to step outside this self-imposed boundary. This is not the role which senior policymakers indicated to the IEO that they foresaw for the IMF.

Three aspects of the current mode of presentation limit the value of surveillance notes. First, although each note is well written and short, yet rich in detail, its value added becomes almost nil when seven such notes are prepared (for both the G-7 and the G-20) every year in almost identical format. Each note meticulously updates the previous one, but rarely

<sup>22</sup>See Popper and others (2005) for one such possible approach.

**Table 3.3. Use and Presentation of Scenario Analysis in the WEO, 2000–05<sup>1</sup>**

Date	Type of Simulation	Where Reported
May 2000	The combined impact of stronger world growth, higher inflation expectations, and a decline in U.S. equity prices on growth and exchange rates in the United States, Europe, and Japan.	Box
October 2000	The impact on 2001–04 GDP growth in major countries and regions of (1) a more rapid slowdown of the U.S. economy; and (2) more buoyant growth in the euro area and Japan.	Appendix
May 2001	The impact on 2001–04 GDP growth in major countries and regions of a more rapid reduction of global imbalances through rapid and more gradual slowdowns of the U.S. economy.	Main text
October 2001	The impact on 2002–06 GDP growth, inflation, and exchange rates in major countries and regions of positive and negative productivity shocks in industrial countries.	Main text
December 2001	Possible global growth effects of a greater-than-expected global shock to business and consumer confidence.	Appendix
April 2002	Impact on GDP growth, inflation, and exchange rates in major countries and regions of further weakness in Japan and reduced willingness of investors to extend exposure to countries with structural current account deficits.	Appendix
September 2002	Sensitivity of GDP growth, current accounts, and real exchange rates in major countries and regions to different assumptions on industrial country productivity.	Chapter II
April 2003	Long-run effects on GDP, consumption, and investment in the United States and the euro area of Europe's competition-enhancing structural reforms.	Chapter IV
September 2003	Assessment of how various emerging market characteristics (e.g., debt load, trade openness, trade exposure to the United States and the euro area, exchange rate pass-through, and monetary regime) affect the volatility of real GDP in response to G-3 real exchange rate volatility.	Chapter II
April 2004	(1) The impact on GDP, real consumption, and investment in the United States and other industrial countries of alternative paths of the U.S. fiscal deficit.	Chapter II
	(2) Trade-related impact on welfare, output, exports, imports, and terms of trade in different regions and country groups of faster-than-baseline Chinese integration into the global economy. <sup>2</sup>	Chapter II
September 2004	Estimated impact on GDP growth and current accounts in emerging Asia of a decline in China's import growth.	Box
April 2005	The implications of different portfolio preferences in the euro area, Japan, and emerging Asia for financial flows into the United States and the sustainability of the U.S. current account deficit.	Chapter II
September 2005	Alternative adjustment paths of global imbalances, given different assumptions on foreign demand for U.S. assets.	Appendix

<sup>1</sup>Unless otherwise noted, simulation is based on MULTIMOD or GEM.

<sup>2</sup>Based on the GTAP model, described in detail in Appendix 2.1 in the April 2004 report.

does a major development change the overall picture, so that any difference from the previous note is usually marginal. Second and more important, the IMF's policy stance is never stated forcefully, and whatever position the IMF may have is given secondary treatment, by being relegated either to a text box or to an annex. Finally, as short as these surveillance notes may be relative to the *WEO*, most senior policymakers still do not read them. The information provided in the notes is typically incorporated in the pre-meeting briefing for ministers and governors and their deputies. For such busy people, even a 10-page note is often too long to read unless it is timely and offers clear value added.

These observations suggest that the IMF must radically change the way its surveillance notes are presented. For them to have a real impact, the IMF should more explicitly spell out economic interac-

tions and the consequences of policy spillovers, and where appropriate, provide sharp policy prescriptions. The staff should also attach a brief, double-spaced, one-page summary of its key message to the front of the note, to be read directly by ministers and by governors and their deputies.

### Identifying the Impact of IMF Multilateral Surveillance

If IMF multilateral surveillance is to have impact on the policies pursued by systemically important countries, its messages must:

- reflect the comparative advantage of the IMF and offer value added over information obtainable elsewhere;

- relate to issues of current interest;
- reach the intended audience, particularly senior policymakers, and exploit the potential for peer pressure; and
- be presented effectively.

