The International Monetary Fund and the governance of international surveillance

Chapter XX

The IMF and the Governance of International Surveillance

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Financial Crisis: A Hardy Perennial: this is not just the title of the introductory chapter of Robert Aliber and Charles Kindleberger's *Manias, Panic and Crashes* (2011), but also an eloquent reminder of one of the distinct features of financial markets, namely, their inherently unstable nature (Minsky 1986). As the global financial crisis of the late 2000s vividly reminded us, during the upward trend of the business cycle, markets are prone to euphoric behaviour that fuels asset and property bubbles. The latter burst as soon as the business cycle deteriorates to the point where debts exceed what borrowers can pay off from their incoming revenues.

Recognising the perennial nature of financial instability, domestic political systems have over time developed several governance arrangements that are meant to circumscribe the effects of financial instability. These arrangements include prudential regulatory regimes, financial safety nets, and legal and accounting procedures. Similar efforts have been undertaken at the global level, where several governance arrangements exist which aim at minimising the likelihood of crisis and ensuring that those crises which do occur do not become systemic. These arrangements, which include both formal institutions and informal social practices, span those designed to prevent the eruption of crises – including surveillance mechanisms, prudential rules and procedures for regulatory cooperation and harmonisation – and those mainly designed to manage crises once they occur, such as the provisions that govern the functioning of the global financial safety net.

This chapter focuses on a specific set of governance arrangements that has been developed with the aim of contributing to global financial stability, namely, the arrangements which preside over the international monitoring of national economic policies. Specifically, my purpose is to assess the changes that have taken place in the governance framework for surveillance in the aftermath of the global financial crisis of the late 2000s. Particular attention will be devoted to analysing the surveillance tasks that the International Monetary Fund (IMF) performs. Indeed, the monitoring, with associated policy advice, of national economic and financial policies is at the heart of that institution's responsibilities.[1] In particular, one of the Fund's key tasks is that of 'help[ing] head off risks to international monetary and financial stability, alert[ing] the institution's 187 member countries to potential risks and vulnerabilities, and advis[ing] them of needed policy adjustments' (IMF 2007). The IMF thus provides a privileged perspective from which to identify some key developments in the policy area of surveillance by shedding light on 'the political architecture for global capital markets' (Pauly 1997: 8).

Distinguishing among the procedural, instrumental and ideational dimensions of governance frameworks, the chapter argues that three main post-crisis trends are emerging in IMF surveillance. The first is increased collaboration with other official regulatory bodies, in particular with the newly created Financial Stability Board (FSB). The second is the deepening of financial sector surveillance within the framework of a macro-financial approach to global surveillance (Moschella 2011; Baker 2012). The third concerns the way in which the crisis has called into question the previously dominant views that markets are self-stabilising, and that emerging market economies – and not advanced economies – are the primary source of risk and should therefore be the main target of international surveillance.

Before proceeding, some clarifications are in order. To start with, this chapter is not meant to provide an assessment of the effectiveness of the post-crisis changes in IMF surveillance as compared to the pre-crisis ones. In other words, its purpose is not to evaluate whether the transformations in the conduct of surveillance will lead the IMF to be more effective than in the past. Nor does the chapter deal with the issue of democratic deficits in the governance arrangements under examination. Instead, its purpose is to bring to the surface some of the most important changes that have resulted from the contemporary global financial crisis in order to reflect on their transformative potential for global financial governance at large.

[1] Of course, surveillance is not the only task the IMF performs. The provision of financial assistance to members facing a fundamental disequilibrium in their balance of payments and the provision of technical assistance are the other main activities that the Fund regularly discharges. Nevertheless, according to some commentators, these other tasks can be considered modalities of surveillance from other perspectives (see, for instance, (Guitiàn 1992: 22-25).

I develop my argument in three steps. First, I tease out some of the conceptual underpinnings of financial governance and introduce the key features of the pre-crisis surveillance governance framework. Second, I trace the changes that have taken place since the start of the crisis in 2007. Finally, I summarise the findings and reflect on their implications for global financial governance and for the challenges that IMF is expected to confront in the near future.

