

Designing a Regional Surveillance Mechanism for East Asia: Lessons from IMF Surveillance

Shinji Takagi
Professor of Economics
Graduate School of Economics
Osaka University

Summary

The process is underway in East Asia to establish an independent surveillance unit to support decision-making in the Chiang Mai Initiative Multilateralization (CMIM). The paper reviews the principles of surveillance, discusses how they have applied to IMF surveillance in practice, and draws lessons for designing an effective regional surveillance mechanism. The need for such a mechanism in East Asia is both immediate and evolving. For the immediate need, surveillance must meet the operational requirements of the CMIM. At the same time, it must also respond to East Asia's evolving need for a formal framework of policy dialogue and cooperation. A review of the rich literature on IMF surveillance has identified at least five organizing principles for an effective regional surveillance mechanism, including: (i) clearly define the purpose of surveillance, (ii) centralize surveillance activities in a single organizational unit, (iii) use objective indicators to inform analysis, (iv) design the governance structure to ensure independence, and (v) provide analysis and recommendations directly to senior policymakers in order to exploit peer pressure. Of these, defining the purpose of surveillance may be the most fundamental requirement for effective surveillance because agreement on the purpose presupposes the surrender by member governments of part of national sovereignty essential for successful policy cooperation. Peer pressure as the primary channel of influence does not preclude active engagement with the public because it is after all through the political process that policymakers are motivated to take action. The surveillance unit should therefore operate with the presumption that it makes a full and complete disclosure of any analysis, view, or information it possesses to the public except when privileged information is involved. To the extent that the quality of the people ultimately determines the quality of the outputs, it is paramount to staff the unit with competent professionals on the basis of merits alone.

Keywords: Regional surveillance; IMF surveillance; surveillance design mechanism; East Asia

JEL Classification: E02, F33

1. Introduction

The paper reviews the principles of surveillance, discusses how they have applied to surveillance conducted by the International Monetary Fund (IMF), and draws lessons for designing an effective surveillance mechanism for East Asia. The recent decision by the ASEAN+3 finance ministers to establish an independent surveillance unit reflects their recognition that surveillance is a necessary part of any conditional lending facility.¹ Up to this point, the Chiang Mai Initiative (CMI), lacking an effective surveillance mechanism, has required that financing beyond 20% of the bilateral swap facility be provided only to a country under an IMF-supported program. With effective surveillance, the multilateralized CMI (CMIM) could rely more on its own judgment to make a lending decision, including the amount and any conditionality, without creating moral hazard or raising concerns that the problems leading to balance of payments difficulties may be fundamental in nature.

As the region's economic integration continues to deepen further, the CMIM may evolve into an Asian Monetary Fund of some sort (Kawai, 2010). Then, surveillance could assume an added dimension. With strengthening interdependence, East Asia is faced with an increasing need for a cooperative mechanism to prevent a crisis from occurring in the first place. It will also need a more effective framework of regional policy dialogue and cooperation to deal with policy spillovers, both to mitigate political tensions and find scope for collective action. Surveillance is the foundation upon which such cooperative schemes can be built.

The rest of the paper is organized as follows. Section 2 reviews the principles of surveillance. Sections 3 and 4 discuss how IMF surveillance has worked in practice by identifying repeated themes in the literature. In particular, Section 3 covers issues related to preparing the content of surveillance (the message), while Section 4 deals with issues related to delivering the message. Section 5 then explores the scope for surveillance by a regional body. Section 6 draws organizing principles for regional surveillance from the literature on IMF surveillance. Finally, Section 7 concludes with a summary of main findings and implications for regional surveillance in East Asia.

2. What is Surveillance?

The word surveillance, in the sense it is used today, appeared for the first time in the early 1970s in the internal documents of the IMF, though the expression "multilateral surveillance" had been used in the work of the Group of 10 (G-10) in the 1960s (James, 1995). Surveillance became part of the lexicon of international economics in connection with the Second Amendment of the IMF Articles of Agreement, which came into force in 1978. Article IV of the amended Articles of Agreement established obligations for the IMF to "oversee the international monetary system in order to ensure its effective operation" and "oversee the compliance of each member with its obligations" specified therein

¹ In May 2009, the ASEAN+3 Finance Ministers agreed that "an independent surveillance unit will be established as soon as possible to monitor and analyze regional economies and support decision-making in the Chiang Mai Initiative Multilateralization. See the Joint Media Statement of the 12th ASEAN+3 Finance Ministers Meeting in Bali, Indonesia, 3 May 2009.