This evaluation has so far addressed each of these ingredients of effectiveness, noting that while IMF multilateral surveillance has largely succeeded in identifying the right issues for analysis, there was considerable scope for improving the way its messages are delivered.

The ultimate test of effectiveness is the final impact of multilateral surveillance on policies adopted by systemically important countries. Such an assessment is difficult to make for a variety of reasons. Countries make policy decisions as a result of multiple influences, of which IMF advice may be only one and is likely not the most important one. Even if there is evidence that policy adjustments are made as a result of international discussions, it is still difficult to know how much of that is attributable to IMF analysis and advice, as opposed to the persuasiveness of partner countries. Governments in any case rarely wish to acknowledge that policy changes are made for international rather than domestic reasons, still less that they are made as a result of advice from an international institution. The IMF's influence may be indirect, for example, through its influence on the public debate. Finally, the IMF may be most effective when it has persuaded those being advised to take full ownership of policy decisions.

With this caveat, the IEO has identified, on the basis of interviews with senior member country officials, the following instances in which IMF multilateral surveillance can be said to have influenced policy debate or policymaking in systemically important countries:

- *Risk transfer to household balance sheets.* The IMF introduced this issue at the Financial Stability Forum (FSF), and subsequently contributed significant supporting material to the discussion. Several officials told the IEO that the IMF material influenced their own preparation for discussion at the FSF. Similar remarks were made about the IMF's work on hedge funds.
- *Structural reform in Europe.* *WEO* analysis of this issue had influenced public debate, and the IMF analysis had been frequently quoted, including by the President of the European Central Bank.
- *Global imbalances and oil prices.* Officials in several countries cited recent IMF analysis on these topical issues as having usefully informed the internal debate. While in many cases these issues were already on the agenda, policymakers considered the IMF work to be for the most part timely and of value in developing their thinking.
- *House prices.* The analysis of house prices in the *WEO* spurred debate in at least one large European country about why prices had risen sharply in some European countries but not in others.
- *Sustainability of public debt.* IMF work on debt sustainability was cited as having prompted further work by officials of a G-7 country.
- *Foreign direct investment (FDI) in financial services.* The Basel-based Committee on the Global Financial System (CGFS) took up the issue of FDI in financial services, and one G-7 country official noted that the IMF representative at the meeting was able to contribute a great deal of detailed knowledge to the discussion. Another (from a different G-7 country) called the IMF's contributions useful and timely.
- Some G-7 officials told the IEO that IMF research mentioned in the First Deputy Managing Director's speech on outsourcing services had affected the domestic policy debate, leading some government officials to alter their previously negative view of outsourcing (see Krueger, 2004).

More generally, we found a widely shared view among the policymakers interviewed that IMF multilateral surveillance, if and when effectively conducted and communicated, was an important global public good, with the potential to provide valued inputs into national and (to the extent it exists) global economic policymaking.

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**Statement by the Managing Director  
IMF Staff Response**

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**Summing Up of IMF Executive Board  
Discussion by the Acting Chair**

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**STATEMENT BY THE MANAGING DIRECTOR ON THE  
INDEPENDENT EVALUATION OFFICE—AN EVALUATION OF  
IMF’S MULTILATERAL SURVEILLANCE**

**Executive Board Meeting  
March 24, 2006**

The IEO’s report provides timely input to the ongoing reflection on strengthening a crucial aspect of Fund surveillance. As emphasized in my September 2005 statement on the Fund’s Medium-Term Strategy, multilateral surveillance is one of the Fund’s most critical responsibilities. Therefore, I am gratified and encouraged by the IEO’s generally positive assessment of the key outputs produced by the Fund in this area, and welcome the report’s focus on ways to increase the effectiveness of the Fund’s multilateral surveillance. The accompanying staff statement provides a more detailed response to the report’s findings and recommendations.

The IEO report also makes four strategic recommendations which, in terms of their broad objec-

tives, are very much in line with those discussed in my Medium-Term Strategy. I look forward to the Executive Board’s discussion of these strategic recommendations. As to any specific organizational solutions that may be needed, the scope of issues to consider is rather broader than those highlighted in this report, and may therefore perhaps be more appropriately assessed in the context of the discussion on the Fund’s overall strategic direction.

