

## KEY POINTS

- The Mutual Assessment Process (MAP) is an innovative and ambitious economic coordination strategy; however, its indicative guidelines and commitments are too vague to ensure accountability and cooperation of member states.
- Other influencing factors, such as continued legitimacy shortcomings of the IMF, underdeveloped macroeconomic modelling and limited negotiating structures have also been identified as areas for improving the effectiveness of the MAP.
- The Group of Twenty (G20) should increase ownership of, and members' accountability to, the MAP; strengthen institutional support for the process; invest in improving global economic modelling capacity; create a "G20 Economic Research Hub"; and bolster negotiating mechanisms in order to ensure the continued utility of the MAP.

## ACRONYMS

AAF	Accountability Assessment Framework
BIS	Bank for International Settlements
EB	Executive Board (IMF)
EDRC	Economic Development and Review Committee (OECD)
G20	Group of Twenty
IMF	International Monetary Fund
IMS	International Monetary System
IEO	Independent Evaluation Office (IMF)
MAP	Mutual Assessment Process
OECD	Organisation for Economic Co-operation and Development

# A MAP FOR STRENGTHENING THE G20 MUTUAL ASSESSMENT PROCESS

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## THE G20 MAP AS A MECHANISM FOR COOPERATION AND ACCOUNTABILITY

The 2007–2009 global financial crisis demonstrated that the world required a much stronger framework for cooperation on financial and economic issues. In September 2009, G20 heads of state responded to this need at the Pittsburgh G20 Summit with the "Framework for Strong, Sustainable and Balanced Growth" (the Framework). The MAP was created to both monitor and support G20 countries in their follow-through on commitments made under the Framework.

Although progress has been made, ongoing strains in the international economic system show that renewed commitment to the Framework and strengthened cooperation mechanisms are crucial to achieving the G20's growth objectives. This policy brief identifies five areas where changes would help to strengthen the MAP: increasing accountability, reinforcing G20 ownership of the MAP, institutional strengthening, improving analytical and economic modelling capacity, and building additional mechanisms for deeper policy trade-offs.

The MAP process pivots around the G20 leaders' annual summits (see Figure 1 for primary documents and process). Each year's core deliverables are presented at the summit in the form of a set of policy commitments from each member, and a combined G20 action plan that serves as a road map for future policy measures and their assessment. The fourth such report was prepared for the Los Cabos G20 Summit

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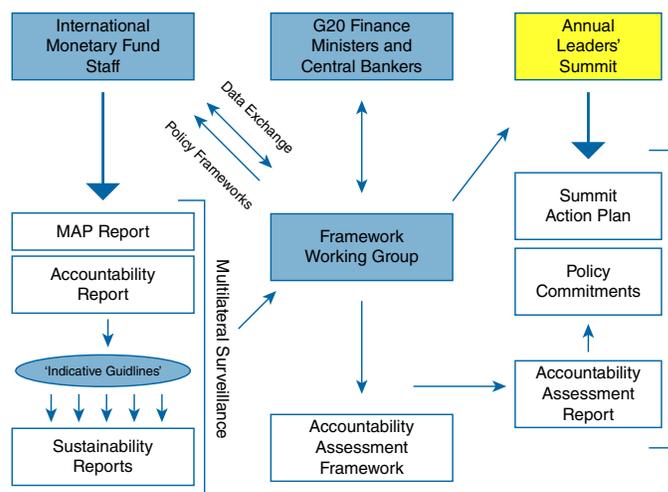
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in June 2012 (International Monetary Fund [IMF], 2011c). While the leaders receive broader annual reports at their summits, shorter update reports are prepared for meetings of finance ministers and central bankers throughout the year.

**FIGURE 1: PRIMARY MAP DOCUMENTS AND PROCESS**



Acting under requests for technical advice — a process initiated by G20 leaders through a strictly voluntary advisory capacity under Article V of the IMF's Articles of Agreement — IMF staff use the economic information and targets provided by G20 members to generate forecasting scenarios. The forecasts are designed to ensure that the individual members' policy choices are consistent with the broader goals of the Framework. To give effect to the principles of growth aspired to in the Framework, the IMF defines *strong* as "above potential," *sustainable* as "increasingly led by the private sector" and *balanced* as "broad-based across G-20 members" (IMF, 2011b: 11).

In cooperation with the IMF, the G20 Working Group has developed indicative guidelines to enhance the benchmarking in the MAP. These indicators are important, as they provide a means for cross-checking

the sustainability of different economic trajectories. Based upon these guidelines, countries with large domestic or external imbalances are flagged for a more thorough sustainability report. This process of benchmarking and flagging is a unique and innovative feature of the MAP. The explicit recognition that domestic policies can, and often do, have large international spillover effects is also a vast improvement over previous processes.<sup>1</sup> Following the Los Cabos summit, reports on members' performance against the guidelines and sustainability reports will be presented to the G20 leaders and the public every two years.

