

Evaluation of Run-Up to Crisis: IMF Fell Short in Warning about Risks and Vulnerabilities

On February 9, 2011, the IEO released an evaluation of *IMF Performance in the Run-Up to the Financial and Economic Crisis: IMF Surveillance in 2004-07*. The evaluation found that the IMF fell short in warning member countries about risks to the global economy and the buildup of vulnerabilities in their own economies in the run-up to the crisis that began to manifest in mid-2007. During the time period under assessment, the banner message of IMF surveillance was characterized by overconfidence in the soundness and resiliency of large financial institutions and endorsement of financial practices in the main financial centers. The risks associated with housing booms and financial innovations were downplayed, as was the need for stronger regulation to address these risks.

Findings. The evaluation concluded that the IMF's ability to identify the mounting risks was hindered by a number of factors, including: a high degree of groupthink; intellectual capture; and a general mindset that a major financial crisis in large advanced economies was unlikely. The evaluation also pointed to weak internal governance and an institutional culture that discouraged contrarian views. Weak financial sector analysis and inadequate attention to macro-financial linkages also played a role.

Recommendations. The report focused on financial sector issues, because of the nature of the crisis. However, most of its recommendations dealt with institutional changes that would improve the IMF's capacity to scan for risks across the board, since a crisis could emerge from another sector. The IEO emphasized the need to strengthen IMF governance, by clarifying the roles and responsibilities of the Executive Board, Management and senior staff and by establishing a clear accountability framework. It also called on the IMF to strengthen its ability to discern risks and vulnerabilities and to cultivate a culture that is proactive in crisis

prevention. In pressing for further action beyond initiatives already launched by the IMF, the IEO highlighted the need to:

- Strengthen incentives to “speak truth to power.”
- Deliver a clear, consistent message to the membership on the global outlook and risks.
- Create an environment that encourages candor and diverse/dissenting views.
- Overcome silo behavior and mentality.
- Better integrate financial sector issues into macroeconomic assessments.

Managing Director's Response. In his statement about the evaluation, IMF Managing Director Dominique Strauss-Kahn expressed broad agreement with the conclusions and recommendations. He emphasized the importance of making key recommendations actionable and highlighted in particular the need for more progress to: promote diverse and dissenting views within the institution; integrate the analysis coming from different IMF products; and deliver clear messages on risks and vulnerabilities.

Executive Board Consideration. In its discussion of the evaluation on January 26, 2011, the Executive Board also concurred with the general thrust of the evaluation and recommendations. Directors believed that the evaluation provided a balanced assessment of the failure of Fund surveillance to adequately anticipate and warn about the global crisis. They broadly endorsed the IEO recommendations, particularly to help strengthen the IMF's institutional environment and analytical capacity. Directors noted that reform initiatives undertaken since the onset of the crisis will help enhance the candor and traction of surveillance. At the same time, they agreed that further action should be considered—including to seek alternative or dissenting views, to broaden the diversity of staff and to strengthen incentives for the Fund to “speak truth to power.” Directors also



Moises Schwartz, IEO Director

considered it crucial that the Fund deliver a consistent message through the *World Economic Outlook*, *Global Financial Stability Report* and other publications.

Moving Forward. The crisis has highlighted the importance of a strong, effective, and well-equipped IMF. The problems uncovered by this evaluation are long-standing, and many of them had been identified in the past. Thus, it is critical to establish a process of monitoring reforms and evaluating their impact, as the basis for designing new and corrective initiatives. The implementation of these initiatives will need close attention by Management and oversight by the Executive Board, as well as the support of authorities in member countries.

Three Evaluations in Progress

The IEO expects to send its evaluation of *Research at the IMF: Relevance and Utilization* to the IMF's Executive Board shortly. This evaluation focuses on the relevance and utilization of IMF research, with member country authorities as the primary target audience. It also examines the technical quality and the management of research. The evaluation adopts a broad definition of research, looking at surveillance-oriented and research-style outputs produced across the institution. The IEO will release the evaluation once it is considered by

the Board, along with management and staff reactions and a summary of the Board discussion.

The IEO has also initiated work on two new evaluations. The first will examine the IMF's advice to countries regarding their **international reserves** and assess the adequacy of IMF policy guidelines on international reserve holdings and reserve accumulation. It will also assess the quality of IMF advice on international reserves, taking into account the perspective of country authorities, and whether policy advice has been clear, evenhanded and consistent across member countries, over time, and accommodative of changing country circumstances.

The second evaluation will examine whether and in what circumstances the IMF is perceived

as a **trusted advisor** to its member countries. The evaluation will identify factors that may affect authorities' choices to engage with the IMF, including seeking advice from the IMF beyond the normal scope of surveillance or program activities. It will also explore the possible tensions between the IMF's surveillance obligations, which carry with them enhanced disclosure requirements, and engagement with the IMF on sensitive issues, which depends on confidentiality.

The IEO is consulting with stakeholders to help define the proposed focus and approach for these new evaluations. Draft issues papers will also be made available on the IEO website for public comment.

Follow-Up on Past Evaluations

In 2007, the IMF Executive Board established a process for follow-up on IEO evaluations and their recommendations. This process calls for a Management Implementation Plan (MIP) to be issued soon after the Board discussion of each IEO report and for a Periodic Monitoring Report to be prepared by IMF staff on an annual basis

to assess the Fund's progress in implementing recommendations endorsed by the Board.

On January 11, 2011, the IMF announced a forward-looking implementation plan for Board-endorsed recommendations of the IEO report on *IMF Interactions with Member Countries*. This MIP is available on the IMF website at http://www.imo-imf.org/eval/complete/eval_01102011.html.

Concerns persist about weaknesses in the system for following up on IEO evaluations.

One issue is the process for monitoring the implementation of IEO recommendations endorsed by the Executive Board. Another concern is how to ensure follow through on broader policy issues raised by IEO evaluations that are of concern to the Board but that go beyond those recommendations endorsed by the Board. To support this process, IEO has now begun preparing background material cataloguing its recommendations and action taken in these areas by the Fund.

Periscope

2010

October:

- Moises Schwartz, IEO Director, and the IEO *Crisis* evaluation team conducted a meeting in Paris with an IEO Advisory Group to discuss the emerging findings of the IEO evaluation of *IMF Performance in the Run-Up to the Financial and Economic Crisis: IMF Surveillance in 2004-07*. A summary of the Advisory Group's views is available on the IEO website at http://www.imo-imf.org/eval/complete/pdf/01102011/Crisis_BP1_Summary_of_Views.pdf.

December:

- Mr. Schwartz attended the annual meeting of the Evaluation Cooperation Group in London.

2011

February:

- Mr. Schwartz presented the findings of the *Crisis* evaluation to IMF staff.

- Nancy Wagner, IEO Advisor, met with authorities in Colombia, Canada and Croatia as part of the new evaluation on the role of the IMF as a trusted advisor.

March:

- Mr. Schwartz presented the findings of the *Crisis* evaluation at Bruegel, an international economics think tank in Brussels, Belgium.
- IEO-co-hosted a seminar with the German international cooperation organization GIZ in Berlin.
- IEO co-hosted workshops with the Hong Kong Institute for Monetary Research and the Department of Economics, Pondicherry



IEO team and Advisory Group

- University, India, as part of the new international reserves evaluation.
- Ruben Lamdany, IEO Deputy Director, presented results of the *Crisis* evaluation to the Executive Board of the European Bank for Reconstruction and Development in London.