Finally, I welcome the IEO’s view of prospects for a greater Fund engagement in and contribution to international policy discussion fora. I look forward to the Board’s reflections on the state of the global peer review system and how key stakeholders, including the Fund, can make it work better.

## STAFF RESPONSE TO THE EVALUATION BY THE INDEPENDENT EVALUATION OFFICE OF THE IMF'S MULTILATERAL SURVEILLANCE

Executive Board Meeting  
March 24, 2006

Staff welcomes the IEO's findings, which affirm the high quality of the Fund's multilateral surveillance products, noting that they have been largely successful in identifying relevant issues and related risks in a timely manner. The staff is also pleased to note that the IEO report confirms the wide interest generated by these outputs within very diverse audiences.

Staff notes that the IEO, in evaluating the quality of multilateral surveillance, focused on hitherto underexamined aspects of quality, such as consistency of coverage with the Fund's comparative advantage, and relevance and timeliness of analyses, which yielded useful insights. At the same time, the report's assessment of the substantive quality of multilateral surveillance could have been more rigorous. For example, the report does not evaluate the ex post accuracy of assessments of risks and vulnerabilities in the various multilateral surveillance outputs. Some of the conclusions drawn by the IEO report in interpreting stakeholder surveys results also seem to reflect as much the authors' perceptions as objective evidence. For instance, regarding the readership of the main reports, it is not clear why it should be considered a failure if principal policymakers read a summarized version from their officials. Likewise, the assessment that "it is not clear that regional outlooks effectively serve a regional surveillance function" is not well substantiated in the report (indeed, it appears to disregard the views expressed by a very high share of nonindustrial country officials). Finally, the claim that the interaction between *GFSR* issues and the G-7 or G-20 is limited ignores the influence of *GFSR* analyses on the agenda of the Financial Stability Forum, the preferred G-7 forum for financial stability issues.

As regards recommendations, staff sees merit in the report's call for stronger integration of the various facets of surveillance, a more proactive role for the Fund in multilateral settings, and a more targeted communications strategy based on well-articulated and "client-focused" products. Indeed, these elements are present in the Managing Director's report

on the Fund's Medium-Term Strategy. At the same time, for the reasons given below, staff has some reservations with regard to some of the report's more specific proposals, particularly, but not exclusively, those under Recommendation 4, and whether they would deliver the desired results. In this respect, staff welcomes the fact that the report puts forward these proposals as "possible options" to be further explored, rather than as specific and firm recommendations. In any case, to avoid unnecessary proliferation of parallel initiatives, these proposals would have to be assessed against viable alternatives, especially those discussed in management's Medium-Term Strategy.

Turning to specifics, we agree with the report's call for a more proactive role in relevant groups (Recommendation 1), and an enhanced role for the Board and the IMFC in multilateral surveillance (Recommendation 2), but we are not convinced that the specific proposals spelled out under these recommendations would work. This said, we feel that the Board is better placed than the staff to comment on issues related to its own work processes.

We see merit in some streamlining of multilateral surveillance outputs and efforts to achieve greater "client-focus" (Recommendation 3), but some of the report's proposals to implement this recommendation would seem to go in the opposite direction. For example, we agree that providing an executive summary of the whole *WEO* would be useful (indeed, a summary of the analytical chapters is already offered in the *WEO*'s Foreword). However, shortening can be carried to excess. In particular, leaving the special topics chapters to a different publication (even if it were the Report on Globalization), as suggested by the IEO, would risk losing vital analytical content and thus diminish, rather than enhance, the persuasiveness and impact of the Fund's multilateral surveillance. Likewise, while we concur that there is scope for better integration and complementarity between the *WEO* and the *GFSR*—indeed, modalities to achieve this are being considered in the context of the Medium-Term Strategy, we think that untying

the release of these publications from the cycle of twice-yearly IMFC meetings for the sake of avoiding bunching could significantly reduce their impact on policy discussions in this forum.

We also welcome the call for a clarification of the scope and outputs of regional surveillance, as also envisaged in management's Medium-Term Strategy. We do not believe, however, that making the Executive Board responsible for determining the precise selection of topics would be in keeping with its institutional role or a useful development.

