FOR AGENDA

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February 15, 1984

To: Members of the Executive Board

From: The Acting Secretary

Subject: Review of the Document "Surveillance over Exchange Rate Policies" and Annual Review of the Implementation of Surveillance

Attached for consideration by the Executive Directors is a paper on a review of the document "Surveillance over Exchange Rate Policies" and the annual review of the implementation of surveillance. Draft decisions appear on page 41.

This subject has been scheduled for Executive Board discussion on Wednesday, March 14, 1984.

If Executive Directors have technical or factual questions relating to Section II of this paper prior to the Board discussion, they should contact Mr. Artus (ext. (5)7676). Questions relating to the other sections of the paper should be referred to Mr. G. G. Johnson (ext. (5)8671).

Att: (1)

Other Distribution:
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INTERNATIONAL MONETARY FUND

Review of the Document "Surveillance Over Exchange Rate Policies" and Annual Review of the Implementation of Surveillance

Prepared by the Research Department and the Exchange and Trade Relations Department

(In consultation with other departments)

Approved by Wm. C. Hood and C. David Finch

February 14, 1984

Contents

	Page
I. Introduction	1
II. Key Issues in the Conduct of Fund Surveillance	1
1. Issues relating to the effectiveness of Fund surveillance over exchange rate policies	3
a. Issues arising in identifying a need for policy changes	4
b. Issues arising in seeking agreement with members on policy changes	6
2. Issues relating to the broader aspects of Fund surveillance	9
a. Issues relating to policy coordination and exchange rate stability among major-currency countries	10
b. Issues relating to the external environment of developing countries	13
3. Summary and concluding remarks	15
III. Multilateral Aspects of the Implementation of Surveillance	16
1. World Economic Outlook and related studies	16
2. Management's role in multilateral meetings	17
3. Multilateral approaches to problems of external indebtedness	17
4. Multilateral approaches to the problem of protectionism	18

Contents

Page

IV. Article IV Consultations 19

1. Reporting on consultations 19
   a. Exchange rate policies 19
   b. External debt and assessment of policy stance in a medium-term setting 21
   c. Protectionism 23
   d. Other aspects of consultation reporting 24
2. Consultation frequency 25
   a. Recent experience with consultation frequency 25
   b. Overdue consultations 28
   c. Specification of consultation cycles 28
   d. Implications of current practices on specification of cycles 30

V. Monitoring of Developments in Exchange Rates and Exchange Arrangements 32

1. Periodic reviews 32
2. Notifications of changes in exchange arrangements 32
3. The information notice system 34
4. Issues concerning the ongoing operation of the information notice system 37
   a. Starting point for measurement 37
   b. Threshold for issuance of information notices 38
   c. Improvements in the system 39

VI. Selected Issues for Board Discussion and Proposed Decisions 40

Tables

1. Views on Exchange Rate Policies in Staff Appraisals for Article IV Consultations Concluded in 1983 20
2. Article IV Consultations--Aspects of Consultation Frequency, 1981-83 26
3. Members for Which More Than 15 Months Have Elapsed Since Last Consultation 27

I. Introduction

Under Article IV, Section 3, the Fund is to exercise firm surveillance over exchange rate policies of members. In order for the Fund to perform its functions in this regard, the Executive Board adopted the principles and procedures for surveillance set forth in the document entitled "Surveillance Over Exchange Rate Policies." 1/ In doing so, the Executive Board agreed to review the document at intervals of two years; on the present occasion the review is to be completed not later than April 1, 1984. Moreover, paragraph VI of the section on procedures states that the Executive Directors shall review annually the general implementation of surveillance; on the present occasion, that review is also to be completed not later than April 1, 1984. This paper is intended to serve as a basis for both reviews. 2/

Section II discusses a number of the key issues in the conduct of Fund surveillance and reviews the principles and procedures involved. The paper then turns to multilateral aspects of the implementation of surveillance (Section III) and the Article IV consultation process (Section IV), while Section V reviews the monitoring of developments in exchange rates and exchange arrangements. Some selected issues on which Executive Directors may wish to focus their attention in their review of the principles and implementation of surveillance are set out in Section VI.

A separate background paper provides factual background on Article IV consultations and on the information notice system. The background paper also includes a comprehensive record of Executive Board meetings and Fund documents relating to surveillance in 1983. References in square brackets in the present paper are to items listed in Table 15 of the background paper. 3/

II. Key Issues in the Conduct of Fund Surveillance

The need to reinforce surveillance and to make it more effective and evenhanded has been a recurrent theme of each annual review of Fund surveillance since the first review in 1979. In part, this concern is due

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1/ Executive Board Decision No. 5392-(77/63), adopted April 29, 1977, Selected Decisions of the International Monetary Fund and Selected Documents, Tenth Issue, pp. 10-14.

2/ The last annual review of the general implementation of surveillance was completed March 28, 1983 (EBM/83/54 and EBM/83/55). The last biennial review of the principles of surveillance was completed in April 1982 (EBM/82/31 and EBM/82/32, 3/17/82, and EBM/82/44, 4/9/82).

3/ Table 15 identifies items by topic, date of Executive Board meeting, and document title.

to the as yet limited experience in the practice of surveillance; and to the central role of surveillance in the international monetary arrangements reflected in the Articles of the Fund as amended in 1978. In the main, however, the desire to strengthen surveillance reflects a certain degree of dissatisfaction with what a number of member countries consider to be its asymmetric incidence and limited effectiveness. The persistence of major international economic problems has done much to feed this dissatisfaction. The pronounced swings in exchange rates between major currencies, the abnormally high and variable levels of interest rates in industrial countries, particularly the United States, and the severe balance of payments and debt difficulties of developing countries have all been viewed as evidence of shortcomings in the effectiveness of Fund surveillance.

The following discussion attempts to delineate more precisely the main areas of concern with the aim of stimulating a discussion of possible ways in which Fund surveillance might be strengthened. The analysis distinguishes a narrower and a broader dimension of surveillance. The narrower aspect relates to exchange rate policies and other measures that are undertaken with the specific objective of influencing the balance of payments. The wider aspect of surveillance emphasizes the need to maintain the "orderly underlying conditions that are necessary for financial and economic stability" (Art.IV, Sec. 1) and embraces, in addition to the policies mentioned above, policies undertaken primarily for domestic reasons but which have consequences for exchange rates and for the international monetary system as a whole.

The surveillance document 1/ enjoins member countries to "avoid manipulating exchange rates . . ." but nevertheless to "intervene in the exchange markets if necessary to counter disorderly conditions" and in doing so to take into account the interests of other members. The document also specifies a number of developments that might indicate a need for discussion with a member. These include protracted large-scale intervention in one direction, and, when for balance of payments purposes, an unsustainable level of official borrowing or lending, the introduction or prolonged maintenance of restrictions on current or capital transactions, and the pursuit of domestic financial policies that provide abnormal incentive or disincentive to capital flows. These principles for the guidance of members and the Fund cover surveillance in the narrower sense.

The broader aspect of surveillance is reflected in specific references both in the Articles themselves and in the surveillance document. Section 1 of Article IV not only enjoins each member to avoid manipulating

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1/ Decision No. 5392-(77/63), Selected Decisions of the International Monetary Fund and Selected Documents, Tenth Issue, pp. 10-15.

exchange rates, but also obliges the member to collaborate with the Fund and other members to promote a stable system of exchange rates. In particular, it refers to the need for each member to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability and to seek to promote stability by fostering orderly underlying economic and financial conditions. It is noteworthy that this provision of Article IV is explicitly cited in the introductory section of the surveillance document. In addition, Section 3 of the document's statement of principles of Fund surveillance requires that the Fund's appraisal of a member's exchange rate policies "shall be made within the framework of a comprehensive analysis of the general economic situation and economic policy strategy of the member and shall recognize that domestic as well as external policies can contribute to timely adjustments of the balance of payments" and "shall take into account the extent to which the policies of the member, including its exchange rate policies, serve the objectives of the continuing development of the orderly underlying conditions that are necessary for financial stability, the promotion of sustained sound economic growth, and reasonable levels of employment."

Although, in practice, the distinction between surveillance in the narrower sense and surveillance in the broader sense is not stressed, Part 1 of the present section of this paper is directed mainly to the issues arising in the conduct of surveillance conceived in the narrower sense. In Part 2, the discussion takes up issues arising more specifically in the wider application of surveillance. Part 3 presents a brief summary and some concluding remarks.

Two stages in the exercise of surveillance may usefully be distinguished. There is first of all the stage of identifying situations requiring change in a member's policies affecting its exchange rate. This stage is one of establishing and analyzing facts, discussing their interpretation (usually with the member's authorities) and of arriving at judgments or assessments. Although the judgments involved in deciding whether a member's exchange rate policies require modification may be difficult, the Fund cannot avoid making those judgments for they are absolutely essential to the conduct of surveillance. When it is decided a situation requires a modification of policies, then the stage of seeking agreement with the member as to the policies required is entered upon. These stages in the exercise of surveillance are involved in both the narrower and the broader aspects of surveillance.

1. Issues relating to the effectiveness of Fund surveillance over exchange rate policies

Six years after the amended Articles of the Fund and the surveillance document became effective, it may be remarked that the international community has been largely successful in maintaining exchange rate flexibility without the kind of competitive devaluations experienced during the 1930s. Nonetheless issues have arisen which bear on the effectiveness of surveillance over exchange rate policies as such.

a. Issues arising in identifying a need for policy changes

Experience over the past several years demonstrates that the indicators listed in the surveillance document, in particular those related to intervention, official borrowing, and restrictions on international transactions, normally provide early signals that a member's exchange rate policies have implications that warrant attention by the Fund. Indeed, in many such instances there are no great difficulties in arriving at judgments or assessments. Other cases are more complex. In these cases, the assessment of the need for policy changes hinges upon an analysis and judgment of the net effects of policies. Illustrations are offered in this subsection of these more complex cases.

