9 CONCLUSIONS AND RECOMMENDATIONS

CONCLUSIONS

The IMF's performance on UMP since the GFC has been wide-ranging and in many respects impressive. It provided early support and validation to the countries leading the way, and made the case for aggressive use in other jurisdictions moving more slowly. It monitored implications for financial stability and helped to develop a new macroprudential policy toolkit. It brought attention to and analyzed spillover effects, and reconsidered advice to countries being affected by these spillovers in a new framework for advice on responding to capital flows. It strengthened its multilateral surveillance, contributed to the G-20 to encourage greater international policy understanding and cooperation, and introduced new precautionary financing instruments.

That said, this evaluation also identifies shortcomings in the IMF's engagement on UMP that reflect longer standing and deep-rooted challenges for the Fund. A number of factors have limited the value added and influence of the IMF's bilateral advice on monetary policy when it was most needed—for the major central banks and for others too. The Fund does not have deep expertise on monetary policy issues, while country teams often rotate quite quickly and its country engagement is usually too discontinuous, hindering the building of relationships and country knowledge. Efforts at systematic cross-country learning were limited and failed to take full advantage of the IMF's perspective across the full policy framework, noteworthy in the limited attention to analyzing costs and benefits of alternative fiscal-monetary mixes once the immediate crisis had passed. Some members still feel that the Fund has not gone sufficiently far to appreciate and respond to the policy challenges they face from cross-border spillovers and volatile capital flows. There have also been long-standing limits on the IMF's ability to encourage international policy cooperation and challenges to designing precautionary instruments that attract broad interest across the membership.

Advanced economies

The IMF played a valued advocacy role on UMP in the MAEs through its bilateral and multilateral surveillance. The IMF quickly developed a corporate view on UMP and adapted it over the course of the decade as the post-GFC recovery evolved, making good use of the reach and influence of its multilateral flagship publications as well as its bilateral surveillance engagement. Senior officials in the AEs that adopted these policies generally appreciated the Fund's support and found the Article IV consultations to be a useful validation of the steps taken. In the case of the euro area in particular, consultations with the IMF seem to have helped in building the case for QE, so that the ECB was better equipped to act when a consensus was reached. With Japan, the Fund was out front pushing the BoJ to take more aggressive action, although a change in political leadership was required before action was taken. U.S. and U.K. central banks acted quickly with the Fund playing little immediate role, but the Fund was helpful in validating difficult decisions.

For smaller AEs, the Fund's engagement on monetary policy issues was quite variable. Among our case studies, it was more intense with Czech Republic and Switzerland, much less so with

Denmark. The Fund had not thought ahead about the challenges that these smaller open economies would face as their policy interest rates approached the zero lower bound, and consultation was limited as their central banks opted to experiment with negative interest rates and exchange rate floors.

IMF staff deserve particular credit for their work in developing the macroprudential policy toolkit to monitor financial stability risks, including those arising from UMP. Over the course of the decade, the Fund generally advised against leaning against the wind in favor of the use of MPPs, although it deviated from this advice in the case of Sweden in 2010–13. In retrospect, this overall approach seems to have been well founded as a basis for policy advice in the post-GFC period. The Fund paid considerable attention to financial stability risks, from UMP and other sources, monitoring the key risks that had been identified as likely to occur from a decade of low interest rates. The Fund did a significant amount of work on providing a framework for the conduct of MPPs, assembling new databases of MPPs taken by countries, and spearheading work on effectiveness of these measures. This work provided high value added and had considerable traction.

While recognizing these achievements, the Fund's work on UMP in the AEs suffered from limitations. Four deserve emphasis.

- First, the Fund does not appear to have been seen as a source of cutting-edge monetary expertise and ideas or as a first port of call for outside advice. Even though this was a time when central banks were often scrambling for advice as they were contemplating innovative policies such as negative interest rates, they generally did not consider approaching the Fund, nor was the Fund consistently ahead-of-the-curve in being prepared with policy advice that would be useful for these countries. This was true not just for the major central banks with their large well-trained staffs, but also for smaller central banks with more limited resources, which tended to look for external advice from central banking networks and BIS staff. The Article IV process was described as useful ex post validation of actions taken and general advice on the future course of policies rather than an opportunity to obtain specific operational guidance on monetary policy issues. To be sure, experience varied across countries, with the Fund having more influence where the relationship was deeper and more continuous, as with the ECB.

- Second, the Fund tended to give considerable deference to monetary policy actions by AEs, albeit with some notable exceptions. For example, the 2011 rate hikes by the ECB, which came in for criticism both at the time and later, were not questioned by Fund staff. The Fund also accepted arguments by central banks on what the effective lower bound on policy interest rates was for their countries even though these central banks later cut rates below those levels. The Fund supported the Riksbank when it was "leaning against the wind" and Canada when it decided against leaning.

- Third, the Fund could have been more energetic in subjecting its advocacy of UMP to strenuous "intellectual stress tests" and ex post empirical assessment, building on its comparative advantage in cross-country engagement. There was a robust internal review process which helped ensure consistent advice across the major economies where senior IMF staff were most heavily engaged, but the Fund was slow to systematically assess experience and share lessons, for example, after the introduction of negative interest rates. The failure of output and inflation to recover as quickly as forecast did not lead to a systematic attempt to understand whether UMP was working as advertised.

- Fourth, the Fund could have been more active, particularly early on, in thinking through policy interactions in a broader macroeconomic framework. At least in hindsight, the Fund was not forceful enough in 2010–12 in making the case that at least for some countries the shift to fiscal consolidation should have been gentler so as to put less burden on monetary policy to take extraordinary steps to support activity even as its ammunition was running out. Such an approach would also have generated fewer financial spillovers on other economies, which proved to be a major challenge for them to handle. Subsequently, the Fund has put much more emphasis on "growth friendly" approaches to fiscal consolidation.

Emerging economies

The Fund launched a number of initiatives to respond to the concerns of EM member countries. It mounted an extensive response to the growing concerns of EM officials, as sustained UMP were associated with volatile capital flows, through a range of empirical and policy analyses, notably the Spillover Reports and the development of the IV on capital flows. The Spillover Reports were a commendable early effort to evaluate cross-border effects of policies using an eclectic range of tools in the absence of an established model in the literature to encompass the complicated financial channels through which such effects could occur. In the work on policies to respond to volatile capital flows that was embodied in the IV, the Fund was able to follow quite quickly the lead of EM policymakers to explore the use of CFMs and MPPs, drawing on the Fund's extensive country experience as well as conceptual work. The IV was quickly established as a framework for thinking through policy challenges created by capital flow volatility in the wake of UMP.

While the Fund deserves credit for its responsiveness to member concerns, the ultimate influence of the spillover work appears to have been limited. Even those favorably inclined to the Fund's efforts often found the models used in the Spillover Reports to be quite opaque and unable to fully address EM policymakers' concerns that the most challenging spillovers occurred through financial channels rather than the more conventional trade channels. Since the scaling back of spillover work as the Spillover Report was discontinued and spillover analysis folded into the *WEO,* researchers at central banks and in academia have been doing more of the innovative work on financial spillovers. Moreover, the impact of the spillover analysis on bilateral surveillance was quite limited. Though the ISD opened up a channel to allow for a discussion of spillover concerns in Article IV consultations, its application has not had much impact on "source" country policies.

Likewise, despite the Fund's welcome agility in developing the IV, some members question whether it went sufficiently far in providing helpful guidance on using CFMs to respond to challenging circumstances. The IV was generally welcomed by EM authorities as expanding their toolkit in principle and as a sign of Fund's willingness to be flexible rather than doctrinaire on issues. In practice, however, there are questions whether this leeway has been exercised to allow policy advice on CFMs to be sufficiently tailored to country circumstances. While some countries such as Brazil reported a positive experience, other EM officials, particularly in Asia, think the IV has been applied too rigidly with considerable friction sometimes arising on how measures should be classified (such differences have occurred on occasion with AEs too). Moreover, they felt that IMF support for unorthodox policy interventions was too slow and grudging—India being an example. Some officials are dissatisfied with the insistence that CFMs should be viewed as last in a hierarchy of options rather than as part of a policy tool-kit. Given their policy constraints, these countries would like on occasion to use CFM pre-emptively and on a sustained basis rather than only after appropriate macroeconomic adjustment and then temporarily.

As in the AEs, Article IV consultations with EM members are generally valued as a high-level check on policies but typically do not provide an in-depth discussion of monetary policy issues. Article IV consultations are valued as a comprehensive discussion of policies in many areas and of the consistency of those policies in delivering desired macroeconomic outcomes. However, on monetary policy issues specifically, the Fund would need to bring much deeper expertise if it desires to provide greater value to central banks. Officials in many central banks noted that Fund staff advice, although sound on general economic grounds, was not operational enough nor with sufficient awareness of market dynamics to offer much practical guidance on the issues confronting them. As a result, over the past decade, many central bank initiatives were usually explained to the Fund later, rather than arrived at through an ongoing dialogue with the Fund. In examples where the IMF's contribution was particularly appreciated, for example, support for China's financial and exchange market reforms, analysis of exchange market intervention in Brazil, and modeling support for India's introduction of an inflation targeting framework, it was based on detailed technical work. More typically, officials turned to central banking networks and BIS staff when they were seeking external input.

International monetary cooperation

The Fund worked hard in the post-GFC period to contribute to international policy cooperation, but the record has been mixed. Consistent with historical experience, the Fund has been most effective in responding quickly to provide emergency financing, less so in encouraging mutually supportive policies among members, including in application of the ISD to discuss spillover concerns in "source" countries.

The Fund's support to the G-20 is considered valuable but the influence on policy choices has diminished over time. The G-20 has emerged as the leading body for discussion and coordination of economic policy issues. IMF support of its work has been much appreciated, particularly in helping with the coordinated fiscal stimulus at the start of the GFC. The Fund's development of exit principles from UMP at the urging of the G-20 was also regarded as useful. Subsequent G-20 initiatives, such as the MAP—which attempts to bring about policy commitments to support global growth—have to date yielded returns less than commensurate with the considerable expenditure of Fund staff time.

The development of the FCL and PLL were steps forward but gaps remain in the global financial safety net. The launch and use of the FCL and PLL, when previous attempts in this direction had failed, was a considerable achievement. Though take-up was limited, the experience of the countries that used these instruments was generally positive. Continued work is needed on design features of the FCL and on proposals for liquidity instruments that would command a consensus within the Fund's membership.

Institutional issues

Notwithstanding the considerable resources applied to bilateral surveillance—far greater than in any other international organization—a number of institutional issues seem to hamper the IMF's value added, at least in the area of monetary policy that is the focus of this evaluation.

- One concern is that while the bulk of macroeconomists doing this work are highly trained and understand monetary issues well, the Fund lacks a core of top, well-connected monetary policy experts to provide support to country teams, particularly when they face unprecedented circumstances and there is a need to think beyond the text book.
- Second, frequent turnover in mission chiefs and country teams makes it difficult for staff to develop relationships and the depth of country-specific expertise to make them a trusted advisor to central bank officials. Notable examples of influence—such as China and the euro area—are cases in which senior staff have worked for longer periods, and engagement is more intense than just a once a year Article IV consultation.

RECOMMENDATIONS

To serve its member countries better in a core area of surveillance, the IMF needs to deepen its expertise on monetary policy issues and re-invigorate its work program. While UMP are now being gradually reversed in many jurisdictions, monetary policy issues are likely to remain salient, and UMP may well be needed in the next downturn, which could well arrive when policy rates are still very low by historical standards. Four broad recommendations are offered on the following page (Box 2), complemented by specific suggestions on how they could be implemented.

Recommendation 1—Develop a small core group of top monetary policy experts at the IMF to keep abreast of and contribute to cutting-edge discussions in the central banking community, support institutional learning, and provide in-depth advice to country teams as and when needed. The attention paid to monetary policy issues over the past decade does not seem to have been commensurate with its importance to the Fund's mandate. The tasks of upgrading work on financial stability, mainstreaming macro-financial surveillance, and increasing work on new macro-structural issues have competed for surveillance resources. With the overall budget envelope likely to remain fixed, the Fund should consider how best to use its existing resources to raise the value added of advice on monetary policy issues.

Specific steps that could be taken:

- For the IMF to be regarded as a source of world-class advice on monetary policy, it is critical to develop a small core of internationally-recognized monetary policy experts headed at a very senior level. This core group would focus on applied monetary policy

BOX 2. IEO RECOMMENDATIONS FOR BOARD CONSIDERATION

Recommendation 1—Develop a small core group of top monetary policy experts at the IMF to keep abreast of and contribute to cutting-edge discussions in the central banking community, support institutional learning, and provide in-depth advice to country teams as and when needed.

Recommendation 2—Deepen work on the costs and benefits of UMP and related policies to develop a playbook on policy responses for use in future downturns. Building on the IMF's comparative advantages, this workstream could draw on cross-country experience to assess and advise on the macroeconomic impact of different UMP, the relative use of monetary and fiscal policies as countercyclical stabilizers, and the roles of monetary policy and macroprudential tools to address financial stability risks.

Recommendation 3—Make sure that the Fund is at the forefront of financial spillover analysis and provision of advice on dealing with capital flows, drawing on its global multilateral mandate, universal membership, and breadth of country experience. The Fund's advice on managing capital flow volatility could be reassessed in light of experience and changing circumstances. The recently initiated IEO evaluation on this topic could provide useful lessons for staff's work on integrated policy framework now getting underway. The IMF's work on financial spillovers could be re-energized, including further research on how fine-tuning the policy mix in "source" countries could help to alleviate adverse spillovers on "receiving" countries, which would help to foster greater international policy cooperation.

Recommendation 4—Draw on lessons from this evaluation to consider steps to deepen and enrich country engagement in bilateral surveillance. The measures needed to provide timely, value-added advice on monetary policies are likely to be relevant more broadly, and could be considered in the 2020 Comprehensive Surveillance Review. Longer tenure of mission chiefs, less turnover among country teams, and more engagement outside the Article IV cycle would help develop the deeper relationships and understanding of country circumstances that are critical for providing timely, value-added advice on monetary policy and more broadly.

issues, with direct application to Fund policy analysis and advice. They would not only keep abreast of but contribute to cutting-edge discussions on frontier central banking issues, convene experts to confer on monetary policy issues of interest to Fund membership, and provide in-depth advice and guidance to country teams as and when needed. There would be an ongoing two-way collaboration between the group of experts and area department teams to ensure that experts remain sensitive to policy needs and support the build-up of monetary policy expertise among country teams.

- Some changes in human resources policy may be needed to attract, develop, and retain top experts. The current promotion policy places great weight on versatility and breadth of experience as the path to senior positions, but this comes at the cost of the depth of expertise needed to provide cutting-edge policy advice in challenging times. While the Fund draws its strength from exposing staff to cross-country experience, there should be scope to allow some staff to develop deeper expertise in specific topics, particularly in core areas like monetary policy. Thus, a top-flight group of monetary experts could be assembled by allowing some younger economists to develop careers based on a specialist expertise—the approach followed in many central banks—together with recruitment of some senior monetary policy experts from central banks (as has occurred in recent months). The Fund could use the expert track now being developed in the new Human Resource Strategy to ensure that these monetary policy experts have comparable promotion opportunities to "fungible" economists.

- Resources for this expert group could be allocated by rebalancing resources within MCM or the Fund more generally. It is worth emphasizing that—in contrast to the IEO's assessment of the substantial resource needs for an upgrade of financial surveillance—the resources needed to raise the Fund's game on monetary policy issues would be relatively modest.

Recommendation 2—Deepen work on the costs and benefits of UMP and related policies to develop a playbook on policy responses for use in future downturns. Building on the IMF's comparative advantage, this work stream could draw on cross-country experience to assess the macroeconomic impact of alternative UMP instruments, the relative use of monetary and fiscal policies as countercyclical stabilizers, and the roles of monetary policy and macroprudential tools to address financial stability risks.

Specific steps that could be taken:

- An update of the 2013 Policy Paper on UMP to learn lessons from more recent experience would help inform the membership and position the Fund to provide advice on the use of UMP in future downturns. This update should include advice on the scope for negative interest rates and further central bank balance sheet expansion across different asset classes, and appropriate use of monetary and fiscal policies as countercyclical tools.

- An update of the 2015 Policy Paper on "Monetary Policy and Financial Stability" would be useful. Substantial recent work on the links between monetary policies and financial conditions and additional evidence on the effectiveness of macroprudential policies and housing sector risks would make such an update valuable in refining, as needed, the Fund's existing policy positions on these topics. Dedicating some resources to following housing sector issues on a continuous basis would maintain the momentum generated by recent work in the *GFSR*.

- To strengthen the Fund's learning from cross-country experience, there could be quarterly or biannual internal reviews of monetary policy challenges faced by central banks in both advanced and emerging economies to identify consistency of advice and draw cross-country lessons. This could be done as part of weekly surveillance meetings rather than setting up a new process. The core group of monetary policy experts should be centrally involved in this review, offering reactions to major central bank policy steps in a timely fashion for use by country teams in Article IV consultations.

- The proposed update of the 1999 Code of Good Practices in Transparency in Monetary and Financial Policies provides a good opportunity to reflect the Fund's latest views on how the governance and accountability of central banks can be enhanced.

- As future use of UMP is likely to generate more debate about its likely distributional effects, the "operationalizing inequality" work stream at the IMF could analyze the distributional impacts of such policies to provide the basis for IMF policy guidance on this issue.

Recommendation 3—Make sure that the Fund is at the forefront of financial spillover analysis and provision of advice on dealing with capital flows. Initiatives over the past decade to assess spillovers and advise countries, particularly emerging markets, on how to deal with them have been welcome but met only partial success. However, the challenges to individual countries and problems for international policy cooperation arising from liquid and open capital markets, and increasingly international investment portfolios, are only likely to increase. The Fund should be ready to reassess its policy framework to guide its advice on how countries should handle volatile capital flows in light of experience and changing circumstances. Research on the financial spillovers from UMP and other policies adopted by "source" countries could be reenergized which could feed into new initiatives to strengthen cooperative behavior across the membership to limit negative aspects of financial spillovers as far as possible. The Fund is the best-placed international financial institution for developing such initiatives given its global multilateral mandate, universal membership, and the depth of country experience on which it can draw.

Specific steps that could be taken:

- Further assessment of IMF advice on capital flows in light of experience and changing circumstances: As a first step, the IEO evaluation on this topic now being initiated will look into how CFMs and other measures have worked in practice to help deal with capital flow volatility, seek views on how they can be best integrated into countries' overall economic strategies, and assess the value added and traction of IMF advice in this area. This work could provide useful lessons for staff's broader work agenda on an Integrated Policy Framework that is now getting under way.

- Re-energizing work on financial spillovers: Spillover work at the Fund, particularly on financial spillovers, seems to have lost momentum and impact since the Spillover Report was discontinued. The Fund should rebuild its focus and institutional expertise on understanding financial spillovers, which could include further work on how different policy approaches in "source" countries could affect spillovers on "receiving" countries. In addition to the spillover work featured in the *WEO*, the Fund could look for other prominent avenues to showcase staff's spillover analysis. For instance, this work could be made a regular feature at the Annual Research Conference, where there is a natural gathering of top academics and policymakers who are interested in these issues.

- Increased attention to promoting international monetary cooperation: Deepened research and analysis on financial spillovers could underpin more forceful efforts by the IMF to advise countries implementing UMP on how policy approaches could be fine-tuned to promote their own domestic objectives while limiting adverse spillovers, as part of Article IV surveillance consistent with the multilateral mandate under the ISD. At the same time, the Fund could support some "blue-sky thinking" towards developing a Code of Conduct (somewhat similar to that agreed among the G-7 on monetary and exchange rate issues) under which major countries would agree to follow policies and practices as far as possible consistent with minimizing adverse spillovers while recognizing the primacy of domestic objectives.

Recommendation 4—Draw on lessons from this evaluation to consider steps to deepen and enrich country engagement in bilateral surveillance. The influence and value added of the Fund's advice on monetary policy at a country level seems limited by broader institutional constraints, including rapid turnover of country assignments that impedes developing deep relationships and understanding of country circumstances and the relatively limited direct engagement outside the annual Article IV cycle. There are also continuing concerns about the effectiveness of learning from cross-country experience and thinking through policy tradeoffs across the macroeconomic framework, both particularly important in unprecedented circumstances and areas where the IMF should have a comparative advantage. While this evaluation has focused on monetary policy advice, the IEO believes that such issues are also relevant for IMF bilateral surveillance more generally, hence the broad recommendation that these issues be considered in the context of the 2020 Comprehensive Surveillance Review now getting under way.

Specific steps that could be taken:

- Longer tenure of mission chiefs and less turnover among country teams would help to build deeper relationships and understanding of country circumstances, increasing the potential for the Fund to serve as trusted advisor, and even to be more confident in pushing back against central bank decisions when this seems warranted. While there are a variety of considerations relevant to determining tenure of country assignments, the evidence in this evaluation reinforces findings in earlier evaluations of the benefits of longer country assignments. Greater attention to ensuring effective handover could also help mitigate the costs of frequent turnover of country desks.

- Country engagement needs to be more continuous. Opportunities should be sought outside of Article IV to build contacts with and provide international perspectives to central bankers. Teams should be encouraged to participate in or host conferences and workshops that delve more deeply into specific issues of concern.