(Section 3[a]) as well as to exercise firm surveillance over the exchange rate policies of its members (Section 3[b]).

The idea of surveillance is considerably older. The first instance of what is commonly regarded as surveillance of the international monetary system occurred within the context of analytical work conducted by the League of Nations (Crow et al, 1999). Surveillance to be conducted by the IMF was foreshadowed by the early wartime discussions between John Maynard Keynes and Harry Dexter White, and was implied by Article I of the founding documents, which characterized the Fund as a mechanism for consultation and collaboration on international monetary problems. IMF surveillance subsequently developed out of two parallel institutional requirements, namely, its regulatory responsibility to assess member countries' need to maintain restrictions on current transactions and its role as a crisis lender (James, 1995).

In IMF terminology, it is customary to use the terms bilateral and multilateral to characterize the two broad categories of surveillance activities. Bilateral surveillance 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. Multilateral surveillance 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), when the IMF was preoccupied almost exclusively with bilateral surveillance.² In 1961, the OEEC's Economic Policy Committee created a study group called Working Party Three to analyze the effect on international payments of monetary, fiscal and other policy measures and to consult on national and international policy measures; the working party was constituted to replicate the composition of the G-10. As a parallel development, in the early 1960s, a working group of finance deputies was established within the G-10 to undertake a thorough examination of the outlook for the functioning of the international monetary system in a multilateral surveillance exercise (James, 1995).

Somewhat confusingly, the term regional surveillance now appears in various IMF documents. For example, the IMF's official statement, in summarizing the Executive Board review of surveillance in 2008, states that one of its core activities is to monitor global, regional, and national economies through bilateral, regional, and multilateral surveillance.³ In this definition, regional surveillance covers a geographically defined group of countries or a regional monetary union, while multilateral surveillance applies to

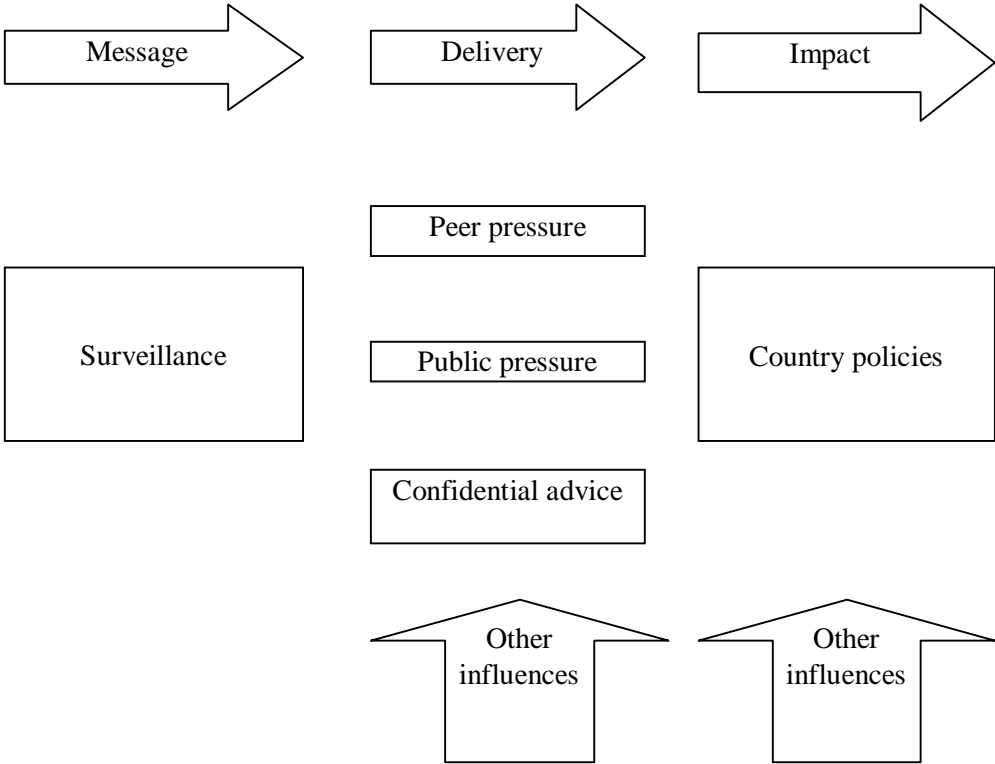
² The OECD's equivalent of bilateral surveillance is conducted through the Economic Development Review Committee, which produces Economic Surveys (Thygesen, 2008; Koromzay, 2008).

