Independent Evaluation Office
of the International Monetary Fund

IMF RESPONSE TO THE FINANCIAL AND ECONOMIC CRISIS: AN IEO ASSESSMENT

October 8, 2014

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The evaluation team benefited from discussions with participants in workshops in Berlin in August 2013—organized jointly with the Federal Ministry for Economic Cooperation and Development (BMZ) and DEval, and in Washington in November 2013 and June 2014.

The report benefited from comments from Jack Boorman, José Luis Escrivá, Masahiro Kawai, Malcolm Knight, Rachel Lomax, Marcelo Selowsky, and Edwin Truman.

Contents Page

Abbreviations iv

Executive Summary v

I. Introduction 1

II. Coordination and Collaboration with Multilateral Entities 3
A. Supporting the G20 Process 4
B. Working Within and With the FSB 5
C. The IMF and the Vienna Initiative 6
D. Working with the EC and the ECB 7

III. IMF Surveillance Following the Crisis 8
A. Assessing IMF Macroeconomic Advice in the Crisis Aftermath 9
B. Financial Sector Surveillance Following the Crisis 14
C. Revamping the Approach to Assessing Risks and Vulnerabilities 18

IV. Strengthening the Global Financial Safety Net 22
A. Resource Mobilization: Strategy and Results 22
B. Updating the Lending Toolkit 25
C. Extending Financial Support to Member Countries 26

V. Conclusions and Recommendations 32
A. Main Findings and Conclusions 32
B. Recommendations 35

Boxes
1. Advice to Initiate Fiscal Consolidation Stemmed from Concerns About Fiscal Solvency and Fiscal Crises 10
2. Varying Messages in IMF Discussion of Unconventional Monetary Policy and Tapering 20
3. IMF Learning from Crises in Asia and Latin America 27

Figures
1. Fiscal Policy Thrust 11
2. IMF Exercises to Address Risks and Vulnerabilities 19
3. Structural Conditionality in IMF Stand-By Arrangements, 1997–2000 vs. 2008–11 30

References 37

Annexes
1. IMF-Centric Timeline of Events (August 2007–December 2013) 40
2. IMF Downsizing During the Crisis 42
3. Abstracts of Background Papers 44
4. Conclusions and Recommendations from Previous IEO Evaluations 46

ABBREVIATIONS

AML-CFT	Anti-Money Laundering and Combating the Financing of Terrorism
CGER	Consultative Group on Exchange Rates
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECB	European Central Bank
EFF	Extended Fund Facility
EMDC	emerging market and developing country
EME	emerging market economy
EU	European Union
EWE	Early Warning Exercise
FCL	Flexible Credit Line
FSAP	Financial Sector Assessment Program (IMF-World Bank)
FSB	Financial Stability Board
FSSA	Financial System Stability Assessment
G7	Canada, France, Germany, Italy, Japan, United Kingdom, and United States
G20	A grouping composed of major advanced economies and systemically important emerging and developing countries
GAB	General Arrangements to Borrow
GDP	Gross domestic product
GFSR	*Global Financial Stability Report*
GPA	Global Policy Agenda
GRA	General Resources Account
G-RAM	Global Risk Assessment Matrix
IMFC	International Monetary and Financial Committee
ISD	Integrated Surveillance Decision
LICs	low-income countries
MAP	Mutual Assessment Process
MCM	Monetary and Capital Markets Department (IMF)
NAB	New Arrangements to Borrow
OECD	Organization for Economic Cooperation and Development
PCL	Precautionary Credit Line
PLL	Precautionary and Liquidity Line
PRGT	Poverty Reduction and Growth Trust
QE	quantitative easing
RWG	Risk Working Group
SBA	Stand-By Arrangement
SDR	Special Drawing Right
TSR	Triennial Surveillance Review
UMP	unconventional monetary policy
WEO	*World Economic Outlook*

Executive Summary

The IMF played an important role within the global response to the crisis. It reformed its lending toolkit and ramped up non-concessional lending, from almost nil to about US$400 billion in 2008–13. IMF-supported programs reflected many lessons from past crises and helped member countries cope with the crisis. The increased lending was enabled by a resource mobilization effort that quadrupled the IMF's resources to about one trillion dollars by 2013. But the agreed doubling of quotas has not become effective, leaving the IMF dependent on borrowing arrangements for more than two-thirds of its total credit capacity.

The IMF's record in surveillance was mixed. Its calls for global fiscal stimulus in 2008–09 were timely and influential, but its endorsement in 2010–11 of a shift to consolidation in some of the largest advanced economies was premature. At the same time the IMF appropriately recommended monetary expansion in these countries if needed to maintain the recovery. However, this policy mix was less than fully effective in promoting recovery and exacerbated adverse spillovers. As time progressed and the growth outlook worsened, the IMF showed flexibility in reconsidering its fiscal policy advice and called for a more moderate pace of fiscal consolidation.

The IMF launched many initiatives to strengthen macro and financial sector surveillance, and expanded its tools and processes to identify and warn about risks and vulnerabilities. Authorities interviewed for this evaluation were largely supportive of these efforts, but they indicated that the number of such initiatives has grown beyond their capacity to absorb the results. Moreover, they highlighted that they would have appreciated earlier and clearer warnings regarding recent critical risks. There are also questions on whether IMF surveillance is currently well placed to detect emerging financial sector vulnerabilities in systemic financial centers in time to warn authorities and the membership at large.

The IMF collaborated with other organizations in important initiatives including the G20 Mutual Assessment Process and the Financial Stability Board. These collaborations were largely effective in addressing aspects of the crisis and also enhanced the traction of IMF advice. Looking forward, to protect the institution's independence and to ensure uniform treatment of the entire membership, the IMF should develop guidelines for structuring such collaboration arrangements that clarify the parties' roles and accountabilities.

Two reforms would enhance the IMF's ability to warn about emerging systemic risks. First, the IMF needs to consolidate the initiatives aimed at identifying risks and vulnerabilities, and it should better disseminate their findings to authorities. Second, it should focus its financial sector surveillance on the five to seven truly systemic financial centers. For these centers, an FSSA should be updated annually in conjunction with the Article IV consultation.

To be better positioned to respond to the next crisis, the IMF should aim to have resources in place in advance of a need arising, relying primarily on member quotas to reduce uncertainty and to strengthen its legitimacy.

I. Introduction

1. This evaluation assesses the IMF's response to the global financial and economic crisis, focusing on the period September 2008 through 2013.[1] It is a natural follow-up to the 2011 IEO report on *IMF Performance in the Run-Up to the Financial and Economic Crisis*. It assesses the IMF's actions to help contain the crisis and navigate a global recovery, assist individual economies to cope with the impact of the crisis, and identify and warn about future risks. The evaluation recognizes that there is still an ongoing debate, which is likely to continue for some time, on the appropriate policy response to a financial and economic crisis of this magnitude.

2. In the aftermath of the Lehman collapse the world entered the most serious financial and economic crisis since the Great Depression. An incipient financial panic led to a sharp global downturn in 2009, giving rise to fears of a protracted recession as in the 1930s. The financial panic was contained as central banks injected massive liquidity into financial markets worldwide and key systemic institutions were rescued. Automatic stabilizers and the adoption of fiscal stimulus also limited the initial loss of output. A global depression was avoided, thanks in part to the concerted response of the international community. But the economic rebound seen in 2010 was followed by slower global growth, and performance since then has been uneven across countries. In many regions and especially in Europe, the economic downturn and loss of employment has been the largest since the 1930s.

3. The IMF played an important role in the concerted response, even though it was in a relatively weak position when the crisis erupted. IMF resources were at a historic low relative to financial flows and the size of the global economy. The organization was in the midst of a major downsizing and restructuring (see Annex 2), motivated by low demand for its lending and the widespread belief that the global economy had entered a period of "Great Moderation." The downsizing resulted in the loss of many seasoned staff, distracted others, and complicated the staffing of program and surveillance missions. There were concerns about the IMF's ability to respond effectively to the crisis because it had not warned about the vulnerabilities that had brought it about. Segments of the membership were concerned with the IMF's performance during the crises of the previous decade. Finally, some large emerging market economies (EMEs) questioned the IMF's legitimacy to play a major role because they felt that they did not have enough say in its governance (see IMF, 2009b).

4. The evaluation is organized around three broad areas of IMF activity: coordination with multilateral entities, surveillance, and financial support to member countries.

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[1] Annex 1 presents an IMF-centric timeline of the evaluation period. The evaluation does not assess lending programs in the euro area, as they will be the subject of a separate IEO evaluation.

Coordination and collaboration with multilateral entities

- The IMF participated in and helped to coordinate global and regional initiatives, e.g., it provided analytical support and policy advice that facilitated the efforts led by the Group of Twenty (G20), and it cooperated with the Financial Stability Board (FSB).

Multilateral and bilateral surveillance

- The IMF agreed on a new surveillance framework that aims to better integrate bilateral with multilateral surveillance, and economic with financial surveillance, and it advised member countries on responses to the crisis.

- It analyzed shortcomings in financial sector policy and regulatory frameworks, and proposed corrective actions. It also made the Financial System Stability Assessment (FSSA) component of the Financial Sector Assessment Program (FSAP) a mandatory part of its bilateral surveillance for the world's top systemic financial centers, to take place at a minimum of every five years.

- It revamped its mechanisms to detect vulnerabilities and risks. In partnership with the FSB, it launched a semi-annual Early Warning Exercise (EWE) to explore tail risks to the global economy.

Contributions to strengthening the global financial safety net

- The IMF quadrupled its credit capacity and made a general allocation of SDRs equivalent to US$250 billion—increasing total SDR holdings tenfold.

- It revamped its lending toolkit, introducing more flexibility in its lending instruments, increased the amounts that members can borrow (i.e., access limits), and streamlined conditionality. It also launched several new instruments, among them the Flexible Credit Line (FCL) to facilitate access to precautionary resources for members with strong fundamentals, policy frameworks, and implementation records.

- It increased non-concessional lending from almost nil before the crisis to about US$400 billion in 2008–13 and contributed to a coordinated effort to limit the withdrawal of private financing in Central and Eastern Europe.

5. This evaluation assesses these activities and explores institutional issues that influenced their effectiveness. It asks what went well, whether lessons from previous crises were applied, and what issues need to be addressed going forward. In addition to asking about past performance, the evaluation asks how well the IMF is prepared for the future: whether it is better equipped to warn of systemic risks, and whether it is better positioned to respond to the next crisis.

6. The evaluation team gathered information through a variety of methods, including reviewing IMF and other documents and undertaking semi-structured interviews with authorities from more than 30 countries, Board members, and current and former Management and staff. The evaluation team participated in workshops and seminars to elicit the views of counterparts from other international institutions and private sector and civil society organizations. Background information and analysis can be found in accompanying background papers.

7. The remainder of this report is organized as follows. Chapter II considers IMF coordination roles in the response to the crisis. Chapter III assesses IMF surveillance following the crisis, focusing on the IMF's macroeconomic and financial sector advice and on its work to strengthen its framework to detect risks and vulnerabilities. Chapter IV examines the IMF's contributions to strengthening the global financial safety net, including its efforts to bolster the resources available to member countries, as well as its lending to countries most affected by the crisis. Chapter V provides conclusions and key recommendations. Annex 1 presents an IMF-centric timeline of developments during the evaluation period, Annex 2 provides the background to and a description of the IMF downsizing exercise of 2008–09, Annex 3 presents the abstracts of the background papers prepared for the evaluation, and Annex 4 summarizes conclusions and recommendations from previous relevant IEO evaluations.

II. Coordination and Collaboration with Multilateral Entities

8. This chapter examines the partnerships and institutional arrangements through which the IMF assisted in coordinating the response to the crisis, as well as its cooperation with national authorities, country groupings, and other international agencies.[2] Specifically, it describes the IMF's relationship with and role within four key operational partnerships: the G20, the FSB, the Vienna Initiative, and the Troika arrangement.[3]

9. The response to the crisis represents a successful example of international cooperation. The IMF played an important role within this response. It supported the G20 process including by providing analytical inputs to the Mutual Assessment Process (MAP). It took the lead in providing financial support for programs in affected emerging markets, particularly in Central and Eastern Europe. It cooperated well with partners and played

[2] This chapter draws on Bernes (2014), which is based primarily on interviews with current and former authorities in 22 countries, 16 of which are members of the G20, as well as with officials from the Bank for International Settlements (BIS), the European Bank for Reconstruction and Development (EBRD), the European Central Bank (ECB), the European Commission (EC), Financial Stability Board (FSB), the Organization for Economic Cooperation and Development (OECD), and the World Bank.

