Statement by the Managing Director on the Independent Evaluation Office Report on IMF Response to the Financial and Economic Crisis: An IEO Assessment

Executive Board Meeting
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The Independent Evaluation Office (IEO) has produced a detailed report that provides valuable insights on how the IMF responded to the global financial and economic crisis.

The analysis in the report is broadly balanced, and I am pleased by the IEO's finding that the IMF played an important role in the global response to the crisis. I do not share part of the assessment and characterization of the IMF's macroeconomic policy advice after the crisis, which misses relevant elements and context of the institution's undertakings during this period.

I also broadly support the report's recommendations. I disagree with the suggestion to conduct Financial Sector Assessment Program (FSAP) updates for the largest systemic financial centers on an annual basis, given high resource costs and limited gains in performing assessments on such a high frequency.

Overall, the IEO report recognizes the important role played by the IMF in the global response to the crisis. The assessment further establishes that the policy advice provided by staff was flexible and adaptable, while IMF-supported programs reflected many lessons from past crises and helped members cope with the crisis fallout. These findings are reassuring.

On post-crisis surveillance, the report agrees that much of the IMF's policy advice was appropriate, in particular the call for fiscal stimulus in 2008-09 and the support for expansionary monetary policies in advanced economies. The IMF's advocacy in 2010 for fiscal consolidation in major advanced economies is judged to have been premature as the incipient recovery observed then proved short-lived. However, as the report acknowledges, this assessment is benefiting from hindsight.

Considering the information and growth forecasts available in 2010, I strongly believe that advising economies with rapidly rising debt burdens to move toward measured consolidation was the right call to make. It is important to note that the IMF's advice was for gradual fiscal consolidation, conditional upon specific country circumstances to balance the needs for protecting the budding recovery and addressing sustainability risks. This advice was complemented with recommendations for reforms to raise potential growth. Moreover, as noted in the IEO report, once it became clear that the growth outlook had worsened, the IMF quickly changed gear and adjusted its advice for countries where such adjustment was feasible.

The report finds that the IMF's efforts to strengthen the global financial safety net, which included a major resource mobilization effort, reforms to lending facilities, and the design and implementation of IMF-supported programs, were largely successful. The IEO assessment rightly emphasizes the importance of adequate and stable resources to reduce uncertainty and strengthen the IMF's legitimacy. Hence, I fully support the recommendation (i) of working closely with the International Monetary and Financial Committee (IMFC) on this matter. At this point, implementation of the 2010 quota and governance reforms remains the highest priority. However, as indicated in the most recent IMFC communiqué, if these reforms are not ratified by year-end, the IMF will build on its existing work and stand ready with options for next steps.

Interactions with other organizations and initiatives during the crisis were found to have been largely effective. Recommendation (ii) suggests the development of guidelines for structuring the IMF's engagement with other organizations, whether as a member or a partner. I can see merit in defining some broadly applicable principles of engagement and cooperation, with the proviso that interactions with other organizations should remain generally flexible and pragmatic, and allow for adaptation to specific circumstances while ensuring evenhandedness. This would also be consistent with the views expressed by most Executive Directors in the

2013 stocktaking of the IMF's engagement with Regional Financial Arrangements.

Following the global crisis, the IMF launched many initiatives to strengthen the integration of macro and financial sector surveillance, and to expand the tools and processes to identify and warn about risks and vulnerabilities. I am pleased that the authorities are largely supportive of these efforts. The suggestion to further integrate and consolidate risk and vulnerability analyses, and to make them more user-friendly (recommendation iii) is well taken and echoes similar feedback in the recent Triennial Surveillance Review (TSR). I am prepared to consider ways to foster greater debate and input on the Early Warning Exercise (EWE). We will also continue to find ways to improve our work on vulnerabilities and risks so that they can most effectively inform our surveillance, both bilateral and multilateral. Both of these efforts should be cognizant of the need not to compromise candor or access to confidential information. It is also our intention to increase the coverage of tail risks in other published surveillance products to further strengthen macro-financial surveillance.

I see limited merit in the report's recommendation (iv) of conducting annual FSAP updates for the five to seven largest systemic financial centers. A somewhat higher frequency than the current five-year cycle for FSAPs may indeed be warranted, as staff has suggested in the past. However, because these exercises put much emphasis on the review of institutional frameworks and issues, the additional insights that could be gained from year-to-year assessments appear small relative to the associated costs. Consistent with the 2014 *TSR*, I see fully embedding macro-financial analysis in Article IV surveillance as the preferred approach to deepen the IMF's assessment of risks and vulnerabilities. The attached statement by staff elaborates in more detail on this and a few other matters.

I look forward to the discussion of the report's findings. Subsequently, I will work with staff to implement the recommendations endorsed by the Executive Board.

