Martin S. Edwards

Associate Professor, School of Diplomacy and International Relations
Director, Center for UN and Global Governance Studies
Seton Hall University
106 McQuaid Hall
South Orange NJ 07079
Tel: 973-275-2507
Email: martin.edwards@shu.edu
===

I'd like to commend the TSR team for the amount of work that they've already done. What's here is an ambitious agenda, and I look forward to reading the findings in detail. It is in that constructive spirit that I offer some observations below.

- In your view, has IMF surveillance improved in recent years? Has there been more focus on risks and the spillover effects of countries' policies? What more can be done to strengthen the Fund's assessment of risks and spillovers?

This is absolutely a yes. I've been struck by the discussions about the so-called fragile five and how much the Article IVs did send warnings to these countries. The notion that the Fund hasn't gotten better at sending warnings as well as diagnosing spillovers is not supported. For more on this, see the attached (unpublished) op-ed.

- How do you assess the contribution of IMF surveillance to the (country and global) policy debate? More specifically, has Fund advice been sufficiently tailored to individual countries' priorities and needs? And are you satisfied with the timeliness and quality of the Fund's analysis/views of policy issues that have systemic implications? What can the Fund do better/more of/differently in adding value to the (country and global) policy dialogue?

I'm a political scientist, and I worry about the fit between country developments and the content of the Article IV report a great deal. Given that the new focus is on stability, there are doubtless political factors that affect macroeconomic stability. These need to be included in the IMF's assessment. Now, this doesn't have to be that complicated. Take a look at the 2013 Article IV for Turkey (http://www.imf.org/external/pubs/ft/scr/2013/cr13363.pdf). It mentions that elections are on the horizon. But how will these elections (or electoral cycles more generally) affect macroeconomic stability? Unfortunately, the sequence of the Article IV missions means we might not have a sense of this – the next mission seems to be scheduled for after the elections. This is a case in which more interdisciplinary research is necessary, and this can inform the work of surveillance teams moving forward.

The central fact is that the choice of "stability" as the buzzword is going to require the Fund to think more broadly about how non-economic factors shape macro stability. We've seen moments in which the Fund has cautiously embraced a dialogue with non-economists, but they were fleeting. This is also a case in which civil society organizations will have a great deal to say about how 'stability' is or ought to be framed. Are we up to the challenge?

- How do you define evenhandedness of Fund policy advice? Do you believe Fund policy advice has been evenhanded across the membership? And have there been significant changes in this respect in recent years? What is your view regarding the Fund's ability and willingness to listen and take into account country authorities' views in policy discussions?

I think this is a real challenge on two levels. First, the Fund is pushing back against *perceptions*. We know this was a problem in the last TSR. In it, there was a survey of country authorities in which respondents asked whether they agreed or disagreed with the statement "The IMF is evenhanded in its policy advice" 58% of authorities from G-20 countries disagreed with this statement. The bigger problem is that the Fund is flying in the face of *established findings.* This is the bigger issue, since some empirical studies suggest that surveillance is prone to the same geopolitical biases as lending. (See Dreher, Marchesi, and Vreeland and Fratzscher and Reynaud for more on this). This is going to be a real challenge, because the TSR is speaking to both groups, and a paper that persuades one group might not persuade another.

- What do you see as the main strengths and weaknesses of IMF surveillance? What do you see as the biggest challenges facing surveillance and how could these be addressed? What specific measures would you suggest to help improve IMF surveillance?

There are four problems:

1) Insufficient learning. The Fund discussions about surveillance seem to operate in a bit of a vacuum. It is not the only economic organization that does this, and some learning from other organizations would be useful. I've done some of this comparative work on the OECD (for more see http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2273302).

   The bigger challenge is that the Fund isn't the only international organization more generally that does surveillance, and it hasn't controlled the debate about how surveillance ought to be reformed. Surveillance is different from conditionality, and there's no 'enforcement mechanism.' But we do know that markets respond to transparency about surveillance (Glennerster and Shin did this, of course, and I found support for their claims in a larger sample here: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2035393) and we do know that countries take issue with the content of staff reports. Both of these are evidence that surveillance is consequential.

   More broadly, international human rights treaties are even more fragile, because they don't have a market mechanism. Few would argue, though, that the global human rights regime is inconsequential. This comparison is an important one. Some would suggest that Fund surveillance needs to look more like the 'hard legalism' of the WTO. We know, of course, that's not tenable. But learning from the international human rights regime suggests a number of different reforms for surveillance moving forward.