Consider the situation of a member that has opted to peg its currency in order to achieve the discipline over its macroeconomic policies that such a commitment may impart. If that member starts to lose competitiveness and its balance of payments deteriorates, a judgment needs to be made as to whether its exchange rate should be changed. Without seeking to elaborate all the policy options that may be available in the circumstances and other conceivable dimensions of the situation, suffice it to remark that a change in the exchange rate does not have unmitigated benefits for the country or its trading partners. Thus for example, an adjustment of the rate early in the period of loss of competitiveness may make for a more orderly adjustment and less disruptive impact on trade patterns generally. On the other hand, it may lead to loss of credibility of the exchange rate policy itself and thus loss of such discipline over policy as may have derived from it.

Consider the question of judging the exchange rate policies of a country that is engaged in external borrowing. The question as to whether a change of policies is required is not complex if the country is already accumulating arrears. Apart from this extreme situation, however, the Fund must repeatedly assess whether the structure of this borrowing country's payments is sustainable under its current policies. In such cases this is a subtle judgment involving the future evolution of the supply of funds and the level of interest rates in world financial markets as well as the growth prospects for the country's exports and the likely course of its domestic output and demand for imports.

Many countries, particularly the developing countries, are faced from time to time by large cyclical declines in the world demand for their exports. In such cases, in deciding whether a change of exchange rate policies is required, it is necessary to assess the extent to which the balance of payments problem reflects temporary cyclical factors as opposed to problems of competitiveness, as well as the ability of the country to weather the cyclical decline in exports without a change in exchange rate policies.

In seeking to assess changes in competitiveness, one is not infrequently confronted with inadequate data or data that are exceedingly difficult to interpret. For example, in countries newly entering upon significant exporting of manufactured goods, large monthly variations in rates of inflation, real wages, and sometimes even exchange rates themselves, make it difficult to assess the degree to which competitiveness may be changing. Furthermore, in many cases changes in competitiveness can be assessed only from indicators based on relative consumer price indexes. As discussed in Section II of the background paper, these indexes often do not fully reflect the costs and prices that determine the ability of countries to compete in world markets.

Particular difficulties of assessing the appropriateness of an exchange rate arise in relation to countries whose national output is highly concentrated in the production of oil. In a number of such countries, petroleum exports have ensured a strong external position. The future of the economy depends to a significant extent upon its diversification and accordingly encouragement to the development of production of a range of traded goods other than oil is warranted. The judgment as to the extent to which the encouragement that is offered in any instance through the setting of the exchange rate is of the appropriate degree is a particularly complex one.

Questions also arise in relation to countries making extensive use of controls over private capital flows. While the precise relationship between controls over capital flows and exchange rates is often difficult to identify, the existence of such controls compounds the difficulties of assessing exchange rate policies. Capital controls thus need to be monitored carefully, especially in the case of countries with sizable and diversified private financial markets.

Where there are extensive domestic controls over prices and wages, an assessment of the appropriateness of exchange rate policies needs to take into account the way these policies interact with policies on wages and prices. In centrally planned economies, for example, official exchange rates are often used principally for converting values of international transactions into domestic currency for accounting or statistical purposes. Thus the commercial exchange rate is not allowed to influence directly the price faced by the producer, who sells his output to a foreign trade organization at domestic wholesale prices. The profits of the foreign trade organization are subsequently taxed by the central government; analogously, losses are subsidized. In similar fashion, the domestic price at which a foreign trade organization sells imports need not reflect either the world price of imported goods or the exchange rate at which foreign purchases by the foreign trade organization are recorded. Recent modifications in some planned economies have strengthened the link between foreign and domestic relative prices, but on the whole these links still tend to be quite indirect, and therefore the impact of changes in the official exchange rate or rates on the structure of domestic relative prices remains muted.

The features of planned economies, such as those just outlined, obviously have to be borne in mind in implementing Fund surveillance. First, to a much greater extent than in other economies the Fund needs to be concerned not only about exchange rates in the narrow sense, but also about the whole set of subsidies, tax credits, and other measures affecting the prices of goods entering into foreign trade. Second, the *Fund has to stress that a relatively simple exchange system--in particular*, a system without discriminatory exchange rate practices and multiple exchange rate practices and multiple exchange rates--would assist decision makers at every level of the economy to improve the efficiency of the member's participation in foreign trade.

The above are only illustrative of the judgments that have to be made in the more complex cases. It is not intended to suggest that most of the cases requiring changes in exchange rate policies are extremely complex. Rather, the contrary is the case. Neither is it intended to suggest that where complexities arise, judgments should be avoided. Again the contrary is the case. It is the view of the staff that the indicators set out in the document remain useful and appropriate in giving guidance in identifying situations that warrant a change of exchange rate policies.

b. Issues arising in seeking agreement with members on policy changes

Not infrequently the staff is convinced that a country's exchange rate policy should be changed, but it finds it difficult to persuade the member of this view. The failure to persuade may reflect a genuine difference of views with the country, but it may also reflect other and more political considerations. National authorities may have domestic goals and constraints that they feel they have to respect even if the result is an inappropriate exchange rate. Whenever agreement is not reached, the surveillance document explicitly requires that this matter be ultimately brought to the attention of the Executive Board. The staff has acted as informally and confidentially as possible in such cases because of the extreme sensitivity of exchange rate issues, but at the same time it has kept the Board informed, in particular through forthright appraisals of exchange rate policies in Article IV consultation reports.

It is mainly in this context of persuasion that it is often argued that Fund surveillance is not evenhanded. The argument is that the Fund finds it easier to apply pressures on countries in deficit than on those in surplus--although from the point of view of the smooth functioning of the international adjustment process, surpluses and deficits can be equally disruptive. Deficit countries, the argument runs, tend to be more constrained in the policies they can adopt, and more dependent on the international community for formal approval of their adjustment policies. This is not simply because such approval is prerequisite to obtaining balance of payments financing from the Fund, but also because it is becoming increasingly important in securing a continued inflow of finance from other official sources and from commercial banks. Surplus countries, in contrast, have much less financial incentive to secure international approval of their policies.

In fact, the international community has been as prompt in registering disapproval when a country is suspected of manipulating its exchange rate in order to achieve undervaluation as when it is suspected of manipulating it in order to achieve overvaluation. For example, the only occasion when the Executive Board requested the Management to hold a special consultation to investigate further the exchange rate policy of a member was in the case of a devaluation that was thought to be excessive. The fear of competitive devaluations is always strong, and it has been further heightened in recent years by the worldwide rise in unemployment.

Many, if not all, of the cases where countries have not been persuaded to change their exchange rate policies in order to have them accord with the exchange rate principles were cases of overvalued exchange rates. Aside from the political considerations referred to above, four main sources of difficulty were encountered. The first was the tendency on the part of some national authorities to persist in believing that their overall policy strategies would ultimately be successful in reestablishing external equilibrium solely through productivity increases and cuts in inflation rates, even at the late stage when the accumulated loss in international competitiveness was so large that the possibility of achieving this objective had become remote.

The second source was the belief that exchange rate flexibility is not needed, and can even be harmful, in particular in developing countries and in the smaller industrial countries. This belief has very profound roots. It is argued that in developing countries market mechanisms work very imperfectly, that supply elasticities are low, that the main initial effect of a devaluation is likely to be a higher inflation, and that a devaluation may have income distribution effects that are socially unacceptable. For the smaller industrial countries, the argument is that with the high import content of consumption and the indexation of nominal wage rates a devaluation leads to a vicious circle of self-reinforcing inflation. In recent years, it has also been pointed out that the main problem is a global problem related to the low level of economic activity in the major industrial countries and the abnormally high level of interest rates, and that neither the foreign exchange price nor the aggregate volume of primary products exported by developing countries to the industrial world is much influenced by exchange rates.

While acknowledging the limits to the role of exchange rate flexibility imposed by the characteristics of countries and by the global nature of the current adjustment problem, management and staff have continued to stress that exchange rates do influence the aggregate volume of products, especially manufactures, that the major industrial countries import from developing countries and from the smaller industrial countries, that in all countries the efficient allocation of foreign exchange among domestic economic agents is greatly enhanced when a realistic price is placed on foreign exchange, that the process of adjusting real wage rates is often facilitated by an exchange rate adjustment, and that a realistic exchange rate is ultimately necessary to avoid a flight of domestic capital. Furthermore, management and staff have stressed that the use of trade and exchange restrictions is a far more costly form of adjustment, in particular in the longer run.

The third source of difficulty was that in a number of cases the underlying structural weakness of the balance of payments was masked either by temporarily high prices of export commodities, such as petroleum and petroleum products, or a series of favorable factors not expected to last. In these cases, the temporary lack of a severe external constraint had the effect of delaying the needed change in exchange rate policies.

The fourth source, which obviously has now disappeared as far as developing countries are concerned but was important through early 1982, was the ease with which many deficit countries could finance their deficits through bank borrowings. This reduced the efficiency of surveillance not only because deficit countries were less constrained in the policies they could follow, but also because they were lulled into believing that their policies could not be all that bad since their creditworthiness was so good. Furthermore, surveillance was hindered because it was difficult for the Fund to criticize the exchange rate policies of countries with large external debts without being accused of jeopardizing the credit standing of these countries and interfering with the free play of demand and supply in the international financial market.

These considerations suggest that strengthening the effectiveness of the Fund's surveillance over its members' exchange rate policies does not require a revision of any of the three sets of principles contained in the surveillance document. It requires a continuous effort on the part of management and staff to sharpen the analysis in order to clearly identify cases calling for discussion with the Fund. It also requires frank and persuasive discussions with members to arrive at a certain common understanding of the problems. Last but not least, the effectiveness of Fund surveillance requires the active and broad support by members of the positions taken by the Fund.

2. Issues relating to the broader aspects of Fund surveillance

Many of the international economic problems of recent years have been associated with the pronounced swings in exchange rates between major industrial countries and the repercussions of the low levels of economic activity and high interest rates prevailing in these countries on the rest of the world. These developments were referred to only in passing in the preceding discussion because they cannot realistically be viewed as resulting from a manipulation of exchange rates or of the international monetary system aimed at preventing balance of payments adjustment or gaining an unfair competitive advantage. Nevertheless, the fact that they result from domestic policies followed for domestic purposes does not prevent them from being viewed with great concern by the international community.

In a fundamental sense, these developments have demonstrated not only the need for exchange rate flexibility, but also its limits. In particular, they have brought an early end to the hope that exchange rate flexibility would go a long way in bottling up the effects of domestic policies in domestic economies. At the same time, these developments have led to a greater recognition on the part of the international community of the broad role of the Fund in overseeing the international monetary system, a role given to it by Section 1 and Section 3(a) of Article IV. An important event in this respect was the decision taken by the seven largest industrial countries at their 1982 Economic Summit meeting to undertake "to strengthen their cooperation with the Fund in its surveillance work and to develop this cooperation on a multilateral basis, taking into account particularly the currencies constituting the SDR." 1/ The Communiqué made it clear that the term "surveillance" was to be given a very broad meaning which included domestic policies having a major international effect.

As discussed later in the present paper, the Fund has responded to the new international economic problems. In seeking to fulfill its responsibility to oversee the system, however, complex issues have been encountered.

1/ Versailles Communiqué, June 1982. See also the Williamsburg Communiqué, May 1983.

a. Issues relating to policy coordination and exchange rate stability among major-currency countries

A major criterion for evaluating the external implications of domestic policies in major-currency countries is whether the behavior of their effective exchange rates appears to be out of tune with the underlying economic and financial conditions. Judgments on this point are arrived at by considering whether the exchange rate appears to deviate very substantially from a sustainable level. In this context, the term sustainable is given its traditional broad meaning: an exchange rate is viewed as being sustainable if it can be maintained over the medium term and is appropriate from the standpoint of the country in question and the international community as a whole. In a paper entitled "Issues in the Assessment of Exchange Rates of Industrial Countries in the Context of Their Economic Policies" (SM/83/263, 12/28/83), discussed in an Executive Board seminar on January 30, 1984, the staff undertook a detailed discussion of the alternative approaches that are available for assessing the sustainable level of the exchange rate, making particular reference to a number of indicators--including measures of international cost and price competitiveness and the more comprehensive "underlying payments balances" approach--as methods of estimating sustainable exchange rates for industrial countries.

The staff paper sought to indicate that, in contrast to judgments of the sustainable exchange rate based on competitiveness indices, assessments based on underlying payments balance considerations are explicitly concerned with developments in both the capital and current accounts, and they allow for the impact of the stance of economic policies on the sustainable level of a country's exchange rate. Although the procedure by which underlying payments balances are calculated is a relatively complex one and there are a large number of difficulties inherent in these projections, the assessment of underlying payments balances is essential to ensure consistency and comprehensiveness in the evaluation of exchange rate sustainability in a multilateral framework.

In their seminar discussion, Executive Directors stressed that the Fund had the responsibility to assess exchange rate developments, particularly among the major currencies, and that the methods presented in the staff's paper were useful in this context. They agreed with the staff that the underlying payments balance approach was more comprehensive than the approach based exclusively on indicators of international cost and price competitiveness, and that, therefore, it provided a better foundation for the assessment of exchange rates. At the same time, Executive Directors stressed that further work was needed to improve the reliability of the underlying payments balance approach and that, in any case, the assessment of exchange rates always required a great deal of caution.

Whenever the circumstances are such that the staff is led to a tentative view that there is an exchange rate problem, it discusses its view with the authorities of the country or countries concerned and seeks to arrive at a common judgment as to the existence of the problem and its nature. The view as to the nature of the problem underlies the delineation of the policy response that is appropriate. However, while in some cases it is relatively easy to trace the source of the exchange rate development to specific policies that are unwise from both the national and international standpoint, in many cases tracing the source of the exchange rate development is a complex task. Two elements that have increased the complexity of this detection task in recent years are the apparent emergence of international divergences in the evolution of fiscal policy as an important factor influencing the exchange rate and the increasing difficulty of determining the right rate of monetary expansion.

The relationship between fiscal policies and exchange rates is clouded by the uncertainty that exists with respect to the future evolution of private aggregate demand and monetary policy. When fiscal policies shift toward expansion at times when economic activity is low and expected to remain so for some time, those policies tend to have only a limited effect on the level of real domestic interest rates or on exchange markets, as the flow of private saving is usually sufficient to absorb the additional government borrowing. On the other hand, at times of buoyant or accelerating economic activity, fiscal expansion tends to drive up interest rates, particularly when the expansion is expected to be persistent; in this case, the effect on the exchange rate depends primarily on the extent to which the fiscal expansion is expected to be accommodated by an expansionary monetary policy. If the fiscal expansion is accommodated, the rising level of domestic interest rates is often associated with anticipations of higher inflation, in which case the combination of policies tends to have the effect of depreciating the country's exchange rate. When the fiscal expansion is not accommodated, then the main effect is often to increase the level of interest rates in real terms, thereby appreciating the exchange rate. In any given specific case, it is often difficult to evaluate expectations and, therefore, the contribution of the fiscal policy to exchange rate developments.

Developments in the monetary area have also made it more difficult to assess the source of exchange rate developments. All of the major industrial countries have placed increased reliance over the past several years on the control of monetary growth as the principal way to set monetary policies in the medium term. More recently, however, it has become increasingly apparent that the "information content of monetary aggregates" is not so easily comprehensible as was once believed. Part of the problem is temporary, associated with the rather sudden decreases in inflation and in nominal interest rates that have characterized the past two years. But part of it may be more long lasting, being associated with the development of close substitutes for money balances as traditionally defined. In any case, at least for the time being it has become particularly difficult to determine the appropriate rates of growth of the monetary aggregates, and, therefore, to assess whether specific exchange rate developments are the result of excessively low or high rates of monetary growth.

While the task of detection is often complex, the process of distinguishing the various issues involved can help to reduce divergences of view. Thus, it is essential for the success of surveillance that, whenever the exchange rate implications of certain policies are not well understood, a serious attempt be made at a very early stage to work toward a meeting of minds on the nature of the processes at work. This is why the Fund has endeavored to develop its analysis in this domain in recent years, and why it has sought through publications such as the World Economic Outlook and the Annual Report, through informal contacts between Management and member countries, and through the regular article IV consultations to represent the conclusions of its work to its members.

Furthermore, it is often possible to identify the broad types of policies that tend to result in undesirable exchange rate developments. For example, divergences in inflationary conditions and in the relative weights of monetary and fiscal restraint in demand management are readily identifiable factors of exchange rate instability. As there is little doubt that low inflation rates are better than high inflation rates, and that a balanced reliance on monetary and fiscal restraint is better than a combination of loose fiscal policy and restrictive monetary policy, it is clear in which direction the convergence should take place. It is these considerations that have led the Fund to stress the need for convergence, in particular among the main industrial countries.

Rigidities are also often readily identifiable factors of exchange rate instability. As discussed in the 1983 Annual Report of the Fund, the exchange rate swings among major industrial countries over the past four years can partly be attributed to differences among countries in the speed of adjustment of wage and price inflation to reduced rates of monetary growth. As inflation abated less rapidly in the United States than in Japan and in the Federal Republic of Germany, nominal and even real interest rates - that is, the difference between nominal interest rates and estimates of expected rates of inflation - rose more strongly in the United States than in the other two countries as a result of a liquidity squeeze. This change in relative monetary conditions was an important factor contributing to the strength of the U.S. dollar from 1981 to the first half of 1982. To reduce these differences in the speed of adjustment of the inflation rate to the rate of monetary growth is a difficult task. Nevertheless, much can be done to speed up adjustment in countries with persistent inflationary tendencies by following a balanced demand management policy and by reducing rigidities in the goods and labor markets.

In the cases discussed so far, the undesirable exchange rate development was mainly related to unbalanced or insufficiently effective domestic policies, so that containment was to be sought in a change of these policies. A dilemma arises when the undesirable development does not appear to be due to weaknesses in domestic policies. In such a case, it may be extremely difficult to contain the development without endangering other policy objectives. Sterilized intervention may at times play a useful role in this context, but, as noted in the report of the working group on intervention, sterilized intervention does not generally have a lasting effect. Unsterilized intervention would certainly be a more powerful instrument, but it is difficult to envisage how a sizable exchange rate appreciation deemed to be undesirable could be contained without a sizable additional monetary expansion that could fuel inflation at some later stage. Thus, it may at times be necessary to accept an undesirable exchange rate development because the costs of countering it would be greater than the benefits.

b. Issues relating to the external environment of developing countries

Turning to the economic problems currently faced by developing countries, it is clear that these countries have to continue to strengthen their adjustment efforts. Their economic resources need to be harnessed to expand exports and replace imports with due regard for comparative advantages, and adequate incentives need to be provided for the investment of domestic saving at home rather than abroad. But it is also clear that developed countries--in particular the major industrial countries--have to contribute to the adjustment process in a major way. Mainly, they have to restore the stable underlying economic and financial conditions that are needed to foster an enlarged demand for the exports of developing countries and a reduction in the interest rate they have to pay on their foreign debt.

The role of the Fund is obviously to foster policies that are consistent with that strategy. There are, however, many issues arising in this context. First, there is the issue of aggregate demand. Now that domestic demand in the United States, Canada and the United Kingdom is expanding at a satisfactory rate, the growth of the global demand for the exports of developing countries is dampened only by the slower growth of domestic demand in continental European countries and Japan. In countries such as France and Italy, inflation remains a severe problem and the authorities have to persist with and in fact strengthen their restrictive demand management policies. In countries such as the Federal Republic of Germany and Japan, major progress has been made in the fight against inflation, but the budget deficit remains sizable and the exchange rate remains under pressure so that the authorities have to maintain their cautious demand management policies.

Second, there is the issue of protectionism. Developing countries, in particular those with very high external indebtedness, will have to expand their exports of manufactured and agribusiness products at a rapid rate over the next few years if they are to restore an adequate external position while sustaining a moderate rate of economic growth. As the income elasticity of the types of manufactured and agrobusiness products that they can export is rather low, even the restoration of a moderate growth of aggregate demand in the industrial countries will not per se ensure a sufficient demand for these products. What will be needed is a marked increase in the market shares of developing countries. This in turn will be possible only if there is a decrease in protectionism in industrial countries with respect to those imports. In that context, a simple admonition against the introduction, substantial intensification, or prolonged maintenance, for balance of payments purposes, of restrictions on current transactions would fall far short of the mark. Of course, a decline in protectionism in developing countries is also needed, particularly to foster trade among themselves.

Third, to foster a reduction in interest rates is no easy matter either. To the extent that high interest rates reflect a persistence of inflationary expectations, the solution is to maintain cautious demand management policies so as to bring about an adjustment of these expectations. To the extent that high interest rates reflect an anticipated shortage of savings, the solution is to adopt measures that would reduce budgetary deficits in forthcoming years. In both cases, there are obvious difficulties of implementation. In particular, as discussed above, the recent instability in the demand for the various monetary aggregates makes it difficult for the authorities to know what rates of expansion of the aggregates are consistent with a cautious policy stance. Furthermore, high unemployment rates oblige the authorities to seek a difficult balance between the need to convince economic agents that the budgetary deficits will be markedly reduced over the next few years, and the need to avoid derailing the economic recovery with a sudden withdrawal of fiscal stimulus.

3. Summary and concluding remarks

The three sets of principles contained in the document remain as broadly acceptable today as they were when the document was drafted in 1977. The difficulties of implementation that have been encountered do not appear to call for a revision of these principles. Rather, they indicate the need for the Fund, working closely with its members, to try to achieve sharper analysis of the impacts of policies and continue to promote the adoption of policies that analysis reveals to be desirable.

Experience in recent years suggests that, at least for the major industrial countries, recourse to a domestic policy stance that fails to take account of the implications for other countries has often been a more serious problem than the implementation of policies designed to manipulate exchange rates or the international monetary system. In particular, changes in fiscal or monetary policies that have not been coordinated with other countries' policies have had the effect of limiting the achievement of economic convergence at high levels of economic performance on which exchange rate stability among the major currencies depends. In addition, the domestic policy stance in major industrial countries has contributed greatly to the emergence of a global adjustment problem between these countries and the developing countries--a problem that severely constrains the growth potential of developing countries and is hardly solvable through exchange rate flexibility alone.

The issues involved in the choice of domestic policies are often more complex and more directly related to internal social and political considerations. However the Fund would not fulfill its broad surveillance responsibilities over the international monetary system if it refrained from forming a view on the domestic policies needed to foster a smooth working of the system and from attempting to persuade its members to follow such policies. The Fund has a very important role to play in assisting countries to take advantage of the gains that can be reaped through international policy coordination. It is through competent analysis and a clear identification of the problems that the Fund must seek to persuade policymakers to take more account of the effects of their decisions on the economies of their partners.

III. Multilateral Aspects of the Implementation of Surveillance

Besides exercising surveillance with respect to individual members through Article IV consultations and the monitoring of exchange rates (described in later sections), the Fund carries out an important part of its surveillance activity in multilateral contexts. The World Economic Outlook, for example, provides a comprehensive framework for analysis of world economic developments. Over the last year or so, moreover, the Fund has become more actively involved in dealing with problems of external debt and protectionism in a multilateral context.

1. World Economic Outlook and related studies

In 1983, the World Economic Outlook continued to provide a comprehensive framework for the Executive Board's review of the world economy and the exchange rate system, and thus for multilateral surveillance over the exchange rate policies of individual members. World Economic Outlook papers were discussed by the Board in February, June, and September [B:1,4,5]. Furthermore, summary papers of the World Economic Outlook were prepared for review by the Interim Committee at its February and September meetings [B:2,6]. The staff analyses underlying these discussions have emphasized the stance of economic policies in those countries that exert an important influence on the international monetary system and, as in recent years, have increasingly stressed a medium-term approach. Medium-term scenarios have been helpful in highlighting the policies needed to achieve a sustainable noninflationary recovery in the industrial countries and in analyzing the adjustment and debt problems of various analytical groups of developing countries in a medium-term context. Specific policy prescriptions emphasized in the past few years have included the perseverance by industrial countries with policies of monetary restraint, the adoption by developing countries of adjustment policies designed to maintain international competitiveness, and resistance to the adoption of protectionist trade measures.

During 1983 and early 1984, the staff also prepared a number of special studies for the Executive Board on particular surveillance topics. Considerable attention was paid to the subject of external debt; studies in this area are discussed in subsection 3 below. On exchange rate policies as such, the Executive Board held a seminar in January 1984 on "The Exchange Rate System: Lessons of the Past and Options for the Future" and "Issues in the Assessment of Exchange Rates of Industrial Countries in the Context of Their Economic Policies," [E:2]. Such special studies, together with the regular analyses contained in the World Economic Outlook and the Annual Report, provide a comprehensive basis for the assessment of policy developments in the major industrial countries and the interactions among them, allowing a special focus to be placed on policy aims or actions of one or more countries and the extent to which they might clash or harmonize with those of others, thereby providing an important framework for the exercise of the Fund's responsibility for surveillance over members' exchange rate policies.

2. Management's role in multilateral meetings

The management of the Fund has also participated in various multilateral meetings of the major industrial countries. The Managing Director attends meetings of the ministers and governors of the Group of Ten from time to time and presents the Fund's views on economic developments from a multilateral perspective. Since the 1982 Economic Summit Meeting (see p. 9, above), the Managing Director has participated in the regular meetings of the ministers of the Group of Five. On these occasions, the Managing Director has reviewed recent developments, particularly with regard to financial and exchange rate policies. He has stressed the need for cooperation among major industrial countries in order to put in place policies designed to achieve convergence toward a lasting reduction in inflation, higher employment, and sustainable economic growth; in this context, he has emphasized the importance of assuring that movements in exchange rates are consistent with underlying economic conditions. He has also sought to focus attention on the policies that would assist in achieving convergence and stability over the medium term. More broadly, in the context of these meetings, the Managing Director has stressed the need for major countries, in framing their domestic policies, to give weight to the impact of their decisions on exchange rates and on economic conditions in other countries.

The Managing Director has also given prominence to surveillance issues in his frequent public statements and informal remarks in various forums.

3. Multilateral approaches to problems of external indebtedness

The debt service difficulties experienced by a number of members over the past several years, and the growth of members' borrowings from commercial banks, have resulted in an increased focus in Fund surveillance on members' external indebtedness. The importance attached to external borrowing and lending policies was underscored by Executive Directors on many occasions throughout 1983 during discussions of the World Economic Outlook [B:1.b], Article IV consultations, and requests for use of Fund resources. Executive Directors considered these issues intensively at their meeting of April 6, 1983, where they discussed "Fund

Policies and External Debt Servicing Problems" and related papers [F:1]. The Board also discussed developments in international capital markets in June [F:2], and held a seminar on questions related to external indebtedness in December 1983 [F:3].

A number of projects are under way to further improve the monitoring, presentation, and analysis of external debt. Through the publication of enhanced and more timely data, the Fund will also be improving the information which the international financial community can use in making independent judgments of the circumstances of member countries. Publication in International Financial Statistics of new tables on international banking statistics began with the January 1984 issue. Work on the development of comprehensive country debt tables by the Bureau of Statistics has also been initiated. Other work being conducted by the staff includes a study of the discriminatory treatment of countries in debt settlements and the pooling of information about technical issues arising in bank debt restructurings. The current World Economic Outlook exercise pays special attention to medium-term debt service prospects, focusing on a group of major debtors, with the intention of illustrating the sensitivity of the projections to changes in various assumptions.

There has also been an evolution in the Fund's relations with private financial institutions. In the past, the Fund's role vis-a-vis commercial banks regarding a country's debt servicing prospects was typically limited to technical assistance to members in improving and presenting statistical material. During the last 18 months, however, in cases where private flows were impaired and countries were seeking comprehensive packages of financial assistance from commercial banks, the Fund has frequently found it necessary to adopt a more active role in securing confirmation from both official and private creditors that the external financing assumptions of economic adjustment programs were realistic. In this connection the Fund staff, when asked to do so by debtor countries, has also been prepared to discuss the outlook for a country's external payments with private financial institutions, as well as with official agencies.

4. Multilateral approaches to the problem of protectionism

Overall developments in protectionism and its global implications are considered by Executive Directors on the basis of periodic staff reviews of international trade policies [G] and in the regular World Economic Outlook reviews. The Managing Director has also given increased attention to the issue of protectionism in his speeches to international bodies and other groups.

In addition to a routine exchange of information with GATT and Fund participation in GATT balance of payments consultations, the increased attention to trade issues by the Fund has led to expanded Fund-GATT collaboration, particularly in the form of more frequent informal contacts between the staff of the two institutions. The GATT secretariat has started to organize information on country lines; this should assist Fund staff in focusing on major trade issues and developments. GATT officials have also visited Washington to discuss the approaches to trade policy employed by Fund staff in the context of Fund-supported adjustment programs, and Fund staff have visited GATT headquarters for informal discussions on relevant trade issues prior to Article IV consultations.

IV. Article IV Consultations

The basic vehicle for the Fund's exercise of surveillance continues to be the Article IV consultation. From time to time, there have been suggestions for changes in the procedures followed in Article IV consultations. No doubt there is room for changes that would enhance the effectiveness of consultations, but in the last analysis the effectiveness of consultations derives from the cogency of the staff's analysis and the Executive Board's discussion, as well as the frequency with which consultations are carried out. Over the last year, there has been further evolution in Fund practices with respect to the subject matter of consultations, particularly with respect to external debt and protectionism. There has also been a marked increase in the number of consultations.

1. Reporting on consultations

a. Exchange rate policies

While the principles of surveillance require the Fund to consider the whole range of economic policies that affect the balance of payments, financial stability, economic growth, and employment, exchange rate policies as such receive particular attention. Staff reports generally contain an extensive discussion of the members' exchange rate and the policies that govern it, staff appraisals generally comment on the appropriateness of the rate or policies, and the issue also figures prominently in Executive Board discussions.

Table 1 attempts to classify the tenor of the views contained in staff appraisals. For the 120 consultations concluded in 1983, 31 staff appraisals commended the exchange rate policies of the member, 9 were neutral, and 60 questioned the policies followed; in 20 cases exchange rate policies were not mentioned. In industrial countries with pegged or cooperative arrangements, mild questions were sometimes raised about the level of the rate, but the willingness of the member to take exchange rate considerations into account in the overall policy stance was generally endorsed. For some industrial countries with more flexible arrangements, on the other hand, the failure of macroeconomic policies to bring about an appropriate exchange rate was emphasized. For developing countries, critical appraisals tended to focus on members with pegs at unrealistic levels, while developing countries with more flexible exchange arrangements were generally judged to have been relatively successful in their exchange rate policies.

Table 1. Views on Exchange Rate Policies in Staff Appraisals for Article IV Consultations Concluded in 1983

	Favorable	Neutral	Mildly Critical 2/	Strongly Critical	Not Mentioned	Total
All consultations	31	9	30	30	20	120
of which:						
Program countries	(13)	(3)	(14)	(5)	(7)	(42)
Distribution by country classification and exchange arrangement						
Industrial	7	2	4	2	1	16
Pegged 1/	(6)	(--)	(1)	(--)	(1)	(8)
More flexible	(1)	(2)	(3)	(2)	(--)	(8)
Developing	24	7	26	28	19	104
Pegged 1/	(13)	(6)	(14)	(25)	(19)	(77)
More flexible	(11)	(1)	(12)	(3)	(--)	(27)

1/ Includes "Flexibility Limited." (See IFS, "Exchange Rate Arrangements" table.)

2/ Includes cases where the staff emphasized the need for keeping the exchange rate under review--often in response to a past experience of inappropriate policies.

Of the 20 countries for which staff appraisals did not mention the exchange rate, 11 were cases of currency unions or of traditional tight links to another country's currency, and the staff implicitly accepted the appropriateness of the arrangement. Five of the remaining cases were oil-exporting countries.

In assessing the appropriateness of exchange rate policy, the staff employed a variety of indicators, particularly the behavior of the real effective exchange rate and the evolution of the balance of payments. In the industrial countries, some measure of the real effective exchange rate was used in all cases. The evolution of the balance of payments itself was less frequently highlighted, though intervention was mentioned in some cases, as were possible effects of capital controls. In developing countries, the behavior of the real effective exchange rate was also considered important, being noted in 64 of the 85 cases where the exchange rate was discussed explicitly in the staff appraisal. The evolution of the balance of payments was also widely used, covering 62 countries. In about one quarter of the countries in this category there was some discussion in terms of the restrictiveness of the trade and payments system, and, where secondary markets existed, reference was made to developments in those markets.

The assessment of exchange rate issues in staff appraisals in most cases, while expressed in circumspect terms, can thus be characterized as frank, and the underlying analysis is reasonably comprehensive. A review of the Chairman's summings up for the consultations indicates that, by and large, the Board endorsed the approach taken. Indeed, the language in summings up was occasionally more pointed than that in staff appraisals. In a few cases the difference was sufficiently marked to suggest that the Board disagreed with the staff--in each of these cases, the summing up was sharper than the staff appraisal. In a number of the instances where the staff appraisal had not included a discussion of exchange rate policy, moreover, Directors indicated the importance they attached to the subject.

b. External debt and assessment of policy stance in a medium-term setting

In the context of their discussions of the Fund's approach to the problem of external indebtedness described in Section III, Executive Directors attached particular importance to the use of Article IV consultations for improving the analysis of external debt policies and prospects in individual countries [F:1.e]. The regular consultation process was seen as a means of improving reporting on external debt developments in member countries, with particular reference to areas such as private debt, short-term liabilities, and the assets of the banking sector at large. The staff was also urged to include in Article IV consultations a description of the medium-term external debt outlook for the country concerned. While such analyses were not to be accorded more significance than the uncertainty of future events allowed, it was important that the Fund try to discuss with member countries the medium-term implications of their policies. It was agreed that such forward-looking technical analyses should be prepared in close cooperation with the authorities in member countries. In view of the uncertainties involved, such analyses were not to be included in the reports on recent economic developments.

Such analyses had previously been included in a few consultations, but, since the April 1983 Board discussion, they have figured in almost all cases where the member's external indebtedness has been a significant issue. For the 61 Article IV consultations concluded in the second half of 1983, 34 staff reports included an analysis of the medium-term debt outlook, normally accompanied by a detailed table showing debt service projections. Of the 12 cases in which consultation staff reports incorporated either a request for the use of Fund resources or a review of a stand-by or extended arrangement, 11 cases included a medium-term debt service scenario. In most of the countries where the medium-term outlook was not discussed, it was because the member was not engaged in significant external borrowing.

Though coverage of the external debt in recent staff reports has been much more extensive than in the past, there is room for further development in presentation and analysis. While most of the 34 staff reports referred to above included projections of the debt service ratio (normally using exports of goods and nonfactor services), only 22 of them provided forecasts of the components of the balance of payments, and, in many cases, the sensitivity of the projections to alternative assumptions was not examined. Furthermore, the link between the external debt outlook and the possible need for adjustments in policies could usually have been drawn more explicitly.

In their April 1983 discussion, Directors noted that it was important that forward-looking external debt analyses should not be limited to countries that were in difficult debt situations or engaged in rescheduling operations. This would be consistent with the notion of uniformity of treatment, and would also serve to show that the forward-looking debt analyses were not in any sense a predictive exercise, but an analytical tool that should become part of the set of elements used in any assessment of the sustainability of a balance of payments situation or of external borrowing policies.

In light of that recommendation, the staff has not limited medium-term external debt analyses to cases where external indebtedness is an immediate problem. Among consultations with industrial countries in the second half of 1983, for example, the staff reports for Australia, Iceland, Ireland, Norway, and Sweden all included illustrative medium-term debt scenarios, and such scenarios will be employed more widely in the future. In light of the discussion of "Issues in the Assessment of Exchange Rates of Industrial Countries in the Context of their Economic Policies," in the recent Board seminar [E:2], moreover, the staff will be cautiously experimenting in selected cases with the concept of underlying payments balances in assessing the viability of members' balance of payments positions and, more generally, their overall policy stances.

c. Protectionism

As called for in last year's surveillance review, the coverage and analysis of trade policy matters in Article IV consultation reports has been expanded, and the consultation discussions in the Executive Board have also increasingly featured protectionism. For all the major industrial countries, coverage has increased and staff appraisals have included assessments of trade policies. The consultations with Japan and the United States, for example, provided comprehensive coverage and assessments. In both cases, the staff reports and Chairman's summings up commented favorably on the commitment of the authorities to liberal trade policies, but noted that certain sectors remained heavily protected. In the case of the United States, it was also noted that protection had increased in some sectors. For the major European countries the analyses recognized that most protectionist measures had been taken in the context of membership of the European Community, but noted that it was the responsibility of individual members to press for reforms within the community. To help establish the background for this analysis, in a number of cases staff members visited GATT headquarters in conjunction with their participation in the consultation missions. 1/

Coverage of protectionist issues was also increased for other industrial countries. An example of such coverage which was commended by Executive Directors was the consultation with Australia. Among the aspects of Australia's trade policies covered in the consultation reports were the history of protectionist policies and a review of the legislative process. A sectoral analysis was also provided, noting the effective degree of protection provided, the high and rising cost of providing that protection, and its limited effectiveness in achieving the objectives desired. There was also an extensive analysis of the impact of protectionism abroad on Australia's agricultural exports.

1/ This occurred with respect to France, Germany, Japan, Italy, and the United Kingdom.

Coverage of the impact of foreign protectionism in the consultations for developing countries was generally limited to brief statements in staff appraisals and Chairman's summings up regretting that impact, but, in some cases, notably the consultation with Hungary, there was more extensive analysis.

In general, a review of recent Article IV consultations suggests that progress to date in the coverage of protectionism has been concentrated on the comprehensive identification of trade measures, the forms they took, and the motivating factors. Over the coming year, the staff plans in relevant cases to improve its reporting as follows:

1. Protectionist measures adopted in the framework of regional arrangements would be featured in the reports for the individual member.

2. Further progress would be made in assessing the impact of protection on domestic adjustment.

3. The impact of protectionist measures on the country's trading partners would be given greater emphasis, including identification of the countries or groups of countries that have been affected.

4. The views of the authorities on the impact of protectionism abroad on the consulting country would be reported.

5. As the staff gains familiarity and expertise on trade issues, reports would provide analysis of specific trade issues of particular importance to the consulting country and its trading partners.

d. Other aspects of consultation reporting 1/

Staff reports have occasionally included mention of the findings of the previous consultation, along with a brief description of recent policy developments against that background. The staff report for last year's consultation with Japan (SM/83/36, 2/18/83), for example, noted the common concerns that underlay the various comments and suggestions made by Executive Directors at the conclusion of the previous consultation, and went on to note that, since then, the Japanese authorities had, in fact, conducted their policies in a manner consistent with the views expressed by the Board. Another example of such an analysis, in a more critical vein, was the staff report for Australia (SM/83/219, 10/26/83). In both cases this approach provided a helpful perspective on the evolution of developments and policies.

1/ Section I of the background paper includes material on the length of staff reports and recent economic developments papers.

Following the conclusion of the 1983 consultation with Malaysia, the Malaysian authorities provided a statement 1/ of adjustments that they were making in the fiscal area. While it would not be productive for the Fund formally to request responses from countries, voluntary statements of this type provide a useful extension of the consultation dialogue.

Following suggestions made at last year's Surveillance Review meeting, new procedures were adopted with respect to the Chairman's summing up. These confirmed previous understandings that any important changes in a summing up suggested by the Executive Director for the country concerned would be circulated to the Board. Moreover, the final versions of summings up now become quickly available in a separate document series that is limited to summings up relating to surveillance.

2. Consultation frequency 2/

Because of the important role played by Article IV consultations in the exercise of surveillance by the Fund, the Procedures for Surveillance 3/ state that in principle such consultations are to take place annually. This goal has proven difficult to achieve for many members, and indeed in the years 1980-82 even the operational guideline that had been adopted, of covering three-fourths of the membership annually, was not met; in 1982, in fact, consultations were held with only 57 percent of the membership. The decline in frequency gave rise to concern, especially with respect to situations where there had been major changes in members' economic circumstances in the long intervals between consultations. The staff paper for the 1983 Surveillance Review thus included an extended discussion of the problems encountered in restoring frequency of consultations to more adequate levels [A:1.a, pp. 12-19]. As a result of the review at that time, the Executive Board established guidelines for determining those cases where consultations should be conducted on a strictly annual basis and adopted certain procedural changes, notably the system of specifying, at the conclusion of each consultation, the expected date for conclusion of the next.

a. Recent experience with consultation frequency

Beginning in the fall of 1982, extraordinary efforts were made to eliminate the backlog of consultations, although, because of the normal lag between staff discussions with authorities and the Board's conclusion

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1/ Circulated to Executive Directors 10/7/83.
2/ Section I of the background paper contains a detailed review of all aspects of consultation frequency.
3/ Selected Decisions, Tenth Issue, p. 13.

of the consultation, the effects of these efforts on recorded frequency did not appear until 1983. As a result, the number of consultations concluded in 1983, 120, was unusually large, particularly in comparison with the 82 recorded in 1982 (Table 2). Membership coverage rose to 80 percent. This involved a record number of consultation missions, 130, compared with 106 in 1982, and professional staff travel in connection with consultations amounted to 11,700 days in the field, up from 10,309 in 1982. The number of staff reports issued had already increased substantially in 1982 to reach 98, and there was a further increase to 118 in 1983. Executive Board time devoted to consultations increased to 199 hours in 1983, 40 percent of total meeting time. This occurred in spite of the fact that for many consultations Board discussion was brief: in 7 cases, less than 15 minutes, and, in 15 others, less than half an hour.

Table 2. Article IV Consultations--
Aspects of Consultation Frequency, 1981-83 1/

	1981	1982	1983
Number of consultations concluded	86	82	120 2/
(percent of membership covered)	(61)	(57)	(80)
Number of consultation missions 3/	88	106	130
Staff travel in connection with consultations (days)	8,404	10,309	11,700
Number of staff reports issued	83	98	118
Executive Board hours	129	163	199
(in percent of total hours)	(29)	(31)	(40)

Source: Background paper, Section I.

1/ Includes items combining consultations with consideration of use of Fund resources.
2/ The number of members covered was 117, as this figure included the consultation with the Netherlands Antilles as well as two cases of members having two consultations concluded within the calendar year.
3/ Includes multiple missions in connection with individual consultations.

Table 3. Members for Which More Than 15 Months Have Elapsed Since Last Consultation

(As of December 31, 1983)

Member	Date Last Consultation Concluded	Number of Months Since Last Consultation Concluded	Projected Date for Conclusion of Next Consultation	Explanation 1/
African Department				
Algeria	9/24/82	15	3/84	--
Botswana	9/20/82	15	2/84	Longer cycle
Burundi	3/22/82	21	2/84	Longer cycle
Cameroon	7/16/82	17	5/84	Longer cycle
Cape Verde	9/27/82	15	8/84	Longer cycle
Chad	4/25/79	56	3/84	Security problems
Djibouti	5/24/82	19	2/84	Longer cycle
Nigeria	9/22/82	15	2/84	Use of Fund resources
Asian Department				
Democratic Kampuchea	10/81/73	121	...	Security problems
Philippines	4/30/82	20	5/84	Use of Fund resources
Middle Eastern Department				
Iran	10/6/78	63	...	Security problems
Iraq	2/29/80	46	2/	Security problems
European Department				
Finland	1/25/82	23	3/84	Longer cycle
Italy	9/22/82	15	1/84	--
Western Hemisphere				
Antigua & Barbuda	4/30/82	20	2/84	Longer cycle
Nicaragua	12/23/81	24	3/84	--
Paraguay	11/25/81	25	1/84	--
Suriname	8/6/82	17	1/84	Longer cycle 3/

1/ "Longer cycle" refers to what the staff would recommend, based on member's current circumstances; "Security problems" refers to cases where the member, in a situation of armed conflict, has declined to receive a consultation mission, or where the security of the mission cannot be assured; "Use of Fund resources" refers to situations where consultation missions or Board discussions were postponed because of negotiations on use of Fund resources.

2/ Staff report issued, but date for Executive Board discussion not yet set.

3/ In view of the deterioration in 1983 of Suriname's economic situation, a standard cycle would now be appropriate.

The improvement in coverage of Article IV consultations in 1983 was particularly marked for countries with Fund-supported programs. Of countries in this category in 1982, 23 did not have consultations concluded that year. In 1983, all but five program countries had consultations concluded, and, for those five, consultations were scheduled to be concluded in the first few months of 1984.

b. Overdue consultations

As was noted in "Frequency of Article IV Consultations--An Interim Report," [C:3] between the end of 1982 and September 1983, the number of countries for which consultations were clearly overdue dropped sharply. This improvement was maintained in the rest of the year. The number of members for which more than 24 months had elapsed since the last consultation dropped from 15 at the end of 1982 to 6 at the end of 1983, while the number for which the time elapsed was in the range of 15-24 months 1/ dropped from 27 to 12 (background paper, Table 2).

Table 3 lists the members for which, at December 31, 1983 more than 15 months had elapsed since the conclusion of the previous consultation. Of the 6 cases for which the interval had reached 24 months, 4 were understood to be affected by security problems that may justify the postponement of consultations. The consultations for the other two, Nicaragua and Paraguay, were concluded early in 1984. Of the 12 members with intervals in the 15-24 months range, 8 had been judged by the staff to meet the criteria for a longer cycle, at least until recently. The delays in the cases of Nigeria and the Philippines were associated with continuing negotiations on the use of Fund resources. The other two cases had just passed the 15-month mark, and were concluded early in 1984. In concluding consultations involving overly long intervals since the previous ones, Executive Directors often emphasized the importance they attached to regularity of consultations and greater frequency in future. Such statements appeared in 1983 in the Chairman's summings up for the consultations with Australia, Bolivia, Denmark, Ghana, Grenada, Israel, New Zealand, and Zaire.

c. Specification of consultation cycles

As part of a stricter approach to consultation scheduling, the Executive Board, at the time of the 1983 Surveillance Review, indicated that, at the conclusion of each Article IV consultation, a date should be

1/ Under the present system of advance specification of consultation cycles, discussed below, the standard cycle is 12 months, with a three-month grace period.

established by which it was expected that the next consultation would be concluded. Observation of the cycle specified in this fashion was not to be rigidly enforced, but it was expected that advance specification would encourage the member, the staff, and the Board to carry out the consultation on a timely basis. By varying the recommendation on the cycle in light of the member's circumstances, moreover, the Fund would be better able to ensure an appropriate allocation of time devoted to consultations.

It was envisaged that, for most members, an annual consultation cycle would be appropriate, particularly those members having a substantial impact on other countries, those with Fund-supported programs, and those for which there were substantial doubts about the medium-term viability of the balance of payments. 1/ For countries on the annual cycle, the objective was to limit the interval between consultations to 12 months, but flexibility would be maintained through a grace period of an additional 3 months. For other members, cycles as long as 24 months could be specified.

The specification of consultation cycles is set out in Tables 3 and 4 of the background paper. There were 84 members for which consultations were concluded in 1983 following the adoption of the system of advance specification of cycles. An annual cycle was specified for 83 percent of those members, and longer cycles, in practice in the range of 14-18 months, for 14 percent. 2/ For two members, Afghanistan and Lebanon, a "flexible approach," was called for, reflecting uncertainties as to when the next consultation mission could fruitfully be scheduled, given the security problems faced in those countries.

1/ As spelled out in [A:1.a] the criteria are: (1) Those members whose economies are on such a scale that developments in them have a substantial impact on other countries, on either a global or a regional basis. (2) Those members that have financial programs with the Fund. (3) Those members whose situations warrant careful scrutiny, in particular those where there are substantial doubts about the medium-term viability of the member's balance of payments situation.

2/ The language used in specifying an annual cycle has generally taken the form "It is expected that the next Article IV consultation with [member] will be held on the standard 12-month cycle," with "recommended" in place of "expected" in the version appearing in the staff appraisal. While this indicates that the objective is to conclude the next consultation 12 months later, it is understood that a delay of up to three months beyond that date would not need to be explained to the Board. Longer cycles are specified either in terms of the date by which the next consultation is expected to be concluded, or in terms of the number of months, as in "will be held on an 18-month cycle."

Judgment needs to be exercised in considering whether a particular member be placed on the annual cycle, as in some cases the criteria do not provide an unambiguous answer. Executive Directors have on occasion raised questions on how the criteria should be applied, and in some cases the authorities of member countries have informally raised questions about their application in their particular situations. Also, the Board has occasionally specified a cycle that differed from that recommended by the staff. Nevertheless, experience to date suggests that there has been considerable convergence of views. In particular, "economies having a substantial impact on others" have been judged to include the 25 or so largest members (in terms of quota), as well as a few smaller economies that are regionally important. The criterion relating to "substantial doubts about medium-term viability" has been broadly interpreted, in that in some cases of smaller members for which doubts about future viability were perhaps not substantial, but which were emerging from a recent experience of serious balance of payments problems, an annual cycle has been specified. In a few instances, moreover, smaller countries that could qualify for a longer cycle have had an annual cycle specified, accounting for the fact that the proportion of members so far placed on an annual cycle is 83 percent, as compared with the range of 75-80 percent projected in last year's surveillance review paper.

