

# NEW SURVEILLANCE TESTS

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IMF monitoring of member countries' economic health faces a new and generational challenge



**F**rom artificial intelligence to climate change, demographic shifts, and the proliferation of industrial policies, the world must navigate major structural transformations in the coming decades. The IMF's surveillance function—its all-important checks of member countries' economic health—can serve as both map and compass. Its analysis of these important shifts can inform more robust policy frameworks to help countries withstand shocks and seize new growth opportunities. But just as countries must evolve and adapt, so too must IMF surveillance.

The Fund has faced challenges before and has shown its ability to change. At times, the IMF has been rightly criticized for its policy advice or for focusing narrowly on some policy adjustments at the expense of others. It has learned lessons,

though, and promoted peer learning to underpin good policy advice, at times more successfully than at others.

At its core, the IMF is a learning institution.

A first key pivot in the Fund's surveillance occurred after the collapse of the Bretton Woods system of fixed exchange rates. This prompted changes to the IMF's Articles of Agreement in 1978, which expanded its mandate beyond exchange rate policies to include monetary, fiscal, and financial policies. The Fund realized that such policies had an impact on domestic and external stability in the new system of floating exchange rate arrangements.

A second key watershed was a string of capital account crises in the 1990s and early 2000s. Mexico's 1994 devaluation was followed by crises in East Asia (1997–98), Russia (1998), Brazil (1999),

Türkiye (2001), Argentina (2002), and Uruguay (2003). These spurred the IMF to sharpen its exchange rate and financial sector surveillance, develop early-warning models, and focus on debt sustainability and sectoral balance sheet analysis.

The capital account crises demonstrated that markets lacked sufficient information—both in terms of data and regarding the authorities’ policy intentions—to make informed decisions on when and where to invest. Markets tended therefore to overreact to any negative news, precipitating a rush for the exit and a self-fulfilling currency crisis. Accordingly, the IMF emphasized that—in addition to providing timely data to allow effective surveillance by the Fund—member countries should publicly disseminate data (notably on the central bank’s foreign reserves) and adhere to transparency standards for monetary and fiscal policies.

The IMF also sought to deepen its understanding of crisis dynamics, viewing them as a combination of an underlying vulnerability (typically a currency, maturity, or debt-equity mismatch) and a specific crisis trigger, which could be domestic or external—economic, financial, or political. In 2001, the IMF developed the Vulnerability Exercise to identify a country’s near-term macroeconomic risks. This exercise has been regularly updated and covers the majority of member countries across different income levels.

During the 2000s, the IMF updated and expanded its surveillance in the context of rising global macroeconomic imbalances, when (mostly) Asian current account surpluses matched the US current account deficit. The Fund sharpened its analytical tools for exchange rate surveillance, including by developing a model to analyze currency valuations in an explicitly multilateral context.

### Important shortcomings

Despite these significant advances, the global financial crisis of 2008–09 revealed important shortcomings in IMF surveillance. As the Fund acknowledged in 2009, “surveillance significantly underestimated the combined risk across sectors, and the importance of financial sector feedback and spillovers.” In response, the IMF introduced spillover reports for the so-called systemic five economies (China, euro area, Japan, United Kingdom, United States) that subsequently shifted to a more thematic approach focused on key spillover issues. It also introduced a requirement for explicit discussion of risks in Article IV consultations. And, given the speed at which developments in the financial sector could ignite and propagate crises, financial stability analysis was integrated more systematically into surveillance. In 2010,

## IMF surveillance in a nutshell

The IMF conducts periodic health checks of its members’ economies via “Article IV consultations,” or bilateral surveillance. As part of this process, which also takes place at the global and regional levels, the IMF seeks to identify potential risks and recommends appropriate policy adjustments to maintain economic well-being—to sustain economic growth and promote financial stability.

During a typical Article IV process, IMF staff assess major economic developments, discuss the national authorities’ intended policy responses (and the possible policy spillovers), and report back to the executive board, thus bringing the collective insights, experience, and advice of the international community to bear on the economic and financial challenges facing the member country. Through its bilateral surveillance, the IMF seeks to complement the views of national policymakers and add value by bringing an external technical perspective, informed by cross-country experience.