We welcome some elements of the recommendation to strengthen the structure of multilateral surveillance by clarifying operational goals (Recommendation 4). However, in our view, the fundamental organizational changes presented for consideration go beyond the IEO's purview. Moreover, we are not convinced, given the report's generally positive assessment of the Fund's multilateral surveillance products, that drastic organizational changes are warranted. While the option to make greater use of the internal Surveillance Committee, chaired by management, to form institutional positions on systemically important issues, has merit and is consistent with the proposals in management's medium-term strategic review, consideration of such an option is a management prerogative. The option of creating a

new surveillance department is unwarranted, while the less radical options, such as to change sign-off responsibilities for papers on systemically important countries, are poorly motivated and their potential downsides (e.g., more complicated bureaucracy) not recognized.

Moreover, the report does not convincingly argue that the causes of the problem identified are organizational. Therefore, rather than organizational solutions, which may disrupt the activity of key departments without achieving much progress, it would seem preferable to explore more substantive approaches to achieving greater integration. The IEO is right in emphasizing the importance of internal incentives in this respect, and this issue warrants further reflection. Some of the proposals of the medium-term strategic review are likely to help in this regard, for example to require Article IV reports on systemic countries to include a section on spillovers. Staff is also exploring a more strategic approach to communications around multilateral surveillance outputs, including better targeting of our efforts to the specific needs of various audiences both within and outside the Fund. This should contribute to strengthen the Fund's multilateral surveillance role in informing both bilateral surveillance and the broader public debate.

## THE ACTING CHAIR'S SUMMING UP

### EVALUATION BY THE INDEPENDENT EVALUATION OFFICE OF THE IMF'S MULTILATERAL SURVEILLANCE

Executive Board Meeting  
March 24, 2006

Executive Directors welcomed the evaluation by the Independent Evaluation Office (IEO) of the Fund's multilateral surveillance, which has provided a valuable opportunity to take stock of achievements and identify areas for further improvement in the quality and effectiveness of this core activity of the Fund. Directors underscored the critical importance of effective multilateral surveillance in promoting global financial stability and sustained economic growth in an increasingly integrated world economy. Further, they observed that the IEO assessment is made all the more timely by the impending discussion of the Managing Director's proposals on the implementation of the Medium-Term Strategy, which can only be enriched by our consideration of the recommendations of this independent evaluation.

Directors observed that multilateral surveillance complements bilateral surveillance by adding global and cross-country perspectives to the analysis of developments in individual countries. They were encouraged by the report's broadly positive assessment of the quality of the analysis contained in the Fund's key multilateral surveillance outputs, and by its assessment that these products have been largely successful in identifying relevant issues and related risks in a timely manner. Directors considered that the wide and diverse public interest in these outputs, documented by the IEO's report, is a testament to this success.

Notwithstanding this broadly positive evaluation, Directors generally agreed with the report's assessment that there remains scope for further improving the Fund's multilateral surveillance. In particular, Directors took note of the recommendation that some of the outputs of multilateral surveillance should give less weight to descriptive information on developments and prospects, and more to analyzing economic policy linkages and the modalities of collective action. Directors also concurred with the report's finding that effectively integrating macroeconomic analyses with financial sector and capital market work remains a significant challenge, as does the task of effectively integrating multilateral analy-

sis with bilateral work. Complementary to these efforts, the scope of regional surveillance should be clarified. Directors called for further careful analysis of these issues, which are crucial for the effective discharge of the Fund's mandate.

Against this background, Directors held a substantive discussion on ways to improve the effectiveness of multilateral surveillance, based on the IEO's four recommendations. Most Directors looked forward to further consideration of the issues in the broader context of the upcoming discussion on the implementation of the IMF's overall Medium-Term Strategy.

