Multilateral Surveillance: the IMF, the OECD and G-20

Kumiharu Shigehara*

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A la cérémonie du 50ème anniversaire de l'organisation de coopération et de développement économiques (OCDE) du 13 décembre 2010 au Palais de l'Élysée, le président français a donné son allocution dans laquelle il a dit que:

"La création du G20 a permis de faire face de manière efficace et coordonnée à la pire crise que le monde ait connue depuis la deuxième guerre mondiale".

Ensuite, it a precisé que "la France a décidé de porter des thèmes difficiles pendant sa présidence du G20 pour cette annee: réforme du système monétaire international."

Le president français a ajouté que "notre organisation monétaire ne peut durablement continuer à refléter le monde d'hier dans lequel ni l'Inde ni la Chine ni le Brésil n'étaient devenues les puissances économiques qu'elles sont aujourd'hui."

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* President of the International Economic Policy Studies Association. Former chief economist and deputy secretary-general of the Organisation for Economic Cooperation and Development and earlier chief economist of the Bank of Japan.

“Le sommet de Séoul a montré tout le chemin qui reste à parcourir pour obtenir cette culture de la coopération, nous ferons des propositions.

Voyons donc les documents de Seoul.

Strengthening Surveillance

While reading the Seoul Summit Document, my attention was attracted in particular to the following two key paragraphs under heading “surveillance”:

19. We recognize the importance of continuing the work on reforming the IMF's mission and mandate, including strengthening surveillance.

20. IMF surveillance should be enhanced to focus on systemic risks and vulnerabilities wherever they may lie. To this extent, we welcome the decision made by the IMF to make financial stability assessments a regular and mandatory part of Article IV consultation for members with systemically important financial sectors.

I shall make some comments on surveillance activities conducted by international institutions, with some focus on the IMF, and argue that the IMF’s tasks to meet the expectations of G20 Leaders must be complemented by surveillance by other international institutions in particular by the OECD.

In fact, several international institutions has been tasked to assess events or forces that are potentially dangerous or disruptive to global economic growth and financial stability with a view to calling for preventive action by national policy makers.

A principal organization charged with these responsibilities, in terms of mandate, authority and resources, is the International Monetary Fund (IMF) with virtually universal membership[1].

Separately, for advanced economies with dominant influences on the global economy and international finance, the Organization for Economic Cooperation and Development (OECD)[2] has been charged with surveillance on both macroeconomic and structural policies to promote economic prosperity within and outside member economies[3].

There are some important institutional differences between the IMF and the OECD in conducting surveillance.

The first aspect of such differences is, as already noted, their membership: the IMF is a universal institution. In contrast, membership at the OECD is restricted.

The second difference relates to the type of fora used for surveillance.

At the IMF, it is meetings of the Executive Board where surveillance is conducted. And the Board is comprised by 24 members and they are all residents in Washington, USA. They are not directly involved in policy making in their capitals.

At the OECD, surveillance is conducted at meetings of committees and their subsidiary bodies all of which are in principle attended by government and central bank officials coming to Paris from their capitals.

Surveillance activities at both institutions are composed of two broad categories.

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[1] At the time of writing, the IMF consists of 186 member countries.

[2] The OECD membership was expanded to 34 countries in 2010.

[3] Shigehara, K. (1996), "Multilateral Surveillance: What the OECD can offer", the 1996 Global Finance Lecture at the University of Birmingham, Paris, OECD. Also available as a working paper from University of Birmingham – International Financial Group.

The first is bilateral surveillance and it refers to the surveillance of the policies of individual countries.
Within the IMF, it is typically conducted through periodic Article IV consultations with all member countries. At the OECD, bilateral surveillance is conducted through the Economic Development Review Committee, which produces Economic Surveys.

At IMF Board meetings for Article IV consultations, even the country to be examined is represented by executive director of that country who resides in Washington, and thus not directly involved in policy making in his/her capital.

On the other hand, at OECD meetings on country reviews, at least the country to be examined is represented by government officials involved in policy making in capitals. Two examining countries often send experts on the country in question from capitals in addition to members of their delegations to the OECD.

The second is multilateral surveillance, and this refers to the surveillance of economic linkages and policy spillovers among countries as well as international or regional economic and market developments. It can complement bilateral surveillance by bringing into the analysis global and cross-country perspectives.

What is now regarded as multilateral surveillance was first developed at the Organization for European Economic Cooperation (OEEC), the predecessor of the Organization for Economic Cooperation and Development (OECD), at a time when the IMF was preoccupied almost exclusively with bilateral surveillance.

In fact, it was in 1961 that the OEEC's Economic Policy Committee created a group called "Working Party No.3" on adjustment of international payments to consult on national and international policy measures with effects on international payments. The Working Party is attended by deputy finance ministers and deputy governors of central banks of G10 countries who gather at the OECD's Paris headquarters. They met every two months or so in the 1970s and 1980s. But the frequency of their meetings was gradually reduced as those members of G7 increased their meetings and more recently as G20-related activities increased.