In addition to requesting technical advice, the G20 has asked the IMF to report on G20 members' progress in addressing imbalances outlined in sustainability reports and to assess the progress G20 members have made on specific previous policy commitments.<sup>2</sup>

At Los Cabos, G20 leaders announced the creation of a new Accountability Assessment Framework (AAF) designed to strengthen the peer review component of the MAP and to increase G20 member ownership of the process (G20 Research Group, 2012). An annual (separate) report will be produced to communicate the key outputs of the AAF to the public; the first of such reports was issued as part of the Los Cabos Action Plan (G20 Research Group, 2012).

1 Previously, the Organisation for Economic Co-operation and Development (OECD) and IMF reporting did not focus on spillovers. As a new addition since 2011, the IMF has also generated annual/biannual spillover reports for the Systemic Five. The Systemic Five comprises the euro area, the United States, Japan, China and the United Kingdom.

2 Starting with the Seoul summit in 2010 each G20 member submits an official policy commitment matrix. Commitments made through this mechanism are designed to increase the accountability of the MAP and to foster greater policy trade-offs.

## INCREASING ACCOUNTABILITY

Sovereign states are free to pursue whatever policies they choose, but in the absence of a quasi-automatic adjustment mechanism — such as the one that existed under the nineteenth-century gold-exchange standard — domestic policy actions, when aggregated to the global level, often result in suboptimal outcomes. With every nation attempting to run a current account surplus, the net result is a shortfall in global aggregate demand — the so-called deflationary bias inherent in the international monetary system.<sup>3</sup> Overcoming this coordination failure is the task entrusted to the MAP.

The MAP should not, however, be viewed as a “silver bullet” solution to the much broader problem of international policy coordination. At most, the MAP can reduce the transaction costs inherent in policy coordination. With appropriate institutional support, the MAP has the potential to improve global economic welfare by providing avenues for policy coordination and a mechanism for overcoming the “prisoner’s dilemma”<sup>4</sup> nature of policy negotiations. With institutional support in place, strong global Pareto improvements are possible (Jenkins and Subacchi, 2011).

In terms of accountability, the MAP represents the most comprehensive international economic governance mechanism developed to date. Previous international processes were not designed for policy cooperation and

3 The International Monetary System (IMS) is defined by the World Economic Forum as a system “of conventions, policies and institutions governing international payments, the choice of exchange rate regimes and the supply of reserves. It creates an environment where international currencies facilitate the exchange of goods and services, the accumulation of savings, price setting and calibration as well as the denomination of balance sheets for both public and private actors. It also allows countries to run deficits in their external accounts and should ideally contribute to a gradual rebalancing of these external positions” (World Economic Forum, 2012).

4 The term “prisoner’s dilemma” is used to define a particular class of games within game theory. It occurs when both players would be better off if they cooperated, but both face incentives to resort to uncooperative behaviour.

coordination in a world of open capital accounts and globalized financial markets, where weaknesses in any one system can reverberate through the world economy at a rapid pace.

Existing international surveillance processes and peer review mechanisms have limited scope and capacity for coordination and cooperation on a global scale. The IMF's founding Articles of Agreement empower the multilateral institution to request information and to conduct mandatory bilateral surveillance over its members' economies under Article IV. The annual Article IV consultations, along with the IMF's multiple global and regional surveillance reports, focus on the stability of countries' monetary, financial, fiscal and exchange rate policies mainly in relation to international monetary system stability.

The OECD also conducts a peer review process every 18 months for each member of its Economic Development and Review Committee (EDRC). The EDRC reviews are predicated upon OECD principles of market-based economies (and democracies) and focus on structural reform and best practices for central agencies. Even though a number of non-member emerging economies such as Russia, India, China and Brazil have recently submitted to EDRC review, the OECD still excludes many important G20 members.<sup>5</sup>

By contrast, the MAP is both independent surveillance and peer review. Using indicators and regular assessments, countries are able to assess the progress each country has made through peer review and multilateral verification. Since the MAP has been in place, G20 countries have made substantial progress on financial regulation and fiscal consolidation; however, the MAP was largely

invisible at the 2011 Cannes summit and, to a lesser extent, at the 2012 Los Cabos summit. Global coordination and cooperation were overshadowed, in both cases, by the need to attend to the euro zone crisis. While such crises must be addressed swiftly, long-term frameworks also need consistent attention. Combined, the G20 Framework and its MAP are the most wide-reaching long-term plan for the global economy. This makes it imperative to keep the MAP a central and visible leaders' priority.

The MAP is a global commitment forum, where intergovernmental negotiations and trade-offs are made and brought home for national legislatures and publics to consider. On the national level, benefits must outweigh the costs from any such global agreements.

While national and international media, political commentators, think tanks and academics play a role in disseminating and validating these international trade-offs (especially by expounding on the shared benefits), unclear measurement indicators, inaccessible technical standards and vaguely defined guidelines make it difficult to hold countries that do not reach targets to public scrutiny. The lack of clarity also makes it difficult to disseminate the importance of cooperation for shared aims, although public attention and support are essential for continued and deepened cooperation. While not all details of the assessment process and negotiations can be disclosed, more accessible public information would improve the accountability and cooperation capacities of the MAP.

To effectively communicate the ongoing process to the public, the MAP should have a permanent and professional Web presence of its own. Currently, the most up-to-date information on the MAP is on the IMF's G20 web page.<sup>6</sup> As the G20 presidency has changed hands,

<sup>5</sup> G20 members that are not also part of the OECD include: Argentina, Brazil, China, Indonesia, India, South Africa, Russia and Saudi Arabia.

<sup>6</sup> See [www.imf.org/external/np/g20/](http://www.imf.org/external/np/g20/).

the official G20 website has been drastically altered and the information links on the MAP are one of the items lost during the transitions. The need for an up-to-date site raises the question of a G20 secretariat and ownership. Whether the G20 assigns permanent or non-permanent staff as a functional secretariat, a stable online presence would assist in consistent information dissemination.<sup>7</sup>

## REINFORCING G20 OWNERSHIP

The potential for cooperation stems from the fact that the MAP is organized by the G20, which also holds design and decision-making responsibilities for the process, while the IMF serves in a technical advisory capacity to the G20 leaders. The G20 leaders established the Framework Working Group to carry out the day-to-day work of the Framework and the MAP. The current process, however, relies heavily on the IMF to establish and assess the norms of accountability.

The G20 should consider implementing a more robust and transparent peer-review process. An improved process would allow G20 countries to collectively and publicly own the peer review process. Annual accountability reports, such as those conducted by the OECD EDRC process, could be implemented, in which a random three-country reviewer group would be established for each member. Comprehensive internal reports could then be provided to the G20, while a smaller, more accessible report on the outcomes of all reviews could be made public, thereby increasing members' public accountability. The repeat-game aspect of this process — paired with the existing IMF reports which would serve as a counterweight — may encourage countries to move beyond the current process where they are collectively

<sup>7</sup> There has been controversy around the idea of a G20 secretariat with dedicated organizational staff, and a general aversion towards the idea remains. See Carin et al., 2010.

wary of publicly scrutinizing each others' policies. For policy commitments to actually carry weight, public benchmarking, "naming and shaming" and credit for cooperative policies must be augmented. The G20 must work to develop clear and objective standards regarding fiscal, micro- and macro-prudential and monetary best practices in order for members to be held to account for the international consequences of their domestic policy decisions (Camdessus and Lamfalussy, 2011).

## INSTITUTIONAL STRENGTHENING

Processes require institutional support for planning, coordination and operations; someone must do the work. Such support can be new, or existing, formal international organizations and secretariats, or they can be less formal mechanisms that are staffed ad hoc. The G20 does not have a secretariat and must therefore rely on others to implement and monitor leaders' commitments. The MAP thus requires the support of staff with deep economic expertise operating on a common understanding of their purpose and methods.

For the MAP to function as envisioned, members must not only possess a shared analytical consensus for modelling the global economy, there also needs to be a credible, independent third party capable of monitoring (and ideally enforcing) the coordination process (Jenkins and Subacchi, 2011). This is the critical role that the IMF is tasked with fulfilling. While the OECD has arguably more experience and expertise in mutual economic policy assessment, many G20 countries are not OECD members. Other institutions, such as the Bank for International Settlements (BIS) and the newly upgraded Financial Stability Board, do not have sufficient resources and broad enough expertise for such a large-scale operation. As a result, the only institution with the credentials to support the MAP was, and continues to be, the IMF. For

this reason, the MAP's credibility is tightly coupled with the perceived legitimacy of the IMF.

Improving the IMF's legitimacy and effectiveness is a complex matter, as the IMF is perceived very differently by developing and developed economies. Many developing and emerging nations continue to distrust the IMF given their past relationships with the institution and its onerous structural adjustment programs (Kawai, 2009). The historic overrepresentation of Western Europe and North America has generated the impression that the IMF operates mainly in the interests of its largest stakeholders, instead of the nations that have been forced to turn to it for support, which has, in turn, strained North-South relations.

In spite of criticisms, the IMF remains a key pillar — arguably the key institutional pillar — of multilateral economic governance. Proof of its ongoing relevance and centrality is the US\$430 billion capital injection it received in 2012. While pledging their funds, leaders insisted that the money was placed at the IMF to be available to all countries, not only to the embattled euro zone members (IMF, 2012b). Because the IMF remains central and continues to face criticism, it is even more essential that IMF reforms aimed at increasing the voice and representation of emerging market economies be implemented without delay. Without such reform, as Haley (2012) argues, “individual national self-interest will prevail and effective international cooperation will remain merely an aspiration.”<sup>8</sup>

<sup>8</sup> It is beyond the scope of this policy brief to go into IMF governance reform in detail. See Camdessus and Lamfalussy (2011); Independent Evaluation Office [IMF-IEO] (2008); and IMF (2009) for key findings.

## IMPROVING ANALYTICAL AND ECONOMIC MODELLING CAPACITY

The IMF's analytical limitations reflect broader deficiencies in pre-crisis macroeconomic analysis. The inability to fully incorporate macro-financial linkages within traditional economic models is, in many ways, a hallmark of pre-crisis macro analysis (Roger and Vlcek, 2011; Caprio, 2011).<sup>9</sup>

Several macro-financial frameworks in use today stress how shocks to bank capital can trigger vicious feedback loops — and accompanying multiplier effects — between the financial sector and the real economy (Bayoumi and Melander, 2008: 5). Recent research also points to the existence of powerful international linkages between national financial systems when financial actors share similar portfolio exposures and leverage constraints (Devereux and Yetman, 2010).

Given that global imbalances are set to remain entrenched in the medium term, deficiencies in the existing macroeconomic financial framework “toolbox” are highly disconcerting (IMF, 2011a: 11). Without a clear and nuanced understanding of global economic interdependencies, policy coordination will continue to be found wanting. For international economic policy coordination to gain traction, countries must possess a shared identification of what the problems are, the nature of these problems, actions to address them, the scope for mid-course corrections and opportunities for shared ex post learning (Truman, 2011). New macroeconomic modelling can help facilitate each of these steps.

Investment in macroeconomic research and development, the strengthening of the institutional capacity for a

<sup>9</sup> For example, see the report on the inclusion of macro-financial linkages in the Fund's research and analysis in the years leading up to the global financial crisis (IMF-IEO, 2011).

variety of intergovernmental research bodies, and increased incentives for prominent public and private research institutes to collaborate is warranted. In theory, models possess the ability to quantify the benefits of cooperative versus non-cooperative behaviour between systemically important nations (Jenkins and Subacchi, 2011). To accomplish this, future models should be capable of simulating “different policy combinations and interactions” (IMF, 2011d). Similarly, potential macro-prudential frameworks and other regulatory regimes (such as the soon-to-be implemented Basel III Accords) need a suite of models that can be used to test specific policies before they are actually implemented. Additionally, new models must be capable of quantifying the long-run gains from financial reform. Only when the IMF — and the other institutions tasked with supporting the G20’s work — possesses the necessary analytical tools for modelling and monitoring the global economy can the MAP truly be expected to bear fruit.

To this end, the G20 should consider establishing an official Economic Research Hub (possibly hosted by the BIS as an expansion of its current Central Bank Research Hub or elsewhere), which would serve to provide a coherent institutional framework for advancing policy-oriented research related to the objectives the G20. Such a centre would coordinate research across different institutions, organize conferences, identify projects for further research, work to give voice to previously marginalized viewpoints and dispense G20-funded grants aimed at key theoretical and analytical issues. In addition, the staff and resources available to the research departments at the IMF and BIS should be increased. The IMF is now a trillion-dollar financial institution; it should possess a research staff suited to its size and mandate. Finally, in order to provide a counterweight to IMF staff analysis, and to further bolster financial market analysis,

the resources available to the Financial Stability Board must be increased significantly.

## **BUILDING ADDITIONAL MECHANISMS FOR MORE SUBSTANTIAL POLICY TRADE-OFFS**

The MAP facilitates the negotiation of coordinated policies for strong, sustainable and balanced growth. The policy agreement mechanisms in the MAP can be strengthened in order to be more effective in restoring global growth and stability. Current policy commitments are ambiguous; indeed, in the recent Los Cabos Action Plan, G20 members recognized that: “policy commitments need to be as specific and concrete as possible, and need to substantively contribute towards the overall objective of strong, sustainable and balanced growth” and “agree[d] on the need for a common approach to measure progress against previous commitments in all policy areas” (G20 Research Group, 2012).