³ See IMF Executive Board Reviews the Fund's Surveillance, Public Information Notice No. 08/133, October 2008. This particular terminology is not consistent with the language of the Articles of Agreement, where bilateral and multilateral ostensibly correspond to member countries and the international monetary system, respectively. There is no counterpart to regional.

the world economy as a whole. But this is not the only sense in which the term regional surveillance can be used in the context of East Asia. Regional surveillance could also mean surveillance conducted by a regional body, whether it is bilateral, multilateral, or even regional. In fact, this is the sense in which the term regional surveillance is used in this paper. Likewise, the term global surveillance is used to mean surveillance conducted by a global body.

Surveillance can be viewed in terms of a results chain consisting of three stages (Figure 1). In the first stage, surveillance produces a message, such as the assessment of crisis vulnerability in a particular country or the need for a particular country to make a policy correction. In the second stage, the conductor of surveillance delivers the message to the relevant audience by utilizing one or more of three available channels: (i) peer pressure through the officials of other countries, (ii) public pressure through the markets or the general public, and (iii) quiet persuasion as confidential advisor to the government. Finally, in the third stage, the message may have an impact on policymaking in the country concerned if the right message is delivered appropriately. I follow this conceptual framework by discussing issues related to preparing the message first (Section 3) before moving on to consider those related to delivering the message in a way calculated to increase its impact (Section 4).

Figure 1: The Results Chain of Surveillance



Source: IEO (2006)

3. Preparing the Message

IMF surveillance has evolved over time, but without clearly defining the purpose. Crow et al. (1999), followed by Boughton (2001), identify the following possible purposes of surveillance: (i) policy advice, (ii) policy coordination and cooperation, (iii) information gathering and dissemination, (iv) technical assistance, and (v) identification of vulnerabilities. But these multiple purposes only highlight the roles that IMF surveillance is understood to have assumed over time but are not explicitly spelled out in the Articles of Agreement. No focused message is possible without a clearly defined purpose. The IMF's Independent Evaluation Office (IEO) concluded in 2007 that the lack of clarity over the purpose of surveillance had rendered IMF surveillance less than fully effective.

The failure of IMF surveillance in some of its fundamental responsibilities has come from the lack of clear agreement on the purpose of surveillance, which in turn is a reflection of the unwillingness of member governments to surrender part of their national sovereignty over economic policymaking to a supranational agency. As a result, the IMF has generally shied away from addressing politically sensitive issues, except when it was pressured to do so by its largest shareholder. Exchange rate policy, which is supposed to be subject to IMF surveillance by the IMF, has not therefore received intensive attention in IMF surveillance (Mussa 1997; IEO, 2007). The IMF is not alone in this failure. The ineffectiveness of multilateral surveillance over international payments at the G-10 and the OECD likewise diminished proportionately as the potential importance of exchange rate adjustment rose in the late 1960s (James, 1995).

Another difficulty involved in preparing clearly focused surveillance outputs is the lack of professional consensus and the consequent role judgment must play in economic policymaking. The absence of a widely accepted economic theory, and the large margin of error in any analytical tool, have meant that experts often hold divergent views on whether a change in exchange rate regime or in the exchange rate level is needed for a given country or more broadly how economies interact with each other in the determination of important endogenous variables. Again, the IMF is not alone in facing this difficulty. The same lack of consensus on economic policy rendered ineffective the multilateral surveillance exercises of the G-10 and the OECD in the 1960s (James, 1995).

In the meantime, IMF surveillance has largely evolved into a form of policy dialogue with member countries, in which the IMF provides analysis of economic developments and policy advice. In this task, any advantage the IMF may have had in the past has greatly diminished, as the level of human capital has risen throughout the world and country-related information has become more widely available. The IMF has struggled to identify its comparative advantage and add value to its surveillance. As a global institution with near universal membership, analysis of cross-border linkages and spillovers is a clear area where the IMF must have advantage, but the IMF's recent internal review states that there is a large unmet demand for analysis of spillovers and for cross-country analysis informing the policy dialogue (IMF, 2008a).

The lack of integration between bilateral and multilateral surveillance has been a repeated theme since Crow et al (1999). This is in part due to the historical origin of IMF surveillance as a bilateral surveillance activity, but more importantly to the failure to clarify

the operational goals and define the mechanism to best meet them (IEO, 2006). As a result, multilateral surveillance has a strong bottom-up element, produced as the sum of bilateral surveillance across all member countries. This tendency has been enforced by the fact that area departments (that conduct bilateral surveillance) usually have the final say on all country matters. Integration is also hampered by the organizational structure in which different departments are charged with different aspects of surveillance (e.g., area departments for bilateral surveillance and the Research Department for multilateral macroeconomic surveillance).

Another area where greater integration is beneficial concerns the linkage between the real and financial sectors. Part of the lack of integration between macroeconomic and financial surveillance reflects the inherent complexities of the matter (McDonough et al., 2006), but financial issues have assumed much greater importance for the identification of vulnerabilities, as the volume of cross-border financial flows has expanded tremendously in recent years. It was only after the 1994 Mexican financial crisis (and especially the 1997/98 Asian financial crisis) that the IMF began to recruit people with financial sector and market experience on any serious scale. Despite progress in recent years, the G-20 Summit in November 2008 still noted that the IMF should give greater attention to financial sectors and better integrate the reviews with the joint IMF/World Bank financial sector assessment programs, with a view to strengthening the role of the IMF in providing macro-financial policy advice.⁴

As the knowledge gap narrows with member governments, the IMF is under pressure to focus on a few areas of strength to add value, to be taken seriously, and consequently to have impact. Member government officials often criticize the IMF's economic policy advice as lacking the country-specific and operational details necessary to be useful. This only shows that, as the educational attainment of economic officials in member country governments has risen, Ph.D. economists with limited policy implementation experience can offer little on the basis of general economic knowledge. Economic officials now demand technical knowledge of the operational aspects of economic policymaking tailored to country-specific conditions, something the IMF staff is not prepared to give.⁵ The IMF also faces increasing competition from other public and private institutions, including internationally active investment banks, in supplying economic analysis and policy advice.

4. Delivering the Message

Providing value added is not sufficient for a surveillance message to have impact. The message must also be packaged in such a way that it is quickly understood and absorbed, and delivered to the right audience. Focus and candor is the key, both of which IMF surveillance is often accused of lacking. The primary reason for the lack of candor comes from the desire of IMF staff to maintain good relations with national authorities and

⁴ G-20 Summit Declaration on Financial Markets and the World Economy, Washington DC, 15 November 2008.

⁵ About 40% of officials who responded to an IEO survey viewed the IMF staff's knowledge of country-specific background as inadequate and its operational knowledge of policymaking as inferior to theirs (IEO, 2007).

therefore avoid offending them.⁶ Crow et al. (1999) used the term "a culture of clientism" to explain the tendency of the Fund, particularly staff in area departments, to be insufficiently frank and direct in its assessment of a country's policies or economic situation.⁷ This same incentive explains the lack of evenhandedness. Larger countries tend to have more influence in the organization so that the IMF staff's desire to be diplomatic is heightened when dealing with large industrial and emerging market economies. It is difficult to substantiate such a claim (IMF, 2008b), but this perception persists, especially with respect to the IMF's interactions with its largest shareholders.⁸

Another element of effectiveness is transparency. IMF (2003) notes that greater transparency could help increase the accountability of the Fund and of member governments, while providing the private sector with better and more continuous information for decision making. A clearly articulated publication policy can depoliticize the supply of information, prevent surprises to the market, and imposes policy discipline on governments. James (1995) called this "a way of involving the world's capital markets in the operation of surveillance," liberating the institution from concerns about confidentiality that has stymied the practice and effectiveness of surveillance. The IMF has come a long way towards upholding the principle of transparency in its practice of surveillance. Even so, surveillance largely remains a restricted exercise between the IMF and member government officials, and IMF surveillance, except in a program context, does not fully exploit the available channels (see Figure 1).

The delivery of IMF surveillance outputs is still focused on the narrow circle of country representatives at the Executive Board and the IMF staff's counterparts in finance ministries and central banks. But these officials are for the most part technical experts who may not have sufficient access to their respective ministers and governors, not to mention prime ministers and presidents. Rarely does the IMF interact with the real decision makers of economic policies in large industrial and emerging market economies. The IMF's confidential advice often does not receive the attention of sufficiently senior officials. In addition, the Executive Board, where surveillance discussions take place, does not have sufficient seniority to serve as an effective peer pressure group.