The system of advance specification of consultation cycles took effect in April 1983, and over the next few months the first consultations with specified cycles will be falling due. No doubt in some cases problems will be encountered in observing the cycle specified, and consideration needs to be given to the question of informing the Executive Board of the reasons for such delays. Separate notes on individual countries may not be necessary; perhaps the best approach would be to provide the Board with brief periodic (perhaps quarterly) reports on consultation frequency.

d. Implications of current practices on specification of cycles

Projections of current trends in the specification of consultation cycles suggest that there may be some 125 consultations annually, which compares with 120 in 1983, and the previous high figure of 105 in 1979. These figures suggest that maintaining the consultation schedule may prove to be difficult. Over time, it is likely that the additional pressures imposed by the large number of requests for use of Fund resources may lessen, and, as members' circumstances improve, it may be possible to lengthen consultation cycles in some instances. For the foreseeable future, however, the workload will remain heavy, and it will be necessary to continue with the adaptations discussed below, if the quality of consultation work is to be maintained.

It will continue to often be necessary to combine staff reports with requests for use of Fund resources, as occurred in 21 cases in 1983. This practice should not, however, be allowed to delay the conclusion of consultations, as has sometimes happened in the past. The practice of combining staff reports with reviews of programs, which has been endorsed by the Board in the past, will continue; 19 such combined reports were issued in 1983.

It will also be necessary to selectively shorten recent economic developments papers. In 1983, those for some members, such as Yugoslavia and Romania, were abbreviated compared to those for the previous consultations, while, for Ivory Coast and Tanzania, the papers were limited to a complete set of tables together, in the case of Tanzania, with a brief review of developments in the exchange and trade system. These practices appear to have been acceptable to the Executive Board, given the circumstances, and it is anticipated that the practice of issuing simplified REDs will continue to expand. Consideration may also be given to omitting the RED in some instances.

Beyond these adaptations, the Board may wish to consider whether more countries should be on longer cycles and whether the maximum cycle length of 24 months should be used in selected cases. Many members, however, particularly some of the smaller ones for which longer cycles are most appropriate, have indicated the importance they attach to annual consultations for assistance with their policy planning.

Another adaptation which has been sometimes suggested is to schedule consultations so as to permit the Board to consider members with closely linked economies at the same time. In contrast to previous practice, the recent consultations with Belgium and Luxembourg were the subject of separate missions and separate staff reports, but, by scheduling the Board discussions consecutively, it was still possible to avoid repetition of common aspects of developments and policies, both in staff documentation and in the Board discussion.

V. Monitoring of Developments in Exchange Rates and Exchange Arrangements

A basic element of surveillance is the monitoring of developments in exchange rates and exchange arrangements. This section describes current practices with respect to such monitoring and the ways in which the resulting information is conveyed to the Executive Board.

1. Periodic reviews

One aspect of the Fund's monitoring process is the circulation of various periodic reports to the Executive Board. The most comprehensive such review is the Annual Report on Exchange Arrangements and Exchange Restrictions, which, besides a detailed examination of each member's exchange restrictions, provides a comprehensive description of the member's exchange arrangements. Changes in exchange arrangements in the course of the year are reported in a quarterly paper that summarizes developments in members' exchange arrangements, shows the latest classification of exchange arrangements, and indicates changes in exchange rates of countries, including those following more flexible arrangements. Members' current exchange arrangements are also summarized monthly in International Financial Statistics.

IFS also provides data on the exchange rates of each member; development of more comprehensive data on multiple exchange rates is currently under way. Charts on exchange market and related developments are circulated to Executive Directors monthly, and comprehensive reports on developments in foreign exchange and financial markets are circulated daily, weekly, and monthly. Since the middle of 1983 recent data on real effective exchange rates have also been provided to the Board in the form of quarterly reports listing available data for each member. [D:1]. (These data are prepared in connection with the information notice system, described in Section V.3, below.)

2. Notifications of changes in exchange arrangements

Besides these periodic reports, certain developments are reported as they occur, in connection with the obligation of members to notify the Fund promptly of any changes in their exchange arrangements. Procedures connected with such notifications were approved in 1977 1/ and over time practices have evolved on what constitutes a change requiring notification. During 1983, 62 changes in exchange arrangements

1/ See Selected Decisions, Tenth Issue, pp. 8 and 9. Also see [D].

were communicated to the Executive Board. 1/ Fourteen of these resulted in a change in the Fund's classification of the arrangements (see below), 32 represented discrete changes in members' exchange rates, and the remaining 16 dealt with other aspects of the exchange rate system not affecting classification. Documentation of changes in exchange arrangements included, where appropriate, background material to clarify and give context to the measures. In 21 of the 62 notifications transmitted in 1983, the staff paper included an appraisal of the measure, in the light of the view of the Fund on the member's exchange rate policy expressed at the time of the latest Article IV consultation discussion with the member. 2/ In the case of one country (Bolivia) the staff's analysis and appraisal of a depreciation of the exchange rate made reference to a recent information notice on appreciation of the real effective exchange rate. 3/ In the majority of the instances in which no appraisal was explicitly provided, the staff paper pointed out that discussion of the measure was to be taken up shortly in a forthcoming consultation report.

During 1983, improvement continued in members' compliance with the standard for prompt notification of changes in exchange arrangements. Eighty-nine percent of the changes were communicated to the Fund either before, or no more than three days after, the change became effective, an increase from the figure of 80 percent recorded in 1982. Of the seven instances in which the standard for notification was not observed in 1983, three involved delays of up to a week, and two of about two weeks, while, for the other two, which involved relatively small changes in the exchange rate, the delay was almost two months. As in previous years, the staff in a number of cases took the initiative of contacting national authorities to ensure that notifications were received by the Fund. Transmittal to the Executive Board was occasionally delayed because of the need to seek further clarification of initial communications. On average last year, a communication was received 2.6 days after the change became effective, as compared with 2.8 days in 1982.

Of a total of 14 countries that changed their exchange arrangements in 1983, only two whose exchange system was previously managed in a more or less flexible manner commenced pegging their currencies to that of another member. In both these cases, the pegging was preceded by a major depreciation of the domestic currency in the official market, and a simplification of the exchange system. Of six countries that gave

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1/ These are listed in Table 18 of the background paper.

2/ In the case of six countries, the communication to the Executive Board was included in consultation reports.

3/ Similar treatment was provided in the case of Guyana's devaluation in January 1984.

up pegging their currency to that of another member, four adopted currency basket pegs (the SDR in two cases), and the other two adopted a managed float arrangement. Of four members whose currencies were previously pegged to the SDR, two shifted to currency basket pegs, one adopted a managed float, and one began to adjust its currency according to a set of indicators. One country abandoned the system of allowing its currency to fluctuate within established margins vis-a-vis the currency of another member, and adopted a managed float. Another member whose currency was adjusted on the basis of a set of indicators also adopted a managed float.

Closely related to developments in members' exchange rate arrangements are changes in their exchange control mechanisms--in fact, as restrictions substitute for adequate adjustment of the exchange rate, they may be viewed as obverse to one other. Besides the provision of this information to the Fund in the context of Article IV consultations, ten staff papers were issued in 1983 advising the Executive Board of such changes. One involved the acceptance by a member of its obligations under Article VIII, four others involved multiple currency practices, and the rest dealt with other exchange system measures.

Overall in 1983, there were 95 Executive Board Decisions relating to members' obligations under Article VIII. Multiple currency practices, which have relatively direct implications for exchange rate policies, were involved in 49 of these cases. Some two thirds of the decisions granted temporary approval of the restrictions or practices involved.

3. The information notice system

Under the notification system, all changes in the exchange rates of members that peg their currencies are reported individually to the Executive Board, as are large discrete changes for currencies governed by more flexible arrangements. Changes in the latter, however, tend to take place almost continuously. The cumulative change over even relatively brief periods can be large, but changes which occur from day to day are generally too small and numerous to be communicated individually to the Executive Board. 1/

The fact that all exchange rate changes for pegged currencies were brought specifically to the attention of the Board, while large changes that take place gradually for other currencies were not, had raised questions of the symmetry of surveillance that were highlighted in the course of the discussions that followed the Swedish devaluation of October 1982. It was particularly noted that changes in the exchange

1/ In practice, changes of less than 5 percent for any of the 54 non-pegged currencies are seldom communicated to the Board.

rates of the currencies of some members that played a much larger role than Sweden in the world economy had been larger, but had not been brought specifically to the attention of the Board because they had taken place gradually over time.

In response to these concerns, last year's Surveillance Review paper presented some suggestions on how exchange rate developments could be monitored on a basis that would be uniform for all members, and the Executive Board indicated that such a monitoring system should be developed on an experimental basis. The system was to focus on changes in real effective exchange rates, which by adjusting exchange rates in light of trading patterns and movements in relative prices provide a measure of the evolution of competitiveness. The main features of this system were: (1) the Board would be informed when the cumulative change in a member's real effective exchange rate, measured from an appropriate starting point, reached 10 percent; (2) the starting point for measurement would be the latest occasion on which the Board had an opportunity to discuss the member's exchange rate policy; and (3) the staff would use its best judgment on the indicator of competitiveness to be employed and would incorporate a description of it in Article IV consultation reports. Besides reports to the Board on individual cases where the 10 percent threshold had been passed, periodic reports comprehending data for all members would be provided, noting cases where changes in the rate over the medium term had been particularly large.

