Guy Quaden: Modernising IMF surveillance

Intervention by Mr Guy Quaden, Governor of the National Bank of Belgium, at the International Monetary Fund–Monetary Authority of Singapore (IMF–MAS) Conference "The IMF and the international financial system: the post crisis agenda", Singapore, 24 September 2010.

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First of all, I would like to thank the Monetary Authority of Singapore and the IMF for inviting me to contribute to this high-level conference.

The world economy has changed in important ways. Capital flows now dwarf trade flows. Many economies are now integrated into world capital markets. Financial sectors have become more interconnected and a channel for rapid transmission of crises across regions and at a global level. This requires Fund surveillance (in other words its crisis prevention role) to adapt both in substance (what surveillance should do) and modalities (how to do it).

I would like to focus on three major topics:

1. the analysis of financial sector stability must be strengthened both at global and country level;
2. bilateral surveillance must be complemented with multilateral surveillance;
3. the so-called traction of Fund surveillance – the ability and willingness of countries to heed Fund advise – must be improved.

Let me elaborate.

Financial sector stability issues

The international community has drawn many important lessons from the recent financial crisis. Implementing the needed changes has only just begun.

The Basel III Agreement, reached only recently, is a major step to make the banking sector more stable and better equipped to absorb losses. It is only a first step. Improving capital adequacy primarily focuses on the stability of individual banks. It is foremost an instrument of micro-prudential regulation. Compliance of individual banks with prudential regulations does not assure the stability of the system as a whole. Macro-financial stability concerns must be kept under constant review and addressed by national institutions – the central banks – with a clear mandate. In the European Union, the European Systemic Risk Board will be established next year and assume an important role at EU-wide-level. However, the implementation of its recommendations will remain largely the responsibility of national authorities. I see an evident parallelism and potential for synergy between the surveillance mandate of the ESRB and IMF surveillance, the latter remaining broader in scope.

After a series of national and regional crises (Mexico, Asia, Russia, ...) the IMF Board adopted in 2000 a Financial Sector Assessment Program. The Fund would at regular intervals (of 3 to 5 years) conduct an in depth evaluation of the vulnerabilities of a country's financial sector and the adequacy of prudential regulation and surveillance. However, the membership could not agree, in a straightforward manner, that financial sector stability was an integral part of Fund surveillance, and therefore mandatory. The technical assistance nature of FSAPs was used by some countries to argue that the Fund should prioritise its resources to countries less equipped to conduct sound financial sector policies. As a consequence, some major systemically important financial sectors that proved very vulnerable did not undergo a timely and sufficiently in-depth scrutiny.

Last Tuesday, the IMF Board decided that the 25 countries with a systemically important financial sector will undergo at least every 5 years an in-depth assessment of their financial sector. Moreover, the Board has stressed that financial sector policies are important in all cases of bilateral surveillance. This is a significant progress.

Multilateral surveillance

Bilateral surveillance, understandably, focuses on how national policies must be conducted in the country's best interest. The premise is simple: if each country achieves internal stability and a sustainable external position without manipulating exchange rates, the system as a whole will function satisfactorily. While this remains largely valid, trade and financial integration and economic interdependence are now so far advanced that national economic interests must be pursued in a shared framework of collective stability. National policies pursued in the country's own best (short term) interest might not be collectively consistent. The problem of the persistent global imbalances is an important example. To complement bilateral surveillance, the Fund must formulate policy-oriented advice on how to improve the coherence of national policies toward improved collective stability and sustainable global growth.

A promising proposal that has been floated recently is the production of spillover reports. It is to be welcomed that the Fund plans to prepare, on a trial basis over the next year, at least three spillover reports for the US, the euro area and China. These reports will focus on outward spillovers of domestic policies of these economies and would involve not only the authorities of these economies (akin to the contact for the regular Article IV consultations) but also the authorities of the economies affected by the policies.

The launch of the first Mutual Assessment Process (MAP) by the G20, in collaboration with the IMF, is a new attempt at multilateral cooperation and coordination. Given the potential benefits, this objective should be pursued with determination. However, the effectiveness of the G20 process still needs to be demonstrated going forward. Moreover, many special topics affecting groups of countries that may include non-G20 members or only a few of the G20 members will remain uncovered in that G20 process. The IMFC could provide a forum for addressing these issues.