There is increasing awareness that, to have impact, the message must be carried to a wider audience, including officials of the ministries of planning, labor, economic, trade and the like as well as government research institutes. To widen the audience even further, the IMF could assume a greater role in providing information to the public in an attempt, as

⁶ Another reason relates to the role of the IMF as confidential advisor to whom privileged information may be provided. There is also the concern that given the perception that the IMF has an information advantage, its remarks about market-sensitive issues can actually impact the markets. However, the reality is that with the exception of program countries the information advantage that the IMF may have once possessed has all but disappeared.

⁷ According to IMF (2008b), about 30% of the mission chiefs surveyed indicated that they had delivered a candid message, while about 50% acknowledged that they had been constrained and were less than candid.

⁸ All three G-20 Summits from November 2008 to September 2009 recognized these weaknesses and charged the IMF to provide "even-handed, candid and independent surveillance of the risks facing the global economy." See G-20 Summit Leaders' Statement in Pittsburgh, 24. 25 September 2009.

Useless truth teller, to influence a member country's economic policies through naming and shaming. Even so there remains an understandable tension between the role of confidential advisor and that of provider of information to the public. Here lies the limitation of an institution responsible to member governments that typically resent the open discussion of market-sensitive material (James, 1995).

The key to resolving the conflict is to determine whether privileged information is involved. What complicates the process, however, is that the markets may think the IMF has privileged information when in practice it does not. In reality, except in a program context, the authorities of member countries rarely give market sensitive information to the IMF. To avoid market surprises when they are not warranted, there must be a clear transparency policy with respect to the public disclosure of information. In this age of the Internet when transparency is the governing principle of public administration of most democratic societies, one rarely possesses information that the market should not possess if it does not have it already.

In this respect, the OECD has a totally different approach to transparency because it strictly views surveillance as a peer review process. Thus, it routinely deletes politically sensitive information from reports before they are released to the public, presumably in deference to national authorities; it also allows national officials greater involvement in the preparation of country-related reports (OECD, 2002). As a mechanism of peer review, OECD (2002) considers the smaller size and relative homogeneity of membership (compared to the IMF), and the practice of assigning two examining countries to one member, to be the strengths. But a report on the economic policies of a country prepared by its own officials is hardly considered by the public to be objective.

5. Exploring the Scope for Regional Surveillance

It would be a daunting task for any organization to match the resources that the IMF devotes to surveillance activities, which probably amount to hundreds of millions of US dollars per year. Although East Asia has a compelling case for having its own surveillance mechanism, with so many other competing global and regional providers of surveillance outputs, it is still legitimate to ask whether East Asia should duplicate the efforts being made elsewhere. The content of regional surveillance should ideally focus on areas in which it can effectively complement global surveillance. To duplicate the efforts being made at other global and regional institutions would not only be an inefficient way of using the world's scarce public resources, and also it imposes an unwelcome, additional administrative burden on the member countries.

Avoiding duplication does not mean that the new surveillance unit should shy away from conducting its own analysis of global and national economic developments. As the regional custodian of pooled reserves and arranger of financial packages, the surveillance unit must be aware of the economic policy challenges in each country and the global environment in which member countries operate. It must also have the technical expertise to form its own judgment of crisis vulnerability, identify regional policy spillovers, and suggest scope for collective action. To perform these tasks effectively, it is critical that the surveillance unit be granted complete access to all surveillance outputs that are produced on the region's economies by the IMF and other institutions. Avoiding duplication suggests

that the unit would not have to prepare elaborate reports on the assessment of developments, economic policies, and prospect at the global level or in individual countries.

Financial surveillance, though critical in assessing crisis vulnerability, is another area where duplication with global surveillance should be carefully avoided. This is especially the case because financial surveillance is a highly labor-intensive activity. There are three aspects to this. First, the right kind of financial expertise is scarce; linking financial analysis to the real sector is an art that is only beginning to develop.⁹ It is unrealistic to expect that the regional surveillance unit will quickly develop expertise in this area. Second, a financial crisis is a relatively rare event and developing crisis-relevant expertise requires global exposure. This expertise can best be fostered at a global institution and shared globally. Third, financial flows are global phenomena and the activities of large financial firms cut across national and regional boundaries. At the same time, supervision of individual institutions can only take place at the national level. Financial surveillance is, therefore, one area in which the regional approach makes little sense.