Governing financial stability: three governance dimensions and pre-crisis trends

Although international financial stability may at first glance appear as a technical matter that is remote from citizens' most pressing concerns, this is clearly not the case. Episodes of distress in global financial markets, including those that arise from poor domestic policies or international capital withdrawals, may destroy the capacity of the domestic financial sector to generate credit for activities such as consumption and investment. The resulting impact on the real economy, in terms of output loss and unemployment, can be severe and long-lasting, as the global financial crisis has once again vividly confirmed. In light of these considerations, it is therefore not surprising that financial stability is usually considered as a public good (Kindleberger 1973) and that states, regulatory authorities and even market participants devote considerable time and resources to designing international rules and institutions that can mitigate the tendency of financial turmoil to spill across borders (Abdelal 2007; Baker 2006; Kapstein 1994; Pauly 1997; Porter 2005; Singer 2007).

The IMF and its monitoring of national economic policies have long played a primary role in the governance framework that aims at preventing financial instability and managing crises once they occur. As conceived in the aftermath of the Second World War, the global governance framework was based on a clear code of conduct that set up the rules that national authorities were expected to follow. Under the par-valued exchange rate system, the international monitoring of the Fund consisted in the application of these rules of conduct, meaning that national policies were judged in terms of their consistency with the agreed par values. With the break-up of the Bretton Woods system in the 1970s, however, the rule-based system of global surveillance gave way to a discretion-based system in which the IMF's assessment of national policies was no longer exclusively anchored to the stability of currencies' par values. With the abandonment of the fixed exchange rate system, and the integration of world's financial markets and associated challenges (Helleiner 1994), the assessment of the consistency of national policies with the international financial stability commitment became a much more discretionary and complicated task.

In order to analyse the main characteristics of global surveillance in the period that preceded the crisis of the late 2000s, it is important to identify a metric for such a judgment. In this connection, I break up the concept of governance into three dimensions that refer to the process through which policy solutions to specific problems are produced, the instruments through these solutions are achieved and, finally, the core beliefs that actors widely share on how to govern a specific issue area. In what follows, I focus on each dimension in turn and exemplify them through the analysis of the pre-crisis governance framework in the area of global surveillance.

First, governance systems vary according to the modalities through which policy solutions are taken or political action is exercised. A key dimension here is the number of actors that are involved in the decision-making process or in the delivery of a specific course of action. For instance, it is plausible to conceive of governance systems as varying along a continuum that ranges from centralised to fragmented. Whereas the former are characterised by the prevalence of one actor over the others, the latter are based on the collaboration of several actors for either adopting policies or carrying out the necessary political action to solve the specific problems of the governance area.

In the case of the global surveillance framework, the IMF has long occupied a primary position in the governance of this issue area. The central role of the Fund was maintained even in the aftermath of the collapse of the Bretton Woods system, when the Fund's responsibilities changed from those of an enforcer of member countries' observance of exchange-rate rules to those of an overseer of individual countries' exchange-rate policies (Guitiàn 1992: 6). Since the early 1990s, however, several international and regional bodies have assumed increasing importance in the conduct of surveillance activity. Along with the IMF and the traditional surveillance functions exercised by the Bank for International Settlements (BIS) and the Organisation for Economic Cooperation and Development (OECD), a more prominent role has progressively been played by groups such as the Group of 20 (G20), regional economic groups, the Financial Stability Board (FSB), and regional/country-specific financial stability risk boards.

The growing relevance of these bodies and the attendant fragmentation of the governance framework can be explained by the shortcomings of the Fund's surveillance which were brought to the surface by the emerging market crises of the 1990s (Independent Evaluation Office 2004, 2005; IMF 1999; Moschella 2010). The Fund repeatedly failed in identifying and warning about the incipient risks to global financial

stability.[2] The complexity and interconnections that characterise today's global financial markets are also helpful in explaining the increasing dispersion of supervisory powers among several international bodies. Since an effective surveillance needs to make sense of macro-financial linkages and linkages across sectors and countries, up-to-date data and analyses are needed on domestic regulatory and supervisory structures, as well as on various market segments. No single organisation or regulatory body can be expected successfully to collect and analyse all the relevant information. The division of surveillance functions across several bodies can therefore increase the effectiveness of this important activity, even though one the unintended consequences could be duplications of work (Schinasi & Truman 2010).

Second, governance systems also vary in terms of the instruments that are used to achieve the stated goal of a policy decision. In this connection, it is plausible to think of governance systems as varying along a spectrum that ranges from the use of hard-law instruments to the use of soft-law instruments. That is to say, whereas some governance systems may be characterised by strong enforcement mechanisms, others are based on instruments such as persuasion and cooperation. The latter may be attractive for national governments that want to limit sovereignty losses. In contrast, governance systems based on hard-law imply delegation of 'authority for interpreting and implementing the law' (Abbott & Snidal 2000: 421-22), which refers to precise, legally binding obligations.