[3] A full assessment of the IMF's participation in the Troika will be conducted in a future evaluation of the IMF's response to the euro area crisis, which will assess IMF-supported programs in the euro area.

important roles within the FSB, the Vienna Initiative, and the Troika, but its effectiveness and legitimacy in coordinating with these entities could have been enhanced by greater clarity on responsibilities and accountabilities.

A. Supporting the G20 Process

10. The G20 assumed leadership in directing responses to the crisis as the forum was elevated to the Heads of State ("Leaders") level in November 2008.[4] This was in keeping with past experience, when the leadership for crisis response passed to political bodies (previously the G7), particularly regarding coordination among large advanced economies.[5] The IMF Managing Director and the Chair of the IMFC participated in G20 Finance Ministers' meetings to facilitate transparency and coordination between the work and political support of the G20 and the universal membership of the IMF.

11. The IMF played a dual role in influencing the G20 and in supporting its work, especially in the early years of the crisis. It played an influential role at the November 2008 G20 Leaders' Summit in calling for a coordinated global fiscal stimulus. Also, the G20 (which has no dedicated secretariat) looked to the IMF to provide analytical support, most prominently for the MAP. The G20 called on the IMF to collaborate with the FSB to promote financial stability and participate in the G20 Data Gaps Initiative. The IMF followed through on G20 initiatives, for instance as the G20-brokered resource mobilization strategy was adopted by the IMFC and implemented by Management and staff working with members.

12. The relationship with the G20 in the context of the crisis raised concerns within parts of the IMF's membership. At successive Board meetings, assurances were sought that decisions regarding the IMF's engagement in the G20 would first be considered by Executive Directors. Some Directors, particularly from those countries not represented in the G20, expressed misgivings about the IMF being so closely involved in the MAP and other G20 activities, given the G20's restricted membership and the heavy demands on IMF staff at a time of constrained resources. They argued that the IMFC was better placed than the G20 to set the course for the IMF in responding to the crisis, given its arrangements for weighted universal representation in decisions.[6] Other Directors, however, thought that involvement

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[4] The G20 was established in 1999 at the level of finance ministers and central bank governors. G20 members account for around 85 percent of global GDP, and two-thirds of the world's population. They also represent 63.4 percent of voting power at the IMF Board (plus the 13.6 percent share of non-G20 IMF member countries represented by virtue of the EU's membership in the G20).

[5] A February 2009 IMF staff paper examining the initial response to the crisis recognized that it was difficult for the IMF to take the lead in coordinating the global response, because of questions about the legitimacy of its governance framework and because it had not provided adequate warning of the crisis (IMF, 2009b).

[6] Some authorities, however, argued that significant quota reform must take place before the IMFC could become the locus for global economic and financial cooperation.

with the G20 would be helpful for the IMF to build political support, and thus gain greater traction for its policy advice.

13. The involvement with the G20 gave the IMF the opportunity to have its analysis reach the heads of state of the largest economies, and to gain traction for its recommendations. On the other hand, the involvement raised questions about whether all members have a voice in decision making, and about to whom the IMF and its management are accountable.

B. Working Within and With the FSB

14. In November 2008, G20 leaders called for the establishment of the FSB as a strengthened successor to the Financial Stability Forum (FSF). The goal was to promote financial stability by coordinating and strengthening regulation and supervision and by exploring sources of financial risks, among other activities. The FSB charter provided for membership comprised of central banks, finance ministries, and other regulators from G20 countries and a few other advanced economies. The IMF and a few other international organizations were also asked to join.

15. In considering whether the IMF should become a member of the FSB, a number of IMF Executive Directors were concerned that FSB membership would affect the IMF's ability to conduct its surveillance mandate and might compromise its independence and its accountability to its membership.[7] A number of Executive Directors representing EMEs expressed reservations and suggested that perhaps the IMF's role in the FSB should be limited to that of observer.

16. The Board ultimately approved IMF membership in the FSB conditional on clarifying that this would have no legal and policy implications for the IMF's rights and obligations and by providing "opt-out" clauses from decisions that may not be consistent with the IMF's legal or policy framework. Directors stressed that the IMF would continue to take the lead in surveillance of the international monetary system and analysis of macro-financial stability issues in its member countries, but that it would collaborate with the FSB to address financial sector vulnerabilities and to develop and implement regulatory, supervisory, and other policies in the interest of financial stability.

17. The G20 called upon the IMF and the FSB to collaborate in identifying macroeconomic and financial risks and the actions needed to address them, and to reshape regulatory systems so that authorities would be able to identify and take account of risks

[7] The discussion centered on the implications of full FSB membership for the IMF's engagement with processes related to Anti-Money Laundering and Combating the Financing of Terrorism (AML-CFT), but the concern was broader. Some Directors were concerned that IMF staff might feel compelled to yield to FSB views on broader financial sector issues.

emanating from the financial sector. The G20 asked them to conduct the EWE and to present the results to the IMFC, in addition to the G20 Finance Ministers and Central Bank Governors. Authorities who had attended the EWE presentations expressed satisfaction with the initiative, although some commented that the outputs appeared more like “two reports stapled together than a single document.” Some authorities believed that this lack of integration carried the potential for missing important risks. The EWE is discussed further in Chapter III.

18. These challenges in the EWE process illustrate the difficulties in fostering collaboration between a treaty-based organization with universal membership and a large professional staff, such as the IMF, and a comparatively small organization with limited membership, such as the FSB. Staff in both organizations were satisfied with their working relationship, but they worked more in parallel than jointly, as evidenced by the EWE. Joint work is particularly difficult when the parties’ mandates, size, structure, and culture are very different. To this end, IMF Management may need to focus on incentives and accountabilities for joint work, which are difficult to establish across institutional boundaries.

19. Authorities from both advanced economies and EMEs wondered whether certain issues—such as the implications of changing regulatory frameworks for capital flows and investment, or the incentives and behaviors of regulatory and supervisory agencies—were not examined sufficiently because of a lack of clarity in the IMF and FSB on their respective mandates. Other interviewees suggested that IMF staff may have yielded to the FSB on such issues out of deference to its expertise and mandate.

20. Overall, IMF collaboration with the FSB, both as a member and as a partner, has served the whole IMF membership well. At the same time, authorities and analysts have raised questions about the impact that this partnership has had on the IMF’s willingness and ability to examine and discuss certain financial sector issues. Preserving the IMF’s actual and perceived independence while working with and within other organizations is difficult and requires that the IMF’s roles and accountabilities be clarified in advance.

C. The IMF and the Vienna Initiative

21. The Vienna Initiative was launched in January 2009 to establish a coordinated framework for financial sector crisis management in the EMEs of Central, Eastern, and Southeastern Europe. This effort involved multinational banks with exposure to the region, their home and host authorities, and several multilateral institutions, including the IMF. While the focus has evolved over time, its main goal remains to prevent foreign banks from withdrawing from the region so as to avoid a financial collapse (see De Haas and others, 2012).

22. The IMF was an important partner in the Vienna Initiative, providing financial support for country programs and policy advice. Authorities and other stakeholders credited the IMF with having played a key role in the efforts to convince banks to maintain exposures

in emerging Europe, thereby avoiding a large capital flight. They appreciated the IMF's use of analytical approaches to bridge differences, particularly in the early years of the crisis. While both creditor and debtor country authorities felt that at times the IMF had pressured them too much, overall they viewed it as a trusted and independent arbiter. Staff from other international organizations were appreciative of the good collaboration with the IMF, noting that this had been better than in the pre-crisis period. One interviewee perceived that a new "humility" on the part of IMF staff had facilitated this improvement in collaboration.

D. Working with the EC and the ECB

23. As the euro area crisis erupted, the IMF was called upon to provide both policy and technical support and eventually to assist in providing financing to advanced economies in Europe.[8] The institutional arrangement that emerged involved a Troika including the EC, ECB, and IMF. This was a novel coordination arrangement in that the monetary authority of the member country in crisis was formally seated on the same side of the table as the IMF. Moreover, there was an understanding that disagreements would not be raised publicly. This arrangement raises questions as to whether it afforded greater traction of the IMF's policy advice, or whether it increased the pressure on the IMF to compromise its positions. Ultimately, such questions can only be answered by examining the context of individual country program negotiations—a task that goes beyond the scope of this evaluation.

24. Most authorities from G20 countries considered that the arrangement was a pragmatic and flexible response to a crisis that could have become systemic at a time of great fragility in the global economy. European authorities believed the IMF was well placed to put crisis-response programs together—a role for which the EC and the ECB lacked experience. Other authorities, however, thought it inappropriate, from a governance perspective, for the IMF to be seated at the negotiating table alongside the monetary authority of a member country. In their view, this implicitly took certain policy actions "off the table" and constituted bad governance. Some authorities also mentioned that this partnership could compromise IMF surveillance of the euro area, including on issues related to countries that did not need IMF financial support. Authorities from EMEs and many other countries asked whether the exceptional access that was provided in support of programs in the context of the Troika would be available in future crises and for member countries in other regions.

25. A full assessment of the effectiveness of the Troika arrangement is outside the scope of this study, but the arrangement has clearly raised concerns regarding the IMF's independence and the principle of uniform treatment of member countries.

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[8] By late 2008, the IMF had already supported Iceland with a Stand-By Arrangement (SBA), the first such financing arrangement for an advanced country in decades.

III. IMF SURVEILLANCE FOLLOWING THE CRISIS

26. This chapter assesses how effectively IMF surveillance responded to the macroeconomic and financial sector challenges in the crisis aftermath, and then examines the IMF's efforts to revamp its framework for assessing risks and vulnerabilities. It concludes that:

- The IMF was effective in calling for global fiscal stimulus immediately following the Lehman collapse. But it prematurely endorsed fiscal consolidation in large advanced economies, and, in parallel, encouraged reliance on expansionary monetary policy to stimulate demand. This policy mix was less than fully effective in promoting recovery and contributed to capital flow volatility in emerging markets.

- The IMF provided analyses of reform priorities in the financial sector and increased its focus on financial stability in economies with systemically important financial sectors by mandating FSSAs for them every five years. But five-year intervals are too long to ensure that the largest financial centers receive the requisite surveillance focus. Also, integrating macro with financial sector analysis remains a work in progress.

- The IMF dramatically expanded its framework for addressing risks and vulnerabilities, filling a number of gaps exposed by the crisis. Authorities who were interviewed for this evaluation appreciated the progress made but found it difficult to absorb the messages from these exercises, and they indicated that warnings on the euro area crisis and the volatility from quantitative easing (QE) and its tapering were not timely or delivered with clarity.

27. In 2012, the IMF adopted the Integrated Surveillance Decision (ISD), which clarifies the framework for surveillance, including the scope of risk and spillover analysis.[9] As the ISD only became effective in January 2013, it is too early for the IEO to evaluate its impact. The recent Triennial Surveillance Review (TSR) (IMF, 2014b) describes its initial implementation.

28. After the crisis the IMF undertook a series of institutional reforms in an effort to improve the quality and effectiveness of surveillance and to address its perceived weaknesses before the crisis. Among these reforms were efforts to encourage internal debates and greater teamwork across departments. There has been some progress in reducing the tendency for "silo behavior" and addressing difficulties staff had encountered in "connecting the dots" between related vulnerabilities identified in different contexts. IMF Management promoted a

[9] The ISD replaced the 2007 Surveillance Decision, which had proved difficult to implement and was perceived not to have provided an adequate framework to address post-crisis surveillance challenges.

number of processes and products aimed at better integrating multilateral with bilateral surveillance and macroeconomic with financial sector analysis, in line with the ISD. It also launched a series of new exercises to identify risks and vulnerabilities and launched spillover reports for five large systemic economies.

A. Assessing IMF Macroeconomic Advice in the Crisis Aftermath

29. The IMF was a leading spokesman for coordinated fiscal stimulus following the collapse of Lehman Brothers. Its own work on the topic over the course of 2008 positioned it to be a leading proponent of a global fiscal stimulus. The IMF explained that stimuli enacted by many countries simultaneously would limit leakages from the national standpoint, thereby countering potential protectionist pressures. By November 2008, it had proposed that countries with fiscal space should contribute to a discretionary fiscal stimulus of 2 percent of global GDP, in addition to allowing automatic stabilizers to operate. Fiscal stimulus was advocated not only for the countries at the center of the financial crisis but also for a much larger segment of the global economy, including euro area economies and EMEs. Authorities and other observers report that the IMF's call for a large and concerted fiscal stimulus at the G20 and through other multilateral and bilateral surveillance channels was influential.[10] The fiscal expansion that followed is widely acknowledged as having contributed to shortening and dampening the recession.