Although these and other reasons argue for concentrating surveillance resources within global institutions, such as the IMF and the Financial Stability Board, this is only true of surveillance designed to identify crisis vulnerability. If the CMIM indeed evolves into an Asian Monetary Fund, the regional approach could play a bigger role in fostering financial cooperation. For example, the regional surveillance unit could assume the role of promoting the development of local currency bond markets under the Asian Bond Markets Initiative (ABMI).¹⁰ Then the quantitative and regulatory monitoring of financial developments in the region becomes a relevant exercise for the regional unit. Currently, the Asian Development Bank (ADB) performs this role informally on behalf of ASEAN+3 by producing the periodic *Asia Bond Monitor* and related analyses. This function of ADB may need to be transferred to the new surveillance unit if policy cooperation in the financial area were to become one of its mandates. Even so, the resource requirements for financial surveillance at the regional level can be kept lean because regional surveillance, out of necessity, must rely heavily on information provided by global and national agencies.

6. Organizing Principles for Regional Surveillance

The preceding discussion has identified at least five principles for organizing an effective regional surveillance mechanism that would complement global surveillance.

- **Clearly define the purpose of surveillance.** The purpose largely determines the content of surveillance. Unless the purpose is clearly defined, a focused message cannot be produced from any surveillance activity. Among the possible purposes of surveillance noted above, the most immediate for East Asia is the identification of vulnerabilities, which should also be understood to include the due diligence task of a crisis lender in assessing

⁹ The IMF is in the process of refocusing on financial sector surveillance and real-financial linkages as a priority area (IMF, 2009).

¹⁰ The ABMI is currently one of the three regional financial cooperation initiatives of ASEAN+3, along with the CMIM and ERPD.

the capacity of a potential borrowing country to repay and the conditions that should be attached to a loan to ensure the CMIM's revolving nature (Kawai and Houser, 2008); over time policy coordination and cooperation could increasingly become part of the purpose of surveillance. Agreeing on the purpose of surveillance presupposes that member governments have surrendered that part of national sovereignty necessary for the regional surveillance unit to perform its clearly assigned tasks, including the commitment to provide the necessary data and information.

Although analytical requirements for identifying crisis vulnerabilities and the scope for collective action are similar, the two purposes may require different approaches to delivering the message. For policy coordination and cooperation, greater use can be made of peer review and resultant peer pressure, which is an approach that has been successfully used by the OECD and replicated more recently by ASEAN. For the identification of vulnerabilities, a less consultative (and in some cases more adversarial) approach that precludes the concurrence and involvement of the countries concerned may be necessary because disagreement is more likely to emerge over an assessment indicating that a country is in danger of crisis or producing a spillover harmful to the interests of the region. An assessment of exchange rate levels or the ability to service debt would also fall into this category.

- **Centralize surveillance activities in a single organizational unit.** The failure to integrate various strands of surveillance has been a regular finding of past reviews of IMF surveillance. The reasons for this failure include the inherent difficulty of the task, the failure to define the purpose of surveillance clearly, and the fact that different departments produce different surveillance products within the IMF. East Asia's regional surveillance mechanism should aim to have an organizational structure that forces integration between bilateral and multilateral surveillance, as well as between macroeconomic and financial surveillance. This is especially important because Asian economies are highly interdependent in terms of both macroeconomic and financial links. The best way to achieve this analytical integration is to put a single organizational unit in charge of all surveillance activities. Given the small membership of the proposed regional surveillance unit and its expected focus on one or two specific purposes, it should be easy to achieve a compact organizational structure.

- **Use objective indicators to inform analysis.** Given the current state of knowledge, the economics profession is rightly skeptical about the ability of economists to find precise metrics for the probability of a crisis or the equilibrium value of a macroeconomic variable. Even so, a model-based approach to economic analysis is a way of forcing surveillance staff to take a position on politically sensitive yet critical issues and include them in the overall analysis. This is especially true when the purpose assigned to surveillance is to identify crisis vulnerability. To aid the process, it is important to develop an analytical framework to assess the level of exchange rates (e.g., a behavioral equilibrium exchange rate model) or the crisis vulnerability of member countries (e.g., an early warning system [EWS]). Moreover, given the tendency of national governments to avoid discussing sensitive issues openly, broad agreement on using a small set of objective indicators, including an indicator of exchange rate divergence, is a way of depoliticizing the surveillance process— at least by putting the discussion of sensitive issues on the table.