The distinction between hard and soft instruments has been useful in examining multilateral surveillance activities such as those that the OECD regularly carries out. In particular, it has been noted that surveillance can be associated with two different sets of instruments. The first are coercive instruments, which induce the fear of being punished. The use of economic sanctions and financial pressures belongs to this category of surveillance instruments. The second are instruments based on persuasion and moral pressures, including shaming, ridiculing and exclusion (Marcussen 2004: 13).

Next to their degree of stringency, surveillance instruments can also be distinguished according to the target of policy analysis and advice. That is to say, some surveillance instruments focus on assessing domestic macroeconomic management, while others are more tailored to assessing the robustness of regulatory, supervisory and crisis management systems. As for the IMF, the original core of the Fund surveillance was macroeconomic analysis. The IMF has traditionally analysed and provided advice on issues

[2] The global financial crisis has been no exception here. As will be clarified at greater length below, the IMF – as most other international observers – failed to clearly identify the signs of the incipient risks to global financial stability and to elicit action from global policy-makers (Independent Evaluation Office 2011).

such as the choice of the exchange rate and the consistency between the regime of fiscal and monetary policy. In contrast, financial sector issues largely fell outside the purview of its monitoring activity at least until the mid 1990s (Gola & Spadafora 2009). The limited attention devoted to financial sector issues is largely attributable to the characteristics of the IMF as an economic organization. In particular, both the composition of its staff, which is primarily recruited from the macroeconomics profession (Momani 2005), and the institutional mandate that govern the Fund's activities have oriented the focus of surveillance towards macroeconomic factors (Moschella 2012b).

From the early 1990s onwards, however, the range of IMF surveillance instruments has been significantly expanded to include financial sector issues. Member countries' policies to develop the domestic financial sector, and ensure sound governance and risk management in financial institutions have been increasingly included in the Fund's analyses. Several factors contributed to the expansion of IMF surveillance towards financial sector surveillance (FSS), including the growing integration of global financial markets and the attendant recognition of the risks that such integration entails, as exemplified in the financial crises of the 1990s (Gola & Spadafora 2009; James 1995; Moschella 2011). However, the development of financial sector analyses has not been an automatic and rapid process with the result that financial sector surveillance was still a work-in-progress process when the global financial crisis burst (Moschella 2012b). One of the negative implications of the poor development of FSS within the Fund has been that the organization's failure to spot the severe risks and vulnerabilities that were building up in the global financial system from 2004 to 2007. Indeed, staff continued to focus on factors such as global imbalances and disorderly dollar decline as the key risks to global stability, largely failing to identify the risks building up in the financial sector where in fact the crisis burst (Independent Evaluation Office 2011).

Finally, it is possible to distinguish different kinds of governance arrangements and trace their evolution over time by focusing on the core beliefs that inform the conduct of a specific area of activity. Indeed, each policy area is characterised by the presence of a deep core of fundamental norms and beliefs which are regarded as widely shared in a policy community (Sabatier & Jenkins-Smith 1993). Core beliefs are distinct from policy solutions or strategies in that they identify basic normative preferences (Steinmo 2003). That is to say, core beliefs provide agents with not only a 'scientific', but also a 'normative' account of how a polity or a specific policy sector is expected to operate, defining 'what the common end of collective action should in fact be' (Blyth 2002: 38; Berman 1998: 29).

Some distinctive beliefs characterised the governance of the policy area of global surveillance in the run-up to the global financial crisis. Specifically, one of the hallmarks of the pre-crisis financial governance was the widespread faith in financial markets as a stabilising and efficient mechanism to ensure global stability and thereby mitigate the risks associated with the integration of world's capital markets (Baker 2012; Helleiner, Pagliari & Zimmermann 2009). This specific world view of financial markets emphasized their self-stabilising quality by virtue of their rational efficiency and capacity to process and respond to information (Best 2010; Blyth 2003). Since private actors were regarded as having a comparative informational and expertise advantage over public authorities, the latter tended to delegate to the former traditional governmental functions. For instance, in the area of market regulation, Adrienne Heritier and Dirk Lehmkuhl (2011) have found that governments tend to rely more frequently on self-regulation by sectoral experts, particularly in areas of highly complex issues of market regulation. The belief in the stabilizing role of the markets and in their superior informational set had important policy implications for the conduct of surveillance.