30. In 2010–11, IMF advice to major advanced economies shifted to favor fiscal consolidation. This advice arose from concern that large fiscal deficits and rising public debt were threatening fiscal solvency and exacerbating the risk of fiscal crises. Moreover, IMF projections as of late 2009 indicated that economic growth in advanced economies would turn positive in 2010 and strengthen in the medium term. Thus in 2010 the IMF endorsed the additional fiscal consolidation that the United Kingdom initiated in mid-2010, and the proposed fiscal tightening that the U.S. authorities targeted for FY2011. Also in 2010, the IMF recommended that each euro area economy engage in fiscal consolidation by 2011 at the latest, inter alia to enhance investor confidence. In particular, the IMF called on Germany to initiate fiscal consolidation by 2011 to set an example for the other economies in the euro area. Box 1 provides illustrative quotations from multilateral and bilateral surveillance and other papers that were discussed at the Executive Board. Figure 1 shows that the fiscal policy thrust in advanced economies became contractionary from 2011 onwards.

[10] The tone for the advice on fiscal stimulus was set by analysis such as the IMF Staff Position Note co-authored by the heads of the Research and Fiscal Affairs Departments (Spilimbergo and others, 2008). This argued the case for fiscal stimulus forcefully: "The optimal fiscal package should be timely, large, lasting, diversified, contingent, collective, and sustainable.…"

Box 1. Advice to Initiate Fiscal Consolidation Stemmed from Concerns About Fiscal Solvency and Fiscal Crises

Examples from multilateral surveillance:

"Hence, on balance, fiscal consolidation should take priority, all else given. Achieving fiscal sustainability will be a difficult and prolonged process, making it imperative for consolidation to begin as soon as there is clear evidence of self-sustaining recovery, whereas monetary policy being generally more nimble can respond more flexibly to evolving macroeconomic conditions. In particular, given a path for fiscal policies, monetary policy can be set to achieve a desired level of overall stimulus" ("Exiting from Crisis Intervention Policies," IMF, January 2010).

"… recent turbulence in financial markets—reflecting a drop in confidence about fiscal sustainability, policy responses and future growth prospects—has cast a cloud over the outlook. Crucially, fiscal sustainability issues in advanced economies came to the fore during May, fuelled by initial concerns over fiscal positions and competitiveness in Greece and other vulnerable euro area economies" (July 2010 *WEO* Update).

"The speed and severity with which financial pressures spread in the euro area should serve as a cautionary tale to Japan and the United States. … The credibility of Japan and the United States could suddenly weaken if sufficiently detailed and ambitious plans to reduce deficits and debts are not forthcoming" (Fall 2011 *Fiscal Monitor*).

Examples from bilateral surveillance in 2010:

"… given the risks posed by budgetary imbalances, the ground should be laid for fiscal consolidation, with a determined start made in 2011; meanwhile, monetary policy can maintain an accommodative stance to offset fiscal drag" (2010 U.S. Article IV).

"With record-high budget deficits, credible *fiscal tightening* is essential to preserve confidence in debt sustainability and regain fiscal space to cope with future shocks. To offset this contractionary impulse and keep inflation close to target over the policy horizon, a highly *accommodative monetary stance* remains appropriate, supporting private demand and net exports. … The consolidation plan … greatly reduces the risk of a costly loss of confidence in fiscal sustainability and will help rebalance the economy" (2010 U.K. Article IV Concluding Statement).

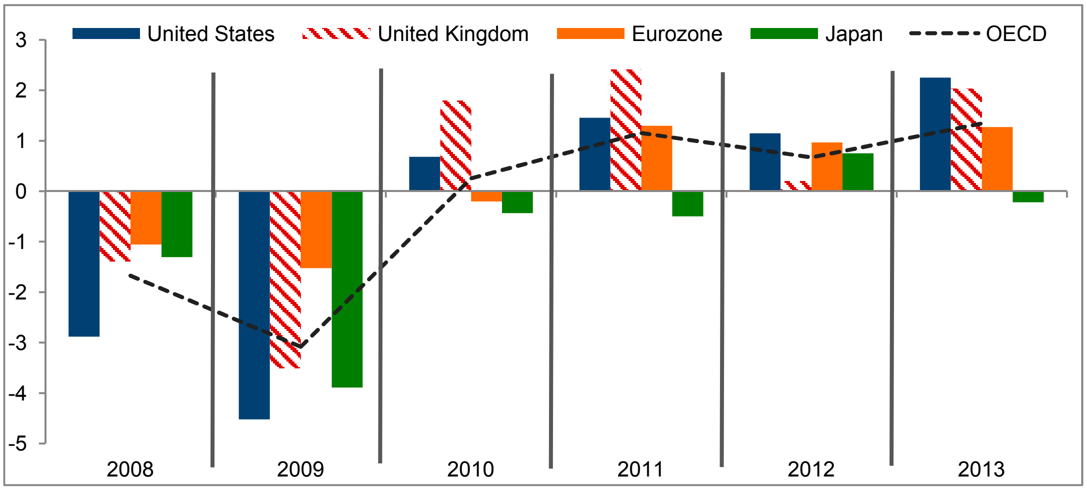
"Immediate action is needed to establish fiscal sustainability…. The aggregate fiscal stance of the euro area is correctly envisaged to be neutral in 2010, while consolidation will start everywhere at the latest in 2011" (2010 Euro Area Policies Article IV).

"The authorities are well aware that a successful fiscal exit will not only establish the credibility of the new national fiscal framework, it will also help anchor fiscal policy in the euro area … a failure to consolidate the public finances in Germany would damage the national and European fiscal frameworks" (2010 Germany Article IV).

31. In parallel, the IMF advocated the use of expansionary monetary policies including QE to counteract the fiscal drag resulting from fiscal consolidation and to sustain growth if needed. As economic growth in advanced economies consistently disappointed during 2011–13, the IMF recommended progressively easier monetary policies to stimulate demand. The dominant IMF view thus became that monetary policy should be the main driver for boosting aggregate demand given the assessment that the major advanced economies still needed further policy support. In 2012, the IMF began to reassess its views on fiscal policy and subsequently called for a more moderate pace of fiscal consolidation if feasible. This reflected both the weaker-than-anticipated recoveries in advanced economies and the results

of its own analysis, such as reported in the Fall 2012 *WEO*, which implied that fiscal consolidation would be more damaging to growth than had earlier been assumed.[11]

Figure 1. Fiscal Policy Thrust
(Percent of Potential GDP)[1]



Source: Davies (2012), estimated using IMF, *WEO* Spring 2014 database.

[1] Calculated as the change in cyclically adjusted general government balance as percent of potential GDP. OECD and euro area weighted by nominal GDP. OECD and euro area exclude Estonia.

Was IMF policy advice well founded?

32. The IMF's call for fiscal expansion and accommodative monetary policies in 2008–09, particularly for large advanced economies and others that had the fiscal space, was appropriate and timely. The support for ultra-expansionary monetary policies in advanced economies in 2010 and beyond was also appropriate, given those countries' contractionary fiscal policies—even if, as mentioned below, greater attention could have been paid to adverse spillovers. Moreover, as time progressed the IMF called for a more moderate pace of fiscal consolidation and showed greater understanding for the use of capital flow management measures taken by EMEs to counter the effects of spillovers. Other aspects of its advice were less appropriate, certainly with the benefit of hindsight.

33. IMF advocacy of fiscal consolidation proved to be premature for major advanced economies, as growth projections turned out to be optimistic. Moreover, the policy mix of fiscal consolidation coupled with monetary expansion that the IMF advocated for advanced economies since 2010 appears to be at odds with longstanding assessments of the relative effectiveness of these policies in the conditions prevailing after a financial crisis characterized by private debt overhang. In particular, efforts by the private sector to

[11] The Fall 2012 *WEO* found that the IMF had significantly underestimated fiscal multipliers in the early years of the crisis.

deleverage rendered credit demand less sensitive to expansionary monetary policy, irrespective of its ability to maintain low interest rates or raise asset prices. Meanwhile, a large body of analysis, including from the IMF itself, indicated that fiscal multipliers would be elevated following the crisis, pointing to the enhanced power relative to the pre-crisis environment of expansionary fiscal policy to stimulate demand.

34. Many analysts and policymakers have argued that expansionary monetary and fiscal policies working together would have been a more effective way to stimulate demand and reduce unemployment—which in turn could have reduced adverse spillovers.[12] Waiting longer to shift to fiscal consolidation might also have allowed for less aggressive monetary expansion, with less negative side effects.

35. The IMF advice was influenced by the assessment of risks associated with different policies as well as by the evolving euro area crisis. For example, the IMF's concern about fiscal crises extended to countries such as the United States and Japan, even as these countries' bond yields were falling to historic lows. In articulating its concerns, the IMF was influenced by the fiscal crises in the euro area periphery economies (see Box 1), although their experiences were of limited relevance given their inability to conduct independent monetary policy or borrow in their own currencies.[13] Moreover, the IMF's debt sustainability analysis did not acknowledge the likelihood that elevated fiscal multipliers in the conditions prevailing after the crisis would render fiscal policy a more powerful tool for reactivating the economy.[14] Nor did the IMF's recommendation to consolidate fiscal policy and use monetary policy to stimulate demand give enough weight to the prolonged deleveraging that typically occurs as private sector balance sheets are repaired following a financial crisis.[15]

36. The risks of ultra-expansionary monetary policy, including unconventional monetary policy (UMP), were not comprehensively discussed until 2013; and it was judged that UMP

[12] For example, Bernanke (2013) emphasized that monetary policy could not fully offset the fiscal contraction in the United States. Draghi (2014) noted that "since 2010 the euro area has suffered from fiscal policy being less available and effective, especially compared with other large advanced economies. … Thus, it would be helpful for the overall stance of policy if fiscal policy could play a greater role alongside monetary policy...." Ball, DeLong, and Summers (2014) indicated that fiscal expansion would reduce the need for extraordinary monetary policies that potentially create instability. Turner (2013) noted the possibility that fiscal and monetary cooperation to reactivate the economy could be more effective than the policies utilized, while reducing adverse spillovers.

[13] Krugman's (2013) Mundell-Fleming lecture at the IMF elaborates on the misdiagnosis of fiscal crisis concerns following the financial and euro area crises.

[14] A number of economists have suggested that under the post-financial crisis conditions that prevailed, fiscal expansion would have been beneficial to fiscal sustainability (For example, DeLong and Summers, 2012).

[15] The length of private deleveraging cycles tends to be proportional to the size of the private debt overhang that constrains spending in the crisis aftermath (Reinhart and Rogoff, 2008; Koo, 2008). Koo (2013) reports that it took until 2005 for Japan's private balance sheets to be repaired following its crisis in 1990.

ought to remain in place because demand stimulus was still needed and the risks could be managed relatively easily. The attention to spillover risks from QE was not commensurate with the disruptions EMEs had witnessed since the crisis. The IMF's 2011 and 2012 spillover reports downplayed the adverse impact of QE on emerging markets, in terms of financial market and exchange rate volatility.

37. In 2013, the IMF did point to the growing tension between accommodative monetary policies and risks to financial stability from credit markets that were maturing more quickly than in typical cycles (Spring 2013, *GFSR*), as well as to the risks that emerging markets might face from destabilizing capital flows (IMF, 2013a). The risks notwithstanding, these reports concluded that monetary policy should remain accommodative to meet advanced economy macroeconomic goals. By September 2013, IMF (2013b) highlighted to a greater extent the adverse spillovers to the rest of the world from the prospective exit from UMP, but by this time EMEs had already experienced substantial volatility in their foreign exchange markets from the prospect of tapering in the United States.

Insufficient tailoring of advice

38. A critique heard from authorities, in several countries is that the IMF did not sufficiently tailor its macroeconomic advice to fit individual country circumstances. Most IMF reports and speeches indicating the need for stimulus added the proviso that this should be subject to available fiscal space. In practice, however, the IMF on occasion used the goal of a 2 percent of GDP global fiscal stimulus as a common benchmark for advanced as well as emerging economies (e.g., IMF, 2009d)—even though many EMEs faced financing and other constraints that made large fiscal expansions risky.[16] Country authorities have indicated that in the months following the Lehman collapse, the messages from IMF Management strongly favored fiscal expansion, sometimes in contrast to advice from bilateral surveillance.

