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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/39

10:00 a.m., March 12, 1984

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
A. Alfidja	L. Doe, Temporary
	L. E. J. M. Coene, Temporary
	X. Blandin
	M. Teijeiro
	J. Delgadillo, Temporary
R. D. Erb	M. K. Bush
	T. Alhaimus
T. Hirao	T. Yamashita
	I. R. Panday, Temporary
	L. Leonard
A. Kafka	
G. Laske	
G. Lovato	
	A. S. Jayawardena
Y. A. Nimatallah	J. E. Suraisry
	T. de Vries
	K. G. Morrell
G. Salehkhou	O. Kabbaj
	E. I. M. Mtei
	J. L. Feito
J. Tvedt	
N. Wicks	T. A. Clark
Zhang Z.	Wang E.

L. Van Houtven, Secretary
B. J. Owen, Assistant

Also Present

African Department: J. B. Zulu, Director; O. B. Makalou, Deputy Director; F. d'A. Collings. Asian Department: R. J. Hides. European Department: L. A. Whittome, Counsellor and Director; J. T. Boorman, A. M. Mansoor. Exchange and Trade Relations Department: C. D. Finch, Director; W. A. Beveridge, Deputy Director; S. Mookerjee, Deputy Director; J. A. Clement, S. Eken, M. Guitian, G. G. Johnson, S. Kanesa-Thasan, N. Kirmani, J. P. Lipsky, R. Pownall, P. J. Quirk. IMF Institute: U Tun Wai, Deputy Director. Legal Department: G. P. Nicoletopoulos, Director; Ph. Lachman. Research Department: W. C. Hood, Economic Counsellor and Director; A. D. Crockett, Deputy Director; J. Artus, J. M. Boughton, M. D. Knight. Secretary's Department: A. P. Bhagwat. Treasurer's Department: M. A. Tareen. Western Hemisphere Department: S. T. Beza, Associate Director. Bureau of Statistics: D. K. Kar. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: S. R. Abiad, H. A. Arias, S. El-Khouri, S. M. Hassan, H.-S. Lee, G. E. L. Nguyen, Y. Okubo, D. I. S. Shaw, D. C. Templeman. Assistants to Executive Directors: I. Angeloni, R. L. Bernardo, J. Bulloch, M. B. Chatah, Chen J., G. Ercel, I. Fridriksson, G. Gomel, V. Govindarajan, D. Hammann, N. U. Haque, A. Koné, E. Landis, J. A. K. Munthali, G. W. K. Pickering, E. Portas, J. Reddy, A. A. Scholten, Shao Z., S. Sornyanyontr, Wang C. Y., A. Yasseri.

1. SURVEILLANCE OVER EXCHANGE RATE POLICIES - REVIEW; AND IMPLEMENTATION OF PROCEDURES FOR SURVEILLANCE - REVIEW

The Executive Directors considered a staff paper reviewing the principles and procedures for surveillance over exchange rate policies, as well as the general implementation of procedures for surveillance (SM/84/44, 2/15/84; and Sup. 1, 2/16/84).

Mr. Laske stated that he was in broad agreement with the staff paper and supported the proposed decisions. Article IV consultations with member countries were a very important, if not the most important, part of the Fund's surveillance function. Unfortunately, it had not been possible in the past to hold consultations with each and every member as regularly as was desirable. He had been impressed by the marked improvement in the coverage of consultations. While Article IV consultations had been concluded with only 57 percent of the membership in 1982, the figure had risen to 80 percent for 1983. The rise implied a heavy workload for the staff and management and also for the Executive Board, which was spending an increasing proportion of its time on consultation discussions. It was not inappropriate, therefore, to look for possible ways of lightening the task without cutting into its substance.

The increased consultation activity had reduced the occurrence of prolonged periods during which no consultations took place to those cases where security problems existed for the staff, Mr. Laske noted. For only one remaining no-risk country--the Philippines--had a considerable time elapsed since the past consultation, and the delay might be due to protracted negotiations on the use of Fund resources. In such a situation, he would have wished the consultation report to be issued separately from the documents on the use of resources, for discussion by the Executive Board earlier than in May 1984, as envisaged. A more normal consultation cycle was also indicated because the Philippines was among those countries where the medium-term viability of the balance of payments was in doubt and where the external debt situation was serious. In general, however, he had no difficulty in accepting the continuation of the practice of combining staff reports for Article IV consultations and papers on requests for the use of resources in a single document.

He welcomed the staff's proposal to make brief periodic reports on the actual frequency of consultations, giving the reasons for any delays, Mr. Laske continued; a semiannual instead of the proposed quarterly reporting should suffice. The staff had also advanced once more the idea of omitting or shortening in some cases the accompanying reports on recent economic developments in a country. He continued to support the idea, in principle, but considered that it should be put into practice on a very selective basis. Reports on recent economic developments provided the only comprehensive and reliable source of economic data for many countries, and national authorities should not be deliberately deprived of them. However, it might be possible, for instance, to consider circulating full reports on recent economic developments in the ten larger industrial countries every other year, issuing only updated tables in the years in between. It would not be out of place to economize on staff resources in that way, when changes from year to year were not so significant as to make annual reports essential. Another option would be to experiment further with new, abbreviated forms of reports on recent economic developments. However, he recalled that a few Executive Directors had expressed some dissatisfaction with the modified and somewhat shorter than usual report on recent economic developments in the United Kingdom (SM/84/43, 2/13/84; EBM/84/30 and EBM/84/31, 2/27/84).

The staff had also mentioned the possibility of scheduling consultations with members whose economies were closely linked, so as to prevent unnecessary repetition, Mr. Laske commented. The suggestion deserved attention, although he noted that because two closely related countries had recently been put on different consultation cycles--18 months for Luxembourg and 12 months for Belgium--only one out of three consultations with Belgium would in future be discussed at the same time as consultations with Luxembourg.

It had become increasingly difficult, as the staff had emphasized in the main body of its paper, to evaluate fiscal and monetary policies and consequently their respective repercussions on exchange rate developments in a multilateral framework, Mr. Laske continued. Although in recent weeks the exchange rates of the more important currencies might have been moving toward more realistic levels, a careful analysis of those most complex relationships would remain necessary. There were certainly no easy ways to carry out that difficult task, but advice founded on a thorough examination of the relevant macroeconomic variables would always be helpful. He encouraged the staff to pursue a pragmatic and all-encompassing approach to surveillance that focused on the overall economic performance of the member country concerned and that assessed the viability of its payments position, as well as its effect on the rest of the world.

The Fund's surveillance analysis could not be an end in itself, Mr. Laske added. Member countries should be expected to accept it as a guide to their own analytical and policy formulation processes, the objective being a closer convergence of the economic policies of individual countries. Unfortunately, and despite the Fund's valuable surveillance work, a satisfactory convergence was still some way off, something that might explain--perhaps to a considerable extent--the continuing difficulties of the world economy.

Referring to the content of consultation reports, Mr. Laske mentioned that the broadened coverage of external debt issues was welcome. The introduction of medium-term debt scenarios had been helpful. The staff had underlined in its paper that there was room for further improvement in presentation and analysis. The problems associated with heavy, or excessive, external indebtedness were likely to remain for some time. An intensification of work in that area was therefore wholly justified.

Another proposal by the staff was for intensified coverage, in appropriate cases, of trade policies, Mr. Laske noted. The discussion in the Committee of the Whole on the Development Committee (CW/DC/84/1, 3/9/84) had shown the Board's strong support for such an approach, and he fully shared the view that the trade policy of individual members bore heavily on the development of their balance of payments situations and on that of their trading partners. Nevertheless, the Fund should be careful not to duplicate the work of the GATT and to preserve a clear demarcation of jurisdiction and responsibility.

The discussion in consultation reports of exchange rate developments and exchange rate policies, understood in a narrow sense, had in his view been adequate, Mr. Laske remarked. The particular sensitivity of the matter was well understood, and the staff might sometimes feel that guarded language was advisable. However, in previous discussions of the subject, he had argued in favor of frankness; when the staff believed that exchange rate management left something to be desired, it should say so in its appraisal, with the appropriate clarity and candor, explaining the reasons for its judgment.

The information notice system should be continued, Mr. Laske considered, with the starting point for measuring the cumulative change in a member's real effective exchange rate remaining the point in time when the change reached a threshold of 10 percent. It was somewhat disappointing to learn that the statistical data base for a number of countries was so weak as to allow no meaningful measurement of real effective exchange rate developments. The countries concerned should be urged to improve their statistics, an endeavor that the Fund could support with technical assistance. Ideally, all member countries, small and large, should be covered by firm surveillance; it would not be satisfactory if the Fund could perform that function only with respect to those countries willing to provide the required information.

In conclusion, Mr. Laske reiterated his support for the proposed decisions. There appeared to be no need at the present time to revise or to modify the three basic principles that guided the Fund's surveillance role.

Mr. Tvedt observed that the information contained in Part II of SM/84/44 provided an interesting supplement to the material before the Executive Board at its recent seminar on exchange rate issues (Seminars 84/1 and 84/2, 1/30/84). He certainly agreed with the staff that the measurement and identification of appropriate and inappropriate exchange rates were delicate exercises from which exact conclusions could not generally be drawn. Nevertheless, as he had indicated at the seminar, the staff had perhaps taken an excessively guarded view, in its paper on issues relating to the assessment of exchange rates (SM/83/263, 12/28/83), of its competitiveness calculations, which could have considerable explanatory power and could in many cases be relied on for making broad judgments of the level of exchange rates and possibly of needed adjustments. In that connection, he would welcome data from more countries on cyclically adjusted unit labor costs corrected for exchange rate changes since those were probably superior to measurements based on consumer price differentials.

Moreover, he also reiterated his support for the staff's studies of underlying payments imbalances for the purpose of identifying unsustainable exchange rates.

It was of course a major responsibility of the Fund to monitor exchange rate developments, Mr. Tvedt added. Important improvements had taken place in the implementation of surveillance in recent years, as regards both its effectiveness and the uniformity of its application. He agreed with the staff that the main principles in the document "Surveillance over Exchange Rate Policies" (Executive Board Decision No. 5392-(77/63), adopted April 29, 1977), remained as broadly acceptable as they had been on their adoption. Those principles covered the spectrum of problems that might be encountered, and, based on them, the Fund continued to be well placed to implement effective surveillance. Developments in the world economy during the past few years had indeed increased the importance of surveillance as well as of the accompanying dialogue, both between the Fund and individual members and within the Fund itself. In that connection, he supported the efforts of the staff to engage in what it called "frank and persuasive" discussions with members on their exchange rate policies when those were judged to be out of line in order to arrive at a common understanding, with all due respect being paid to the confidential nature of such discussions and issues.

With increased interdependence in the world economy, the scope for individual countries to pursue autonomous policies had continuously narrowed, Mr. Tvedt remarked. Added burdens were thereby placed on the shoulders of policymakers, particularly in the larger industrial countries, which had to assume responsibility for the implications of their policies for other members.

In spite of smaller differences between price and cost trends in the major countries than for many years, Mr. Tvedt continued, considerable uncertainty still prevailed regarding the present level of important exchange rates. Even though the convergence of price and cost trends was a positive feature, the experience of recent years showed that there was a genuine need for greater harmony in economic policies. In the prevailing situation, for example, there was a need for a change in the mix of monetary and fiscal policy in the United States. If such a change took place, it would be easier to attain the desired higher level of activity in Western Europe and Japan without risking exchange rate volatility. The role of the Fund in that connection was to emphasize the interaction of policies in the various countries, and for that purpose, the World Economic Outlook exercises and publications had been and would be of increasing value.