To start with, the widespread faith in markets as agents of financial stability led to the conclusion that the 'right' purpose of international surveillance should have been that of enhancing transparency (see also Best 2005). Increased information would have allowed market participants to make more informed and rational investment decisions, enabling them to discipline those countries judged to be following inappropriate policies and therefore ensure global financial stability. The belief in the self-stabilising quality of markets also led to the reliance on market discipline as an instrument to enforce global surveillance. Indeed, it is possible to say that one the most important pre-crisis trends was the partial privatisation of global surveillance activity as part of a broader trend towards the involvement of the private sector in global economic and financial governance (Cutler, Haufler & Porter 1999; Graz & Nölke 2008; Hall & Biersteker 2002).

This is particularly evident in the standards and codes initiative which followed the Asian financial crisis. The logic that underpinned this initiative was that international financial standards might be of help to promote good economic policies and transparency and therefore contribute to international financial stability (Financial Stability Forum, 2001; 2000). Nevertheless, it was also widely believed that the success of the international standardisation initiative was closely dependent on the involvement of the private sector (Mosley 2003). If market participants had assessed countries' performance against internationally recognised standards in their investment decisions, thereby pricing capital on the record of compliance with international standards, the threats to international financial stability would have been reduced (Fischer 1999). The initiative consequently delegated the international monitoring of domestic policies to

the private sector by giving it the task of assessing domestic policies against globally defined standards and enforcing them, 'as non-compliance would send negative signals to the international financial community, resulting in possible capital flight and investment strike' (Soederberg 2003: 13).

Finally, it is interesting to note that another core belief of the pre-crisis governance framework was the assumption that the main threat to global financial stability would have emanated from the vulnerabilities in the domestic financial system of emerging market countries. This belief was nurtured by the experience of the Asian crisis. The fact that weaknesses in domestic financial sectors – substantial foreign borrowing by the private sector and a weak and over-exposed banking system – significantly contributed to the severity of the 1997 crisis strengthened the position of those who argued that the focus of international surveillance should shift towards the assessment of the domestic financial systems of emerging market countries (see Eichengreen 1999; Goldstein 1999; Kenen 2001). One of the most visible implications of this belief was that the aforementioned international financial standard initiative was directed at the diffusion of international financial standards, modelled upon those of the Western countries (Mosley 2010, 738). The expectation was that the diffusion of the standards developed in the advanced economies would have diminished the probability of a crisis in an emerging country with the attendant global contagion.

In short, the governance of global surveillance in the late 1990s was staked on the premise that the main risk to the global economy was likely to materialise in the domestic financial system of emerging market countries. Hence, these countries were encouraged to bring their domestic financial systems in line with those of the advanced countries by following internationally recognised standards of financial conduct. In other words, it was 'implicitly assumed that [Western] regulatory systems had been operating efficiently' (Walter 2008: 22, 24). The unleashing of the global financial crisis proved these assumptions wrong. The Western world expected the crisis to erupt in a developing country whereas, in fact, it erupted in the most sophisticated financial market in the world. In what follows, I trace what has changed in the governance framework as a result of the crisis using as a benchmark the three dimensions just outlined.

Emerging post-crisis governance forms

The global financial crisis, like most of the other crises that preceded it, has dramatically shown the challenges that global surveillance faces in light of the integration and complexity of world's financial markets. The IMF failed to identify the risks that were building up in the global financial system and to provide clear warnings to spur remedial political action. Specifically, the IMF performed poorly in identifying the risks that were building up in the US housing sector, as well as those in the global financial system as a whole as the result of the securitisation of mortgages and the reliance on the shadow banking system (Independent Evaluation Office 2011). Likewise, it proved unable to appreciate the channels of global financial contagion and their implications for the real economy. These problems, which were not unique to the IMF but common to most of the international bodies tasked with surveillance responsibilities, were compounded by severe blind spots in the data available to financial regulators and supervisors. For instance, there have been serious information gaps about the quality of securitised instruments and the global interconnections of financial institutions via derivative transactions (Financial Stability Board & IMF 2009).

Faced with its weaknesses, the Fund has started an in-house reflection on the key elements of its surveillance strategy (IMF 2009b, 2010a, 2011b) and embarked on a process of reform to improve its activities. At the same time, the Fund has been called on to expand its surveillance repertoire by the Group of 20 (G20) leaders and has been involved in new surveillance initiatives with other international bodies. Let us assess these changes against the three governance dimensions identified in the previous section.