39. Article IV reports for large EMEs provided a more balanced discussion that acknowledged the risks of fiscal or credit expansion. They tended to support the stimulus programs that had already been undertaken following the Lehman collapse, while highlighting the risks of ongoing fiscal or credit expansions, and several of them appropriately urged an exit from such expansion. In some cases, these expansions, accompanied by looser credit standards, led to overheating. The expansion of public and private debt in some EMEs rendered them more vulnerable to capital flow volatility even as such volatility was rising.

40. Finally, greater differentiation could have been exercised in recommending fiscal stimulus during 2008–09 to euro area economies taking into account their different fiscal and

[16] Indeed some, including some G20 members, faced circumstances (such as high fiscal and current account deficits, high inflation, and rising sovereign borrowing costs) that made any significant stimulus risky.

current account positions. This differentiation was particularly important in light of the constraints to pursuing countercyclical polices imposed by the architecture of the currency union, which could not be changed at that time. Without such changes, however, the onus of contributing to the global stimulus should have been placed on the most creditworthy economies in the currency union.[17]

B. Financial Sector Surveillance Following the Crisis

41. In the crisis aftermath, the IMF was given a bigger role in financial sector surveillance. The IMF's main vehicle for multilateral financial surveillance, the *Global Financial Stability Report (GFSR),* reflected the IMF's evolving views on lessons from the crisis and recommended policies to boost financial resiliency. The *GFSR* has become "a basic reference point on financial sector issues" according to one prominent interviewed official. In addition, the IMF membership agreed to make the FSSA component of the FSAP mandatory for the 25 (subsequently 29) most systemically important financial centers. Finally, the G20 called on the IMF to collaborate with other international organizations, regulatory bodies, and standard-setting agencies to develop recommendations to strengthen supervisory, regulatory, and macro-prudential frameworks—inter alia by becoming a full member of the FSB. These three interrelated aspects of the IMF's financial sector surveillance are discussed below.

Financial sector analysis in the *GFSR* and other IMF documents

42. Before the crisis, the IMF was largely of the mindset that minimal regulation and light-touch supervision would suffice to bring about financial stability, since financial markets were self-stabilizing. IMF documents showed a tendency to applaud financial innovations that increasingly relied on structured instruments, such as collateralized debt obligations used in mortgage-backed securities, which contributed to higher leverage in financial institutions.

43. Staff views evolved with the crisis. A number of Board papers between early 2008 and early 2009 crystallized staff thinking on the causes of the crisis and on lessons for financial regulation and the global architecture needed for financial stability (IMF, 2008; IMF, 2009a; IMF, 2009b; IMF, 2009c). As the crisis unfolded, the IMF began to warn that growing weaknesses in major financial institutions posed a serious risk to global financial stability, and to recognize the need for quick action to address these institutions' deteriorating solvency. The IMF estimated the cost of the banking crisis and highlighted the urgency of

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[17] IMF staff members indicated that the need for reforms to the currency union was conveyed in informal discussions with euro area authorities. More recently, IMF staff, Allard and others (2013), discussed issues relating to the architecture of the currency union.

bank recapitalization, raising these issues before many country authorities had acknowledged the scope of the losses and the fragility of their financial sectors.

44. In diagnosing the causes of the crisis, the IMF emphasized market failures, insufficient regulatory and supervisory resources and powers, and deficiencies in the coordination of policies across countries. The IMF consequently recommended a reform agenda involving greater transparency and information disclosure to address market failures; expansion of the regulatory and supervisory perimeter together with empowerment of supervisory and regulatory agencies through strengthening their capacity, mandate, and authority; and greater international collaboration and coordination in the regulation and supervision of interconnected financial institutions.

45. Beyond these core strategies, the IMF provided detailed assessments of an extensive array of relevant regulatory and supervisory concerns. It advocated making financial institutions more transparent, less complex and less leveraged—a turnaround from its pre-crisis views (IEO, 2011). Thus the IMF supported proposed reforms to enhance capital and liquidity buffers, strengthen oversight over shadow banking, limit systemic risks from the use of over-the-counter derivatives, and strengthen the means to resolve systemically important financial institutions. On several occasions, the IMF criticized the pace of implementation of the financial sector reform agenda and highlighted the nature of prevailing risks. Finally, the IMF engaged in research and policy work on macro-financial linkages and the potential for macro-prudential policies and tools to contribute to financial stability. Nevertheless, more effort is needed to operationalize these efforts by better integrating the analysis and messages of the *WEO* and the *GFSR* and in the bilateral context (see below).

46. The move in these directions was gradual, and in some areas further analysis and a possible rethinking of positions may be needed. During 2008–09, the IMF seemed timid in its analysis and critique of elements of Basel II. Its analysis, particularly during this period, underplayed the role of governance weaknesses in regulatory agencies, which in some countries had led to lax enforcement even when regulators had the authority to act. As important, the IMF's analysis did not give sufficient weight to how regulatory and supervisory deficiencies had shaped the incentives and actions of decision makers within financial institutions prior to the crisis. Its analysis and advice along these dimensions improved over time, but even in the later period it did not focus enough on the governance of supervisory and regulatory agencies. This is particularly important given the emphasis on granting these agencies greater authority.

Mandatory financial stability assessments

47. The FSAP program was launched after the East Asian crisis to assist member countries identify weaknesses in their financial sectors and to provide recommendations on how to

address them.[18] The IMF is principally responsible for the assessment of financial stability issues, which is presented in the FSSA report that is discussed by the IMF Board alongside the country's regular Article IV consultation report. The Article IV report is expected to integrate the FSSA findings and recommendations into the macroeconomic framework.

48. In September 2010, the Board made FSSAs a mandatory part of the IMF's bilateral surveillance for the world's top 25 systemic financial centers every five years (see IMF, 2010).[19] By mid-2014, 24 of the original 25 jurisdictions had undergone financial stability assessments under the FSAP. A review of a sample of FSSAs that was conducted for this evaluation indicates that these assessments can be a useful tool for assessing risks to financial and macroeconomic stability. It found that the recommendations in the FSSAs were reflected in the corresponding Article IV reports, and that subsequent Article IV consultations followed up on the issues raised in the FSSAs.[20] The review found, however, that there is still room for improvement in how the staff integrates its financial sector and macroeconomic analysis.[21] This finding is consistent with a June 2014 report of an IMF staff working group, which noted that the range and analytical quality of financial sector issues covered in Article IVs varies widely, and that they are often treated as add-ons. Also, the recent FSAP review (IMF, 2014d) noted that the evaluation of financial sector oversight and supervisory effectiveness in FSAPs is often driven by identified gaps in formal compliance with established international standards rather than by the impact of these gaps on systemic risk.

49. More than any other instrument available to the IMF, FSSAs have the potential to detect emerging financial risks in time to act upon them. But recent experience with financial sector developments raises the question of whether with their current frequency, FSSAs are adequately placed to detect and warn about emerging vulnerabilities in time to act upon them. The IMF Board has discussed a staff proposal to conduct mandatory FSSAs every three years, but consensus could not be reached.[22] IMF staff notes that under the current resource envelope and allocation mechanism, some (non-systemic) countries may have to wait more than a

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[18] The FSAP was established as a voluntary program conducted in partnership with the World Bank. The World Bank is responsible for the diagnosis of developmental institutional issues, which is conducted mainly for emerging markets and low-income countries (LICs). The assessments are conducted by large teams of international experts and take a significant amount of time.

[19] In 2013, Denmark, Finland, Norway, and Poland were added to the list of countries for which FSSAs are mandatory.

[20] Seven FSSAs were reviewed: for Brazil, China, France, India, Italy, Switzerland, and the United States.

[21] Another challenge that requires continuous attention is to enhance candor in FSSAs for systemic financial centers; this is complicated by concerns about the possible systemic consequences of negative findings.

[22] IEO (2011) recommended that the five-year interval for mandatory FSSAs be reconsidered once sufficient information became available on how rapidly the assessments become outdated. The IEO emphasized the need to prioritize the country coverage and periodicity of FSSAs according to risks and systemic importance.

decade between FSAPs (IMF, 2014d). To address such concerns, the June 2014 IMF staff working group report recommended strengthening the capacity of area departments to conduct financial sector surveillance.[23] Such mainstreaming of financial surveillance into the regular Article IV surveillance would increase country coverage and still provide sufficient depth for most countries. But this is a process that would take many years, and only experience will tell whether it will be effective.

50. The critical concern from a global perspective is for the IMF to be able to detect emerging vulnerabilities and risks to financial stability in the systemic financial centers. The experience over the past few years indicates that these vulnerabilities and risks can emerge in a period much shorter than five years. This view is shared by IMF staff who have indicated that FSSAs conducted every five years are too infrequent to provide continuous surveillance of financial developments and macro-financial linkages. Mainstreaming of financial stability surveillance to area departments—in particular, to undertake assessments with the requisite depth needed in economies with systemic financial centers—is not a feasible objective in the short term. Nonetheless, it would not be prudent to delay strengthening surveillance in these countries. A simple perusal of the list of 29 countries raises the question of whether the program of mandatory FSSAs is appropriately targeted. From a global stability perspective, a strong case can therefore be made to increase the frequency of FSSAs for the few countries with truly systemic financial sectors.

51. The IMF has one of the largest combinations of talented macroeconomists and financial economists of any institution. In addition, the Monetary and Capital Markets Department (MCM) has assembled a large group of financial sector experts who have specialized experience in financial supervision and regulation. The IMF thus appears uniquely placed to combine these skill sets to produce more integrated macro-financial analyses. Since 2009, the IMF has significantly increased its efforts in this direction. Focusing these efforts initially on countries with systemically important financial centers appears appropriate and, if successful, could be expanded to other countries. It would also further enhance the quality of *GFSRs.*

Interacting with the Financial Stability Board

52. Chapter II discussed issues of coordination between the IMF and the FSB. It pointed out that staff from both organizations were satisfied with the interaction, but that it was important for the IMF to clarify responsibilities and accountabilities to ensure its independence. Also, concerns have been voiced that the two organizations were working in parallel rather than in an integrated manner. To mitigate both these concerns, the IMF should

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[23] The working group proposed that the principal responsibility for financial surveillance and macro-financial work at the country level rest with area departments, which would therefore need to build a critical mass of macro-financial economists by training, hiring, and transferring relevant staff from other departments.

continue to build up its own capacity to assess risks and vulnerabilities in the financial sector as part of its work on FSSAs, Article IV consultations, and *GFSRs*. This would allow the IMF to develop methodologies that it could bring to bear in cooperating with the FSB, and would also allow for independent views on financial sector issues.

C. Revamping the Approach to Assessing Risks and Vulnerabilities

53. Following the crisis, the IMF greatly expanded its framework to detect and warn about risks and vulnerabilities. The reforms included the establishment of an interdepartmental Risk Working Group to coordinate the IMF's work on risks; the introduction of the EWE to identify tail risks and "connect the dots" between different risks and vulnerabilities; vulnerability exercises for advanced countries and for LICs to complement the vulnerability exercise for emerging markets that was in place before the crisis; spillover reports to assess the impact of outward spillovers from systemic countries; the *Fiscal Monitor*—a third IMF flagship report that assesses fiscal sustainability issues; a Pilot External Sector Report, which extends and deepens the earlier Consultative Group on Exchange Rates exercise; and a Tail Risk Group, composed of economists not involved in the regular risk exercises, that looks for tail risks from a fresh perspective.

IMF risk management framework

54. As illustrated in Figure 2, the current system for addressing risks and vulnerabilities has three basic layers:

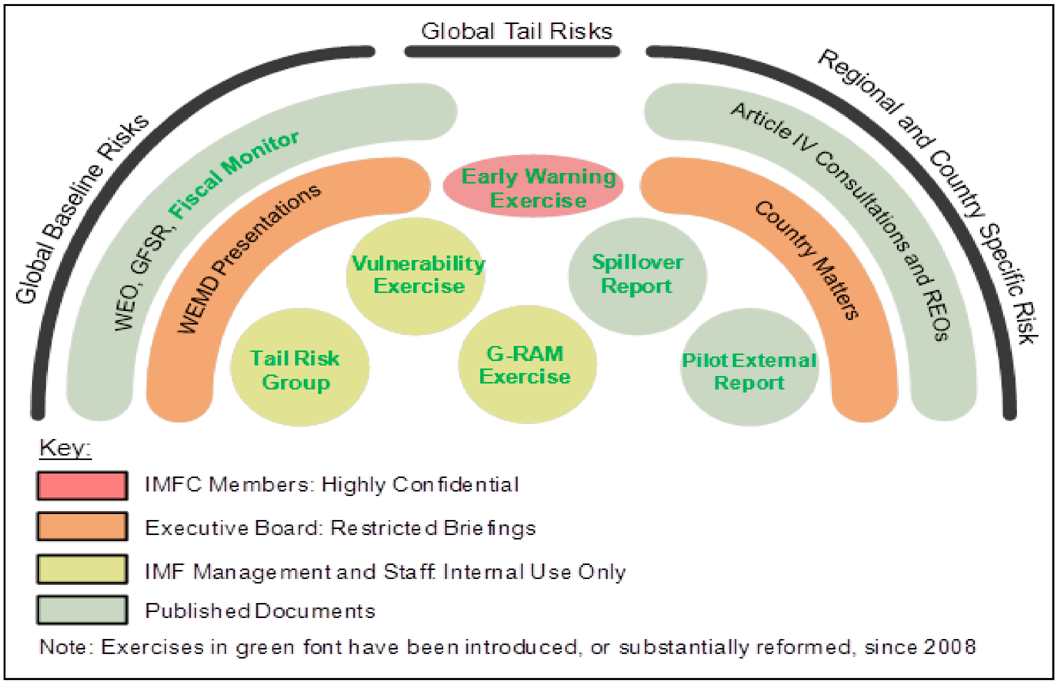
- Published outputs—the multilateral flagships, *Regional Economic Outlooks*, G20 papers, and the Article IV consultations, which cover baseline risks.

- Confidential outputs—the EWE, whose findings are presented to senior policymakers at the IMFC; and the World Economic Markets Development and Country Matters briefings presented to the Executive Board, which are intended to cover the full gamut of baseline and tail risks.

- Analytical inputs to this work, which include the vulnerability exercises, the Global Risk Assessment Matrix, and the conclusions of the Tail Risk Group (which are restricted to Management and staff), and the spillover reports and the Pilot External Sector Report (which are published).[24]

[24] The objectives of the spillover and pilot external sector reports in particular go well beyond providing inputs to risk assessment.

Figure 2. IMF Exercises to Address Risks and Vulnerabilities



55. Although the risk assessment framework now fills gaps exposed by the crisis, it has become very complex, involving nine different exercises managed in five separate departments.[25] The volume of analysis is very difficult to absorb, both for policymakers and for IMF staff. Substantial efforts and transaction costs are incurred to ensure consistency, which is not always achieved (Box 2). Moreover, staff do not appear to look back to assess whether risks did or did not materialize, and draw relevant lessons. Finally, the approach and methodologies used by the IMF are considered opaque by many country authorities, diminishing their policy traction.

56. A number of interviewed authorities expressed appreciation of the IMF's efforts to revamp its risk assessment capabilities, but considered that the discussion of the two systemic problems that manifested in the post-Lehman period—the crisis in the euro area and the destabilizing capital flows that followed the announcement of prospective QE tapering in May 2013—was not conducted in a timely manner. Moreover, some officials considered that the IMF was still too hesitant to highlight risks with sufficient urgency if this entailed criticizing the policies of influential members.

[25] While some of the new products do not focus solely on risks, the External Advisory Group to the 2014 TSR indicated: "The Fund is trying to do too much. By trying to spot every risk 'under the sun,' it is in danger of missing the big risks" (IMF, 2014c).

Box 2. Varying Messages in IMF Discussion of Unconventional Monetary Policy and Tapering

In early 2013, the Early Warning Group began to focus on the potential for volatility in the event of a prospective U.S. exit from UMP.[1] Its work touched off internal debate between those who believed that U.S. monetary tightening in response to higher U.S. demand growth was likely to have positive spillovers and those who saw a risk of a disorderly reaction in financial markets, accompanied by interest rate overshooting. In the event, the *WEO, GFSR*, Global Policy Agenda (GPA), and EWE presented the following messages at the Spring 2013 IMFC meeting:

- The *WEO* noted that while the Federal Reserve might have to raise interest rates earlier than planned, prompting capital outflows from EMEs, in this event any commensurate increase in emerging market risk spreads was likely to be limited and temporary, and the overall impact would be positive.
- The *GFSR* observed that the potential for capital flows to persist or accelerate, partly driven by low interest rates and higher risk appetite in advanced countries, would increase financial stability risks; and that emerging markets could prove vulnerable to an eventual rise in global interest rates amid rising uncertainty.
- The GPA noted that concerns were rising about the spillovers from loose and unconventional monetary policy and that many EMEs were concerned about the possible blow to output and the financial system if large inflows of capital were rapidly reversed.
- The EWE noted that while a U.S. recovery was good for the global economy, countries should be prepared for volatility resulting from a U.S. monetary policy exit. It considered the implications of a scenario of a sharper than expected rise in U.S. long-term interest rates for emerging markets, and how that might interact with emerging market vulnerabilities, and made specific recommendations on policy measures to reduce risks.

Source: Robinson (2014).
[1] This risk was also flagged by the Tail Risk Group in February 2013, although only as one of nineteen potential tail risks.

57. Authorities from across the membership believe that for this important work to be helpful, staff would need to produce a short integrated summary of the IMF's views on the global outlook, risks, and vulnerabilities, and the measures needed to address them, as background for each IMFC meeting. This summary should be concise and written with high level officials as its target audience. In parallel, to address concerns about opacity, the IMF should periodically produce a note describing the main risk-related exercises and their methodologies. This methodological note could be more technical and would aim at officials involved in similar activities in ministries and central banks. It would help improve the transparency and credibility of the IMF's work and would provide opportunities for internal and external feedback on the system as it evolves.

Options for simplification and strengthening

58. Various options have been put forward by external contributors to the 2014 TSR and in Robinson (2014) to simplify the risk management framework.[26] In parallel, given the rapid

[26] The 2014 TSR recognizes the need to further improve the IMF's risk and vulnerability framework. However, it emphasizes the need to intensify the ongoing effort by bridging remaining gaps including by adding additional reports and quantification. This report, on the other hand, gives greater emphasis to: streamlining,

(continued)

expansion of departmentally-based exercises, more effort is needed to ensure the IMF can develop a consistent and integrated assessment of global risks. Such integration would benefit from incorporating perspectives from outside the IMF.[27]

59. The EWE is among the most important of the innovations introduced after the crisis, and was generally praised by those authorities who attended EWE presentations alongside the IMFC meetings. That said, there is room to improve its impact in a number of areas. Most senior policymakers interviewed were unaware of the main messages from the EWE, due to the restricted attendance and limited debriefing by the participants, and they were not able to find many concrete examples of follow-up in their organizations. In practice, the IMF and the FSB have worked in parallel on their presentations. This runs counter to the goal of ensuring that the interaction between macro-financial and regulatory issues is appropriately covered.

60. The EWE thus needs to be revamped to make it more useful and user-friendly: it should foster greater debate and input by authorities, and outreach on its results should aim at authorities in at least a significant majority of member countries. One way to address these objectives would be for IMF Management to brief the Board after each EWE session on the main messages from the discussions, and on necessary follow-up by the IMF and by members themselves.[28] This would enable Executive Directors to share these key messages from the EWE with a wider group of senior policymakers. In addition, the IMF in collaboration with the FSB should explore ways to better integrate their analyses, even if they continue to have two separate presentations.

61. The effectiveness of any risk assessment system depends critically on staff's willingness to raise alternative and contrarian views and on effective cooperation across units to be able to "connect the dots." Senior IMF staff interviewed for this evaluation believed that the IMF had become more open to discussing risks and that interdepartmental meetings and task forces had helped break silos, encouraged team work, and provided fora for vigorous debate. Nevertheless, the IMF has continued to encounter difficulties in integrating messages from the flagship reports and risk assessments prepared by its different departments.[29] Moreover, the 2013 Staff Survey suggests that A-level staff members (who

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consolidation and simplification of the Fund's risk management framework; enhancing communication of EWE findings to policymakers; and improving the transparency of the Fund's work.

[27] IEO (2011) had recommended the establishment of a small risk unit, reporting directly to Management and staffed in part by external analysts, that would serve to identify emerging risks and to protect the IMF from the tendencies of insularity and groupthink that affect large bureaucracies. The existing RWG has a different role, which is to coordinate views across departments.

[28] The Executive Board is already being briefed on the preliminary findings of the EWE prior to the IMFC presentation. The brief following the EWE session would focus on the discussions and on follow-up actions.

[29] Box 2 illustrates the difficulties of integrating the work of different departments with a case study on how publications from different departments assessed the risks associated with the prospective tapering of QE.

constitute most of the IMF's staff) still feel constrained in speaking their minds.[30] These factors suggest that further progress in these areas is still needed.

IV. STRENGTHENING THE GLOBAL FINANCIAL SAFETY NET

62. This chapter discusses the actions taken by the IMF to contribute to strengthening the global financial safety net in response to the crisis. First, it examines the IMF's resource mobilization efforts, then the reforms of lending instruments, and finally the design and implementation of IMF-supported programs.

63. The chapter concludes that the IMF's efforts in this area were largely successful. Although the IMF was not well positioned in advance to respond to a crisis of this magnitude, it responded quickly. It quadrupled its resources and lent almost US$400 billion to 38 countries to help them deal with the crisis; it also raised additional concessional resources, facilitating an almost doubling of lending to LICs. It modified its lending instruments to make them better suited to the circumstances—speeding up negotiations, loosening access limits, increasing frontloading, and streamlining conditionality. It launched precautionary instruments, although their design still needs fine-tuning to address limited demand and concerns on exit. The current credit capacity at 1 trillion dollars seems appropriate, but with an agreed increase in IMF quotas still pending, the size and modalities of the IMF's financial resources remain an issue going forward.[31]

A. Resource Mobilization: Strategy and Results

64. In September 2008, IMF credit capacity stood at about US$250 billion, of which US$210 billion were in quotas and the rest in two standing arrangements, the General Arrangements to Borrow (GAB) and the New Arrangements to Borrow (NAB), through which the IMF could borrow from certain member countries in case of extraordinary needs.

65. The IMF and its members had twice assessed the adequacy of IMF quotas since they were last increased in 1998, but those discussions took place at the time of the "Great Moderation," when country authorities and to a significant degree IMF Management and staff deemed it unlikely that substantial IMF lending would be needed.[32] Further, in the years

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[30] In this regard, the Fund's survey results compared unfavorably with those of comparator organizations.

[31] Credit capacity measures the maximum total lending commitments the IMF could undertake from quota and borrowed resources, minus a prudential balance. The IMF's capacity to make new lending commitments is calculated by subtracting existing commitments from this total credit capacity.

[32] For instance, Mervyn King, Governor of the Bank of England, argued in a 2006 speech on IMF reform that "from time to time, there may well be financial crises when it would be appropriate for the international community to provide temporary financial assistance. … But [it] has not been the role for the IMF vis-a-vis any developed economy for many years. Moreover, nor is it likely to be true of many important emerging market economies in the future" (King, 2006).

leading up to the crisis, IMF liquidity was high, because few members had sought financial support. As a result, there was no strong push from IMF Management or consensus within the membership for a general increase in quotas at either the 2003 or 2008 reviews.[33]

66. With the crisis escalating, policymakers turned their attention to increasing the IMF's resources, as concern grew about their adequacy.[34] In April 2009, the IMFC endorsed a multi-pronged strategy that had been articulated earlier that month by the G20 Leaders. This strategy consisted of borrowing from member countries (partly as a bridge to a quota increase), and accelerating the 14th General Review of Quotas for completion by January 2011. To boost global reserves the IMFC agreed on an issuance of new SDRs. The IMF also sought to double the concessional resources available for LICs.

67. The IMF thus dramatically increased its financial firepower to more than US$1 trillion by end-2012. The resource mobilization effort allowed the IMF to respond to member country requests for financial support, and authorities interviewed for this evaluation were satisfied overall with the results of this effort.

68. However, the resource increase has, thus far, come solely from three waves of borrowing. First, a series of bilateral borrowing agreements with individual member countries almost doubled the IMF's credit capacity to US$460 billion by March 2010. Second, in March 2011, an expanded US$580 billion NAB took effect, raising credit capacity to more than US$725 billion.[35] Finally, in late 2013, a new round of bilateral borrowing provided potential additional resources of more than US$400 billion. A doubling of IMF quotas and associated governance reforms was agreed in December 2010. These have not taken effect because the United States has not ratified all the necessary agreements.

69. The first wave of borrowing arrived only "just in time" to ensure that the IMF was not liquidity-constrained in responding to program requests. A number of the interviewed authorities pointed out that an important contribution of the IMF to global financial stability

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[33] An ad hoc increase in quotas took place, along with related governance reforms, in 2006. Another ad hoc increase had been agreed in 2008 but remained pending.

[34] For example, a *Financial Times* headline in late October 2008 stated that "IMF firepower could soon fall short" and another one in early 2009 conveyed escalating concerns that "IMF resources are far from sufficient." Moreover, it was clear that the IMF could not serve as liquidity insurance for EMEs that were asked to undertake fiscal expansion. For instance, in February 2009, Martin Wolf (in the *Financial Times*) argued that "the resources available to the IMF, even with their hoped-for doubling, are too small to give most emerging economies the confidence they need to risk keeping their spending up."

[35] The expanded NAB (which includes new participants such as Brazil, China, India, Mexico, and Russia) is more flexible in that it is easier to add new participants and increase contributions. Also, it is activated for six-month periods, rather than for specific programs. On the other hand, activation now requires a higher super-majority of 85 percent, but this has been achieved every six months since April 1, 2011. Also, commitments to the NAB still need to be renewed every five years.

is the confidence it gives to financial markets that resources are available *in advance* to deal with crises. In the early months of the crisis, the IMF could not play this role of calming the markets.

70. Because the agreed quota increase has not yet taken effect, the IMF remains reliant on borrowing for 70 percent of its credit capacity, and access to more than half of the IMF's credit capacity is controlled by a super-majority of creditors. Agreement on the resource mobilization strategy, and success in securing borrowed resources, hinged importantly on the understanding that borrowing would not substitute for a quota increase. This principle underlies the statement by the IMFC, in its initial endorsement of the strategy, that "while an expanded NAB is an important backstop for IMF resources, we recognize that it is not a substitute for a quota increase" (IMF, 2009e). Some of the authorities interviewed for this evaluation were also concerned about the risks involved in the need to renew and reactivate the NAB and to extend the bilateral borrowing agreements.

71. The prolonged reliance on borrowing undermines the IMF's functioning as a universal cooperative that is governed by all members through a system of weighted voting. The quota increase, although it would bring only a small additional increase in credit capacity, would have important implications for IMF governance.[36] In addition to restoring the primary reliance on quotas, the 2010 quota reform would bring a shift in shares and chairs from advanced economies to faster growing emerging markets. Although the shift would still leave EMEs under-represented relative to their shares in the global economy, the 2010 reform has been seen as an important step to enhancing the legitimacy of IMF governance.

72. In addition to dramatically increasing resources for its general lending, the IMF nearly doubled its concessional lending capacity by raising additional loan and subsidy resources. Also, in 2012, the IMF put in place a strategy for a self-sustaining framework for concessional lending with an annual capacity of about SDR 1.25 billion going forward.

73. Another important contribution to global liquidity was the increase in global SDR holdings by the equivalent of US$250 billion in August 2009.[37] The new allocation expanded global SDR holdings tenfold, with nearly US$100 billion going to EMEs and developing countries. This represented a significant increase in their reserves; and more broadly, it boosted global liquidity and arguably contributed to market confidence.

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[36] A number of member countries would roll back a substantial part of their increased NAB contributions, once the quota increase becomes effective.

[37] At the same time, the IMF also completed a long-pending special SDR allocation equivalent to US$33.5 billion for 41 members that had joined the Fund since the last allocation in 1979.

B. Updating the Lending Toolkit

74. When the crisis struck, the IMF was already in the midst of reconsidering its lending facilities. With virtually no demand for non-concessional lending, many felt that the existing IMF lending instruments did not match member needs. The potential for an IMF crisis-prevention instrument had been much discussed, but no consensus had been reached about design and terms. Further, countries considered that approaching the IMF for support entailed stigma and were accumulating large precautionary reserves as self-insurance or were pursuing alternatives such as reserve pooling arrangements.

75. The crisis intensified the discussion of the IMF's lending toolkit, resulting in decisions in March 2009 to recast the terms of existing lending instruments and introduce new instruments for precautionary lending. The reforms included:

- A doubling of the limits on the level of resources normally available under non-concessional programs; greater front-loading of resources at the start of a program; and a rationalized structure for charges, maturities, and fees.

- Streamlined conditionality, including by eliminating structural performance criteria, and recommitting to greater parsimony and criticality in conditionality.

- Two new precautionary instruments to make resources rapidly available with high or no access limits: the FCL and the Precautionary and Liquidity Line (PLL).[38] These instruments require pre-qualification based on strong policies; the FCL has a higher qualification bar and no ex post conditionality for drawing the resources.

- In July 2009, the IMF established the Poverty Reduction and Growth Trust (PRGT) which has three concessional lending windows, to better address the needs of LICs. It also doubled access limits and temporarily set a zero percent interest on concessional credits, which has been extended and continues through end-2014.

76. Three FCL arrangements were approved shortly after the creation of this new instrument—for Mexico (SDR 31.5 billion), Poland (SDR 13.7 billion), and Colombia (SDR 7 billion). Three successor arrangements have been approved for each country, with their terms extended to two years.[39] As intended at the time they were approved, countries have not drawn on these FCLs.

[38] To date, only Morocco has used the PLL. Prior to this, the Precautionary Credit Line, a short-lived predecessor of the PLL, had been used only by Macedonia.

[39] The arrangements for Mexico and Poland were augmented and currently stand at SDR 47 billion and SDR 22 billion, respectively, while the Colombian arrangement was scaled down and is now at SDR 3.9 billion.

77. Authorities in countries with FCL arrangements believe that the FCL played an important role in calming markets and continues to be a useful tool in maintaining confidence in a time of uncertainty in the global economy. They praised the FCL as having served as a signal of support for their macroeconomic policies and a "seal of approval" that has helped promote market confidence.

78. However, no additional FCL arrangements have been approved, even in the face of waves of global market stress in the five years since its creation. Some authorities interviewed for this evaluation argued that the FCL's strict qualification criteria may preclude many countries from accessing it, but surveys conducted by the IMF indicate that a preference for self-insurance, access to alternative financing, and stigma were key factors inhibiting FCL use.[40]

79. None of the FCL users has yet exited the instrument. Authorities in these countries believed that the FCLs should remain in place until the IMF unequivocally communicates that global risks have subsided. A number of other authorities indicated a concern that continued use of the FCL ties up IMF resources for an extended period. In any case, there is widespread understanding that pushing users to exit could create signaling problems and undermine the confidence-building objective of the instrument. These issues suggest a need for further experimentation and innovation in precautionary lending instruments.

80. Overall, the reforms of lending instruments addressed many of the concerns of member countries about the lending toolkit, and helped make IMF lending more helpful in coping with the crisis.

C. Extending Financial Support to Member Countries[41]

81. Member countries hit by the crisis began turning to the IMF for financing support immediately in September 2008. The primary tool of support was the SBA: the IMF approved 17 SBAs for more than SDR 50 billion in the first year of the crisis and an additional 20 SBAs for SDR 50 billion between September 2009 and the end of 2013 (eight countries were supported by more than one SBA). The IMF has also deployed the EFF several times since 2008, increasing the use of this instrument over time. In addition, it moved quickly to launch the FCL, rapidly approving the first three arrangements under this new instrument, which together initially totaled SDR 52 billion, and rose to SDR 76 billion.

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[40] On the supply side, FCL arrangements require the Fund to set aside the full amount of resources committed, so the capacity to provide these credit lines is not unlimited, particularly given that they are typically large.

[41] This section draws on Takagi and others (2014), which analyzed 25 SBAs approved during 2008–11. This sample covers all countries that received support under SBAs during this period, except for Seychelles where discussions began early in 2008, and Greece, whose program will be the subject of a future IEO evaluation. In the case of countries where there was more than one SBA, the sample only included the first. Takagi and others (2014) also report on case studies for several SBAs, mostly in Central and Eastern European countries. Their paper does not cover the EFFs approved for five countries during this period.

82. The IMF also provided substantial concessional support to LICs. LICs were not at the epicenter of the crisis that struck in September 2008, but they faced volatility in food and fuel prices and subsequently confronted declines in trade and tourism, as well as fluctuations in aid flows. The IMF expanded its average annual concessional lending commitments to SDR 1.6 billion on average in 2009–12, up from SDR 0.7 billion on average annually in 2000–08. A recent IEO review identified progress in addressing issues in the IMF's engagement with LICs during the last decade, while also pointing to a need for continued attention to supporting broad-based growth, poverty reduction and the safeguarding of social and other priority spending (IEO, 2014).

83. The remainder of this section focuses on 25 SBAs approved during 2008–11. The focus of the analysis is on the main shared characteristics of the programs, and not on the details of the negotiations, design, or implementation of each of them. Some of these details are referenced in this report to illustrate the "big picture."

Learning from experience

84. As a whole, experience with these programs suggests that the IMF took into account lessons from past crises. Programs were designed and negotiated faster than in the past. They accommodated a larger share of countries' needs, understanding that current account adjustment was more difficult in a global crisis and that capital markets were more volatile and undergoing a flight to quality. These larger programs also allowed for more front-loading, and conditionality was streamlined (see Box 3). Overall, these SBAs helped the member countries cope with the crisis, but clearly there was room for further learning and improvement in each of them. Some of these country specific issues are presented in ex post evaluations prepared by IMF staff, but they are not generally discussed in this report.

Box 3. IMF Learning from Crises in Asia and Latin America

Considerable learning has taken place at the IMF since the emerging market crises of the late 1990s and early 2000s. As a result, IMF-supported programs in response to the current crisis have included:

- Large, frontloaded access, in collaboration with other partners.
- Proactive involvement with the private sector, e.g., the Vienna Initiative.
- Streamlined structural conditionality that is more focused on the IMF's core areas of competence.
- Greater awareness of balance sheet effects in designing exchange rate policy and forecasting the impact of the crisis on growth.
- Explicit recognition of risks and contingency planning in case assumptions fail to hold.
- Flexibility in targets and approaches (including direct budget support and judicious use of capital and exchange controls).
- A public communications strategy to build investor confidence and public support through enhanced transparency and by explaining the logic of the programs.

85. **Speed**. Emergency mechanisms to speed program design and approval were activated for five new programs and two augmentations. The first 14 SBAs took an average of 6.2 weeks from the start of program discussions to Board approval, with the Ukraine program approved in only 4 weeks—among the fastest processing times in IMF history. The time taken to approve programs lengthened as the crisis progressed, averaging 12.2 weeks overall for SBAs approved in September 2008 through end-2011.

86. **Size.** All but one of the SBAs approved in the first year went beyond the normal access limits. Four early SBAs—for Hungary, Iceland, Latvia, and Romania—exceeded 1,000 percent of quota. The IMF noted in its initial review of crisis programs that programs in the initial wave amounted to nearly 6 percent of GDP, which was higher than the average of about 4 percent of GDP in past capital account crises, although similar in terms of the share of gross financing needs (IMF, 2009g). IEO analysis (Takagi and others, 2014) confirms this conclusion: access was on average almost 4 percentage points of GDP larger than that in SBAs approved in 1997–99. In particular, these four European programs were three to five times larger in relation to GDP than were the programs approved in 1997 for Thailand, Indonesia, and Korea. In this regard, authorities—mainly but not only in EMEs—indicated that they hoped that the larger access that characterized IMF financing in the post-2008 European programs would serve as a precedent for future crisis lending.

87. **Front-loading.** IEO analysis found an average frontloading factor of about 25 percent in 2008–13, almost 10 percentage points higher than in pre-2008 programs. Front-loading was greater in the earlier programs, and decreased as the crisis subsided. It was greater in countries that faced both current account and banking crises, and where the fiscal deficit was larger in relation to GDP; it was smaller in successor arrangements, in programs that were larger in relation to quotas, and where countries had larger reserves relative to GDP.

88. **Program design.** Departing from normal practice, IMF-supported programs allowed direct budget support, including in Ukraine, Hungary, Latvia, Romania, and Bosnia and Herzegovina.[42] Although this was not without precedent, it reflected the IMF's adaptation to the reality of governments losing access to funding; this approach was subsequently incorporated in guidelines for staff issued in March 2010. Several senior officials in Europe interviewed for this evaluation indicated that the prospect of direct budgetary support raised the attractiveness, and helped overcome the stigma, of IMF financing at a critical time.

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[42] In commenting on an earlier draft of this report, the IMF Legal Department noted that: "According to the IMF Articles of Agreement, a purchase in the General Resources Account can only be made if "the member represents that it has a need to make the purchase because of its balance of payments or its reserve position or developments in its reserves" (Article V, Section 3(b)). However, a member receiving IMF financing for addressing its balance of payments problems can use the domestic counterpart of such financing for budgetary support purposes."