2) Insufficient connections. The focus on traction is a good idea, but I worry that we're not going far enough here. This holds in two senses. First, the term traction is never defined, and it is not clear what the mechanism is to generate more traction. The guidance note

frames traction as stemming from creating a dialogue, but I think this misses the point. It gives short shrift to *outreach.* We know this is a problem. When there is little evidence that the Article IV for the US in 2011 was on the radar screens of politicians in the executive or legislative branches, at a time in which IMF advice *should have been useful,* we know that there is a problem. (For more see this: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2313743).

Second, the documents themselves are not designed to help create a discussion about traction. The statements on "effectiveness of past surveillance" are not clear enough – this is a case in which the OECD does markedly better. Now, one would sensibly counterargue that we can't necessarily attribute IMF influence here, but the bigger point remains that the Fund can't have a serious conversation about traction without requiring that all Article IVs take past surveillance seriously. If we want a conversation about traction, we can no longer leave the issue of performance ambiguous in staff reports. There are doubtless research design challenges with the counterfactual (would a country have adopted policy reforms without them being mentioned in an Article IV?), but you do have lots of smart people on staff.

3) Insufficient transparency. The Fund has done a good job with making some information from the TSR public, but more than topline results are necessary. Legitimating surveillance starts with being clear about data. We can do better here. Everything can be made anonymous by country.

4) Insufficient incentives. I was struck by a paragraph in the External Advisory Group report in 2011 about cross country work: "management should set clear targets on cross country work…to help create the right internal incentives to get the work done" It is clear that some internal incentives exist (otherwise we would not have seen the impressive progress to date), but these need to be strengthened in order to move surveillance from what it is to what it could be.

Don't blame the IMF for the emerging market currency crunch!

In the past year, emerging markets have gone from investors' darlings to a collective headache. One group of emerging markets, comprised of Brazil, India, Indonesia, South Africa, and Turkey, have seen their currencies plummet by 15-20% over the past year, and several of these countries have had to take aggressive steps to guard against capital flight. Emerging economies can no longer be thought of a steady source of global growth, especially when the above countries have been labeled by Morgan Stanley as the "fragile five."

When economic moments like these take place, it is customary to ask if the international institutions that have been created to help regulate financial markets are up to the challenge. The good news is that International Monetary Fund surveillance of these emerging markets has been unambiguous about the potential downsides of economic integration. In stark contrast to previous years, IMF surveillance has sent clear warnings to policy makers in these countries about the risks posed by Fed policies. A lively debate has emerged over who is to blame for the "fragile five." In this case, it is quite clear that the IMF is not the problem.

Surveillance is the ugly duckling of IMF operations. Countries have annual meetings with IMF staff, and this process results in a lengthy document in which the Fund gives its assessment of the state of the member country's economy and offers advice in the form of policy recommendations. The problem with surveillance is that it can be ignored; countries cannot be penalized by the Fund for failing to heed its advice.

Historically, politicians in emerging markets can point to many areas in which the IMFs advice has not been good. We need only remember the Fund's obsession with fiscal austerity for Korea in 1998 (at a time when it was running budget surpluses!) as well as the Fund's single-minded focus on opening capital markets despite the weak record of bank supervision in many countries. The mistakes of the Asian crisis have led to many developing countries choosing to stockpile foreign reserves as a potential buffer from the rigors of IMF conditionality. Surveillance was also unfocused in the run up to the global economic crisis, as it failed to send clear signals to developed country politicians about the potential hazards in the mortgage market.

Has the Fund let the "fragile five" down? The reports written by the Fund staff for the past two years for these five countries have sent clear and unambiguous signals about policy challenges stemming from the monetary policies of developed countries. For all five countries in 2013, each report contains a risk assessment matrix that lists potential challenges for each country. For each country, this document discusses both domestic and international policy challenges. In the surveillance reports for these five countries in 2013, the risk assessment matrices address either the danger of distortions from developed country unconventional monetary policy or the danger of emerging market capital flow reversals. These reports describe the likelihood of such outcomes as either moderate or high, and the potential economic impacts from such events are also described as either moderate or high. In short, IMF surveillance is providing clear warning to these countries.

This claim is further strengthened by looking at the 2012 surveillance reports for these countries. Here, the main external danger for these countries took the form of a global financial tightening stemming either from a Chinese growth slowdown (for South Africa and Indonesia) or Europe (for Brazil, India, and Turkey). The IMF has been warning policy makers in these countries of the dangers of a sudden shift in financial market sentiment well before talk of a taper was reality.

The IMF has learned a harsh lesson from recent years, and surveillance has transformed to restore the Fund's role as a harsh truth-teller. The record suggests that policy makers in emerging markets received clear public messages of warning about the dangers of cheap foreign capital as well as the threat posed by those sources drying up. Whether officials in the fragile five countries heed these lessons in the coming weeks will determine whether this crisis is a temporary setback or growing cause for concern.