First, in relation to the process through which policy solutions are produced, one of the consequences of the post-crisis reform process has been increased collaboration between the IMF and other regulatory bodies, namely, the G20 Leaders and the FSB. The IMF has been asked to expand its monitoring activities by assessing the compatibility of the G20 countries' national economic policies with the objective of achieving strong, sustainable and balanced growth within the framework of the Mutual Assessment Programme (MAP). The Fund has also been involved in a number of surveillance activities carried out in conjunction with the FSB, which include the IMF-FSB Data Initiative and the Early Warning Exercise (EWE).

The Data Initiative aims at redressing one of the problems experienced during the crisis, namely, the lack of information on key financial sector vulnerabilities relevant for financial stability analysis. Indeed, at the height of the crisis, it became clear that there were scarcely any data available on the level of borrowing outside the traditional banking system, exposures taken through complex instruments, or the cross-border

linkages of financial institutions. As a result, measuring risks deriving from maturity transformation or assessing the extent to which financial institutions and markets were interconnected proved very difficult. The IMF-FSB Data Initiative has thus started identifying the main gaps that need to be covered, as well as the lead international agency that will take responsibility for collecting the relevant data for each area (Clegg and Moschella forthcoming). The EWE, in turn, is an attempt to signal trends that could make markets or countries vulnerable to unanticipated events. It is meant to analyse vulnerabilities in depth, focusing on channels of transmission and contagion (IMF, 2010b: 10). Both the IMF-FSB Data Initiative and the EWE were expressly mandated by the G20 Leaders, respectively in April 2009 and November 2008.

These joint initiatives confirm one of the key pre-crisis trends, namely, the dispersion of surveillance responsibilities in the governance framework among several international bodies. This is also particularly evident in the new functions attributed to the FSB (Griffith-Jones, Helleiner & Woods 2010; Helleiner 2010; Moschella 2012a). Indeed, one of the main changes associated with the transformation of the Financial Stability Forum (FSF) into the FSB in April 2009 was the enhancement of the monitoring functions attributed to the new body. In addition to the tasks that had already been mandated to the FSF – to assess vulnerabilities affecting the financial system, identify and oversee action needed to address them, and promote coordination and information exchange among authorities responsible for financial stability – the FSB has been tasked with the responsibilities of a) monitoring and advising on market developments and their implications for regulatory policy, b) advising on and monitoring best practice in meeting regulatory standards, and c) undertaking joint strategic reviews of the policy development work of the international standard setter bodies (SSBs) to ensure their work is timely, coordinated, focused on priorities and addressing gaps (Article 2 of the FSB Charter).[3]

The FSB has also started been tasked with the responsibility of conducting a programme of peer reviews, consisting of both thematic reviews and country reviews. Whereas thematic reviews focus on the implementation across the FSB membership of the financial standards developed by SSBs and analyze areas important for global financial stability, country reviews focus on the implementation and effectiveness of regulatory, supervisory or other financial sector policies in a specific FSB member jurisdiction. Country reviews are also conducted in cooperation with the international financial institutions in that they examine the steps taken or planned by national authorities to address the recommendations contained in the IMF-World Bank Financial Sector Assessment Program (FSAP) and Reports on the Observance of Standards and

[3] The other tasks attributed to the FSB are those of setting guidelines for the establishment of supervisory colleges; managing contingency planning for cross-border crisis management; and collaborating with the IMF to conduct Early Warning Exercises.

Codes (ROSCs). In short, the bulk of the new functions delegated to the FSB revolve around those of an enhanced monitoring of global stability and domestic regulatory and financial policies, therefore creating the conditions for potential duplication of work with the IMF.