In setting up the system, the staff already had available real effective exchange rate indexes for most member countries. The features of the indexes varied widely from country to country, however, and it was decided on grounds both of uniformity of treatment and the need for computational and data collection efficiency that it would be desirable to develop a few standard indexes of general applicability. The features of these indexes are set out in Section II of the background paper. For 14 industrial countries, the index of relative normalized unit labor costs already published in IFS was adopted, brought up to date each month with staff estimates. A second type of index, applied both to those 14 countries and to 22 other countries with significant exports of manufactures, was based on relative consumer prices, with the weights for each country's trading partners taking account of both direct bilateral trade and the extent to which the countries competed in third markets. For most other members, a similar type of index, also based on relative consumer prices, but with weights which were based purely on bilateral trade with the 36 core manufacturing countries, was developed. For 35 members, the unavailability of reliable price or other data has so far made the computation of a meaningful index difficult. In view of the experimental character of the system to date those members have not yet been included but, as is noted below, efforts are continuing to make the system totally comprehensive.

The first calculations of real effective exchange rates from the system were reported in July in "Indicators of Real Effective Exchange Rates," [D:1]. This paper focused on exchange developments in a medium-term context (1978 up to April 1983). For selected countries, charts were provided, and countries whose indexes had changed by more than 20 percent since 1978 were flagged. Updates of this information are provided to the Board on a quarterly basis.

A second paper, issued simultaneously, established the "Initial Basis for the Information Notice System" [D:2]. This paper noted that, as of April 1983, 12 members had had changes of 10 percent or more in their real effective exchange rates since the last time the Board had had an opportunity to discuss their exchange rate policies.

Since then, information notices have been issued for six members. 1/ They have generally included a brief factual discussion of developments in the member's exchange rate and costs and prices, together with a statement of how these were related to the balance of payments and to other developments in the economy. Some indication was given of the relevance of the developments to the appropriateness of the member's policies, either through a staff appraisal or through reference to a recent or forthcoming Board document. Such appraisals normally took as their starting point the Board's last discussion of the member's policies.

In the drafting of information notices, it is recognized that passing the threshold is not, in itself, an indication of a policy problem; rather it serves as a device for triggering an appraisal of the country's policies. (By the same token, of course, an unchanged real effective exchange rate does not necessarily mean the absence of a policy problem.) The change in the real effective exchange rate itself is but one component of that appraisal, and in some cases other evidence may strongly suggest that in fact no policy problem exists. 2/ In most cases, however, the signal conveyed by the information notice system index is likely to be reinforced by a more detailed examination. This was the case with four of the six notices issued in 1983.

Each of the cases in 1983 involved a real appreciation, where a rapid rise in costs or prices was not offset by effective depreciation of the currency. In one case (Iceland) this result was not thought to

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1/ Argentina, Guyana, Suriname, Bolivia, Nigeria, and Iceland. In the case of Iceland, the information notice was incorporated in the staff report which was issued at the same time. (See Table 19 of the background paper.)

2/ Some of the conceptual issues involved in the use of real effective exchange rates are examined in Section II.3 of the background paper.

mean a significant decline in competitiveness, as it was associated with a sharp decline in real wages as part of an adjustment program. In one other case (Argentina), it was not considered that any special action needed to be taken by the authorities, but it was suggested that future developments needed to be followed closely in case policy action was needed. The other information notices all called for early correction. In each case a staff report was shortly to be issued or a consultation mission was scheduled for the near future. (Section II of the background paper includes a more detailed discussion of information notices issued in 1983.)

The circumstances of the last year have resulted in a relatively small number of information notices. Besides the unusually large number of consultations, there were a very large number of Board discussions in relation to use of Fund resources. This meant that for many countries there were relatively short intervals since the latest Board consideration of their policies, the basis for determining the reference date. For a number of members that had recently experienced significant real changes, moreover, the interval was shortened by establishing the initial reference date as July 1983 under the procedure adopted in the paper setting out the initial basis for the system. The fact that exchange rates among the large industrial countries were somewhat less volatile in 1983 than in other recent years also contributed to the smallness of the number of information notices.

So far, no information notice has given rise to special discussions with a member, though the results have been brought to members' attention in the course of Article IV consultation discussions and discussions on the use of Fund resources. Moreover, no information notice has been brought to the Board agenda. This reflects the fact that in most cases the Board was shortly to have the opportunity to review the country's policies, usually in the context of an Article IV consultation.

4. Issues concerning the ongoing operation of the information notice system

a. Starting point for measurement

The basic vehicle for surveillance over members' exchange rate policies remains the Article IV consultation, together with, where relevant, Board discussion of financial programs developed in support of requests for use of Fund resources. That being the case, it seems appropriate that the focus of information notices be on changes that have occurred since the last such discussion in the Board--that is, conclusion of Article IV consultations and discussion of requests or reviews of stand-by or extended arrangements or requests for compensatory financing in the upper tranche. The Board's attention is also drawn to the member's exchange rate policy when notifications are issued on the occasion of changes in exchange arrangements; where these involve changes in the exchange rate, they of course also involve changes in real effective exchange rates. Finally, once an information notice is issued, the month of issuance provides a new reference date for measuring changes.

This seems to be an appropriate method for determining the starting point for measurement of changes in real effective exchange rates. It is important, however, that the Board be kept fully informed of developments in the real effective exchange rate for each member. As called for in last year's review of surveillance, Article IV consultation reports should incorporate a description, with relevant data, of the real effective exchange rate used for the member. The quarterly reports on real effective exchange rates also provide data in a medium-term context.

b. Threshold for issuance of information notices

Last year's discussion focused on two alternative thresholds, changes of 5 and 10 percent in real effective terms. Some Directors felt that a 5 percent threshold would result in too large a number of information notices for such notices to be meaningful. Others felt that any change as large as 5 percent was important and should be subject to an information notice. It was decided that, in view of the experimental nature of the system, a 10 percent threshold would apply initially.

Adoption of a 5 percent threshold would, of course, have resulted in a substantially greater number of information notices during the period under review. The July paper establishing the initial basis for the system would have identified 21 countries, rather than 12, as having passed the threshold as of April 1983, and in the remainder of 1983, 32, rather than 6, information notices would have been issued. (See Table 14 of the background paper for details of this simulation.)

Such a flow of notices might tend to detract from the meaningfulness of the system, particularly when so many of them would involve a straightforward continuation of past trends that the Board had already discussed at length. In many cases, moreover, data are subsequently revised, particularly for many smaller countries for which data on prices are available only with long lags that require staff estimates to be employed for recent months. Of the 53 cases where initial data indicated a change in excess of a 5 percent threshold, 14 were subsequently revised to less than 5 percent. (In several such cases, of course, the 5 percent threshold was, in fact, exceeded in a later month.)

While there is little doubt that a change of competitiveness of 5 percent is large enough to attract the attention of market participants and authorities, these considerations suggest that, at least for the coming year as more experience is gained, the 10 percent threshold be retained. Subsequent downward revisions of changes of 1 or 2 percentage points would obviously not be critical in such cases.

c. Improvements in the system

In general, the system is working well and is acting as a useful complement to the system of notification of changes in nominal exchange rates. It has, moreover, had the important consequence of the development of a more uniform approach to real effective exchange rates in the Fund's country work; progress has also been made, in cooperation with member countries, in improving underlying data on prices and exchange rates. It therefore seems appropriate that the system be continued, with improvements as necessary and appropriate.

The most important improvement that needs to be made is to expand the coverage of the system. At the present time, real effective exchange rates are not calculated for 35 members. In one case, Democratic Kampuchea, no basis exists for making such calculations; in a second, Afghanistan, the economic dislocation associated with the current situation is so great that a meaningful calculation is not possible. For the other members, however, the problem is largely one of nonavailability of reliable data on movements in consumer prices. In view of the importance of such information, not only for measuring competitiveness, but also in the more general context of the Fund's economic analysis, the staff, in connection with the Article IV consultation process, will stress the need for improvements in data on inflation, but, in some cases, may need to resort to estimates.

Improvements in the data base will, of course, continue to be made. Among those currently under way are: (1) an expansion of the coverage of the unit labor cost type of index to include other members with adequate information on normalized unit labor costs in manufacturing; (2) development of composite exchange rates for all members whose trade is carried out at multiple exchange rates; and (3) adjustments of weights to better measure the competitiveness of some small developing countries with large trade in manufactures with small neighboring countries (e.g., some of the countries in Central America).

VI. Selected Issues for Board Discussion and Proposed Decision

1. In their review of the document "Surveillance over Exchange Rate Policies," Executive Directors may wish to focus on issues associated with the identification and correction of inappropriate exchange rate policies. They may also wish to refer to issues relating to policy coordination and exchange rate stability among major currency countries, and on the way these and other aspects of the external environment impinge on developing countries.

2. In their review of the implementation of surveillance, Directors may wish to comment on the following aspects:

a. Are there ways in which Article IV consultations could be made more effective, bearing in mind the already high level of activity in the Fund with respect to consultations and use of Fund resources? In particular, would Directors see ways in which further improvements could be made in implementing Fund surveillance more uniformly throughout the membership?

b. Is the treatment now being given in consultation reports to matters such as exchange rate policies, external debt, and protectionism appropriate?

c. Would Directors support the broad thrust of the discussion in Section IV regarding the implications of the present and projected very high number of consultations? Also, would Directors wish to have available periodic reports on cases where difficulties are encountered in observing specified consultation cycles?

d. Are Directors satisfied with the progress being made regarding the establishment of the information notice system as set out in Section V?

Proposed Decisions

The following decisions are proposed for adoption by the Executive Board:

(1) The Executive Board has reviewed the document "Surveillance over Exchange Rate Policies" as provided in paragraph 2 of Executive Board Decision No. 5392-(77/63), adopted April 29, 1977, and will review it again at an appropriate time not later than April 1, 1986.

(2) The Executive Board has also reviewed the procedures relating to the general implementation of the Fund's surveillance over members' exchange rate policies, as required by paragraph VI of Procedures for Surveillance in the document "Surveillance over Exchange Rate Policies" referred to in (1) above, including the procedures for the conduct of consultations under Article IV, which consultations shall comprehend the consultations under Article VIII and Article XIV, and approves the continuation of the procedures as described in SM/84/44 , in the light of the Managing Director's summing up, until the next annual review, which shall be conducted not later than April 1, 1985.