The IMF also promotes worldwide economic and financial stability via its multilateral surveillance. It monitors developments in the global economic and financial system, analyzes cross-border spillovers in systemic economies, promotes information sharing, and provides policy advice.

regular assessments under the Financial Sector Assessment Program became mandatory for countries with systemically important financial sectors. Thus, the focus of IMF surveillance broadened to include policies related to members’ domestic and balance of payments stability as well as global stability through spillovers.

During the latter part of the past decade, the IMF further adapted surveillance in response to criticism that it did not sufficiently tailor its policy advice to diverse member countries. In 2020, the IMF introduced the Integrated Policy Framework, which jointly considers monetary, exchange rate, macroprudential, and capital flow management policies and their interactions with each other and with other policies. This framework is used to assess policies implemented by countries and calibrate IMF advice accordingly. In so doing, the IMF has focused more on tailored and granular recommendations in bilateral analysis, underpinned by analysis of country-specific circumstances. Multilateral flagship reports also now provide differentiated analysis and recommendations for countries in different income groups, complemented

by regional economic outlooks that offer targeted advice on the key policy challenges facing each geographic region.

### Greater resilience

More recently, IMF surveillance has had to grapple with the combination of a once-in-a-century pandemic, the rise of geopolitical tensions, new wars, geoeconomic fragmentation, and a surge in inflation and interest rates, along with a slower outlook for medium-term growth, especially for emerging market and developing economies. These shocks have taken an unconscionable toll on lives and livelihoods, with the most vulnerable countries and people hit hardest.

Most emerging market economies have shown much greater resilience to this recent turmoil than to the global financial crisis. Sound macroeconomic and financial policies and strong institutions, consistent with IMF policy advice, are important contributors to this resilience.

Going forward, the IMF's immediate surveillance priorities are to help all member countries achieve sustained disinflation, implement adequate fiscal consolidation, safeguard monetary stability, and address postpandemic debt overhangs and financial sector vulnerabilities. Given low productivity and deteriorating medium-term growth prospects, the IMF's surveillance is developing policy advice to reinvigorate growth while preserving the hard-won gains of decades of global economic integration.

More work is needed, though, if IMF surveillance is to effectively help member countries navigate emerging transitions. This requires focused macroeconomic analysis and policy advice, in close coordination with other relevant international institutions.

In the area of climate, the Fund adopted a strategy in 2021, reflecting growing recognition of the threat climate change poses to growth and financial stability. Since then, the Fund has made significant progress in integrating climate issues into its multilateral analysis and bilateral surveillance.

Artificial intelligence, meanwhile, presents a promising opportunity for international cooperation to both maximize the benefits and manage associated risks. A set of global principles for the responsible use of AI could achieve this. Here, too, IMF surveillance can help anticipate macroeconomic impacts, identify spillovers, and foster prudent policy responses.

As more countries pursue industrial policies to enhance competitiveness in a more fragmented world, IMF surveillance has assessed the economic effects of these policies and analyzed their cross-border spillovers. Such policies often do more economic harm than good, trigger tit-for-

tit retaliation that reduces net benefits, and can be captured by special interests (Ilyina, Pazarbasioglu, and Ruta 2024). In this area of surveillance as in all others, the IMF must continue to play the role of ruthless truth teller.

Of course, all these challenges will prove difficult for countries to manage without inclusive growth strategies. Amid a widening gap in income levels within and across countries, the need to reverse declining productivity and growth trends is urgent. We have proposed a framework for prioritizing and sequencing macrostructural reforms to accelerate growth, alleviate policy trade-offs, and support the green transition in emerging market and developing economies (Budina and others 2023). It shows that prioritizing the removal of the most binding constraints on economic activity could boost global output effects by about 4 percent in just two years. Our work integrating gender into surveillance shows that narrowing gender gaps in labor markets and access to finance pays large dividends for growth and stability.

### Pursuit of prosperity

The past 80 years of IMF surveillance offer some valuable insights. A robust assessment of economic policies is critical to garner credibility and traction with policymakers. Surveillance must stay ahead of the curve and anticipate problems that threaten domestic or external stability, including spillovers from the policies of systemically important countries. This is because correct policies take time to identify, implement, and take effect. The essence of surveillance is its agility and responsiveness to the IMF's diverse membership.

As we navigate an increasingly fragmented and uncertain world, the IMF's surveillance role is even more critical. It's not just about safeguarding the economy—it's about uniting us all in the pursuit of a prosperous future in a dynamic yet stable global economy. In so doing, IMF surveillance will remain an essential and valued global public good. **F&D**

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