NOT FOR PUBLIC USE

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/55

3:00 p.m., March 28, 1983

J. de Larosière, Chairman
W. B. Dale, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	W. B. Tshishimbi
J. Anson	
J. de Groote	H. G. Schneider
	A. Le Lorier
	J. Delgadillo, Temporary
R. D. Erb	C. Dallara
M. Finaish	
	I. R. Panday, Temporary
T. Hirao	T. Yamashita
R. K. Joyce	
A. Kafka	
G. Laske	G. Grosche
	C. P. Caranicas
R. N. Malhotra	
Y. A. Nimatallah	J. E. Suraisry
J. J. Polak	T. de Vries
	K. G. Morrell
G. Salehkhou	O. Kabbaj
F. Sangare	E. I. M. Mtei
	J. L. Feito
J. Tvedt	A. Lindø
Zhang Z.	Wang E.

L. Van Houtven, Secretary
R. S. Franklin, Assistant

Also Present

African Department: F. d'A. Collings. Asian Department: I. Otani. European Department: B. Rose, Deputy Director; A. Knöbl, S. Mitra. Exchange and Trade Relations Department: C. D. Finch, Director; W. A. Beveridge, Deputy Director; S. Mookerjee, Deputy Director; D. K. Palmer, Deputy Director; G. Belanger, J. Berengaut, S. Eken, H. W. Gerhard, G. G. Johnson, S. Kanesa-Thasan, R. Pownall, P. J. Quirk. Fiscal Affairs Department: V. Tanzi, Director. Legal Department: J. G. Evans, Jr., Deputy General Counsel; W. E. Holder. Middle Eastern Department: K. Nashashibi. Research Department: W. C. Hood, Economic Counsellor and Director; C. F. Schwartz, Associate Director and Director of Adjustment Studies; R. R. Rhomberg, Deputy Director; J. Artus, M. D. Knight. Secretary's Department: J. W. Lang, Jr., Deputy Secretary; A. P. Bhagwat. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer. Bureau of Statistics: A. C. Bouter, J. B. McLenaghan. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Director: S. R. Abiad, A. A. Agah, J. R. N. Almeida, C. J. Batliwalla, H.-S. Lee, P. D. Péroz. Assistants to Executive Directors: E. M. Ainley, H. Alaoui-Abdallaoui, L. Barbone, J. Bulloch, L. E. J. Coene, T. A. Connors, A. Halevi, J. M. Jones, M. J. Kooymans, P. Leeahtam, W. Moerke, V. K. S. Nair, Y. Okubo, J. K. Orleans-Lindsay, J. G. Pedersen, M. Z. M. Qureshi, J. Reddy, D. I. S. