

## Conclusions and Recommendations

This chapter presents the main conclusions of the evaluation and discusses recommendations that could improve the effectiveness of the IMF in its crisis-related activities, namely, in conducting surveillance both before and during a crisis, in helping coordinate responses to a crisis, and in providing a financial safety net that members can tap to respond to a crisis.

### A. Main Findings and Conclusions

The IMF played an important role in the global response to the crisis. This represented a marked turnaround after several years of limited influence and almost no lending. The challenge of the crisis came when IMF resources were at a historic low relative to the global economy and the size of trade and financial flows, and against the backdrop of a major downsizing exercise.

In hindsight, the IMF downsizing exercise turned out to be a mistake and its timing unfortunate. It was prompted by reduced income due to limited lending, and the view that the “Great Moderation” meant that major crises were unlikely and the IMF would not need to play the role of “global firefighter.” The crisis dispelled this view, and the IMF was caught with a much-reduced number of staff experienced in program design and implementation. It is to Management and staff’s credit that they were able to step up to the challenges of the crisis, in spite of the stresses generated by the downsizing.

Members allowed the IMF to shrink relative to potential needs because they thought that the IMF’s resources were sufficient to respond to the likely scope of future crises, and also because they trusted that funding could be raised quickly if needed. Notwithstanding the success thus far in responding to requests for financial support, the fact that resources were not in place when the crisis struck added uncertainty in a fragile situation, and led to

a suboptimal composition of funding. A more adequately endowed IMF could have provided greater reassurance to financial markets that resources were available to assist countries affected by the crisis. Mobilizing additional resources as needed to respond to a crisis, rather than in advance, is also likely to increase the reliance on borrowed resources, since increasing quotas typically requires more extended technical and political discussions.

Currently, only 30 percent of the resources available to the IMF are in the form of quotas, compared with more than 80 percent before the crisis. Realigning this ratio has been complicated by the delay in implementing the quota reform agreed in 2010—which also has delayed the realignment of member quotas and voice to more adequately reflect the dynamic shift of EME weights in the global economy.

The trust of member countries in the IMF and the effectiveness of its surveillance are intimately connected to the IMF’s legitimacy. For example, authorities in several EMEs and other countries suggested that IMF views on spillovers from unconventional monetary policy, and on the advisability of capital controls to deal with the consequences of these spillovers, did not give enough weight to their circumstances. Similarly, authorities in some countries hoped (but were not confident) that the IMF’s exceptional lending terms during this crisis, particularly for European countries, would be available to other countries in future crises. These concerns are exacerbated by the under-representation of EMEs in the governance of the IMF. As such, quota and governance reform are critical to give greater legitimacy to the IMF, and to reinforce its role in global surveillance and crisis response.

The IMF participated in, and helped coordinate, global and regional initiatives, including with the G20 and the FSB. These initiatives facilitated the response to various aspects of the crisis and enhanced the traction of IMF analysis and advice. In many cases, however,

these partnerships raised questions about the IMF's role, accountabilities and independence, as well as about how to ensure uniform treatment of all member countries.

The IMF's overall record in post-crisis surveillance was mixed. Its calls for global fiscal stimulus in 2008–09 were timely and influential. However, by 2010 it had endorsed a shift to consolidation in some of the largest advanced economies, coupled with monetary expansion to stimulate demand if needed to maintain the recovery. The call for fiscal consolidation proved to be premature, as the recovery turned out to be modest in most advanced economies and short-lived in many European countries. The recommended policy mix was not appropriate, as monetary expansion is relatively ineffective in boosting private demand following a financial crisis. And, by 2012, a large body of analysis, including within the IMF, suggested that fiscal policy would have been a more effective way to stimulate demand, and could have allowed a less expansionary monetary policy. The policy mix pursued by advanced economies had destabilizing spillover effects on emerging markets, exacerbating volatility in capital flows and exchange rates. Also, the IMF did not sufficiently tailor its advice to countries based on their individual circumstances and access to financing when recommending either expansion or consolidation.

Professional opinions on the nature of the financial crisis and on how to address it have not converged, and caution is needed in drawing policy lessons from an unprecedented episode. There is a growing recognition that a more sustained fiscal expansion in large advanced economies would have been beneficial. On the other hand, debates will likely continue on the relative risk of policies given the information available at the time. In any case, the IMF showed openness and flexibility in reconsidering its fiscal policy advice once the growth outlook worsened, calling for a slower pace of consolidation. At this juncture, the IMF should strive to remain a focal point of debate and discussion and continue to encourage an environment that remains genuinely open to alternative perspectives.

The IMF has made progress in breaking silos and encouraging internal debate. Yet difficulties in integrating important messages from its flagship reports and risk assessments, and the finding that staff members still feel constrained in speaking their minds, suggest that progress in these areas is still needed.

Following the crisis, the IMF issued important analyses of regulatory reform priorities in the financial

sector, many of which represented an appropriate turnaround from pre-crisis positions. Its major operational initiative, to make FSSAs mandatory every five years for economies with systemic financial sectors, was welcome. However, experience has shown five years is too long an interval to be able to detect emerging vulnerabilities in a timely manner. Thus more frequent in-depth financial sector surveillance of the largest systemic financial sectors could be particularly critical in preventing global crises.

The IMF launched many initiatives to strengthen the integration of macro and financial sector surveillance, and expanded its tools and processes to identify and warn about risks and vulnerabilities. Most authorities interviewed for this evaluation were supportive of these efforts, but indicated that the number of such initiatives had grown beyond their capacity to absorb the results. Moreover, they stressed that they would have appreciated earlier and clearer warnings regarding critical risks, especially regarding the euro area crisis and the potential impact of quantitative easing and eventual tapering.

The crisis provided further impetus for revamping the IMF's lending toolkit to make it more responsive to members' needs. The FCL is an important innovation to facilitate access to precautionary resources for countries with very strong track records and sound fundamentals. Authorities of the three countries using the FCL believe that it met its goal of calming markets and providing a "seal of approval" for their sound policies. However, the FCL has been used by only three countries, none of which has yet exited from it, indicating that more experimentation and reforms may be needed to meet the needs of a larger set of countries.

The IMF ramped up its nonconcessional lending from almost nil in 2007 to about \$400 billion between September 2008 and the end of 2013, helping countries cope with the crisis, and containing spillovers. Programs reflected lessons from past crises: they were larger and more front loaded, and conditionality was more focused on core macro issues.

Against this positive assessment regarding programs, some lessons can be drawn for future crises. Programs succeeded in restoring investor confidence quickly but authorities' interest in continuing with the program engagement subsided once the immediate crisis was over. Also, many countries did not sustain the reforms they had undertaken under the program once they withdrew from the arrangement. This highlights the perennial issue of whether structural and long-term fiscal

issues can be effectively tackled by conditionality during a crisis—or more practically of how to design reforms that will be sustained beyond a program relationship with the IMF.

## B. Recommendations

This evaluation found that member countries and partners appreciated IMF contributions to the global response to the crisis, and that IMF financial support helped many member countries to mitigate the impact of the crisis. It also found that aspects of IMF activities could be improved to better warn the membership about mounting risks and vulnerabilities and about policies to mitigate them, and to be better prepared to contribute to the global safety net.

The following four sets of recommendations address concerns about the IMF's size and structure of funding, about managing partnerships, and about how to make macro and financial surveillance more effective and useful for member countries.

(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.*

The appropriate size of the IMF and the structure of its funding should be derived from the role that its members want it to play. To contribute to crisis prevention and resolution, the IMF should have enough resources to respond to member country needs in an unexpected crisis. To be most helpful, these resources should be available in advance of when they are needed, either as quotas or standing borrowing arrangements with automatic triggers. There is no perfect formula to estimate the optimal size for the IMF. It appears that the current level of resources (with a credit capacity of about \$1 trillion) served the IMF well during the recent crisis and could be a useful benchmark for equipping the IMF for the future. However, at least until the 2010 quota increase is implemented, the IMF's credit capacity relies disproportionately on borrowing, detracting from the IMF's legitimacy as a quota-based, universal cooperative, and adding some (albeit small) funding risk.

Management could work with the IMFC to re-examine its quota review process to help ensure that the IMF has sufficient resources already in place to respond to a

global crisis, and to reflect shifting weights in the global economy. The IMFC could also explore alternative arrangements to deal with an impasse on quota reviews.

(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.*

Over the past few years, the IMF has coordinated and partnered with other organizations in critical initiatives such as the G20 MAP, the newly-created FSB, and the Troika. These initiatives proved largely effective in addressing aspects of the crisis and also helped to enhance the traction of IMF analysis and advice. In some cases, however, they raised questions about the IMF's role, accountabilities, and independence, as well as about how to ensure uniform treatment of all IMF members.

(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.*

Authorities appreciate the new initiatives to tackle gaps that existed before the crisis, but indicated that the number and scope of such exercises has grown beyond their capacity to absorb the results. They urged that findings from the EWE be disseminated to a wider group of authorities. They also asked that risk analysis, including discussions of risks in IMF flagship reports, be better integrated, consolidated, and presented to them in a manner that can be absorbed more easily.

(iv) *FSSAs for the world's five to seven largest systemic financial centers should be updated annually in conjunction with IMF's bilateral surveillance.*

IEO (2011) welcomed the decision to make the FSSA mandatory for the largest 25 financial centers every five years, but raised the concern that more frequent assessments may be needed to detect emerging vulnerabilities in rapidly changing financial markets. The number of countries with mandatory FSSAs and the periodicity of assessments were decided by balancing the need to identify systemic risks with the resources available for the program. But experience has shown that an interval of five years between FSSAs

is too long, particularly for the largest systemically important financial centers. To address this concern, IMF staff have suggested mainstreaming financial sector work by training area department economists and placing financial sector specialists in area departments. This is a welcome initiative, but it will take a long time to yield results. It is IEO's view that the membership

will be better served by focusing on the top five to seven financial centers, those that are truly systemic. For these, an FSSA update could be prepared every year in advance of the Article IV consultation. The other countries on the current list could continue having an FSSA every five years, subject to resource constraints.