Second, in terms of the instruments through which global surveillance is conducted, the post-crisis debate and reforms indicate a twofold development. To start with, there is a persistent reluctance to rely on hard measures to ensure compliance with the recommended policy advice.[4] That is to say, there have been no serious attempts at strengthening the corrective arm of global surveillance. Rather, in the 2011 Triennial Surveillance Review, the IMF emphasised 'the heavy premium' that its membership places 'on the cooperative nature of the institution', therefore rejecting the use of sanctions or other hard-quality instruments to enforce compliance with surveillance recommendations (IMF 2011a: 11). The reluctance to embrace hard measures to enforce the findings of global surveillance is also evident in the workings of the FSB. Specifically, in spite of the expansion of the FSB's responsibilities in enforcing compliance with international standards, the procedure for addressing the consequences of non-compliance has not been clarified (Helleiner 2010, 18). The decision-making rules that have been designed for the Plenary, which is the FSB decision-making body, constitute a further problem for the enforcement of global surveillance. In particular, the Plenary operates on the basis of consensus meaning that a decision is considered adopted if no voting member oppose it or actively vote against it if given the opportunity. Here the potential problem is that the required unanimity implied in the consensus rule may weaken the FSB's capacity to enforce members' compliance with their commitments to undergo peer-reviews and implement international financial standards. Indeed, it is hard to see how a non-complying jurisdiction will have its membership revoked if a consensual decision is needed in the Plenary (see also Baker 2010: 22; Helleiner 2010: 11; Moschella 2012a).

Furthermore, the post-crisis debate and reforms indicate renewed efforts in integrating financial sector issues into regular surveillance. These are exemplified in a number of policy initiatives. For instance, the IMF's financial stability assessments under the Financial Sector Assessment Program (FSAP) have been made mandatory for 25 members with systemically important financial sectors in an explicit recognition of the devastating implications that financial regulatory issues can have for global stability and economic well-being. The IMF has launched the vulnerability exercise for advanced and emerging market economies (VEA and VEE) and low-income countries (LICs) alike. The EWE the Fund conducts with the FSB is a further

[4] An exception to this trend is represented by the surveillance reforms in Europe, where the European Union (EU) Commission has advanced proposals that include fines and other penalties from countries that deviate from the recommendations issued under the EU multilateral surveillance exercise.

example of the way in which the Fund is strengthening its oversight of financial sector issues. Indeed, in the attempt to detect vulnerabilities to global financial stability, the EWE incorporates measures of common distress across global financial institutions and nonfinancial firms, as well as across sovereigns and asset markets (such as equity and credit markets) and data on cross-border bank exposures (IMF 2010b: 16).

Next to the focus on financial sector issues, the post-crisis debate and reforms also indicate strengthened efforts in deepening understanding of the links between financial and real activity and refining analysis of interconnectedness (IMF 2012). In short, the Fund is reorienting the focus of its surveillance instruments towards a macrofinancial or systemic approach (Moschella 2011). As the IMF (2012: 4) puts it:

> Recognizing the increased interconnectedness among countries and financial markets, there is a need for a more systemic focus, as well as a more integrated approach to macrofinancial policies, at the global level.

In other words, IMF surveillance instruments have been refocused to the task of 'connecting the dots' in order to improve the organization's understanding of the spillovers from highly interconnected financial centres, institutions, and markets. To achieve this goal, the Fund has launched spill-over reports for systematically-important countries, including the United States, China, Japan, the Eurozone countries and the United Kingdom. That is to say, it has developed assessments of the international impact of the policies of the world's five largest economies. The increased attention towards spillovers in surveillance activity is further attested in the Decision on Bilateral and Multilateral Surveillance adopted by the Fund's Executive Board in July 2012, i.e. the Integrated Surveillance Decision (ISD). Under the new Decision, if spillovers from a member's policies are considered to have the potential to undermine global economic and financial stability, these policies need to be discussed with the member within the Fund's bilateral surveillance (ISD paragraphs 22(iii)(b), 22(iv), 22 (vii)). The reorientation towards systemic surveillance is further evident in the design of the EWE which 'aims to "connect the dots" between different risks, uncovering the scope for potential spillovers, and to understand their systemic impact. … focusing on channels of transmission and contagion' (IMF 2010b: 10). The Fund is aware of the need to combine more effectively the findings of its bilateral and multilateral surveillance to deepen its understanding of the links between financial and real activity (IMF 2011b).

Finally, and closely connected to the transformations described thus far, the crisis seems to have brought about some important changes at the level of the belief system. In particular, the IMF's efforts at building a macrofinancial approach to surveillance point to a new understanding of what is the most appropriate focus of the policies of this area (Moschella 2011). In particular, similar to the shift towards macroprudential regulation that is taking place in international supervisory bodies such as the BIS and the FSB (Baker 2012), the shift in the IMF suggests that the focus of international surveillance should no longer be confined to that of enhancing transparency and information to the markets, based on the belief that the private sector 'knows best' how to contribute to global financial stability (Kodres & Narain 2010, 4). Rather, the focus of international surveillance should be on the markets themselves. As the IMF unmistakeably puts it in one of the documents in which it investigates the causes of the crisis, the financial turmoil revealed that 'market discipline failed as optimism prevailed, due diligence was outsourced to credit rating agencies, and a financial sector compensation system based on short-term profits reinforced the momentum for risk taking' (IMF 2009a, 2; also de Laroisiére 2009; Financial Service Authority 2009).