89. SBA-supported programs generally targeted a gradual reduction in the fiscal deficit, seeking to manage the tradeoff between supporting the economy during a downturn and achieving medium-term fiscal sustainability. Unlike the 1997 Asian crisis programs, no post-2008 crisis program sought to achieve a surplus in the short run. In Iceland and Latvia, the programs targeted a large initial increase in the fiscal deficit, in light of the expected costs of bank restructuring. In the event, fiscal deficit outturns were larger than programmed, because the IMF relaxed targets when the crisis proved to be more severe than forecast. Even so, in most instances IMF financing did not appear to have accommodated the full extent of the fiscal shortfall, with automatic stabilizers partially offset by fiscal measures.

90. About half the programs called for greater exchange rate flexibility, although the IMF was alert to the possibility that a large depreciation could have adverse balance-sheet effects.[43] While early SBAs saw a similar size of depreciation to that in SBAs before the crisis, their currencies were stabilized once the program was in place; later programs saw little or no currency depreciation. Coupled with large, front-loaded financing, judicious use of capital and exchange controls may have contributed to this outcome, as was evidenced in Iceland, for instance.

91. Structural conditionality was more streamlined and more focused on the IMF's core areas of competence. Structural conditionality, as measured by the sum of performance criteria, structural benchmarks, and prior actions, was considerably lighter than it was in programs of the period 1997–2000 (see Figure 3).[44] As the crisis evolved, however, the number of structural conditions increased somewhat, with the average number rising from 8.8 per year in the SBAs approved in 2008 to more than 10 in those approved in 2010 and 2011 (compared to 15.3 per year in programs approved in 1997).[45] Similarly, the focus of structural conditions increasingly extended beyond the IMF's core areas of competence over time. In the sample of 25 SBAs studied by the IEO, the share of structural conditions that fell in core areas declined from 87 percent in those programs approved in 2008 to 68 percent in those approved in 2011.

92. **Risks**. Program risks were covered in Board documents for all programs but were presented in a pro forma manner. An IEO review of internal staff documents indicated that IMF staff had done serious due diligence in contingency planning during program design and negotiation. However, staff had difficulties finding ways to convey these contingent plans without risking undermining program implementation.

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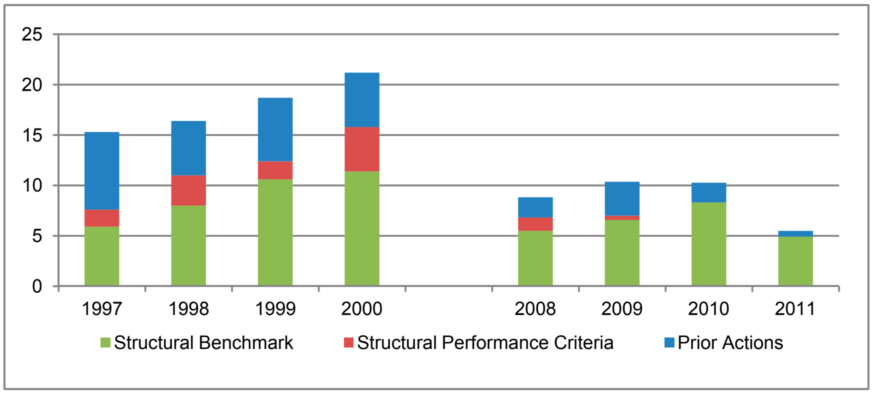
[43] In a few instances including Latvia, the IMF supported a decision to maintain the peg, although this was not without controversy even within the IMF.

[44] This comparison is complicated by the discontinuation of structural performance criteria in March 2009.

[45] Many of these programs, however, were co-financed with the EU and other donors that imposed additional structural conditionality.

Figure 3. Structural Conditionality in IMF Stand-By Arrangements, 1997–2000 vs. 2008–11
(Number of Conditions Per Program Per Year)



Sources: IEO (2007) for 1997–2000; IEO staff estimates for 2008–11.

93. **Outreach**. The IMF devoted significant efforts to explaining that the programs were credible—a critical element, given that an important aim of the programs was to restore investor confidence. There were frequent outreach activities to explain the programs to politicians, business and labor leaders, journalists, and academics, in order to build national ownership of the IMF-supported programs.

94. **Collaboration.** The IMF collaborated with other multilateral and bilateral donors in a transparent manner, especially in the early European programs. At least 17 of the 25 SBAs studied by IEO, including 7 of the 8 European programs, involved some degree of collaboration with other agencies. Organizations collaborating with the IMF characterized their working relationships as effective, although there was a learning curve due to the lack of established protocols for such collaboration with some of the organizations.[46] The program for Hungary represented the first case of IMF-EU collaboration, and set a precedent for future requests for financial support by EU members. It was followed by Latvia and then others. In all cases, IMF staff enumerated these additional sources of financing in a transparent way, which helped to enhance the credibility of the financing packages.

95. **Private sector involvement.** The IMF proactively sought private sector involvement, particularly in those European countries where foreign-owned banks had a large presence. In Hungary, the IMF organized a meeting of public entities and the foreign strategic owners of six large banks immediately after starting to negotiate the program. Subsequently, the IMF

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[46] For example, in Latvia, tensions arose with the EU in the summer of 2009, although these were at least as much due to different views of the problems and their solutions as to difficulties in interactions between staff of the two organizations. The IMF was hesitant about concluding a review because of doubts about fiscal targets, but the EU made a decision at the highest political level to release its second tranche as it became concerned that a delay could precipitate a run on Latvia's currency. The IMF mission felt that its negotiating position had been weakened by the EU action.

actively participated in the Vienna Initiative that aimed at keeping the private sector involved, as discussed in Chapter II.

96. **Outcomes.** Overall, IMF programs in the crisis aftermath helped contain the economic and financial fallout from the crisis. Unlike in previous emerging-market crises, a widely-feared financial meltdown was avoided (except in Iceland, where the collapse of the banking sector was a fait accompli by the time the country approached the IMF). A limited number of bank failures occurred (e.g., in Ukraine and Latvia), but even there the fiscal costs were contained.[47] Latvia could not avoid a deep recession, but nonetheless succeeded in its primary objective of defending its currency peg, allowing it to adopt the euro on January 1, 2014. Large programs also contributed to restore investor confidence.[48]

97. Despite these overall successes, IMF engagement also encountered policy reversals and program interruptions. In a number of countries, especially in high access cases, structural reforms and fiscal consolidation efforts did not progress much or were reversed after the program engagement ended. For example, in Belarus, fiscal policy was relaxed as soon as the program ended, and quasi-fiscal activities expanded (their containment had been the program's key objective). In Hungary, although substantial fiscal consolidation had been accomplished, some of the achievements were reversed after the program relationship ended. These are not isolated instances, and they highlight 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 the program relationship with the IMF.

98. Staff often found it difficult to build consensus on reforms during the short duration of a program and, coupled with their legitimate concerns about downside risks, did not always press their case vigorously. The authorities' interest in continuing with the program engagement was not sustained once the acute phase of the crisis was over. Only 62 percent of the committed resources were drawn; and 11 of the 25 SBAs were ended ahead of their original expiration date, sometimes without completing several of the programmed reviews.[49] This is not a new phenomenon; experience shows that countries with IMF programs frequently revert to their own policy framework and timetable once they no longer need IMF support. Nonetheless, beyond mitigating the immediate acute crisis, it leaves a question about whether recent crisis programs contributed to medium- or long-term sustainability.

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[47] The fiscal costs, at 4.8 percent of GDP in Ukraine and 2.5 percent of GDP in Latvia, were significantly smaller than in earlier crisis.

[48] A number of officials and experts thought that what ex post proved to be over-financing in many of the programs, may had contributed to their credibility and to the restoration of investor confidence.

[49] It was not unusual for borrowers in earlier crises not to fully draw available resources. For example, utilization rates were 62 percent in Indonesia, 1997–99; 93 percent in Korea 1997–99; and 83 percent in Brazil 1998–2002.

V. Conclusions and Recommendations

99. 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

100. 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.

101. 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.

102. 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.

103. 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.

104. 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 UMP, 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.

105. 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.

106. 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.

107. 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.

108. 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.

109. 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.

110. 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 QE and eventual tapering.

111. 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.

112. The IMF ramped up its non-concessional lending from almost nil in 2007 to about US$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.

113. 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

114. 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.

115. 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 one trillion dollars) 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 FSSA 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.

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ANNEX 1. IMF-CENTRIC TIMELINE OF EVENTS (AUGUST 2007–DECEMBER 2013)

August–December 2007

- U.S. sub-prime collapse, diminished liquidity in interbank markets (August)
- ECB injects €95b into market (August)
- **IMFC: strong fundamentals, robust EMDC growth (October)**
- **MD external message: IMF has key role to play in "credit crunch" (November)**
- **MD internal message: cut US$100m from administrative budget (November)**

2008

- **IMF Board approves new income model (March); "Downsizing"(April)**
- **MD indicates shift focus to global financial and economic concerns (July)**
- Lehman Brothers files for bankruptcy; credit markets freeze (mid-September)
- **IMFC calls on IMF to recommend actions to restore confidence and stability (October)**
- Japan initiates contributions to IMF, pledges US$100b (November)
- **IMF MD calls for coordinated global fiscal stimulus at the G20 Leaders' Summit in Washington (November)**
- Federal Reserve announces QE (November)
- G20 Leaders call for expanded Financial Stability Forum (November)
- **IMF Board approves SBAs for Ukraine, Hungary, Iceland, Pakistan (November); Latvia (December)**
- **IMF releases Staff Policy Note on "Fiscal Policy for the Crisis"(December)**
- **IMF continues with implementation of the "downsizing"**

2009

- Vienna Initiative launched (January)
- **IMF staff releases "Initial Lessons of the Crisis" paper (February)**
- **IMF Board approves lending toolkit reforms: doubles access limits; eliminates Structural Performance Criteria; creates FCL (March)**
- **IMF Vulnerability Exercise for Advanced Countries launched (March)**
- **IMF Board approves Mexico FCL (April)**
- G20 agreement to treble IMF lending resources to US$750b (London Summit) (April)
- FSB established; IMF/FSB Inaugural EWE is conducted (April)
- **IMF Board approves FCL for Poland, Colombia (May)**
- **IMF launches *Fiscal Monitor* (July)**
- **"Downsizing" ends: 25% of senior staff have exited the IMF (May)**
- **IMF Governors approve SDR allocation (August)**
- G20 Pittsburgh Summit: G20 launches MAP; announces fulfillment of promise to contribute over US$500b to expanded NAB (September)
- **IMF revamps FSAP, introduces Risk Assessment Matrix (September)**
- EWE methodology introduced at IMF/FSB workshop (October)
- **IMF: agreement reached to expand NAB (November)**
- IMF Board approves 13 SBAs (2009)

2010

- **IMF issues "Exiting from Crisis Intervention Policies" paper (February)**
- Enhanced cooperation between EU, ECB, and IMF to assist Euro members develops as the Troika (March)
- G20 Toronto Summit: first G20 MAP presented (June)
- **IMF Board approves IMF membership in FSB (September)**
- **IMF Board endorses mandatory minimum five-year FSSAs for top 25 systemic financial centers (September)**
- G20 Finance Ministers agree to double IMF member quotas (October)
- Federal Reserve announces QE2 (November)
- IMF Governors approve 14th General Review of Quotas (December)
- IMF approves 8 SBAs (2010)

2011

- **IMF approves PCL for Macedonia (January)**
- **New and enhanced NAB approved and activated (April)**
- **IMF Board begins discussion on macro-prudential policy framework (April)**
- **IMF approves EFF for Portugal (May)**
- **Strauss-Kahn resigns as IMF MD (May); Lagarde appointed (July)**
- **First Consolidated Spillover Report on Systemic-5 Economies issued (July)**
- ECB injects over €1trillion into Eurozone financial institutions (December)
- Euro area countries commit to providing additional resources to the IMF (December)

2012

- Vienna Initiative relaunched as "Vienna 2" in response to renewed risks (January)
- G20 Finance Ministers announce new round of bilateral borrowing commitments for the IMF ($430b) (April)
- **IMF Global-Risk Assessment Matrix and Pilot External Sector Report introduced (June)**
- **IMF Board completes 2011 Review of Conditionality (September)**
- Federal Reserve announces QE3 (September)
- **MD's Global Policy Agenda to the IMFC: the world economy has slowed more than anticipated; quota and governance reforms must be completed (October)**

2013

- **ISD takes effect (January)**
- **IMF January 2013 deadline to complete quota formula review passes with no action**
- **IMF Board discusses "Unconventional Monetary Policies" (April)**
- U.S. General Accounting Office announces assessment of international financial regulatory reform in the face of the crisis, including activities of the IMF (May)
- **IMF Board discusses "Key Aspects of Macro-Prudential Policy" (July)**
- G20 Summit: IMF MD notes that many emerging markets are slowing (September)
- **IMFC: downside growth risks persist (October)**
- Federal Reserve announces tapering of QE3 (December)

ANNEX 2. IMF DOWNSIZING DURING THE CRISIS

In 2006, the IMF was projecting a budget shortfall and faced pressure to establish a new income model in light of sharp decreases in lending operations.[1] An April 2007 report to the IMFC noted that the IMF needed to place its finances on a sound footing and be run on a tightened budget.[2] In November 2007, the Managing Director informed staff that the IMF would have to find US$100 million worth of cuts to offset its income shortfall. In March 2008, the IMF Executive Board approved a new income model and, a month later, a medium-term budget which provided for US$100 million in savings over a three-year period.[3] These savings were to be achieved by "refocusing" operations, and introducing efficiency gains. But it was clear that savings of this magnitude would require a significant reduction in staff.