Prioritization and collaboration

The improvement of surveillance will require adequate resources and Fund members should not withhold them. But it is obvious that choices will have to be made among a very wide range of ideas; and priorities will have to be set. This should happen taking into account in particular the effectiveness and cost of each proposal and the work done by other international institutions.

When considering the creation of IMF surveillance products, sufficient attention should be devoted to the integration of these products in the overall IMF surveillance framework in order to maximise the effectiveness of and the synergy among all these products. The Fund has indeed already a large array of surveillance instruments (at bilateral, regional and multilateral level: Article IV, FSAPs, WEO, GFSR, REO, EWE, Vulnerability Exercises in EMs, Multilateral Consultations ...) which are the result of its efforts to keep its relevance in a changing world.

At the same time, close cooperation with other international institutions and fora is essential, taking due account of comparative advantages and expertise, and avoiding duplication of efforts. Regarding, for instance, financial stability surveillance, the IMF and the FSB work together on the Early Warning Exercise and on systemically important financial institutions. Nevertheless, there remains probably room to improve further the coordination of their activities. In retrospect, we have to admit that the record of both the FSF and the IMF was less than perfect. The Fund has also to collaborate efficiently with the Basel institutions: with the BIS, that produces high-quality macrofinancial research, and with the Basel Committee on Banking Supervision, given that it has much responsibility for micro-financial issues.

Another proposal which is gaining attention is to tailor further the content and frequency of the surveillance process according to the specific circumstances of each member country, and thus also according to the systemic importance of the country concerned. While I can certainly see merit in this proposal, it should be kept in mind that surveillance is important for all countries and that all members have the right to receive adequate policy advice during regular Article IV consultations. Tailoring consultations to specific circumstances should not lead to diverging surveillance quality for different categories of members.

Traction of Fund surveillance

I come to my last topic: the so-called traction of Fund surveillance.

With highly competent economic analysts in central banks and governments in most countries, some have questioned the usefulness of Fund surveillance. Such is not my view. The added value of Fund surveillance rests on the political independence of the Fund opinion. Like independent central banks, Fund experts put longer term considerations above short term political calculus. In doing so, the Fund steers policy makers toward more honesty and boosts the government's ability to implement often politically difficult reforms.

There is a debate about how transparency can help improve traction of Fund surveillance. Prior to the Mexican crisis in 1994, IMF surveillance reports were highly confidential. Today, all Article IV reports, with a few exceptions, are available on the Fund's website. For the Fund, the challenge in this context, is to be perceived as an impartial advisor and monitor, not too tied by its structure to the official view in which problems are downplayed[1].

Let's be frank. The IMF must indeed avoid public clashes about short term emergencies. On this, candid analysis is only acceptable if treated with the needed degree of confidentiality. Full and unfettered transparency could on the contrary induce complacency and a loss of credibility for the Fund. However, at the same time, the IMF must become more pro-active in persuading public opinion, social partners, and NGOs of the long-term costs of unadjusted policies and of the long-term gains that will outweigh short-term pain. Explanation by a credible international institution that promotes a global common good, might find more support from the public for long-term objectives than politicians believe there is.[2]

Much has been said and written on improving the governance of the IMF and enhance ministerial involvement. Many observers conclude that nothing really happens at the international meetings of the IMF and the World Bank. This perception is not entirely unfounded. As I see it, the central task of ministers and governors meeting in the IMF is to seriously discuss policy-oriented multilateral surveillance reports. This is a task that the IMF Executive Board can only prepare. In the end, it is up to the policymakers at the highest level to agree on how consistency among their policies can be promoted, and policy coordination improved. Pursuing these objectives will elevate the level of ambition of Fund surveillance and the cooperation of its members to a higher level than that exists now. Today's conference should advance our ambition.

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[1] Cfr. for instance the interview of Professor Reinhart published for the attention of the IMF staff in November 2009.

[2] Cfr. for instance Raghuram Rajan, Fault lines, page 215.