Next to the emerging change in the belief in market discipline, the crisis and the attendant reforms to surveillance activities within and outside the IMF suggest another area where pre-crisis beliefs have at least been shaken. While it was widely believed the international surveillance should focus primarily on the domestic financial systems in emerging market countries, one of the lessons of the crisis has been that such a limited focus was not helpful to the maintenance of global financial stability. Indeed, advanced economies constituted a primary source of risk, not only for the eruption of the crisis but also for its contagion, primarily via the financial channels. As the IMF (2011c: 15) puts it, 'the experience of the crisis suggests that more effective advanced economy regulation and supervision—consistent with international standards—would not only have better supported domestic stability, but would also have helped make capital flows safer.' As a result, many of the surveillance reforms have explicitly been targeted at reinforcing the surveillance over advanced economies. The Fund's vulnerability exercise for advanced economies, as well as the systemic spill-over reports, are among the clearest examples in this regard. To these, we can certainly add the G20 surveillance exercise and the FSB peer-review processes.

In summary, in the aftermath of the global financial crisis major changes have taken place in the conduct of IMF surveillance. These changes relate to the collaboration with other international bodies tasked with surveillance functions, the nature of the instruments used in the exercise of these functions and the core beliefs that guide them. The conclusions to the chapter now reflect on the implications of these findings for the evolution of both the IMF and global financial governance.

Conclusions

It is widely recognised that an external shock, such as a financial crisis, is likely to act as the catalyst for institutional change. The global financial crisis has been no exception, with 'change' touted as the catchword in the international financial governance debate (Moschella & Tsingou 2013). This chapter has engaged with the question of change in the aftermath of the crisis by focusing on the adjustments that have taken place in the governance arrangements that preside over the conduct of surveillance, particularly as they affect IMF surveillance.

The findings suggest some important implications for both global financial governance and the IMF. From a global perspective, the evidence lends support to existing propositions that the global financial crisis has the potential to generate a profound reorientation in the philosophy that underpins global financial regulation and supervision (Baker 2012; Foot & Walter 2011, 249; Germain 2010; Pagliari 2012; for a more sceptical view, see Broome, Clegg & Rethel 2012). Although the initial response to the global financial crisis reiterated the need to rely on greater transparency, disclosure and improved risk management as the most appropriate responses to the financial turmoil (Best 2010), the debate has since shifted to the question of how to strengthen public-sector initiatives, be they the improvement of IMF surveillance or the creation of new international bodies such as the FSB. Of course, this does not imply that market discipline has disappeared from the philosophy that underpins processes of global surveillance. More narrowly, the post-crisis debate and the new macrofinancial or systemic approach to surveillance imply a higher degree of intervention by public authorities and a shift away from an excessive reliance on the principles of market discipline (e.g. IMF, Bank for International Settlements & the Financial Stability Board 2009).

As for the IMF, the changes that are documented in this chapter indicate the emergence of at least three challenges for the organisation. First, the progressive fragmentation of international surveillance calls for the establishment of mechanisms of cooperation among the many institutions involved. For instance, as noted earlier, the strengthened surveillance role for the FSB risks creating tensions and duplication of work with the IMF. This development thus requires the establishment of an appropriate division of labour and mechanisms of inter-institutional collaboration (Draghi & Strauss-Khan 2008). In the conduct of the EWE,

agreement has been reached that the IMF will lead the work on macroeconomic and macrofinancial vulnerabilities, while the FSB will take the lead on vulnerabilities and regulatory challenges in the financial sector (IMF 2010b: 4).

Second, the rejection of a more robust framework for surveillance – including potential sanctions on countries for non-compliance with the Fund's recommendations – casts doubt on the potential of the IMF's procedures of multilateral surveillance to induce change (for an alternative approach to sanctions, see Palais Royale Initiative 2011; Truman 2010). As has often been noted (Broome & Seabrooke 2007; Lombardi & Woods 2008), IMF surveillance is severely limited by the inherent voluntarism of soft law, which is unable to oblige reluctant governments to change their policies.