The staff's arguments on symmetry, on page 7 of SM/84/44, were not quite convincing, Mr. Tvedt remarked. An equally prompt registration of disapproval by the international community when a currency was undervalued as when a currency was overvalued did not necessarily signify evenhandedness in Fund surveillance of surplus and deficit countries. Thus, a deeper analysis of the question of symmetry would be desirable before the next review of surveillance policy.

Referring to the discussion of intervention on page 13 of the staff paper, the view of his authorities was that unsterilized intervention could at times have a useful effect on exchange rate developments without jeopardizing other economic policy targets, Mr. Tvedt said. Even limited intervention could affect market expectations favorably, provided that it was in harmony with the general economic policy of the authorities. Moreover, even when a balanced economic policy was being pursued, the need for exchange market intervention could arise at times because of market inefficiencies. Furthermore, his authorities would raise once again the question whether the great reluctance shown by some member countries to engage in exchange market intervention was compatible with the principles governing an active surveillance policy.

The broadened coverage of Article IV consultations was welcome, Mr. Tvedt commented. In the present circumstances, more thorough attention had to be focused on trade policies and foreign debt. Those were not unrelated issues because the pace of recovery and the restoration of manageable debt situations in the more heavily indebted countries would to an important extent be determined by the trade policies pursued, particularly by the major industrial countries. Consequently, those policies warranted close scrutiny by the Fund. For that purpose, the Fund's contacts with GATT should be increased within the framework of existing collaboration practices. The more systematic collection of debt statistics was of great importance in strengthening surveillance.

He attached considerable importance to the medium-term analyses that were contained at present in most consultation reports, Mr. Tvedt remarked. Even though such analyses were by necessity based on a variety of underlying assumptions and were sensitive to changes in them, they nevertheless provided a helpful exposê of the constraints that were likely to face the authorities in their respective countries in the years ahead.

The continued development of the information notice system would make it easier to initiate Board discussions about the exchange rate policies of individual members in the interval between Article IV consultations and could ensure greater symmetry in the application of the guidelines, Mr. Tvedt considered. Indeed, his authorities wondered whether such matters should not be discussed in the Board more frequently than hitherto. At the same time, they felt that the surpassing of a chosen threshold should not automatically trigger a special consultation.

The increased frequency of regular consultations had also intensified the surveillance activity of the Fund, Mr. Tvedt commented. The work load for the staff was clearly heavier, not least in those departments with the responsibility for numerous members that had Fund programs requiring frequent reviews and negotiating missions as well as Article IV missions. In the circumstances, he would be ready for the time being to receive complete reports on recent economic developments only every other year, at least for some of the countries visited annually or even perhaps more often. At the same time, he underlined the importance of those reports, and in particular of the accompanying appendices on specific aspects of policy or institutional arrangements. Every now and then, those appendices could perhaps be attached to the regular staff reports instead.

Having agreed on an intensified consultation cycle, it was important to adhere to it, Mr. Tvedt considered. Consequently, he would welcome periodic reports on any difficulties encountered in observing specified cycles.

Undeniably, Mr. Tvedt remarked, countries with Fund-supported programs were under greater scrutiny than other Fund members, but not only as a matter of more intense surveillance. Those countries were also receiving a form of technical assistance through that channel.

An issue that was intimately linked to the surveillance function of the Fund was the phenomenon of asymmetry in current account statistics, about which his chair had often voiced concern, Mr. Tvedt recalled. He looked forward to the discussion of the issue scheduled for April.

In conclusion, Mr. Tvedt reiterated his satisfaction with the improvements in the surveillance procedure over the past year. He endorsed the suggestions made by the staff in SM/84/44 for further improving the various aspects of those procedures as well as the formally proposed decisions.

Mr. Kafka remarked that his general agreement with the staff paper and his acceptance of the proposed decisions did not mean that he was satisfied with the way surveillance had worked, but only that he saw no radically different procedures that could be adopted.

The staff was quite right in stating on page 2 of its paper that a number of member countries--although it would be more correct to say many member countries--felt that surveillance by the Fund had an asymmetric incidence and limited effectiveness, Mr. Kafka continued. That was true particularly of what the staff called the "wider dimension" of surveillance. It was clear that the Fund had no significant sanctions that it could bring to bear against members--developed or developing--unless they required its financial assistance, although it was not completely helpless. Again, the staff was right to claim that the way to enhance the effectiveness and promote the evenhandedness of Fund surveillance was through deeper analysis and greater efforts at persuasion. It would be even more desirable if clichés, of which staff reports were by no means free, could be avoided.

The subject of particular concern to him was protectionism in all countries, but especially on the part of creditor countries, Mr. Kafka observed. There were already effective constituencies pleading for solutions to other vital policy problems, such as the speed of recovery and the mix of fiscal and monetary policies. Those bearing the brunt of protection in its varied forms--tariffs, abuse of antidumping and countervailing duties, and pressures for voluntary export restraints--did not have such a constituency. The Managing Director had taken certain initiatives, and should be encouraged to do more, as should the Executive Board, the governing body of the Fund. More and more of the Fund's work on subjects that might be of general interest was being published. Protectionism offered a fertile field for studies and for their publication, which was not always a weighty but often a helpful sanction. Care would have to be taken not to tread on the GATT's toes, but it would not be necessary to duplicate the work of the GATT if the suggestions he was making were accepted.

The staff's reports were replete with complaints about spreading protectionism, but they were couched in very general terms, Mr. Kafka continued. He would like to see, in staff reports for each member country, the results of an investigation showing the quantitative impact of protectionist measures adopted since the preceding consultation on past and expected growth rates of exports, by category and subcategory. Conclusions could then be drawn as to the damage done when promising export developments were nipped in the bud, damage that might otherwise be overlooked. Those quantitative studies should be expanded to highlight not only the impact on growth of new protectionist measures, but also the benefit that could flow from increased trade if old protectionist measures were abandoned.

In stressing the need for undertaking and publishing quantitative studies, he did not wish to play down the importance of the staff's own suggestions, especially those on pages 23 and 24 of its paper, Mr. Kafka said. He was particularly pleased that the staff was proposing to bring to the notice of the Executive Board, in staff reports for consultations with individual member countries of customs unions, the protectionist measures that had been adopted by the unions.

He disagreed with at least one of the suggestions made by the staff under the general heading of the frequency of consultations, Mr. Kafka observed, namely, that reports on recent economic developments be shortened or omitted. He would prefer to increase the number of staff members rather than abandon one of the Fund's most useful activities.

Mr. Wicks considered that, by and large, the staff paper directed attention toward the right issues. Referring to those issues selected for discussion--the first of which concerned policy coordination and exchange rate stability among major-currency countries--he noted that the important point, as agreed at the Versailles and Williamsburg summits, was that effective surveillance should aim at spelling out the implications of domestic policies of the major industrial countries, not only for other Fund members but also for the functioning of the international monetary system and for world trade generally. The key to that exercise had been well described in the second full paragraph on page 12 of SM/84/44, in which it was emphasized that convergence had to be centered around the right mix of policies throughout the whole policy spectrum. Distorted domestic policies in the major countries would prejudice hopes for sustainable economic growth, not just among those major countries but throughout the world. Where fiscal and monetary policies were tugging in opposite directions, it was admittedly difficult to form a judgment about the exchange rate. Nontheless, the guiding principle of convergence clearly pointed to steering domestic policy developments in a desirable direction. If all elements of the surveillance process--as demonstrated in the World Economic Outlook exercise, Article IV consultations, the Fund's Annual Report, and the Managing Director's various informal contacts--were well coordinated, the outcome could be satisfactory.

It might be argued that different views were possible on such complex matters, and that the Fund should therefore not be too forthright in offering judgments on the appropriateness of members' policies, Mr. Wicks commented. His own authorities would however urge the Fund to be active in giving explicit guidance on exchange rate and domestic policies.

The need for the Fund to assess the impact of industrial countries' domestic policies on international liquidity, as well as on its members' economies, had not been explicitly mentioned in the staff paper, Mr. Wicks noted. It would be useful to know whether the staff was in fact hinting at the need for the surveillance process to make such an assessment in its reference on page 15 to the domestic policy stance of major industrial countries having contributed to the emergence of a global adjustment problem between them and developing countries that was hardly solvable through exchange rate flexibility alone. His authorities certainly considered that the impact of certain countries' domestic policies on global liquidity should be a matter for surveillance by the Fund.

In response to the staff's requests for ways in which the Fund's surveillance could be more uniformly implemented throughout the membership, Mr. Wicks wondered whether one way might not be to pay more attention to adjustment policies in a regional context. As he had stated on previous occasions, it would be helpful if staff reports for Article IV consultations with countries whose economies were dominant in their region, perhaps because they were especially powerful financially, could include a separate section on the effect of such countries' policies on others with which they had significant trading and financial relationships. His second and related suggestion was that the Fund should concern itself with the consistency of the policies being pursued in various economies within a region, having in mind the best interests of that region as a whole. To cite three particular regions, it seemed relevant to ask what effect the many Fund-supported adjustment programs being followed in Latin American countries were having on trade within the region generally. It might also be worthwhile for the staff, at some suitable opportunity, to appraise the policies of the European Community, not just of its individual ten members, but of the Community as a whole, because it did after all hold itself out as having an independent economic approach. A third region where the relationships between economies might be looked at in a little more detail was West Africa, where for many reasons there were, he understood, particular interactions. The statement by the Managing Director at EBM/84/12 (1/23/84) on the work program had included a reference to staff studies under preparation on the theory and design of financial programs, and on the global effect of Fund-supported adjustment programs. The regional points that he had made might perhaps be taken up in those studies.

The staff's efforts to obtain better statistics from members, to which reference was made in the paper, certainly had his full support, Mr. Wicks observed. But important as good statistics were, not all member countries could afford to divert skilled manpower from economic management to the collection of statistics. In some countries, the severe lack of trained personnel required officials to establish different priorities.

The use of medium-term balance of payments and debt projections was extremely helpful, Mr. Wicks said. Such analyses should become a routine part of the Fund's work instead of being confined to countries in difficult debt positions or engaged in debt rescheduling. In making such medium-term projections, the staff could however provide more information on the various components of the capital account and, in particular, illustrate how the projections would alter with changes in various underlying assumptions.

The emphasis in the staff paper on trade policy was welcome at the present juncture, Mr. Wicks commented. As Mr. Kafka had suggested, staff reports should take nontariff barriers into consideration, in addition to looking at normal tariffs. Attention should also be given to subsidies on inputs that permitted certain industrial products to be manufactured within a country at what might be called a "below-the-world-market price." Such subsidies could distort international trade just as much as full-fledged tariffs.

Fund surveillance could be strengthened in several other areas, both by expanding the coverage of staff reports for Article IV consultations and by undertaking special studies, Mr. Wicks said. On capital flows, he looked forward to the special study on direct investment flows to developing countries, which was to be issued later in the year. He also urged the staff, during Article IV consultations with industrial countries, to analyze the openness of capital markets. For reasons that were not clear to his authorities, some industrial countries had more open capital markets than others. As for the developing countries, the staff might try to pay particular attention to barriers to foreign direct investment because they could affect the long-term sustainability of the balance of payments in the same way that restrictive exchange and trade practices did.

The second area that needed highlighting in staff reports, Mr. Wicks added, concerned the financial position of the noncentral government component of the public sector. For example, there were times when the pursuit of an appropriate fiscal policy by the Central Government could be undermined by inconsistent financial policies pursued at the local government level or by large state enterprises.

The third area to which more thought should be given, Mr. Wicks considered, was related to what he would call medium-term structural adjustment. While Article IV consultations quite properly emphasized the classic components of macroeconomic management, emerging structural strains in an economy should also be a focal point. That would be consistent with the growing tendency to analyze policies in a medium-term framework. One way of proceeding might be to undertake general studies of certain subjects that would then serve as a reference point in individual consultations with members to determine whether or not they were dealing with those subjects in an appropriate way. Among the possible topics was the role of government generally in economic management; the scope for liberalization of markets, especially labor markets; the development of various budget schemes designed to assist structural change, such as loan guarantees, that could be of great importance in the allocation of financial resources; and the fiscal consequences of an aging population.

The practice of linking staff reports for Article IV consultations with reviews of programs under arrangements with the Fund was helpful and should continue, Mr. Wicks considered. Nevertheless, he had strong doubts about combining staff reports with papers on requests to use the Fund's resources, especially when the negotiations were protracted. In several cases, it had been extremely helpful--not just to the Executive Board and the staff, but to the member--to have a staff report for an Article IV consultation well in advance of the paper on the request for an arrangement with the Fund. On another point, he agreed with the staff's proposals relating to the continuation of the information notice system.

If he had suggested a number of ways in which the implementation of the surveillance process might be further improved, Mr. Wicks remarked, it was in no way because of dissatisfaction with the work of the staff. His authorities had been impressed by the quality of the staff's work, which had improved in the past year despite the burden imposed by the need to catch up on consultations with members.

Mr. Leonard observed that the staff document clearly demonstrated the progress that had been made over time in developing the Fund's surveillance, which had been entirely beneficial for the operation of the international monetary system. In reviewing those activities, with a view to improving them further in the future, he noted first that the guidelines for the conduct of surveillance remained appropriate, and that there was no reason to modify the document entitled "Surveillance over Exchange Rate Policies."

As for the implementation of surveillance, the effective achievement of the multilateral objectives of surveillance, particularly as they related to policy coordination and exchange rate stability among major currencies, rested greatly on the quality of the analysis in identifying problems and devising cogent and persuasive responses, Mr. Leonard continued. It was one of the Fund's functions to set out the policies and measures of individual countries in an international context, showing the effects of national decisions on members' trading partners and on financial markets. He agreed with the staff that the issues involved were at times complex and that there could be difficulties in reaching a common understanding. If the Fund's influence were to be effective, the maintenance of high standards of analysis would thus be of crucial importance. His chair regarded the staff's work as being of that high quality, as was amply demonstrated by its recent comprehensive papers on exchange systems and issues in the assessment of exchange rates of industrial countries. The one cautionary note he would sound was that only those areas of research with the greatest potential for producing helpful analysis should be pursued, because of the Fund's limited resources. If, after a reasonable period of exploration, it appeared that a particular approach was unlikely to shed much additional light on an issue, alternative, possibly less ambitious approaches should be considered. He was thinking in particular of the complex methodology used by the staff in calculating the longer-run equilibrium values of exchange rates.

He agreed with the staff that problems of external indebtedness required closer attention in the Fund's surveillance of individual member countries, Mr. Leonard went on. The papers produced by the staff and discussed in the Board in 1983 had been useful, and he would support projects to improve the monitoring, presentation, and analysis of external debt. Comprehensive country debt tables would be helpful, and in that connection, the proposed meeting of compilers of debt statistics, to take place later in March and to be chaired by the Fund, with representation from the OECD, BIS, Berne Union, and the World Bank, was a welcome initial step.

With respect to Article IV consultations, he largely agreed with the staff's comments, Mr. Leonard remarked. He was pleased to note that the backlog in consultations had been reduced, but he continued to be concerned about those consultations that had been postponed because negotiations were taking place on the use of Fund resources. When an Article IV consultation had not taken place for over a year, and the country in question sought to use Fund resources, the consultation should be completed before the request for a stand-by or extended arrangement was brought to the Executive Board. Fortunately, there was at present only one member with which an Article IV consultation had not been held that was contemplating the use of Fund resources.

On the frequency of Article IV consultations in general, Mr. Leonard added, he broadly agreed with the three criteria used to select those members with which consultations should be held on a 12-month or what was being called the standard cycle. Nevertheless, consultation discussions in the Board over the past year suggested the need to identify clear-cut criteria for excluding members from the standard cycle. That need was particularly evident for the smaller industrial countries, as experience had indicated. In addition, smaller countries that would qualify for a longer cycle had indicated their preference for a shorter one because of the importance that they attached to annual consultations for assistance in their policy planning. In sum, management should exercise judgment and take a flexible approach in specifying consultation cycles, bearing in mind also the wishes of the authorities concerned.

He had found the expanded treatment of external debt in consultation reports useful, and he urged that the quality of information be further improved, Mr. Leonard continued. It was also important to indicate the key assumptions underlying any projections and, insofar as possible, to use similar assumptions from one country to another. There might sometimes be good arguments for making alternative projections, either in their own right or as an adjunct to work on the sensitivity of projections to particular assumptions. He had noted from the first paragraph on page 23 of SM/84/44 that medium-term debt scenarios "will be employed more widely in the future." In the view of his chair, if such assessments were to be made for any countries not experiencing difficulties with external indebtedness, they should be done for all countries, not only for selected ones.

As for protectionism, some strengthening of surveillance might perhaps be possible, Mr. Leonard suggested. In particular, he wondered whether more emphasis could be given in individual consultations to trade and exchange restrictions, from the point of view of the effect of the underlying system in place in the countries concerned as well as from that of developments in the system; the long-term costs should also be discussed. In that connection, he supported the staff's intention to look more closely at protectionism by country groupings.

There was a clear appreciation in the staff paper of the interplay between domestic economic policies and pressures on exchange rates, Mr. Leonard observed. Over time, Fund surveillance had focused more and more on that interplay, leading to a greater understanding of the causative factors at work, the way in which they operated, and the kind of policies needed to deal with them.

A major issue requiring the attention of governments in both industrial and developing countries was employment and unemployment, Mr. Leonard considered. In many countries, it was an essential issue around which economic management revolved, and to the resolution of which fiscal, monetary, and industrial policies were largely directed. There were also good grounds for believing that, far from diminishing, the employment and unemployment problem was likely to be more urgent in the years ahead and would continue to engage the attention of national and international authorities. Yet the staff paper, while it discussed monetary, fiscal, and other policies affecting exchange rates, made no reference to an issue that so often dominated the shaping of those policies. He had no doubt at all that the staff, in conducting Article IV consultations and in other areas of the Fund's surveillance, was fully aware of the issue; the question was whether the time had come to take more explicit account of it and of its influence on policy formation in the Fund's future work of surveillance. It would of course be necessary to avoid duplicating the work of other agencies more directly concerned with the employment problem. It would also be necessary to ensure that countries were not in any way provided with an excuse for misdirected fiscal or other policies on the grounds that they were necessitated by a difficult unemployment situation. The aim should be to discuss the employment problem in individual countries in the context of the specific policies recommended by the Fund for those countries. He would expect such an approach to have the same beneficial effects that had followed from the Fund's concentration on other policy areas.

Mr. Nimatallah stated that he could support the proposed decisions. He welcomed the opportunity to review Fund surveillance, the need to strengthen it being as evident as ever. The sustainability of the ongoing recovery in the world economy was in doubt. Exchange rates for the major currencies continued to show substantial short-term volatility. International trade was subject to growing protectionist barriers, and many countries continued to confront serious debt problems.

The staff had discussed in detail in its papers the difficulties faced by the Fund in exercising its surveillance responsibilities effectively, and he agreed with its conclusions, Mr. Nimatallah continued. The principles contained in the Executive Board's 1977 decision remained as relevant as they had been at the time of its adoption. Furthermore, the decision provided the right balance between specificity and flexibility, and any attempts to change it would encounter serious difficulties. The emphasis should be on sharpening the analytical tools underlying the surveillance exercise, as well as on intensifying efforts to reach a common understanding with member countries on the issues involved. After all, the effectiveness of surveillance ultimately depended on the willingness of all member countries to cooperate with the Fund.

Referring to some of the specific issues involved in the implementation of surveillance, Mr. Nimatallah welcomed the recent emphasis in Article IV consultations on external debt and protectionism. He could support the staff's suggestion to focus more sharply in consultation papers on protectionism, given the seriousness of protectionist pressures in many countries.

The staff conceded that it had encountered some complex issues in evaluating economic policies in the industrial countries for the purposes of surveillance, Mr. Nimatallah continued. There had been particular problems in determining what constituted a sustainable exchange rate; what an excessive rate of monetary expansion was; and what impact fiscal policy was having on the exchange rate. He agreed with the staff's call for a more extensive analysis of those issues. Two criteria had generally been used in evaluating the need for exchange rate adjustment in developing countries, namely, changes in real effective exchange rates, and balance of payments developments. Although necessary considerations, they were not sufficient to judge the extent of the exchange rate adjustment. The concept of the real effective exchange rate suffered from both conceptual and empirical difficulties. Furthermore, a weakening in the balance of payments position required a detailed analysis of the likely reaction of export and import activities to an exchange rate change.

Welcome efforts had been made since the autumn of 1982 to eliminate the backlog in consultations, Mr. Nimatallah observed. It was important for the Fund to be well informed of developments and changes in economic policies in member countries, the purpose being to minimize the risk of surprises. He endorsed once more the criteria specified in 1983 for placing countries on an annual consultation cycle: they should be countries having a large impact on the economies of others, countries using

Fund resources; and members whose balance of payments viability was in doubt. He would add to that list those countries requesting an annual cycle.

He continued to support the rule calling for Executive Board discussion of consultation reports within three months, Mr. Nimatallah said. It was important that the reports discussed by the Executive Board be as up to date as possible. In many cases, he saw merit in combining staff reports for Article IV consultations and papers on the use of Fund resources. However, if an Article IV consultation had not been held with a member for a relatively long time, and if the member wanted to use the Fund's resources, the staff report for the consultation should be brought to the Executive Board before the request for Fund resources. The staff and management could then take note of the Board's point of view.

As he had mentioned at the time of the 1983 review of experience with the implementation of surveillance, Mr. Nimatallah recalled, the information notice system was a useful additional tool that could help the Fund in its surveillance of members' exchange rate policies. But too much should not be expected from the system, with its rather arbitrary cutoff points and definitional problems. He was not sure how the system could be made more useful, unless specific action on the part of the Fund were triggered when a notice was issued.

Finally, Mr. Nimatallah wondered whether the Managing Director's summings up could be made more useful as a focal point for following up surveillance. He could not offer any specific recommendations, but asked the staff to look at ways of using the summing up as another surveillance tool.

Mr. Alhaimus stated that he had no difficulty with the staff's conclusion that the principles set out in Decision No. 5392-(77/63) remained broadly appropriate. SM/84/44 continued to provide a reasonable balance between the need for specific guidelines that offered a workable framework and the need for the flexible application of established procedures. Therefore, the remaining question concerned the interpretation of those principles and guidelines, and the effectiveness with which they had been implemented since the previous review of the document in 1982.

The staff papers showed that some progress had been made over the past two years in strengthening the Fund's surveillance over exchange rate policies, as reflected in the intensification of the Fund's consultation activities both with individual countries and in a multilateral framework, Mr. Alhaimus observed. There was also clearly a heightened awareness of the complexity of the issues relating to surveillance and the importance of more thorough analysis of the interrelationships among fiscal, monetary, interest rate, and exchange rate policies for a sound identification of the problems and for the formulation of appropriate policy recommendations. In that regard, he welcomed the increased emphasis on the broader aspect of surveillance. Indeed, as noted in the staff paper, the fact that the pronounced swings in exchange rates between major currencies might have resulted from domestic policies followed for domestic purposes did not prevent those swings from being viewed with great concern by the international community. Clearly, the swings had contributed to the low levels of economic activity and high interest rates in major-currency countries and in the rest of the world.

While he had noted the staff comments on the issue of asymmetry in the Fund's surveillance, Mr. Alhaimus continued, it was still unclear how that issue could be tackled in the future. As many Directors had emphasized in the past, the staff in its reports often made cautious assessments of exchange rate policies pursued by industrial countries, on the grounds of the difficulties and uncertainties involved in the exercise. In contrast, a generally much more forthright approach was taken in a number of developing countries, where exchange rate adjustments of fairly precise magnitudes were frequently recommended in the context of adjustment programs. Another aspect of the asymmetry was to be found in the degree to which the Fund's policy analysis and recommendations were reflected in the policies actually pursued by member countries. The tendency was again for the Fund's views to prevail more often in developing countries, particularly those using Fund resources, than in industrial countries. It would have been useful if the staff had commented on the extent to which the Fund's analysis had influenced the mix of domestic policy in major industrial countries. It had been correctly noted on page 15 of the staff paper that "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." The Fund had an important role to play in helping to promote the needed discipline and compatibility of policies through its surveillance of major-currency countries in particular, because of their weight in the world economy.

As for the impact of the external environment on the economies of developing countries, Mr. Alhaimus went on, the staff paper had gone on to conclude correctly that "the domestic policy stance in major industrial countries had contributed greatly to the emergence of a global adjustment problem between these countries and the developing countries...." Clearly, the direction of and changes in domestic policies pursued by major industrial countries had an important bearing on the level and variability of international interest rates, exchange rates, trade, and capital flows. Indeed, the instability associated with such changes imposed constraints on the policy choices of developing countries and hindered their adjustment efforts, particularly with respect to the management of external debt. Therefore, it was important that adjustment programs supported by the use of Fund resources be sufficiently flexible to accommodate the various uncertainties associated with the external environment.

Referring more specifically to issues of implementation, Mr. Alhaimus noted that surveillance by the Fund in a multilateral context had acquired particular importance in light of the increasing linkages in the world economy. Welcome efforts had been made by management to draw attention to major issues facing the international economy, such as external debt and protectionism. He also welcomed the increased emphasis in the World Economic Outlook and the Annual Report on those issues and on the interconnections of policies, especially among industrial countries. Another question that might deserve greater attention in the multilateral context of surveillance was the consistency of exchange rate recommendations by the Fund. The effectiveness of simultaneous devaluations in countries in the same region or with close economic links had been questioned in the past, and it might be useful if the Fund's position on the matter could be made clearer. On a related issue, he had noted with interest the summary in Table 1 of SM/84/44 of views expressed in staff appraisals on exchange rate policies. That the appraisals had been critical, either mildly or strongly, of the exchange rates of 54 developing countries during 1983 consultations could be interpreted to mean that the staff considered that a depreciation should have been effected in numerous cases, especially for the 28 countries where the staff had been strongly critical of exchange rate policies.

In the implementation of surveillance under Article IV consultations, Mr. Alhaimus added, he had noted the increased scope of coverage over the past year of external debt and protectionism, and encouraged the staff to continue in the same direction. The staff's plans for improving the reporting on protectionism, mentioned on page 24 of SM/84/44, were particularly welcome.

The treatment in country reports of exchange rate policies deserved particular attention, Mr. Alhaimus considered, especially where a central role was assigned to the exchange rate in the context of Fund-supported adjustment programs. In some cases, the need for an exchange rate adjustment was evident, whereas in others it was not. As recent Board discussions had demonstrated, even when the need for some adjustment in the rate was not questioned, the size and pace of the adjustment often were. For those reasons, the staff should in the future, and to the extent possible, try to make explicit the assumptions on which it based its position on exchange rate policy. As the Chairman had noted in summing up the discussion of the 1982 review of the staff paper on surveillance, several Directors had pointed to the need to look for ways of improving the Fund's appraisal--both quantitative and qualitative--of competitiveness and of the role of exchange rates in the adjustment process, of better assessing the adequacy or appropriateness of different exchange rate regimes, and of adjusting those regimes when warranted. While he realized that it was not always possible to simulate or quantify precisely the impact of exchange rate adjustments, it would still be useful to indicate, for example, the assumed elasticities, in broad terms, of exports and imports with respect to the exchange rate. That would help the Board to reach judgments on such an important matter, and it would avoid making the discussion, both in the Board and with national authorities, appear somewhat dogmatic.

On the frequency of consultations, Mr. Alhaimus said, the present criteria for determining whether a member needed to be kept on a standard or longer cycle were appropriate and should therefore be maintained. In principle, the pressure on the Fund's time and manpower should not be a reason for curtailing the scope and frequency of Article IV consultations, but he recognized the practical problems associated with the increasing load on both the staff and the Board, and he could therefore go along with the suggestion to use the maximum cycle of 24 months when appropriate. Furthermore, he had no major difficulty with combining staff reports for Article IV consultations with reports on requests for the use of Fund resources. The suggestion of simultaneous Board discussions on countries with closely linked economies had certain drawbacks and could be considered only in exceptional cases, provided also that the members concerned were duly sounded out on the procedure.

The simplification and shortening of staff reports on recent economic developments should not, Mr. Alhaimus emphasized, occur at the expense of losing relevant information that in many cases was not available elsewhere. For the same reason, if a full-fledged report on recent economic developments was not warranted for a particular consultation, it would be desirable to issue updated information instead. Moreover, it seemed unnecessary to consider providing the Executive Board with quarterly reports on the frequency of consultations, because the information was already provided in the annual review of surveillance.

With respect to the Fund's monitoring of developments in exchange rates and exchange arrangements, Mr. Alhaimus concluded, the procedures outlined for operating the information notice system seemed satisfactory on the whole, including the maintenance of the 10 percent threshold for issuing notices. While he welcomed the suggestions by the staff for improving the coverage and accurateness of real effective exchange rate data, it was important to recognize the limitations of such data as indicators of changes in members' competitiveness. That was particularly so when the structure of an economy was such that trade flows were not responsive to price-adjusted exchange rate movements. In a number of countries, exports were almost totally concentrated on a single primary commodity, which was completely inelastic with respect to exchange rates. Moreover, in some of those countries, there were virtually no import substitutes. Clearly, in such instances, caution was called for in interpreting changes in the real effective exchange rate. More explicit allowance could be made for such considerations in the future, in both staff appraisals and recommendations in reports for Article IV consultations, as well as in information notices, which were primarily intended to bring attention to changes in a country's competitiveness.

Mr. Lovato stated that the biennial review of the surveillance document gave the Executive Board a useful chance to give fresh thought to an important function of the Fund. He shared the staff's view that the basic principles governing the surveillance role of the Fund, as laid out in Article IV itself and the document under review, were sufficiently general and remained valid. Nevertheless, the rules governing the practical implementation of those principles would have to retain a good deal of flexibility over time in order to meet as closely as possible the needs of a changing economic environment.

On the general aspects of surveillance, Mr. Lovato went on, he supported the view that no sharp distinction could be made in practice between its narrow form, namely, that relating strictly to exchange rate and balance of payments policies, and its broad form, covering all elements of the economies and particularly the policies of the countries involved. The experience of the past decade showed, as had been noted during the Board's recent seminar on exchange rates, that generalized floating was far from providing the insulation and additional freedom for the conduct of policy by single countries hoped for by some economists at the beginning of the 1970s. The divergence of policies and the connected instability of private expectations had led to worrisome fluctuations in exchange rates and ultimately to attempts to limit those fluctuations by administrative measures. In sum, if surveillance were to be effective in the medium run, narrow surveillance would have to go hand in hand with broad surveillance.

Thus, for the proper exercise of broad surveillance, the Fund had both bilateral and multilateral responsibilities for the international monetary system, Mr. Lovato ovserved. The Fund would have to form careful and express clear views on the domestic policies of all member countries, and do so in a uniform way, irrespective of whether members were seeking financial support, and of whether they were small countries or countries whose policies had an impact on the world economy.

Referring more specifically to the Fund's analysis of member countries' economies, Mr. Lovato remarked, there had been some noticeable improvements in the quality of background papers, particularly relating to external debt and trade policies. Fiscal policy was another area in which alternative projections could be useful, particularly when public deficits and debt service trends were of major concern. Generally speaking, background papers should provide substantial information on structural and country-specific features. Some of the material was frequently covered by the appendices to reports on recent economic developments, and no reduction in the size of those reports should be made at the expense of the information provided. In addition, specific data series--for example, indicators of competitiveness based on traded goods prices--were occasionally available for particular countries but not for others. He believed that that information should be used whenever available, even when it was not directly comparable with information on other countries.

As for the flexibility of surveillance, Mr. Lovato observed, the establishment of a system of occasional information notices on divergences in real exchange rates had been welcome. The point was whether and how those or other similar notifications that might be needed should be linked to the regular work of the Executive Board. In particular cases, for example, if a country's situation was evolving rapidly and an urgent review was advisable, the initiative to undertake it or to hold a consultation could originate directly with the Executive Board. The staff's early warning that serious imbalances were developing in certain areas could help to trigger the process. At the same time, it might be appropriate to reconsider the length of the consultation cycle for some other countries, as indicated in the staff paper, by making occasional use of the 24-month cycle.

In sum, while he still felt that he could agree with the basic principles that had inspired the Fund's surveillance in recent years, and could therefore support the proposed decision, Mr. Lovato concluded, he saw scope for some improvement in the way in which surveillance was being conducted. The three aspects that he had indicated--symmetry in the exercise of multilateral surveillance, attention to country-specific aspects and information, and flexibility as well as promptness in responding to rapidly evolving situations--appeared to him to deserve closer attention in the future.

Mr. Hirao stated that effective surveillance by the Fund could make an important contribution to the smooth operation of the international monetary system; the present review provided another opportunity to further improve its effectiveness.

He could broadly endorse the approaches taken in the staff paper, Mr. Hirao commented. As for the issues selected for discussion in Part VI, he would not repeat his arguments during the extensive discussion in the Executive Board seminar on January 30, 1984, on the issues associated with the identification and correction of inappropriate exchange rate policies. To be brief, he noted the large number of difficulties inherent in the assessment of whether or not a structure of exchange rates was appropriate; great caution would be required if policy implications were to be drawn from the mechanical application of certain methods of assessment.

As for the coordination of policies, which had also been discussed in the seminar, a sound noninflationary policy was the most effective path to an appropriate exchange rate structure, Mr. Hirao emphasized. Therefore, if there were to be any convergence of policy resulting from cooperation among major industrial countries, it should be directed toward sustainable economic growth and a lasting reduction in inflation. A number of factors obstructed the coordination of policy in the right direction, most notably rigidities in goods and labor markets, together with structural problems in public finance and elsewhere. Those factors might constitute formidable constraints. Accordingly, the coordination of demand management policies would always require supporting measures on the supply side and attention to other structural problems. In that connection, he supported the suggestion made by Mr. Wicks.

On matters relating to Article IV consultations, Mr. Hirao went on, staff reports generally covered most relevant policies. More recently, emphasis had been given to exchange rates, external debt, and protectionism, which was broadly appropriate. The assessment of those issues had been frank and straightforward in most cases, and the underlying analyses had been reasonably comprehensive. The inclusion of an analysis of the medium-term debt outlook had become a more regular feature in staff reports. He welcomed the progress made in that respect. The Fund was uniquely positioned and qualified to do such important work. The staff paper noted that there was room for further development in presentation and analysis. Perhaps further analysis of the sensitivity of the projections to alternative assumptions would prove helpful. Where assumptions were made, they should be stated clearly, so that misleading impressions could be avoided. It was appropriate that, in order to ensure uniformity of treatment, the staff had not limited such analyses to cases where external indebtedness was an immediate problem.

The recent coverage of protectionism had generally been adequate, Mr. Hirao considered. The staff intended to make further progress in covering several other aspects of protectionism; the intention to assess its impact on domestic adjustment was certainly welcome.

He had been encouraged to note that the number of consultations concluded in 1983 had risen significantly, Mr. Hirao said. Extraordinary efforts had been made by the staff since the fall of 1982 to eliminate the consultation backlog. In order to prevent overdue consultations in future, the momentum of those efforts should be maintained. The consultation cycles specified seemed to have been broadly appropriate, although the usefulness of the practice itself had yet to be proved. Where delays were encountered in observing the specified cycles, brief periodic reports--perhaps quarterly ones--would seem appropriate.

Because of the heavy work load that would remain, Mr. Hirao noted, some continued adaptations to the staff work on consultations would probably have to be made if the quality of the work were to be maintained. The practice of combining staff reports for Article IV consultations with reports on requests to use Fund resources would be helpful. However, as noted in the staff paper, that practice should not be allowed to delay unduly the conclusion of consultations. It would also be helpful to schedule consultations of members with closely linked economies at the same time. Reports on recent economic developments might be shortened on a selective basis, as the Chairman had concluded in his summing up of the discussion on the review of the procedures for surveillance in 1983; but changes of substance in economic policies and in institutional settings should always be incorporated in the yearly staff report.

On the monitoring of developments in exchange arrangements and exchange rates, it was encouraging to note that the compliance of members with the standard for prompt notification of changes in exchange arrangements had continued to improve, Mr. Hirao concluded. He hoped that further progress would be made. He had no difficulty in continuing the information notice system, with some necessary improvements. However, in the paper prepared for the seminar held in January, the staff had made the point that focusing on changes in real effective exchange rates alone would not provide an adequate basis for assessing the appropriateness of exchange rates; such changes were only one component of the appraisal. In conclusion, he supported the proposed decisions.

Mr. Feito said that he could support the proposed decisions. He could also broadly endorse the staff's appraisal and recommendations embodied in Parts III, IV, and V of SM/84/44, and he would therefore concentrate his comments on Part II, dealing with key issues in the conduct of Fund surveillance.

His first point concerned the asymmetries surrounding Fund surveillance over exchange rate and financial policies, Mr. Feito observed. The exchange rate surveillance apparatus had been considerably improved and made more evenhanded by the establishment of the information notice system. Although the system still had to be further developed and refined, it was fair to say that it represented a major effort to correct the bias of surveillance in favor of members operating under more flexible exchange arrangements. Certainly, there remained asymmetries relating to the Fund's power to enforce the implementation by members of the right exchange rate and other policy actions. It was evidently easier to ensure the implementation of a desired exchange rate and policy package by members carrying out financial programs supported by the Fund than by other members. However, asymmetrical treatment would be involved only to the extent that exchange rate and other economic disequilibria experienced by members not engaged in a Fund program were of a size comparable to those experienced by members implementing Fund-supported policy packages. Moreover, a strong judgment by the Fund on the exchange rate and underlying economic policies, even if they were not being conducted within the framework of a Fund program, could exert a considerable influence on the future shape of those policies. Again, however, the moral suasion and related pressures that the Fund could apply to that subset of members were much more effective in open economies that were more highly dependent on the confidence of the international community than in other more closed and usually larger economies. Those latter limitations of Fund surveillance were inescapable, and were in a way inherent in the current international monetary system.

His second point relating to the broader aspects of Fund surveillance, Mr. Feito continued, was that the most serious international economic problems of recent years had been associated not with exchange rates as such, but rather with the pronounced swings in real interest rates in major world financial centers. Exchange rate conflicts among countries had largely been a by-product of those swings. In other words, the main autonomous source of international maladjustments had been not the functioning of the exchange rate system but that of the international liquidity system. The proper inference to be drawn was that the surveillance apparatus would have to be targeted at international liquidity. The failure of the international community, since the inception of the floating-rate regime, to prevent either very low real interest rates during most of the 1970s or extremely high real interest rates since the early 1980s was at the root of most of the international economic malfunctions during the whole period, the oil crisis not being fully excluded, and the external debt crisis being almost fully explained by that sequence of phases of very negative and highly positive real interest rates. Although those phases had, in the main, been the result of a mix of overexpansionary and overcontractionary financial policies in the countries that were the issuers of the main international media of exchange, their effects on the international community had been magnified by the functioning of international financial intermediation.

Whereas it was always difficult for the Fund to influence, to any significant degree, the conduct of national monetary policies of its largest members, at least within the framework of the current international monetary system, it was conceivable that means could be devised to minimize the impact of those policies on other members, Mr. Feito considered. One way would obviously be by the allocation and cancellation of SDRs. The SDR scheme, however, did not at present allow for symmetrical treatment of excessively high and excessively low international liquidity. Moreover, the doubts that some major Fund members had about the SDR itself prevented a proper discussion of liquidity issues within the framework of the SDR scheme.

There were nevertheless other ways to influence international liquidity, for instance, by controlling the multiplier effects of international financial intermediation, Mr. Feito noted. Many proposals had been made during the first stage of the development of Eurofinancing and other international financial intermediation practices, under which the Fund would have been asked to look at those practices from the perspective of a central bank and then to stabilize the supply of international credit accordingly. Those warnings about the need to control international liquidity had been dismissed, on the grounds that private international capital markets were self-equilibrating. With the benefit of hindsight, it was fair to say that those self-regulating movements were not without unduly high costs for the international community. It was not surprising that some of the earlier proposals for the control of international liquidity by the Fund were being put forward again, as in the recent Per Jacobsson lecture given by Mr. Witteveen. He would not dwell on the details of those proposals but would rather encourage the staff to look again into the possibilities open to the Fund for controlling international liquidity. To that end, the Fund should develop its broader surveillance responsibilities under Article IV, Section 3(a).

In sum, Mr. Feito concluded, there had been many improvements of the surveillance system, such as increased frequency of consultations, closer attention to external debt and protectionism, and more prudent and systematic analysis of exchange rate issues. Substantial work remained to be done, however, to strengthen surveillance in the broader sense of overseeing the functioning of the international monetary system. In that respect, ways and means by which the Fund could exert a more active influence on international liquidity developments should be explored and eventually made part of the armory of surveillance tools.

Mr. Blandin observed that both the areas of success and those where further progress should be made were clearly shown in the staff paper, which also stressed the crucial role played by the Fund in carrying out its surveillance mission. Generally speaking, he was in broad agreement with the staff's approach.

As for the issues selected for the Board's discussion, Mr. Blandin remarked, it was impossible not to agree with the staff that the Fund's activities relating to Article IV consultations and the use of resources were already at such a high level that there was little room for maneuver. However, attention and energy should continue to be focused on Article IV consultations, which were at the heart of Fund surveillance. In that respect, the question was whether the three basic principles underlying surveillance should be reinforced. In the light of those principles, a more active role could be envisaged in which the Fund would assess the appropriateness of the exchange rate policies followed by member countries when those policies were likely to have a direct impact on the international monetary system and on the international community as a whole. As an illustration, he cited the clear preference shown by the staff on page 12 of SM/84/44 for "a balanced reliance on monetary and fiscal restraint" rather than "a combination of loose fiscal policy and restrictive monetary policy." On page 14, the staff regarded the slower growth of domestic demand in continental European countries and Japan as having a dampening effect on the exports of developing countries.

Those two examples of the staff's views, among many others, suggested that the Fund should perhaps depart from its sometimes too cautious approach toward the policies followed by some important member countries, and be more precise in its recommendations, Mr. Blandin continued. It was to be regretted that staff reports for consultations included only a description of exchange rate policies. In many cases, the Fund could go further and express a view on the appropriateness of specific measures taken or envisaged in the exchange rate field, including intervention on foreign exchange markets. In that connection, the staff should develop further its studies on the indicators of exchange rate deviations and on the sustainability of the major currency rates, as described in the papers prepared for the January seminar on exchange rate issues.

The Fund's analysis of external debt policies and prospects in individual countries was acceptable, although the use of medium-term debt scenarios might prove very useful, Mr. Blandin noted. As for protectionism, his chair particularly appreciated the Fund's intention to emphasize protectionist measures that had an important impact on trading partners, as mentioned on page 24 of the staff paper. Moreover, he fully supported the broad thrust of the discussion in Part IV of the staff paper relating to Article IV consultations, and he therefore had no difficulty in supporting the proposal for periodic reporting.

Finally, the threshold for the issuance of information notices should be lowered somewhat, Mr. Blandin said, at least for the major currencies and especially for the five currencies of which the SDR basket was composed. In addition to data, some comments could be made on developments in the exchange rates of those currencies.

Mr. Panday noted that he endorsed the principles and procedures followed by the Fund in conducting its surveillance function. The principles contained in the original document on surveillance remained as valid as they had been when the decision approving them had been adopted. He supported the proposed decisions.

However, his chair had two major concerns, Mr. Panday went on. First, how could the Fund enforce its recommendations on sovereign member countries? Many of the recommendations of the Executive Board were not implemented by members. It would be interesting if staff reports could in future include a page summarizing the recommendations of the Executive Board relating to the previous Article IV consultation and describing the progress made in implementing them. A good basis would thereby be provided for examining the effectiveness of the Fund's surveillance work.

The second concern related to the uniform implementation of surveillance, Mr. Panday concluded. Surveillance was more effective in small countries and debtor countries that had Fund programs. Only with such countries was the Fund able to ensure that its recommendations were put into effect. In all other countries, particularly the large industrial countries that had a major impact on the world economy, the Fund had very little influence on policies. Therefore, he recommended that the Fund give more consideration to ways of conducting its surveillance functions more equitably so that not only debtor countries but also countries that did not have Fund programs adopted policies that helped the world community to prosper.

Mr. Doe expressed support for the implementation of the Fund's surveillance responsibilities, defined more broadly than narrowly, and for continuing to expand the coverage of macroeconomic developments in member countries. He endorsed the staff's effort to broaden the coverage in its papers on the debt situation and debt profile of members. For many countries, the debt problem was likely to remain serious in the foreseeable future, and sustained attention would therefore have to be paid to it. He would welcome a more ample description of such aspects as the terms of the debt, including maturity, grace period, interest rate, and other charges; an evaluation of the role of the contracting parties in the emergence of the debt problem; and an assesment of the ability of countries benefiting from debt rescheduling to honor future payment schedules. Similarly, he would like to see an improvement in the coverage of the public sector's domestic debt and the outstanding debt of the public sector to the private sector. The collection and analysis of more qualitative information on debt could guide the national authorities toward the adoption of a more appropriate policy.

He also endorsed the wider scope that was being given in consultation reports to the examination of restrictive trade policies, Mr. Doe continued. In that vein, he subscribed fully to the view expressed by the staff on page 14 of SM/84/44 that a durable improvement in the market share of developing countries was not likely to come about unless barriers to trade imposed by their current and potential partners were eliminated. The tolerance of many of those developing countries for internal financial adjustment had almost reached its limits. Therefore, the strain imposed on them by their large debt service could be alleviated only by means of a sustained increase in their export earnings. He was also in agreement with the staff in calling for an increased trade flow among developing countries.

With respect to the implementation of surveillance and its impact, Mr. Doe observed, the need for better cooperation on the part of the authorities of the major industrial countries could not be overemphasized. The economic interests of the people, not only of other nations but of their own as well, would be better served if those main industrial countries heeded the call of the Fund's management for a change in some of their domestic financial policies. In the absence of a more appropriate response on their part, any suggestion that the Fund was discharging its duty of economic oversight evenhandedly was bound to be viewed with skepticism.

As to the format of reports on recent economic developments in member countries, Mr. Doe said, the staff stated on page 31 of SM/84/44 that an increasing number of those reports might take the form of short papers, with brief coverage of certain aspects of macroeconmic developments. In some instances, it was indicated, the reports would simply take the form of a set of tables. He for one had serious reservations about that approach. He would find it disturbing if the steps taken already in that direction were repeated, especially for developing countries. His reasons included, first, the fact that even in the absence of major institutional changes, the evolution of macroeconomic aggregates and of policy changes needed to be amply explained; second, the report on recent economic developments might be the only source of comprehensive and relatively coherent descriptive information available on a regular basis; and third, while the confidential nature of the staff report for Article IV consultations precluded its wide circulation, national authorities might find the communication of reports on recent economic developments less objectionable.

In light of those and other considerations, Mr. Doe stated, the experiments referred to on page 31 of SM/84/44 should be seriously reconsidered. He recognized the strain on the staff--especially on staff members of some of the area departments--arising from generally tight mission schedules. However, that problem should not lead to denying Fund members the benefit of a complete and regular report. Other avenues, including an increase in personnel and a broader participation of the staff of functional departments in missions, should be explored in order to alleviate the work load.

An aspect of the consultation process that did not appear to have been dealt with widely in the staff paper on the review of surveillance, Mr. Doe considered, concerned the application of the three-month rule for the completion of consultations undertaken with some member countries whose official language was not English. Quite often, the preparation of the staff report and its translation into French, Portuguese, and Spanish for the relevant members of his constituency was a time-consuming and tedious exercise. The late circulation and arrival of the national language version of the consultation report in the member country drastically reduced the response time of the authorities before the expiration of the three-month deadline. Therefore, his chair would like the aforementioned considerations to be borne in mind in the application of the three-month rule. He expressed the hope that Executive Directors would consider sympathetically requests for increasing the staff of the Bureau of Language Services.

In summary, Mr. Doe remarked, he supported the expansion in the scope and frequency of the surveillance of economic and financial policies undertaken by Fund members. The impact of those policies, especially those of major countries, should be highlighted in the consultation reports. Those reports should contain comprehensive statistical and descriptive information. Similarly, the three-month rule for the completion of the consultation should continue to be applied flexibly to take into account the language constraints that he had mentioned. He also endorsed the progress made thus far in setting up a framework for informing Executive Board members of significant exchange rate developments in relevant countries. In that respect, he had no difficulty with the improvements being contemplated. He supported the proposed decisions.

Mr. Mtei said that he had no difficulty in agreeing with the broad thrust of the staff paper or in supporting the proposed decisions. Two main issues had been flagged for the discussion. First, on the conduct of Fund surveillance, there was universal agreement on the real need to strengthen surveillance, a need that had been central in the various reviews in the past. To many, that need had its roots in the asymmetry inherent in Fund surveillance activities, which had been effective only in respect of developing countries, particularly those making use of Fund resources. The staff had pointed out on page 7 of SM/84/44 that the international community had been prompt in registering disapproval of inappropriate policies, and it had directed attention to the instance of a special consultation with a developed member country suspected of having devalued its currency excessively. Yet the general impression had been that that case was an isolated one, made possible by the relatively small size of the country in question, and that it had received attention because of the perceived loss of competitiveness on the part of industrial countries to that relatively small industrial country. By and large, the Fund had not yet devised an effective mechanism for making surveillance over the exchange rates and other policies of the large industrial and other surplus countries effective, even though what happened in those countries determined the smooth running or otherwise of the international monetary system. In addition, from the standpoint of the efficient functioning of the international adjustment process, surpluses and deficits could be equally disruptive, a fact that even the staff had acknowledged.

As the staff had noted, Mr. Mtei continued, the indicators that it had listed, particularly those related to intervention, official borrowing, and restrictions on international transactions, normally provided early signals that members' exchange rate policies had implications warranting attention by the Fund. Difficulties could arise because in a number of cases judgments hinged upon the analysis of the costs and benefits of policies. But more often than not, the net effects were obvious even to the layman; the mix of domestic economic and financial policies was a case in point. While he recognized that a member had the right to choose whatever policy mix it thought appropriate, in doing so, it should take full cognizance of its obligations under the Articles of Agreement regarding surveillance, which required that the interests of other members should not be ignored.

In that context, Mr. Mtei went on, he had noted with concern the staff's pertinent observation that the domestic policy stance of industrial countries, which over the years had failed to take account of international ramifications, had constituted a more serious problem for the international monetary system than exchange rate manipulation. The problem was compounded by the fact that members often ignored the requirement to intervene in the foreign exchange market to counteract disorderly developments. Countries took advantage of the difficulty in determining what constituted disorderly developments, and refused to intervene in the market. There had been cases of interest rates having been used to keep the exchange rate at unprecedentedly high levels, in the full knowledge that to do so while inflation was being brought under control could give rise to increased protectionist pressures. Furthermore, the staff had arrived at the conclusion, on page 15 of SM/84/44, that "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..." one that was "hardly solvable through exchange rate flexibility alone." To his mind, that was an apt assessment of a major cause of the economic and financial plight of many developing countries. In spite of that acknowledgement, however, exchange rate adjustment was often presented--in staff reports for Article IV consultations and those on the use of Fund resources--as the panacea for the economic ills of those countries. Consequently, the brunt of the burden of adjustment was being borne by helpless countries. That was clear evidence of the inequitable working of the international adjustment process, which there was as yet no way of righting under the Fund's surveillance procedures.

The solution to the inequity problem lay in the better coordination of international policy, in the view of the staff, Mr. Mtei observed. While he agreed, it was important to point out that experience had shown that the persistent divergence of perceived national interests was a major problem. The failure thus far to attain the needed policy coordination was therefore not surprising. The reality was that economic giants were living together with much smaller economies that were at different levels of development, had varying economic structures, and attendant group interests such that countries' policies were unlikely to converge completely. Perhaps a set of objective criteria was also required to enable the Fund and the countries themselves to monitor adherence to the rules of the game, together with courage and boldness on the part of the Fund staff in examining objectively the appropriateness of a policy, suggesting alternative policy mixes, and identifying those countries that consistently failed to adhere to the agreed rules. A complementary requirement would be a commitment, at the highest political level in the major industrial member countries, to abiding by those rules in the long-term interest of the whole international community, including their own countries. Unless that commitment could be made, the achievement of the objectives of surveillance would continue to be elusive.

On the review of the implementation of surveillance, Mr. Mtei mentioned that the array of instruments through which the Fund conducted its surveillance was impressive and exhaustive. He would therefore limit his remarks to Article IV consultations, the usefulness of which could not be overemphasized. The Fund should continue to make use of consultations as affecting as possible. While it might not be possible to hold consultations as often as desirable in all countries, efforts should be made to continue the annual consultation cycle with the major industrial countries, whose policies had far-reaching repercussions outside their national boundaries. Staff reports on those consultations should be frank and bold, embodying detailed analysis and identifying policies that might cause problems for third countries. Whenever the subject had been raised in preceding consultation reports, the views of the authorities at that time should be restated, alongside the measures taken since the conclusion of the previous consultation. Such a presentation was necessary if statements of good intentions were to be matched with subsequent concrete actions. Viewed in that context, he would have no problem in going along with the proposals on page 24 of SM/84/44 for reporting protectionist measures detected in members' trade policies and practices. Similar ways should be devised to draw attention to members' fiscal and monetary policies that had adverse effects on exchange and interest rate movements.

Mr. Morrell said that he could support the proposed decisions. No revision was necessary to the text of the 1977 surveillance document. The evolution of the practice of surveillance suggested that there was sufficient breadth in the wording of the document to allow for surveillance of policies, even those adopted for domestic purposes, as long as they had an adverse impact on other countries. He agreed with the suggestion in the staff report that experience in recent years, at least in the major industrial countries, showed that recourse to a domestic policy stance that failed to take account of the implications for other countries had often been a more serious problem than policies designed to manipulate exchange rates or the international monetary system. He encouraged the Fund in implementing surveillance to carry that broad interpretation further, based on recent experience and the present outlook. The 1977 surveillance document seemed to permit a further evolution of practice in that direction; any shortcomings derived from difficulties of implementation, not from inadequacies of the mandate.

Some of the criticism leveled against the Fund for what was considered to be asymmetrical surveillance was somewhat unfair, Mr. Morrell considered, and was in some respects similar to the criticism often made of the Fund's adjustment programs. The apparent leverage that the Fund could bring to bear against countries using its resources stemmed from the very necessity of adjustment. In carrying out surveillance, the Fund was evenhanded in its analysis, in the force with which it conveyed the substance of its views during Article IV consultations, in its approach to surveys of the World Economic Outlook, and in its issuing of exchange rate notifications. But despite his belief that the Fund's approach was already evenhanded, it could be made even more so, with respect to deficit and surplus countries alike. In that respect, he welcomed the efforts of the Fund, particularly of the Managing Director, to persuade important countries to contain fiscal deficits, to improve access to developing country exports, and generally to improve the climate for global economic recovery. The Fund had to continue to find ways to encourage the major countries in particular to contribute to the adjustment process.

Article IV consultations should take into account, in an analytical way, the effect of the policies of other countries on the country with which the consultation was being held, Mr. Morrell observed. He had noted the staff's plan to improve its reporting on the impact of foreign protectionism in Article IV consultations held with developing countries. Beyond simply regretting the impact of protectionist measures, he would welcome, where feasible, more numerical analysis of the effect of major protectionist measures on the exports and external position of the given country. On the medium-term assessment of external indebtedness, he too saw value in presenting the projections under alternative assumptions. The staff might wish to present more than one scenario--say, a high-case and a low-case scenario--as the staff of the World Bank did in preparing its development reports. The value of the projections as analytical tools rather than as predictive exercises, a distinction that might not always be apparent to non-Fund readers of staff reports, would thereby be enhanced.

Apart from those points, he was generally satisfied with the contents of staff reports for Article IV consultations, Mr. Morrell noted. On the frequency of consultations, while he shared the concern about the need for timeliness, strict insistence on promptness and regularity should not lead to a sacrifice of thoroughness. Having increased the proportion of countries on an annual cycle to 83 percent of the membership in 1983, the Fund might have reached a plateau for the coming years. However, it should be careful not to slacken its surveillance effort by reducing the frequency of consultations. Such a reduction would be shortsighted, if the result proved to be a deterioration of economic performance and a consequent demand for greater use of the Fund's resources. Similarly, the value to many countries of Article IV consultations had to be recognized. In that respect, he had been attracted to the suggestion that an additional criterion for deciding on a 12-month cycle might be the country's own wishes. He could endorse the adaptations suggested by the staff on page 31 of SM/84/44 to reduce the work load--and thereby the length of the Board's discussions--and he was particularly interested in the possibility of scheduling consultations with closely linked countries so that the Executive Board could consider them on the same day. He had in mind the smaller Caribbean islands or Pacific island countries. It was also helpful to consider staff reports for Article IV consultations with the major economies within a short space of time; it had been useful to discuss the consultations with the United Kingdom and Japan only two days apart. For obvious reasons, many other factors affected scheduling, but the possibility of consecutive meetings should be borne in mind.

His chair was generally satisfied with the progress made in implementing the Executive Board's decision to establish the information notice system, Mr. Morrell said. The point for starting the measurement currently used remained appropriate, namely, the timing of the discussion on the previous Article IV consultation or on the use of conditional resources. In addition, the 10 percent threshold was still appropriate; if it were reduced to 5 percent, the number of notices would be too great and would detract from the exercise. He encouraged the staff to continue to make technical improvements. One such improvement that had been described was the expansion of the coverage of the unit labor cost index to include other members that had adequate information on normalized unit labor costs in manufacturing. He wondered whether data limitations were the only impediment to the use of that index. For example, would normalized unit labor costs provide an accurate picture of competitiveness for countries with a dual economy or with an agricultural sector that accounted for a major share of exports?

Mr. Zhang stated that he was in full agreement with the staff's main conclusion that the domestic policy stance in major industrial countries had had more serious international implications than the manipulation of exchange rates, and that it had also contributed greatly to the emergence of global adjustment problems between those countries and the developing countries.

The report under discussion began by recalling that the need to make surveillance more evenhanded and more effective had been a recurrent theme of annual reviews since 1979, Mr. Zhang continued. As for the implementation of surveillance, it was clear from the discussion in the report that the disparity in the strictness and effectiveness of surveillance between major industrial countries and developing countries had been intensifying rather than moderating. In developing countries, tighter financial conditions and high international interest rates had increased the efficiency of surveillance, along with the Fund's willingness to criticize their exchange rate policies. Yet there seemed to have been no marked progress or increase in the efficacy of the Fund's surveillance over the exchange rates of major industrial countries since the 1982 economic summit meeting.

The staff paper pointed out that exchange rate instability in the major industrial countries had been due to divergent inflation rates and imbalanced fiscal and monetary policies, Mr. Zhang observed. Since, according to the staff, a low inflation rate was preferable to a high one, the direction in which convergence should take place was clear. If a country had a very large budget deficit, convergence required the maintenance of a moderate rate of monetary expansion and a reduction of the deficit. But if that country insisted on running a very large deficit, what should it do? Was it appropriate for it nonetheless to restrain monetary expansion in order to curb inflation, even at the cost of sharply higher interest rates and/or exchange rate appreciation? Or was it appropriate for the country to adopt a more balanced financial policy involving less monetary restraint? In the latter case, the consequences of the fiscal expansion would be accommodated but would be bottled up in the economy by depreciation. Flexible exchange rates gave the major industrial countries the option of using an unbalanced policy mix to curb inflation through the effects of an appreciated exchange rate and higher interest rates, while sustaining activity and maintaining political support for economic policies by heavy deficit spending.

Furthermore, assuming that a major industrial country were determined to combine a large budget deficit and a restrictive monetary policy, Mr. Zhang commented, its exchange rate would have a tendency to become overvalued, and interest rates in other major industrial countries would tend to rise as those countries resisted the depreciation of their currencies by tightening monetary policy. Thus, the corollary of an unbalanced policy mix in a major economy was a general tightening of market conditions and abnormally high interest rates in international capital markets. Was it not fair to say that under those conditions, the capital-importing developing countries were exposed to severe balance of payments strains, and came under increased pressure for exchange rate depreciation because the major economies were able to pursue destabilizing financial policies?

On a related specific point, Mr. Zhang added, the staff in its report held the view that monetary developments had made it more difficult to assess the causes of developments in the exchange rates of major currencies. Thus, for the time being at least, it had become particularly difficult to determine the appropriate rates of growth of the monetary aggregates, and therefore to assess whether specific exchange rate developments were the result of excessively low or high rates of monetary growth. That statement had important implications for the exercise of Fund surveillance over exchange rate policies of major industrial countries, and it would be helpful if the staff could elaborate further on those implications.

The situation of the centrally planned economies was far more complex than suggested in the two paragraphs that it had been found necessary to devote to them in the report, Mr. Zhang commented. Historically, the measures mentioned had been introduced long ago in order to correct certain imbalances and structural rigidities, or as a means of directing internal economic activities. Furthermore, while it was reasonable to believe, as the staff said, that the unification of the exchange rates would assist decision makers in increasing economic efficiency, it could by no means be considered the sole factor to be taken into consideration in order to improve general economic conditions. Thus, a hasty elimination of exchange restrictions might result in exacerbating the difficulties that those countries aimed to correct.

Experience showed that exchange rate reform in centrally planned economies was a time-consuming process, and that other factors or objectives than those suggested in the report needed to be taken into consideration, Mr. Zhang observed, the most notable one being income distribution. It was however interesting to note that, in a later paragraph on the same page of the report, not connected with centrally planned economies, the staff recognized that "national authorities may have domestic goals and constraints that they feel they have to respect even if the result is an inappropriate rate."

On the implementation of surveillance, Mr. Zhang asked the staff to state whether or not it was appropriate and practical to lengthen the standard consultation cycle to, say, 15 or 18 months, or to group countries into different categories to which the standard cycle would apply.

The need for simultaneous reviews of the policies of major industrial countries, to ensure consistency and compatibility in the policies of their closely linked economies and to assess the combined effects of their individual policies on the world economy as a whole, had been further intensified during the past year, Mr. Zhang stated. Therefore, he urged the staff to focus its analysis even more on the significance and impact of the policies of each of those countries in light of the policies being implemented or planned in the other countries, and to bunch--to the extent practicable--the discussions by the Executive Board of the staff reports for Article IV consultations with those countries.

He would like to have a description of the criteria used in categorizing the staff's views of an exchange rate policy, Mr. Zhang said. Had the same standards been applied to the major industrial countries and to the developing countries, and to countries with a Fund program and those without programs? What bearing had those views had on the actual recommendations that the staff had made to individual governments to change their exchange rate policy? Would it be possible to include a more elaborate presentation on that subject in the report for the 1985 review? In conclusion, he supported the proposed decisions.

Mr. de Vries observed that his Netherlands authorities continued to believe that the Fund's surveillance was not as effective as it should be. At the same time, they were not hopeful that what they perceived to be considerable shortcomings in the way in which surveillance was implemented could be corrected. If easy solutions had been at hand, they would already have been found and put into practice. One fundamental obstacle to putting surveillance on a stronger footing was the widely divergent attitudes of countries to exchange rate policy. In the end, it was the thoroughness of the Fund's analysis and its power to convince and persuade that would have to bring about some meeting of minds on that difficult issue.

That general judgment of his authorities seemed to have been confirmed by the discussion, Mr. de Vries remarked, which had been directed at a variety of problems that had a bearing on exchange rate developments, of course, but only a peripheral one. For instance, reference had been made to protectionism, trade policy, the role of government in an economy, structural adjustment policies, unemployment, and the consequences of supporting aging populations; in addition, detailed comments had been made about the timing of consultations and the nature of the reports prepared by the staff. Nevertheless, his chair continued to believe--his Netherlands authorities in particular--that exchange rates were important; they not only reflected domestic policies and economic developments, in both the private and the public sectors, but also influenced them.

One way to focus the Fund's surveillance activities more closely on exchange rate policies, Mr. de Vries considered, might be to resume the earlier practice of making medium-term estimates of the current account on the balance of payments of countries whose currencies were of major importance and that fluctuated in value. The Netherlands authorities had been glad to see that a step in the direction of such analytical activity had been made in the recent staff paper on the assessment of exchange rates of industrial countries (SM/83/263, 12/28/83).

Another possible step would be to take greater account of the interdependence of the economic systems of the major members, Mr. de Vries added. The Executive Board's discussions of the staff reports for the Article IV consultations with the United Kingdom and Japan had, it was true, recently been scheduled closely together, as had those for the United States and Germany in the past. But neither the staff reports themselves nor the Board discussion had dealt adequately with the interdependent factors affecting those economies. He recalled that, at the time the Executive Board had considered the staff report for the Article IV consultation with Japan--the Fund's second-largest member, and a major industrial country vitally dependent on international trade--he had been struck by the absence of any reference in the summing up to developments in the world economy. With the usual and proper prudence, some judgment had been expressed about the exchange rate for the yen, and it had been recognized that it was the yen exchange rate vis-à-vis the U.S. dollar and vis-à-vis the European currencies that was of relevance, but nothing had been said about developments, either in Europe or in the United States, that had influenced those relationships. An effort should be made to improve the approach not only so that the Fund could better fulfill its surveillance functions, but also because unless it did so, it would not have an adequate and balanced picture of developments in a given country.

Presumably, the Article IV consultations with Germany and the United States would again be scheduled closely together, Mr. de Vries continued. The Chairman had indeed already asked Executive Directors to comment on the influence of U.S. policies on the rest of the world. Perhaps the staff could focus the consultation with the U.S. authorities on the effects on the U.S. economy of sluggish economic developments in Europe and the consequent lack of investment opportunities and profits in other industrial countries.

The effects of regional relationships, to which Mr. Wicks had referred, were of two types, Mr. de Vries observed. First, there was the effect on the policies of countries within a region. To cite the European Monetary System as an example, the smaller members of the system tried to maintain exchange rates that were stable vis-à-vis those of the major members; to the extent that they were successful, the stabilization of exchange rates implied a significant policy harmonization. Perhaps the Fund needed to pay more attention, in its forthcoming consultations with major members of the system, to the second type of effect, that of the policy of the European Monetary System on the outside world.

Reference had been made during the discussion, Mr. de Vries noted, to the statement by the staff that the domestic policy stance in major industrial countries had contributed greatly to the emergence of a global adjustment problem between industrial countries and developing countries. His Netherlands authorities trusted that the staff did not mean that those countries should abandon their efforts to reduce or to eliminate inflation and budget deficits. Surely, the idea was rather to point out that the necessity to tighten up previously loose policies was inevitably influencing the world economy as a whole. Earlier in the same paragraph, a case for the convergence of economic policies had been made, but as Mr. Hirao had said, it was necessary to try to converge at near-zero inflation rates and at sustainable rates of growth. The present effort of governments to do so, which was taking place against the background of the inflationary decade of the 1970s, was of course having a painful effect on the economies of the industrial countries themselves and thus on the rest of the world. The prime objective should still be to achieve convergence at a zero rate of inflation and with sustainable growth rates; only then would governments once again have the luxury of choosing their policy instruments freely.