At the IMF, multilateral surveillance is conducted in the context of half-yearly World Economic Outlook exercise and by resident Board members, and not by officials coming from capitals as is the case of OECD multilateral surveillance.

Division of labour between the IMF and the OECD?

In his speech in December 2007 in Australia, Mr. Mervyn King, the Bank of England governor called for radical overhaul of the IMF[4]. One of Mr. King's specific recommendations was that duplication should be avoided among international organisations.

In an article I wrote immediately after his speech, I agreed with many of his views but added that utmost care would be required in rationalizing the surveillance activities of the IMF and the OECD so that it should not result in weakening of surveillance on the interaction between macro economic and structural policies. Coherent review of key economic players' actions or non-actions in these two policy areas is clearly needed in today's international setting.

To make this point clear, I pointed out that large rises in unit labour cost in several member countries of euro area that had persisted even after their participation in the area had not only weakened their international competitiveness and worsened external current accounts, but the divergence of their unit labour cost performance from sustained declines in Germany clearly pointed to the emergence of an underlining threat to the viability of the euro system with adverse consequences for global macro economic stability. Many

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[4] Mervyn King, "Through the Looking Glass:Reform of the International Institutions", Inaugural International Distinguished Lecture to the Melbourne Centre for Financial Studies, Australia on 21 December2007, http://www.bankofengland.co.uk/publications/speeches/2006/speech296

euro area countries competing with Germany can no longer use exchange rate adjustment to narrow relative cost disadvantages vis-à-vis Germany. Accelerated labour market reform is the only way to prevent a buildup of macroeconomic tensions within euro area with possible undesirable sedondary effects on the US, Japan and the rest of the world. These remarks made in 2006 unfortunately proved to be true.

As financial and exchange market participants attention shifted on the unsustainable macroeconomic situation associtated with the combination and fiscal laxity of maladjustment of labour market policies and fiscal laxity persistenly observed over years in several euro area countries with one-size-fit-for-all monetary policy and without the possibility of exchange rate adjustment among euro member countries the euro section of global financial markets became volatile and as a consequence the Japanese yen exchange rate soared against euro.

This undesirable euro weakness and weak growth prospects in euro area is projected to exert adverse on the Japanese economy in 2011, worsening economic trends from 2008 onwards which resulted from the yen's sharp appreciation against the US dollar after its subprime market debacle.

Reflecting foreign investors' increased confidence in the Japanese financial markets, knowing that about Japanese banks' limited exposure to foreign toxic assets, yen rose sharply, knocking down Japan's exports, and Japan's output declines were the sharpest among G7 countries in both 2008 and 2009.

In my view, surveillance of macro policies should go hand in hand with structural policy surveillance in to order to prevent anomaly whose underlying cause is the malfunction of structural policies combined with rigidity in macroeconomic policy management.

More to the point, Mr. King noted that in the IMF report on the US economy for 2006, the electricity sector and competition among auto manufacturers and airlines had been picked up as areas deserving the Fund staff's special examination, and argued that these were areas which should be reviewed within the OECD process. I agreed with this view. But, this does not mean that at the same time, the OECD should discontinue macro economic analysis and forecasting which is essential for examining the interrelationship between macro and structural economic forces and making recommendations on a coherent set of macro and structural policies over the medium term.

That said, the current OECD framework for multilateral surveillance of macro economic and structural policy issues is unsatisfactory even for major member countries, not to speak of those issues in key non-member economies with significant global ramifications such as China. Specifically, the joint participation of very senior policy makers in macro economic and structural policy areas from examining countries as well as from countries to be examined should strengthen the role of the OECD's Economic and Development Review Committee.

I would also argue that the European Union's process of multilateral surveillance by top policy makers of participating countries on the interaction of macro economic and structural forces and policies should not reduce the importance of the OECD surveillance process which puts both EU and non-EU countries such as the US and Japan under peer review simultaneously as "examining countries" and "countries to be examined".

More generally, a fundamental rationale for multilateral surveillance is that policies implemented in one country or in one region spill over to others, and that co-operative policy making, involving full recognition of other countries' or other regions' actions, can achieve better economic outcomes than independent action.

A parallel argument for policy co-operation is that each country acting alone may have an incentive to adopt "beggar-thy-neighbour" policies, even though if all countries did so, all would lose.

There is also a political rationale for multilateral surveillance: it can make policies more palatable to domestic residents, in the face of competing interests within governments, each having different, often conflicting, policy agendas. A quid pro quo, or even international peer pressure, could tip the balance in the mechanism of domestic policy formation, making it possible to implement good policies.

More broadly, multilateral surveillance can assist structural reform in individual countries by allowing experience to be shared, maintaining the peer review and providing the public with informed and authoritative assessments of what needs to be done and the potential gains from reforms.

The scope of the IMF surveillance has widened since the breakdown of the fixed exchange rate system in the early 1970s, with institutional and structural issues gaining steadily increasing emphasis. This has been particularly evident since the Asian crisis in the late 1990s. For example, in the 2006 Article 4 consultation with Korea, the IMF Executive Board once again stressed the need for Korea to address underlying structural difficulties, by reviving the SME sector and modernizing the labour as well as financial markets.