Finally, the post-crisis changes to IMF surveillance pose important efficiency and legitimacy challenges that derive from shift towards a systemic surveillance approach (Moschella 2012b). As for the efficiency challenge, a question can be raised regarding whether the Fund's organisational culture is ready for the complexities associated with conduct of systemic surveillance. For instance, it has been repeatedly noted that poor financial expertise has prevented the Fund from developing fully-formed understandings of the relationship between financial sector weaknesses and global macroeconomic and financial stability on several occasions (e.g. IMF 1999; Moschella 2011). This pattern was replicated in the run-up to the global financial crisis. Indeed, the dominant macroeconomic expertise of IMF staff helps explain why, in spite of the alarm bell sounded by the crises of the 1990s, staff continued to focus on factors such as global imbalances and disorderly dollar decline as the key risks to global stability, largely failing to take action to address the risks building up in the financial sector (Independent Evaluation Office 2011). Within the IMF, these problems are well-known (IMF 2011b), as reflected in the Action Plan for Surveillance where the Managing Director calls for increased use of financial sector expertise in Article IV consultations to be achieved by assigning a financial expert to each Article IV team for countries with systemically important financial sectors and for countries with mounting financial vulnerabilities, as well as by deepening internal training on these issues (IMF 2012, 8).

Furthermore, a major concern surrounds the ability of the IMF to the collect the relevant data to conduct systemic surveillance (Moschella 2012b). Indeed, systemic surveillance entails taking into the consideration not only government policies but the activities of those actors that form the financial system, including large financial institutions, counterparties and asset managers. The problem for the IMF is that having

access to this information would require the organisation to request its members to report data that they are not currently obliged to report.[5] The IMF is well aware of these shortcomings. For instance, in a background paper to the proposal to give the Fund the role of a systemic supervisor, it acknowledges that, 'although financial network analysis is increasingly recognized as a priority, the limited availability of data is a major challenge. Progress in mapping the international financial network is most advanced in banking, based on data collected by the BIS. ... But in other areas, there are substantial data gaps' (IMF 2010c: 9). In particular, the most serious gaps concern data-related exposures and maturities in debt securities and derivatives markets, foreign exchange markets and international equity markets. Data are not only missing. In other cases, data do exist but not in a useable form. This is particularly the case for networks involving decentralised over-the-counter (OTC) markets where intermediaries typically know their own exposures but not those of counterparties. However, this discussion is not meant to suggest that the IMF has not – and is not able to develop – the analytical skills to undertake a through surveillance of the global financial system, as some commentators imply (Bossone 2009). The problem is more simply that the reforms that are taking place in IMF surveillance are at the limits of the Fund's expertise and resources, raising the question of whether the organisation is up to the task.

Finally, next to efficiency challenges there are also legitimacy challenges, associated with the shift to a macrofinancial or systemic approach to surveillance. Exploiting the discretion accorded to the Fund in the conduct of surveillance, the Fund is suggesting incorporating systemic surveillance into its mandate by changing its staff's operational practices and adjusting existing instruments. In other words, no formal change to the Fund's Articles of Agreement is envisaged and the discussion on a Multilateral Surveillance Decision, which would help clarify the scope and modalities of the new surveillance, is staked on the premise that such a decision is not proposed for adoption – at this stage, at least (IMF 2010a: 6). However, switching to systemic surveillance without a formal mandate cannot but aggravate the crisis of legitimacy of the organisation, especially in light of the scope of the proposed reform. That is to say, the lack of legalisation of IMF reform risks compromising the legitimacy of the organization (see Beetham 1991: 17-21), undermining the very effectiveness of the proposed reform. Indeed, developing an approach to financial supervision that is premised on the assumption that domestic financial sector policies should be judged in terms of their spill-over effects for other countries requires significant political support, since members, at least in principle, agree to adjust their financial policies not for the sake of their domestic economy but for the well-being of the international system. Hence, in the absence of the necessary political

[5] Although under Article IV, Section 3(b) member countries have an obligation to provide the Fund with the information needed to conduct bilateral surveillance over exchange rate policies, Article VIII, Section 5 clarifies that members are under no obligation to provide information 'in such detail that the affairs of individuals or corporations are disclosed.'

support, a change in the Fund's mode of surveillance is unlikely to be fully implemented, making the overall project of reforming IMF surveillance less successful than its designers believe it will be.

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