#### Recommendation I

Directors took note of the report's call for the IMF to strengthen its role at the center of a more robust global peer review system by establishing a more proactive engagement with relevant intergovernmental groups. Most Directors concurred that, while the Executive Board and the IMFC remain the most appropriate fora for discussions of policy spillovers and possible responses, the IMF should also enhance the effectiveness of its participation in other fora—such as, but not limited to, the G-7 or the G-20—which also provide opportunities for a frank exchange of views on these issues. Directors stressed that the IMF should provide leadership to the global economic community in trying to promote cooperative solutions. In doing so, the Fund should draw on its unique strengths of near-universal membership and access to policymakers of all systemically and regionally important countries. At the same time, it would be important to ensure that the Fund does not depart from its core mandate in pursuing these efforts, and that they are carried out in a transparent manner. In this regard, Directors agreed that the surveillance notes prepared for the G-7 and G-20 meetings could be more focused on policy spillovers and options for addressing them, and that outputs directly targeted at senior national

policymakers would be helpful. Such notes should be consistent with the policy advice in Article IV and other surveillance discussions of the Executive Board. While a number of Directors also noted that greater continuity of IMF representation at these meetings could be considered, most Directors did not support the establishment of a unit whose sole or main purpose would be maintaining constant contact with relevant officials.

## Recommendation 2

Most Directors welcomed the report's recommendation to enhance the roles of the Executive Board and the IMFC in multilateral surveillance. However, they considered that the IEO's characterization of formal *WEO* and *GFSR* sessions fails to do justice to the usefulness of these exchanges, noting that Board discussions in various multilateral surveillance contexts are generally free and open. At the same time, many Directors saw merit in the Board identifying and agreeing on key issues for ministers to discuss during the IMFC meetings, focusing on matters related to policy spillovers and scenarios for collective action. Most Directors did not support the setting up of a standing Board committee to monitor progress on strengthening the IMF's and the Board's surveillance activities. They considered, rather, that the full Board should retain ownership and oversight of this central surveillance function of the Fund.

## Recommendation 3

Directors observed that, to heighten the impact of multilateral surveillance outputs on the global policy debate, they could be better targeted to their core audience, streamlined, and focused on key issues. While most Directors considered that a major streamlining and focusing of the *WEO* are not necessary and would detract from the quality of the underlying analysis, Directors offered a number of useful suggestions for further consideration. On issues of content, some Directors supported the suggestion to integrate better financial and capital market issues in the *WEO*'s Chapter I. They called for more analytical treatment and discussion of exchange rate issues, with some Directors cautioning the staff to be mindful of market sensitivities in the public communication of such analyses. Several Directors also considered that greater use could be made of scenario analysis, with sharper messages for policymakers. Most Directors did not find attractive the option of separating the chapters on special topics of the *WEO* and the *GFSR* and creating a separate globalization report to feature them. More generally, many Direc-

tors were not convinced of the merits of a new globalization report. Most Directors also did not favor changing the timing of the *WEO* and the *GFSR*. On presentation and communication issues, some Directors felt that the *WEO* and the *GFSR* should have more focused messages and better reflect the Fund's unique role and perspective, facilitated by more collaboration in the production of these two reports. A few Directors supported the issuance of a biannual Board statement on the state of the world economy. Some Directors also suggested that publication of surveillance products in languages other than English could facilitate the effective dissemination of the results of multilateral surveillance and of the key Fund messages to a broader audience.

Directors welcomed the opportunity to consider further the scope of regional surveillance. They observed that staff has taken various initiatives in recent years, including the more formally conducted surveillance of common currency areas, and the production of papers for regional Board seminars. Directors concurred that it would be useful to clarify, in the context of the medium-term strategic review, the scope of regional surveillance, including the role of regional outlooks prepared by staff. Directors also saw merit in focusing these efforts on regional economic interlinkages and policy spillovers, and in better integrating them with multilateral surveillance. Some Directors supported the possibility of reorienting some regional studies on the basis of their analytical focus, rather than on the basis of geography, but most Directors did not favor separating analytical chapters from regional outlooks. Directors looked forward to reviewing these issues further.

## Recommendation 4

Directors took note of the report's recommendations on strengthening the structure of multilateral surveillance by defining organizational strategies and accountabilities. They agreed that it would be beneficial to clarify the operational goals of multilateral surveillance, but were not persuaded about the need for broad organizational changes. In particular, many Directors stressed that the risks and costs of fundamental organizational changes should be carefully considered before embarking on such steps. Directors agreed that priority should be given to strengthening the integration between multilateral and bilateral surveillance, particularly of systemically important countries. Many Directors were skeptical about the recommendation to establish a Surveillance Department. Directors looked forward to discussing these issues further in the context of the medium-term strategic review.