While this conclusion of the IMF Board discussions based on staff papers on these issues is right, there is a concern that the Board members who largely represent finance ministries, constituencies with essentially macroeconomic background and less expertise in labour and other social policy affairs, can make peer pressure effective in such policy areas.

One way to cope with this problem would be closer co-operation between the IMF and the OECD at least for surveillance on OECD member countries and some key non-members with which the OECD has established co-operative relationships in recent years. Indeed, a feature that sets the OECD apart from many other international organisations including the Bretton Woods institutions is its wide variety of specialized Committees and their subsidiary bodies that are attended by officials from capitals, rather than representatives permanently stationed in Paris.

The principal advantage of this arrangement is that the members of the OECD Secretariat have very close contacts with policy makers and experts in national administrations working on both macro and a wide range of structural policy issues and, conversely those in national administrations are deeply involved with the work of the Secretariat. Hence, multidisciplinary activities involving various directorates of the OECD Secretariat serving different Committees which should help narrow differences of views between government departments and thereby assist governments in designing and implementing a coherent set of macroeconomic and structural policies.

Actually, the IMF has an observer status at OECD meetings on both macro and structural policy issues and at the time of financial crises which hit Mexico and Korea soon after their accession to the OECD, informal contacts between the IMF staff and the OECD secretariat members proved useful to co-ordinate policy prescriptions to be formulated in the respective surveillance frameworks of the two institutions.

But, more formal and strengthened two-way co-operation, including the OECD's observer status at the IMF Board meeting discussions on OECD countries and key non-members could enhance the effectiveness of IMF surveillance, perhaps in enticing the sense of participation in its surveillance process among various departments of governments directly involved in structural policy making in capitals with which the OECD Secretariat has close working relationships.

OECD process of surveillance

The OECD strictly views surveillance as a peer review process. Members of the OECD Working Party No.3 are deputy finance ministers and deputy governors of central banks of G10 countries who gather at the OECD's Paris headquarters, as such they directly participate in policy-making in capitals. The OECD secretariat independently prepares analytical reports and policy recommendation papers for their meetings. After the meetings, it routinely deletes politically sensitive information from reports before they are released to the public. It also allows national officials greater involvement in the preparation of country-related reports.

Compared with the IMF, the OECD has been considered to have some other advantage as a mechanism of peer review: the smaller size and relative homogeneity of membership in addition to the wider coverage of policy areas beyond macro.

But, increased membership over the past decades (from 20 member countries in 1960 when the OECD started to 34 countries now) has eroded these comparative advantages.

Moreover, despite enlargement of membership, the relative weight of the OECD area in the world economy has been steadily declining. In 1975, the OECD area accounted for 65 per cent of world GDP. In 2015, its share in world GDP is projected to decline to about 50 per cent. On the other hand, the total size of the economies of Brazil, China, India, Indonesia and South Africa accounts for 25 per cent of world GDP.

Thus the role of OECD multilateral surveillance has become less effective in the task of promoting global economic prosperity with financial stability. Fundamental restructuring of the OECD whose membership does no longer reflect reality of the global economy is urgently required on the occasion of its 50th anniversary this year.[5]

G20 Surveillance Process

G20 has the same size of membership as the OECD when it was created in

[5] For detail, see Shigehara, K. (2009), “Aratana Kokusai Keizaishakai Chitsujo no Kouchiku (Establishing a New Global Economic and Social Order)” (in Japanese), *Gaiko Forum (Diplomacy Forum)*, No. 249, Tokyo. April.

1960. A major difference is country composition. The OECD initially comprised of the Unites States, Canada, and 18 European countries which were all members of OEEC, and there was no members from Asia-Pacific and Middle and South Americas. G20 includes a number of countries in these regions while a number of European member countries of the OECD are not included in the G20.

As already said, at the OECD, a subsidiary group of fairly small membership called as Working Party No.3 was created to exercise most intensive peer review on international payments adjustment. This body, which is G10 based, did function as the most active multilateral surveillance forum until non-Japan East Asia gained significance as an economic and financial power.

G20 Mutual Assessment Process is designed as “country-led, consutative” peer review process. Whether G20 would need a smaller subsidiary group to exercise effective peer review like at the OECD remains to be seen.

Another major issue is whether the G20 process can function effectively without a permanent secretariat. The OECD has a permanent secretariat with professional staff of high quality which conducts independent analysis, prepares economic forecast and makes policy recommendations.

In the age of globalisation with ever growing international spillovers from the interplay of macro and structural policies and such forces in individual countries, no matter how good analytical work on macro and structural issues is individually, multilateral surveillance cannot be effective without systematic interdisciplinary work such as to synthesize opposing political constituencies, essentially spending and non-economic considerations vs. budget control ministry concerns to protect taxpayers and to achieve sustained macroeconomic stability and prosperity.

In concluding, I would stress that it is only with the strong political will of key players at leadership levels in the world economy that we can succeed in a radical reform of international institutions to make them more relevant to the new circumstance.