- **Design the governance structure to ensure independence.** Independence is a feature that ensures candor and evenhandedness in surveillance, especially when the identification of vulnerability to crisis is involved. The lack of independence from political interference has created the perception that the IMF is harsher on its assessment of developing countries than of large industrial countries, leading developing member countries to become less enthusiastic about accepting IMF advice. Kawai and Pomerleano (2009) state: "The institution that is conducting the analysis and making judgments about the stability of the system must not have anything other than its own reputation riding on its assessment." Civil servants, whether national or international, may be talented and well intentioned, but usually do not possess the kind of independence required for dispassionate analysis and advice (Stern, 2009).

To the extent that surveillance must be organized within an institutional setup, there must be a mechanism to offset the bureaucratic tendency to compromise in reaching consensus views, especially when the assessment of crisis vulnerability is involved. One way to achieve this is to give as much voice as possible to individuals along with accountability, perhaps by putting a committee of prominent independent experts in charge. At the same time, the surveillance unit's staff must be shielded from political interference. There must be both the right incentives to encourage them to be candid and truthful in raising issues that countries may find uncomfortable discussing openly and an institutional mechanism to protect them when they displease member country officials.

- **Aim to reach the senior policymakers directly.** Regional surveillance should not follow the organizational structure of IMF surveillance in which the IMF's Board of Executive Directors is the primary audience. In fact, it is through the utilization of peer pressure that regional surveillance can potentially have the greatest advantage over IMF surveillance. The IMF is a near universal organization with 185 member countries that are represented by 24 resident Executive Directors. By necessity, not all Executive Directors represent their own countries and their seniority limits their relevance as a peer pressure group and in policymaking for individual national governments. If the new regional surveillance unit simply replicates this institutional setup of IMF surveillance, East Asia will lose the greatest potential advantage of having its own surveillance mechanism.

To yield more impact than IMF surveillance, regional surveillance must aim to reach senior policymakers directly by using the periodic forums of finance ministers and central bank governors, or to be even more effective, heads of state or government. It is in such forums that the impact of peer pressure can be maximized. Therefore, there would be no role in the regional surveillance unit for a resident executive board. Such a board could become an instrument of political interference to be used by national governments when uncomfortable issues arise. And given the likely seniority level of resident directors, it also would not be an effective peer pressure group. With even some large international organizations facing calls to replace resident boards with non-resident boards of senior policymakers,¹¹ there is no reason to create a resident executive board of mid-level officials at the new surveillance unit in East Asia, where the membership is small and the size of the geographical area is manageable.

¹¹ For governance issues related to the IMF Executive Board, as well as the issue of a resident versus non-resident board, see IEO (2008).

Peer pressure as the primary channel of influence (cf. Figure 1) should not preclude the surveillance unit's active engagement with the public. After all, it is only through the political process that policymakers are motivated to take action. There may be an occasional need to keep the discussion of some issues confidential, but to be effective surveillance must strive to utilize all channels of influence, including public pressure and market discipline. In order to avoid market surprises in cases when regional surveillance informs the public as the ruthless truth teller, there must be a clear transparency policy for the public disclosure of information. In an age dominated by widespread access to information via the Internet and in which transparency is the governing principle of public administration in most democratic societies, hardly anyone possesses information that can or should be kept from market participants. The surveillance unit should therefore operate with the presumption that it makes a full and complete disclosure of any analysis, view, or information it possesses to the public except when privileged information is involved.

7. Conclusion

The process is underway in East Asia to establish an independent surveillance unit to support CMIM decision-making. First and foremost, the ASEAN+3 finance ministers need to define the purpose of regional surveillance. Unless there is complete agreement on what the purpose is, surveillance cannot produce a clear message and be effective. The need for regional surveillance is both immediate and evolving. For the immediate need, the purpose is to cover the operational requirements of the CMIM as a conditional lending facility, which includes the identification of vulnerabilities and the due diligence task of assessing the capacity of a potential borrowing country to repay. Over the medium term, regional surveillance must also respond to East Asia's evolving need for a formal framework of policy dialogue and cooperation as economic integration and macroeconomic interdependence deepen.

Clearly defining the purpose of surveillance presupposes that member governments have surrendered that part of national sovereignty necessary for the regional surveillance unit to perform its assigned tasks, including the commitment to provide the necessary data and information. This gives the regional unit an advantage not claimed by the IMF, whose surveillance has suffered from the lack of a clearly defined purpose, which on a deeper level is a reflection of the unwillingness of member governments to surrender part of its national sovereignty over economic policymaking. Likewise, in terms of delivering the message, the regional unit should aim to reach senior policymakers directly by not replicating the institutional setup of IMF surveillance where the executive board of mid-level officials plays a central role.