Table 1. The Managing Director's Position on IEO Recommendations

Recommendation	Position
(i) Management should work with the IMFC to ensure that the IMF has sufficient resources to contribute to future crisis resolution. Quotas should be sufficient to cover members' needs under likely crisis scenarios, with borrowing arrangements set up to deal with tail risks.	Support
(ii) The IMF should develop guidelines for structuring engagements with other organizations, whether as a member or a partner. These guidelines should clarify the IMF's roles and accountabilities in order to protect the institution's independence and to ensure uniform treatment of all members.	Qualified Support
(iii) Management needs to consolidate and simplify the current framework to identify and assess risks and vulnerabilities. In particular, the EWE needs to be made more user-friendly, it should foster greater debate and input by participants, and outreach on its results should aim to reach authorities.	Qualified Support
(iv) FSAPs for the world's five to seven largest systemic financial centers should be updated annually in conjunction with IMF's bilateral surveillance.[1]	No Support

[1] FSAP updates will result in updated Financial Sector Stability Assessments (FSSAs).

Detailed Staff Comments to the IEO Report on the IMF's Response to the Financial and Economic Crisis

Staff shares the thrust of the assessment and of most recommendations in the IEO's informative report. However, we disagree with part of the assessment of the IMF's macroeconomic policy advice after the crisis and we do not support the recommendation to produce annual Financial Sector Assessment Program (FSAP) updates for the largest systemic financial centers. The comments below elaborate further on these two issues.

Policy advice in the crisis aftermath

The view that the IMF's advice to major advanced countries prematurely moved from stimulus to fiscal consolidation is based on hindsight and misses important context. The IMF advised fiscal expansions when the crisis broke and the risk of a deep and prolonged global economic downturn was very high. The call for consolidation at a measured pace from 2010 onward occurred when that risk had sharply decreased and growth was widely seen as recovering. The IMF's advice at the time took into account that indebtedness was rising very fast. It sought to reduce fiscal vulnerabilities with appropriate caveats to avoid derailing the budding recovery, including warnings against frontloading the adjustment (see further below). The IEO report cites low bond yields in major advanced economies as evidence that concerns about fiscal risks may have been overstated by the IMF. However, these yields were heavily distorted by monetary policy, which limited their signaling power for sovereign risk.

Staff advice for gradual fiscal withdrawal in 2010 was always conditional. The IMF's fiscal policy advice was from the beginning contingent upon each country's economic recovery, and fiscal and financial circumstances.[1] The IMF also emphasized that the *composition* of fiscal policy should be "growth-friendly", stressing in many cases the need for medium-term fiscal consolidation to avoid the risk of being forced into frontloaded adjustments, while providing support for demand in the short term, to the extent possible. The G20 authorities themselves were deeply concerned about a new round of market upheaval and sought commitments to reduce public deficits and debt levels (2010 Toronto Summit). Overall, the IMF was aware of the adverse effects of fiscal consolidation on demand and therefore recommended only a moderate and measured withdrawal, unless otherwise dictated by acute financing constraints (as turned out to be the case in some program countries).

We also have some difficulty with the assertion that the policy mix recommended by the IMF exacerbated adverse spillovers. The IEO report suggests that fiscal expansions should have been maintained for a longer period. However, the effectiveness of fiscal policy in boosting demand is premised upon the continuation of extremely loose monetary policy—a key condition for high multipliers. While there are channels through which accommodative fiscal policy and somewhat tighter monetary policy could have reduced external spillovers and capital flow volatility, it is not clear that these channels would have worked very effectively under the circumstances, which included severe financial system impairment. Moreover, greater fiscal accommodation required availability of financing, which was a constraint in a number of countries. Overall, the Fund was cognizant and analyzed the risks of extraordinary monetary easing for recipient countries but judged that these were outweighed by the benefits to global stability and growth. When very accommodative monetary policy conditions persisted over a more extended timeframe, the focus on assessing financial stability risks and adverse spillovers increased.

Recommendation to conduct annual FSAP updates[2]

We have reservations about the merit and practicality of conducting annual FSAP updates for the world's five to seven largest systemic financial centers. First, FSAPs largely focus on structural and institutional factors, which for the most part are slow-moving. While a somewhat higher frequency than the current five-year FSAP interval may be desirable for systemic financial centers (as staff has previously suggested but was not supported by the Executive Board), assessments undertaken within less than three years would seem largely redundant. Second, defining the cut-off point in terms of number and identification of the "largest systemic financial centers" to be targeted under the proposal could prove challenging and would remain to some extent arbitrary. Finally, conducting annual FSAPs in a

[1] See, for example, Blanchard and Cottarelli (2010), *Ten Commandments for Fiscal Adjustment in Advanced Economies*.

[2] Financial Sector Stability Assessments (FSSAs) are the reports that derive from the FSAPs. FSAP updates will result in updated FSSAs.

few countries could limit the intensity of financial sector surveillance elsewhere given limited IMF resources, including financial experts. In staff's view, the 2014 Triennial Surveillance Review (TSR) recommendation (which was strongly endorsed by the Executive Board) of mainstreaming financial stability including by drawing on financial stability assessments as appropriate offers a more promising approach to detecting emerging vulnerabilities and risks, and can be implemented within reasonable time. More details on tools, practices, and capacity building for this approach will be provided soon in the context of the 2014 TSR Action Plan.