

Evolution of Macro-Surveillance for the World Economy: An Under-Emphasized Dimension

Ralph C. Bryant
The Brookings Institution

Peer-review surveillance – a "mutual assessment" process such as envisaged in the G20 leaders' September 2009 Pittsburgh communique -- has the potential to play a valuable role in intergovernmental cooperation. For example, it could helpfully analyze global-imbalance issues (such as those identified by Kemal Dervis in his paper) and thus point the way toward cooperative approaches for reducing the imbalances and the frictions they engender. At its best, peer-review surveillance could provide systemic refereeing of national adjustment actions, monitoring the observance of international traffic regulations, and inducing cooperative coordination of national macroeconomic policies.

Can peer-review surveillance deliver on its potential? To address that question, I will outline the features of an ideal peer-review surveillance process. Sadly, I will conclude that at this point the world community is very far from being able to realize a process like the one in my sketch.

Sketch of an Ideal Process

Cooperative macro-surveillance should entail a slow but steady intensification of intergovernmental consultations about the current and prospective world economic outlook, paying special attention to macroeconomic policies, exchange rates, and payments imbalances. A successful process will require two essential ingredients. The first is a backstopping by an international staff unit responsible for administrative and analytical support. (Given the shortness of time for our discussion, I will not delve into the important issues of the institutional venue for the location of that staff unit, and how its work would be arranged and financed.) The second ingredient is a process of gradual improvements in the analytical understanding of macroeconomic interactions among countries and gradual improvements in the multi-country models used to analyze those interactions.

In an ideal process, each participating government would submit periodic projections of a *baseline outlook* to the international staff unit. (The consultations and projections within each nation would involve the fiscal authority, the central bank, and other government agencies.) Each government's baseline outlook would assume no departures from its macroeconomic policies presently in force or, alternatively, could incorporate policy changes already decided on or very likely to be made. An individual government would concentrate most on projecting the key macroeconomic variables pertaining to its own economy. But each government would be free to submit projections for other economies if it chose to do so.

Each national projection would be derived with the aid of one or more analytical frameworks – for short, “models” -- that try to be internally consistent. Each government would be willing to—and would—exchange information about its models and projection methods.

The international staff unit would provide its own baseline projection of the outlook for each major nation or region. The analytical support staff in the unit would make its own models and projection methods transparent to national governments. And it would function as a clearinghouse for the exchange of models and projections among governments.

A wide range of quantity and price macroeconomic variables—for domestic real sectors, domestic financial sectors, balances of payments, and international markets—would be projected and reported in each baseline outlook. Those preparing the projections would employ best-practice analytical techniques to render the projections for all the variables internally consistent – both within national economies, and, still more difficult, across the world's major economies. The actual instruments of each nation's monetary and fiscal policies and, of course, the ultimate target variables of national policies would feature most prominently. But key intermediate, indicator variables also would be included. (Treatment of exchange rates in the projections would be an especially delicate matter.)

The international staff unit would play a key role in evaluating the different versions of the baseline outlook. For example, the staff unit would prepare a systematic comparison of the new baselines prepared for the current projections round, pointing out inconsistencies among the nations' and the staff unit's versions. The staff unit would also systematically compare the ex ante outlooks submitted in the preceding round with updated information about ex post actual outcomes.

Another vital component of the mutual-assessment process would be *what-if simulations*. Such simulations, judiciously chosen to shed light on issues of current relevance, would examine the consequences of changing this or that policy instrument. Similarly, simulations would be prepared to predict what would happen if one or another type of non-policy shock were to occur. Changes in macroeconomic variables resulting from these hypothetical policy and non-policy alterations would be measured and compared with the baseline outlook. The what-if scenarios would be prepared, at a minimum, by the international staff unit. Ideally, national governments also would prepare them, especially for changes in their own policy instruments but even for changes in other governments' policy instruments and for various nonpolicy shocks.

Differences in models would of course lead to differences in the answers to the what-if questions. No attempt would be made to suppress differences attributable to model uncertainty. On the contrary, the range of differences would be the focus of attention in the consultations and would be important grist for the mill of the analytical support staff unit, suggesting problems with the differing models or properties needing clarification.

The baseline outlook projections, some of the most relevant what-if scenarios, and the evaluations prepared by the staff unit would be examined in *periodic meetings of national policymakers and preparatory meetings of their deputies*. The consultations would also involve frank exchanges of information about individual governments' goals. Efforts would be made to classify differences in the baseline projections and what-if scenarios according to whether they were due to differences in identification of initial conditions (current positions of the national economies), differences in national goals, differences in preferred analytical models, or differences in assumptions about expected future non-policy shocks.

In auspicious circumstances, some activist coordination of national policies could be agreed by finance ministers and leaders, and subsequently monitored after implementation of the agreements.

A plausible by-product of this strengthened process for ongoing consultations would be some convergence in the analytical understandings brought by policymakers to the consultations. Preferred models for describing national economies and cross-border spillovers could become less diverse. One can even imagine that some convergence might eventually occur in the way government officials articulate national goals and identify common goals.

Reflections from the Sketch

Much more could be said about all the aspects of my sketch. But here I emphasize just one single conclusion. To repeat, success for peer-review surveillance requires the *2 essential ingredients of an analytical staff unit to support the process, and the gradual improvement of the analytical foundation* for studying macroeconomic interactions.

As far as I can tell, the G20 "Mutual Assessment" exercise so far has had little or no explicit discussion about these two issues. Nor has our discussion at the conference here grappled with them.

Does the role of the IMF staff in the first rounds of the G20 Mutual Assessment Process constitute the nascent beginnings of a recognition of these issues? I would like to believe the answer is "yes." But I am not confident that that is so.

Does the IMF World Economic Outlook exercise have some elements of this process? The answer to that question is "yes." But the elements are loose, far from sufficiently elaborated – because the analytical underpinnings do not permit a more elaborate and successful process.

By emphasizing the absence of adequate analytical support, I don't want to be misunderstood. The establishment of the G20 Mutual Assessment Framework does take favorable steps in the right direction for encouraging peer-review surveillance. It is less unpromising than previous efforts at multilateral surveillance, including those taken within the IMF itself.

Nonetheless, the conclusion I am emphasizing is important, and badly under-appreciated. So here, again, is the "bottom line" about peer-review surveillance that you should take away from my brief observations. *Without the supporting role of a proactive international staff unit, and most fundamentally without improvements in the underlying analytical foundation of knowledge, the near-term prospects are not good for effective peer review in the G20 "Mutual Assessment" process.*

If the world community really wants to advance the Mutual Assessment Process, it will have to tackle how to build up an analytical backstopping for the process. Policymakers in particular will have to devote more resources, deliberately and systematically, to achieving this buildup.

Policymakers and the public in general do not find the analytical foundations of policymaking a sexy subject. But over the longer run, building more solid analytical foundations is the only reliable way to improve policy debate and to render policy decisions and intergovernmental peer surveillance more likely to occur and more robust to error.