In a world where other public institutions, notably the IMF, are involved in surveillance, it is important that regional surveillance be designed to complement global surveillance. Because Asian economies are highly interdependent, regional surveillance should take an integrated approach that combines country-level and region-level analyses. To help achieve this analytical integration, it should centralize all activities in a single organizational unit. To depoliticize the discussion of sensitive issues, regional surveillance should utilize objective indicators, while remaining aware of the inability of economics to provide precise metrics. To enhance candor and evenhandedness, the governance

structure should be designed to ensure independence while bestowing accountability on the individuals in charge; there must be both a right incentive to encourage staff to be truthful and a mechanism to protect them when they state things that are not pleasant to member government officials.

The primary determinant of success for the East Asian surveillance unit, however, will be whether it can garner respect and credibility from the public, based on the merit of its analysis and the effective delivery of key messages. Especially as the unit increasingly plays a role of broker for policy coordination over time, the reputation of neutrality, evenhandedness, and competence will become critical for its success. It is ultimately the quality of the people that determines the quality of the outputs. Staffing the unit with competent professionals whose abilities and qualifications are beyond dispute would be a first step, in making surveillance achieve its intended purposes in East Asia.

References

- J. Boughton. 2001. *Silent Revolution: The International Monetary Fund 1979–1989*. Washington DC: International Monetary Fund (IMF).
- J. Crow, R. Arriazu, and N. Thygesen. 1999. *External Evaluation of IMF Surveillance* (report by a group of independent experts). Washington DC: IMF.
- Independent Evaluation Office (IEO). 2006. *Multilateral Surveillance*. Washington DC: IMF.
- IEO. 2007. *IMF Exchange Rate Policy Advice*. Washington DC: IMF.
- IEO. 2008. *Governance of the IMF: An Evaluation*. Washington DC: IMF.
- International Monetary Fund (IMF). 2003. *Enhancing the Effectiveness of Surveillance-Operational Responses, the Agenda Ahead, and Next Steps*. Prepared by the Policy Development and Review Department. Washington DC: IMF.
- IMF. 2008a. *Triennial Surveillance Review: Overview Paper*. Prepared by the Strategy, Policy and Review Department. Washington DC: IMF.
- IMF. 2008b. *Triennial Surveillance Review: Thematic Findings*. Prepared by the Strategy, Policy and Review Department. Washington DC: IMF.
- IMF. 2009. *Surveillance Priorities for the International Monetary Fund, 2008*. 2011. Available at www.imf.org/external/np/pdr/surv/2008/index.htm.
- H. James. 1995. The Historical Development of the Principles of Surveillance. *International Monetary Fund Staff Papers*, 42 (4), pp. 762. 791.

- M. Kawai and C. Houser. 2008. Evolving ASEAN+3 ERP: Towards Peer Reviews or Due Diligence? *Shaping Policy Reform and Peer Review in Southeast Asia*. Paris: Organization for Economic Cooperation and Development, pp. 65. 98.
- M. Kawai. 2010. From the Chiang Mai Initiative to an Asian Monetary Fund. Paper prepared for the Asian Development Bank project "The Future Global Reserve System: an Asian Perspective."
- M. Kawai and M. Pomerleano. 2009. International Financial Stability Architecture for the 21st Century. Available at <http://blogs.ft.com/economistsforum>.
- V. Koromzay. 2008. Peer Review: Example of Economic and Development Review Committee. *Shaping Policy Reform and Peer Review in Southeast Asia*. Paris: Organization for Economic Cooperation and Development, pp. 278. 281.
- W. J. McDonough et al. 2006. Report of the Review Group on the Organization of Financial Sector and Capital Markets Work at the Fund. Washington DC: IMF.
- M. Mussa. 1997. IMF Surveillance. *American Economic Review*, 87 (2), pp. 28. 31.
- Organization for Economic Cooperation and Development (OECD). 2002. Peer Pressure as Part of Surveillance by International Institutions. Discussion led by Niels Thygesen, Chairman, Economic Development Review Committee, 4 June.
- N. Stern. 2009. Re-casting the International Financial Institutions. Available at <http://blogs.ft.com/economistsforum>.
- N. Thygesen. 2008. Comparative Aspects of Peer Reviews: OECD, IMF and the European Union. *Shaping Policy Reform and Peer Review in Southeast Asia*. Paris: Organization for Economic Cooperation and Development, pp.135. 147.