On points of detail, Mr. de Vries stated, first, that negotiations with the Fund on the use of its resources should not be allowed to lead to unreasonable delays in holding Article IV consultations with the member concerned. Consultations should in principle take place according to the normal cycle. The Executive Board should also be informed whenever difficulties were experienced in holding consultations on the cycle set for the member.

Second, the inclusion in staff reports of forecasts of the medium-term balance of payments and debt positions in a number of countries was welcome to his Netherlands authorities, Mr. de Vries said. However, they would like to have the assumptions underlying the scenarios spelled out somewhat more clearly, if possible. They also attached great importance to the staff reports on recent economic developments in member countries because they provided a central pool from which otherwise scattered information could be drawn. His chair had, like others, found it hard to identify the basic elements in the rather too abbreviated or sophisticated statistical material included in the report on recent economic developments in the United Kingdom. There had been a similar although less serious problem with the material in the report on recent economic developments in Japan.

His third point, Mr. de Vries remarked, was that it would be all to the good if more specific attention could be paid in Article IV consultations to trade policies, including aid to industry.

Fourth, he had come to believe that the information notice system had not worked very well, Mr. de Vries commented. One major shortcoming was the use, as the reference rate, of the rate that had existed at the time of the Executive Board's previous discussion of the member's exchange rate policy. If the Executive Board decided, after holding such a discussion, that a member's exchange rate policy was not necessarily out of line, it would still have to accept the rate on the date of that discussion as the reference rate for the subsequent notification. The procedure was symptomatic of the caution and lack of self-confidence with which the Fund undertook its surveillance activities. Far less concern, and much clearer views, were expressed by the Fund on members' adjustment programs than on exchange rate policies.

Finally, Mr. de Vries expressed support for the proposed decisions. However, it was not with great enthusiasm, for the reasons that he had explained.

Mr. Jayawardena said that in considering the nature of surveillance, it was necessary to be mindful that in reviewing a member's exchange rate and balance of payments outlook, the Fund was in fact reviewing the totality of its policies--domestic and external--whose total impact was reflected in the exchange rate and the balance of payments. Hence, the Fund would have to continue to improve its analyses of domestic policies and their interaction, because those were the factors that ultimately yielded a given external policy. In that respect, he welcomed the recent emphasis on trade policies and the debt profile. He would also like to have a more explicit description or analysis of the structural rigidities that it was said were hampering the orderly development of policies in many countries.

The basic problem with surveillance was the asymmetry between surplus and deficit countries or between members using or not using Fund resources, Mr. Jayawardena remarked. The problem arose when the Fund's assessment was converted into positive action. Even borrowing countries that were expected to take corrective measures needed to be able to develop greater conviction about the wisdom of their choice of policies. The design of programs and the simulation of their impact over the medium term was crucial in that respect. As for the impact of members' policies on the economies of other countries, like Mr. de Vries, he believed that reliance should be placed largely on the quality and comprehensiveness of the Fund's assessments, if surveillance were to be successful.

It might also be helpful if efforts could be concentrated on the major economies of the world, including an assessment of the impact of their domestic policies on all other economies, Mr. Jayawardena continued. For instance, a separate section could be included in the staff reports on the external impact of the policies of the five major industrial economies, on developing countries in particular, if that could be done without eroding the principle of evenhanded treatment of all members. It might also be useful in such an exercise to make a careful simulation of alternate sets of policies over the medium term, as had been done so well in the staff report for the Article IV consultation with Italy. Such simulations, which would no doubt be approximate, would help authorities to appreciate the virtues of different options as well as draw attention to their international responsibilities.

The Article IV consultation procedures might also be made more effective, Mr. Jayawardena suggested, if reference were made in a separate section in the staff report to the Executive Board's views at the time of the previous consultation--as summed up by the Chairman--of the progress made on important policy areas, together with the reaction of the authorities to the Board's views. The Fund's dialogue with member countries might thereby be improved and surveillance made more effective.

Finally, on the question of evaluating exchange rates, and the related information notice system, Mr. Jayawardena reiterated the view of his chair that real and effective exchange rate calculations were subject to several conceptual and practical limitations. While the usefulness of those calculations should be improved, they should be interpreted flexibly in prescribing policies. He welcomed the proposal to improve the data base of countries in order to fulfill that task. The threshold of a 10 percent exchange rate change for issuing a notice could be retained, subject to the above qualification. It might also be opportune for the Fund to hold a few seminars with officials from member countries who had to work on the type of statistics required so that the Fund could understand the problems involved, while at the same time, the Fund itself would have an opportunity to explain the rationale behind its own endeavors.

Mr. Coene considered that the staff had evaluated adequately all aspects of the Fund's surveillance activities. While he recognized the difficulties involved in evaluating an appropriate exchange rate, in the broad as well as in the narrow sense, his chair felt that the Fund should attempt to make a frank and clear judgment about the rate if surveillance were to have any meaning. Much had been done to improve the assessment, and the Fund's surveillance activities had intensified over the recent period. Efforts to improve Fund analysis and deepen Fund understanding of the exchange rate issue would, however, have only a limited effect if the recommendations formulated by the Fund did not lead to a greater convergence of policies, particularly in the major industrial countries.

As a first step, Mr. Coene continued, clear, precise, and frank analysis of the exchange rate might improve members' understanding of the Fund's recommendations, and thereby perhaps lead to a greater convergence of views and policies. Basically, greater exchange market stability was a matter of how to make economic policies more responsive to external requirements. That kind of responsiveness would be greatly enhanced, particularly on the part of reserve currency countries, if policies could be made more dependent on the obligation to settle payments imbalances to some extent. For that to happen, a basic requirement would be for the Fund to agree on the establishment of mutually consistent equilibrium exchange rate zones, which would also be consistent with the international adjustment process. Analysis of underlying payments positions, as described in detail in the papers prepared by the staff for the January seminar, was a first step in that direction. The analysis should be further elaborated in order to arrive at clear judgments about equilibrium exchange rates.

The use of alternative medium-term scenarios for the major countries might also be of significant help in assessing exchange rate issues, Mr. Coene considered. The more effective implementation of the Fund's surveillance would depend on concentrated efforts to obtain an improved policy response. He fully supported Mr. de Vries's suggestions in that respect. He could also support most of the suggestions made by the staff, although some of them did not, in his view, go to the root of the problem. While it was fully appropriate to analyze trade issues and protectionism, the Fund should not forget that they were manifestations of the existence of inadequate exchange rates. It would be more productive for the Fund to try to bring exchange rates closer in line with their equilibrium rates than to deal with the consequences of inadequate rates.

In conclusion, Mr. Coene supported the proposed decisions. In making the implementation of its surveillance more effective, the Fund should concentrate on procedures to improve the response of member countries to its recommendations, particularly that of the major industrial countries.

Mr. Delgadillo commented that he also concurred with the thrust of the staff papers and had no difficulties in accepting the staff conclusion that the principles of surveillance remained broadly acceptable and that difficulties in their implementation did not call for their revision.

The domestic policy actions of member countries, or sometimes the lack of them, did have important consequences for the international community, Mr. Delgadillo continued. Swings in exchange rates, high interest rates, large fiscal deficits, and protectionist measures constituted examples of problems that had adverse effects on many countries. The undesirable incidence of those problems had indeed made the Fund's role in overseeing the international monetary system more important. The real question was whether the Fund's performance of that role had so far eased those problems or led to any improvement in overall conditions in the monetary system. There was no simple answer to that question. If the Fund were to strengthen its surveillance activities, a number of prerequisites would have to be met: first, it would have to be more widely realized that true international cooperation meant avoiding the continuation of an economic and financial environment and/or the adoption of policy actions that had an adverse impact on other countries; second, Fund management and staff would have to continue their efforts to identify, analyze, and discuss problem cases; third, member countries would have to respond positively to situations that clearly needed correction.

Exchange rate stability among major-currency countries was one important criterion for evaluating the international consequences of internal policies, Mr. Delgadillo stated. The Fund's assessment of exchange rate developments and of the need for policy coordination continued to be an important task. The presence of factors that had increased the difficulty of detecting problems pointed to the need for further improvement in the methods being used at present. Perhaps the analysis could be expanded to consider in more detail the intricacies of relationships among fiscal, monetary, interest rate, and exchange rate policies. Of particular importance, apparently, was the connection between fiscal policy and exchange rate developments in some major-currency countries. That most undesirable exchange rate developments had taken place owing to unbalanced or insufficiently effective domestic policies, indicated clearly that there was much room for improvement in the policies of many of those major-currency countries. Fiscal and monetary disruptions should be emphasized along with the traditional aspects of exchange rate instability.

He was in basic agreement with the staff, Mr. Delgadillo went on, that if the adjustment efforts of developing countries were to be successful in the medium term, it was essential that there be a significant improvement in the external environment in which those countries operated. The adjustment process would have to be supported by a reduction in real interest rates and in protectionist tendencies, and by the avoidance of action by larger member countries that provoked adverse global consequences. A relevant question in that connection, which had been discussed on previous occasions in the Executive Board, was how to implement surveillance more effectively in countries that did not make use of the Fund's resources. Clearly, more needed to be done to obtain a response from member countries to the recommendations made in Article IV consultations. He fully endorsed the staff view that "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," and that the growth potential of developing countries hinged on the solution of that problem.

Referring to the implementation of surveillance, Mr. Delgadillo considered that it might be useful, in future staff reports, to include an account of the Fund's recommendations that had actually been implemented by major member countries. He welcomed the increase in the number of staff reports for Article IV consultations. The coverage of those reports appeared to be reasonably comprehensive. Issues regarding the exchange rate were adequately highlighted, but there was some room for improvement both with respect to internal indebtedness and protectionism. With respect to the former, expanded coverage in a number of cases could include forecasts of the components of the balance of payments. As for the latter, he welcomed the expanded coverage of trade policy matters. However, as Mr. Kafka had pointed out, there was a need to specify more clearly the essential data; similarly, specific policy recommendations to reverse protectionist tendencies should be made. In general, he looked forward to the implementation of the staff's plans to improve its reporting, as outlined on page 24 of SM/84/44.

Referring to the present practice for specifying consultation cycles, Mr. Delgadillo added, he could support the suggestion that the Executive Board should be provided with a brief written report whenever there were unavoidable delays. Nonetheless, he was somewhat worried about other implications of the current practice because of the work load being imposed on the staff. If the quality of the consultations, and hence of the Fund's surveillance activities, were to be maintained, some of the adaptations cited in the report might prove to be counterproductive. For instance, shortening, simplifying, or eliminating reports on recent economic developments would deprive the Fund and its members of useful and sometimes crucial information on economic and financial matters.

Finally, Mr. Delgadillo observed, he was in a position to express the satisfaction of his constituency with the progress being made in implementing the information notice system. The threshold of 10 percent for changes in real effective exchange rates seemed adequate and should therefore be maintained for the time being. Again, he supported the improvements that the staff envisaged making in the system by expanding its coverage and the data base.

The Executive Directors agreed to continue their discussion in the afternoon.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/84/38 (3/9/84) and EBM/84/39 (3/12/84).

2. ADMINISTRATIVE BUDGET FOR FY 1984 - ADDITIONAL APPROPRIATIONS AND TRANSFER OF APPROPRIATIONS

The Executive Board approves the proposals set forth in EBAP/84/45 (3/6/84).

APPROVED: August 29, 1984

LEO VAN HOUTVEN
Secretary