The Los Cabos AAF was set out to improve the nature of the process along these lines. Even though leaders have committed to making more specific and measurable commitments and reporting, the first round reports could be improved.<sup>10</sup> Future commitments should be even more specific, measurable, achievable, results-oriented and time-delineated. Goals should be reported on in the specific, quantitative and benchmark-driven formats of the MAP reports for each G20 country and should be more easily comparable.

The G20 has many backlogged objectives. Objectives should be clarified, sorted, re-prioritized and committed to for the following year during G20 meetings and published as part of the meeting outcomes. Some former objectives could be dropped after they are reported on.

<sup>10</sup> See [www.g20.utoronto.ca/summits/2012loscabos.html](http://www.g20.utoronto.ca/summits/2012loscabos.html) for an example of the current format for reporting member nations’ policy commitments.

A pruning process will help to keep leaders and officials focused on policy priorities that are deemed to be most necessary to accomplish and report on for the next cycle, along with a short list of key long-term indicators that should be ongoing mainstays.

In the medium term, the MAP should look for a means of establishing clearer assessments of the national and international cost-benefit implications of policies, to facilitate deeper commitments and more accountability to them.<sup>11</sup> By focusing the commitments on specific goals and numbers, trade-offs could be made more easily among countries. An aspirational analog is tariff trade-offs under the General Agreements on Tariffs and Trade, which were easier to agree to and accomplish because they were quantified and tradeable.

This will be a challenge, as economic policy impacts are more difficult to quantify and more difficult to trade off. Nevertheless, progress on such calculations and negotiation structures can provide important opportunities for global cooperation. With focused and deeper commitments being traded, countries would be able to hold each other more accountable for a smaller set of more specific deliverables. While cooperation and successful growth are the desired objectives of the process, a revamped mechanism would allow for the possibility of correction as countries would be able to scale back or redirect their policies in the next round if other countries were clearly not committing resources to the group targets. If clearer impact assessments of policies were also developed, the G20 could look to developing a system of fines or penalties for countries that did not allocate resources and policy changes to support global objectives (also suggested by Camdessus and Lamfalussy, 2011: 8).

<sup>11</sup> As noted earlier, improvements in macroeconomic modelling capacity could greatly assist this process.

A potential consideration under this strengthened trade-off mechanism could be commitments for more balanced global demand and sustainable fiscal policy. In surplus countries, additional spending on national welfare policies could reduce national savings rates and decrease external surpluses. In deficit countries, a trade off could be to fully provision for welfare costs. While the primary purpose of welfare reform would be the reduction of external imbalances, this has the added benefit of increasing economic and social sustainability in both sets of countries while improving intergenerational equity.

In order to foster farsighted and balanced trade-offs, a “wise persons council” composed of diverse eminent persons from G20 and non-G20 countries alike could provide broader input, mediate grievances and overcome negotiation impasses between nations. Non-confrontational and candid interplay between G20 officials and independent advisers would help to facilitate more robust and meaningful policy discussions and trade-offs (Schwanen, 2010). An alternative take on such a body, and one that would certainly run up against strong national objections, would be to empower the council to actually adjudicate disputes and levy penalties, based on a previously agreed framework, against persistent transgressors (Blustein, 2012).

## CONCLUSION

The MAP is the highest-level forum for economic policy coordination in the world. It has achieved significant bounds towards global cooperation for strong, sustainable and balanced growth; however, there is still much that can be strengthened in order to ensure its continuing relevance. Such improvements will require substantial policy and monetary commitments from G20 members, but these allocations would be well made if they contribute to global economic stability and growth.

Institutional resistance and domestic opposition will need to be overcome; however, with a renewed commitment to cooperation and coordination, this is achievable.

## RECOMMENDATIONS

The G20 should:

- increase the public accountability of the MAP through accessible, comparable and easily digestible annual reporting;
- increase its ownership of the process, by ensuring more direct communication between IMF staff analysis and G20 leaders, and by strengthening the Working Group with additional peer-review capacity;
- encourage reforms in the IMF's governance and management structures to strengthen the institution that the MAP relies most heavily upon;
- invest in macroeconomic research and development for enhanced global economic modelling capacity and create an Economic Research Hub to coordinate ongoing research at the international level; and
- bolster MAP negotiating mechanisms to foster deeper commitments through the improved assessment of national and international cost-benefit trade-offs, and investigate potential penalties for compliance failures. The creation of an independent "wise persons council" to help facilitate this process is also recommended.

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