In February 2008, Management announced that a "downsizing" would take place in two stages.[4] During the initial stage, from March 1 to April 21, 2008, staff could volunteer for separation. Afterwards, depending on the outcome of the first stage, there could be a need for mandatory separations. In the event, 20 percent of eligible staff volunteered to separate—higher than targeted, particularly at the mid-level, thus eliminating the need for mandatory separations. Nearly 500 staff, including 28 percent of administrative support staff, 10 percent of mid-level staff, and 24 percent of senior managers exited the IMF between May 2008 and May 2009 as a result of the downsizing.[5] In the first half of 2008, Management established a hiring freeze. The MCM Department was also restructured in September 2008, its second reorganization since 2006.

Soon after, faced with higher demands stemming from the crisis, the IMF reversed the hiring freeze and launched a substantial external recruitment drive. More than 100 economists were hired by end-April 2009, including experts in the financial sector area. By the end of FY2012, the IMF's workforce had recovered to more than 3,000 staff, up from about 2,500 in FY2009. Nonetheless, according to an internal 2013 Corporate Workforce Planning paper, a large share of this recruitment was for externally-financed capacity building, while IMF-financed activities remained "relatively flat."

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[1] Managing Director's Report on Implementing the Fund's Medium-Term Strategy (April 2006).

[2] Report of the Managing Director to the International Monetary and Financial Committee on the IMF's Policy Agenda (April 2007).

[3] FY2009–FY2011 Medium-Term Administrative, Restructuring, and Capital Budgets.

[4] Staff Bulletin 08/3, Refocusing and Modernizing the Fund: The Framework for the Downsizing Exercise (February 29, 2008).

[5] Message from the MD on the Completion of the Voluntary Phase, May 19, 2008.

The downsizing created uncertainty and anxiety among staff, undermining staff morale[6] and distracting Management as serious global turmoil was mounting. Morale remained low in the aftermath of the exercise, as indicated in an IMF staff survey conducted in June 2008: asked about the impact of the restructuring, almost half of the respondents said the IMF would now be a worse place to work and only one-sixth thought it would be better. Given the large share of senior managers who separated voluntarily, the IMF lost some of its most experienced staff, just when it was needed for a rapid response to the crisis. Indeed, in a staff survey conducted by a crisis-affected area department in October 2009, respondents felt that the downsizing exercise had impeded the IMF's ability to provide intellectual leadership; in the words of one respondent, "the conjuncture of the restructuring and the crisis has had disastrous consequences on the leadership provided by the department."[7]

Executive Directors also voiced concerns about the impact of the downsizing on the IMF's capacity to both respond to the crisis and fulfill its mandate. These comments came at the outset of the crisis and were reiterated in particular throughout 2009–10 as the IMF staff's role in providing analytical support for the G20 MAP ramped up and as the European crisis intensified. Illustrative examples include:

> It is most unfortunate that the downsizing of IMF staff has come at a time when the IMF should be most active. This is evident in a number of departments, in particular the MCM, where staff resources are strained by the ongoing crisis missions and in providing support to area departments. The recent increase in MCM's workload appears to have pushed many other priorities further down the list. Even surveillance seems to be suffering (November 2008).

> [O]ne cannot help but wonder if the preoccupation with … the downsizing exercise lessened our focus on the vulnerabilities building up in the global financial system and contributed to the IMF's missing the fallout and risks from the subprime crisis … the IMF now faces a heightened risk due to the … downsizing (March 2009).

> While we are fully supportive of the new responsibilities that the IMF has taken on in the area of early warning, and the G-20 mutual assessment process, it is important that these responsibilities do not affect the resources that are needed for the IMF's bilateral surveillance and outreach efforts (June 2009).

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[6] Staff Association Committee statements (late 2007–early 2008).

[7] See IEO (2011).

Annex 3. Abstracts of Background Papers

BP/14/06, "IMF Leadership and Coordination Roles in the Response to the Global Financial and Economic Crisis," by Thomas Bernes

This report examines authorities' perceptions of the IMF's coordinating roles and its collaboration with other multilateral entities in the response to the crisis, namely the G20, the FSB, the Troika and the Vienna Initiative. The report found that partners appreciated the IMF's collaboration in what were effective initiatives. Building upon these developments and clarifying roles, responsibilities and accountabilities with the G20 and other international organizations are key challenges going forward.

BP/14/07, "IMF Macroeconomic Policy Advice in the Financial Crisis Aftermath," by Sanjay Dhar

This paper assesses the effectiveness of the IMF's macroeconomic surveillance in the aftermath of the crisis. In 2008–09, the IMF was influential in calling for coordinated macroeconomic stimulus. But by 2010 it endorsed the fiscal consolidation plans of the major advanced economies, which turned out to be premature. Since then it advocated the use of accommodative monetary policies including QE to counteract fiscal drag and boost disappointing growth during 2011–13. The mix of fiscal consolidation and monetary expansion was less than fully effective in reactivating advanced economies and contributed to capital flow volatility. There was also insufficient tailoring of advice to countries facing very different circumstances in the crisis aftermath.

BP/14/08, "Aspects of IMF Financial Sector Surveillance During the Crisis," by Ross Levine

This paper assesses IMF financial sector surveillance as reflected in post-crisis *GFSRs* and a sample of FSSAs for systemically important financial sectors. The IMF warned about the need for quick action to address the deteriorating solvency of financial institutions. However, it underplayed governance weaknesses in regulatory agencies and how to address them, and the role of flawed regulatory policies in shaping incentives of decision makers in financial institutions. The technical quality of FSSAs was generally sound but some of the advice did not adequately consider country-specific factors.

BP/14/09, "The IMF Response to the Global Crisis: Assessing Risks and Vulnerabilities in IMF Surveillance, by David J. Robinson

This paper analyzes the IMF's approach to assessing risks and vulnerabilities as part of its multilateral and bilateral surveillance, especially the changes introduced following the crisis. A variety of new exercises have improved the analysis and filled gaps existing before the crisis. However, the analytical framework remains a work in progress and it will be critical to ensure that the current focus on risks and vulnerabilities is maintained. The paper also provides recommendations to consolidate and simplify the system, strengthen risk analysis and integration, improve dissemination, and increase policy traction.

BP/14/10, "IMF Efforts to Increase the Resources Available to Support Member Countries," by Eduard Brau and Louellen Stedman

This paper assesses the resource mobilization strategy implemented by the IMF as the financial crisis unfolded, when its resources were at a historic low relative to the size of the global economy and financial flows. Through the leadership of the G20, the IMF was able to quadruple its lending capacity to more than US$1 trillion by May 2014. While the resource mobilization strategy successfully enabled the IMF to respond to member needs, the outcome left the IMF reliant on borrowed resources for a prolonged period, as an agreed quota increase did not take effect.

BP/14/11, "The IMF's Lending Toolkit and the Global Financial Crisis," by Thomas Reichmann and Carlos de Resende

This paper examines the revamping of the lending toolkit since crisis: access limits and frontloading were increased, and conditionality streamlined. The IMF also launched the FCL, a precautionary instrument with no access limit and no conditionality for members with good policies and a strong track record. While the FCL has been praised by the three countries using it, further improvements are needed to address the needs of a larger group of countries.

BP/14/12, "A Review of Crisis Management Programs Supported by IMF Stand-By Arrangements, 2008–11," by Shinji Takagi and others

The paper reviews crisis management programs supported by Stand-By Arrangements in response to the crisis. The IMF was rapid, flexible, and decisive in providing financial support, thereby allowing a smoother adjustment in the midst of an adverse external environment, and averting deeper output contractions. Programs incorporated lessons from earlier crises: structural conditionality focused on core areas, they tried to avoid too rapid an exchange rate depreciation, and used public communications to build investor confidence. Vulnerabilities remained in many countries, however, highlighting the inherent difficulty in using short-term crisis management programs to tackle longer-term structural issues.

Annex 4. Conclusions and Recommendations from Previous IEO Evaluations

This annex lists selected conclusions and recommendations from four previous IEO evaluations dealing with crisis management and surveillance activities aimed at detecting risks and vulnerabilities in the international monetary and financial system.

1. The IMF and Recent Capital Account Crises: Indonesia, Korea, Brazil (IEO, 2003)

To increase the effectiveness of surveillance, Article IV consultations should take a "stress-testing" approach.

Management and the Board should take additional steps to increase the impact of surveillance, including by making staff assessments more candid and accessible to the public.

The IMF should play a proactive role as a crisis-response coordinator, strengthen integration of crisis management work, and ensure that the financing package is sufficient to generate confidence.

When parallel financing is sought from other institutions, the terms of reference for their engagement should be specified at the outset, including mechanisms to resolve differences of view and the manner in which their inputs are reflected in program design.

The IMF should ensure, particularly in high-access cases, that the technical judgment of staff is protected from political interference.

The IMF should focus conditionality on areas critical for crisis resolution and not use crises as an opportunity to force long-outstanding reforms, however desirable they may be, in areas that are not critical to the resolution of a crisis.

Program design should include an agreed strategy to communicate the logic of the program and any subsequent program-related information to the public and the markets.

2. Multilateral Surveillance (IEO, 2006)

The content and form of multilateral surveillance outputs should be streamlined and focused on key issues and, if necessary, existing publications should be consolidated.

The IMF should include coverage of banking sector risks in multilateral surveillance outputs.

The IMF should increase integration between *WEO* and *GFSR* and bilateral and multilateral surveillance (silo structure; bottom-up approach; too many products, too little focus).

The IMF needs to strengthen the multilateral dimension of surveillance, particularly for systemically important countries, by clarifying operational goals, organizational strategies, and accountability.

The IMF should become more proactive with respect to intergovernmental groups, particularly the G7 and the G20. Increasingly, the IMF must draw on its strength (universal membership) and comparative advantage to provide leadership to the global system.

3. Financial Sector Assessment Program **(IEO, 2006)**

The most systematic shortcoming in FSAPs was insufficient attention to cross-border financial linkages and their potential consequences. In a minority of the assessments, there was insufficient linkage between macroeconomic and financial sector components.

Candor was sometimes lost at the critically important stage in the preparation of Article IV surveillance reports. The degree of country ownership and the degree of integration between the work of the FSAP team and area department team influenced how well key FSSA messages were integrated into Article IV reports.

The IMF should strengthen links between FSAPs and Article IV surveillance by mainstreaming FSAPs and follow-up work into regular surveillance activities; it should also strengthen the internal review process to ensure that key messages on macro-financial stability are fully reflected in Article IV surveillance.

The IMF should improve the quality and impact of FSAPs through clearer prioritization of recommendations; improved stress-testing analysis; and more systemic inclusion in the analysis of cross-border, financial sector linkages. It should also utilize financial sector expertise more effectively in the surveillance process.

4. IMF Performance in the Run-up to the Crisis **(IEO, 2011)**

The IMF's ability to correctly identify mounting risks was hindered by a high degree of groupthink, intellectual capture, a general mindset that a major financial crisis in large advanced economies was unlikely, and inadequate analytical approaches.

The IMF should create a risk assessment unit that reports directly to Management, with the purpose of developing risk scenarios for the systemically important countries and analyzing tail risks for the global economy.

The IMF needs to: create an environment that encourages candor and considers dissenting views; modify incentives to "speak truth to power;" better integrate macroeconomic and financial sector issues; overcome the silo mentality and insular culture; and deliver a clear, consistent message on the global outlook and risks. To this end, it should foster greater cross-departmental collaboration, and provide clarity in rules and responsibilities for internal review processes.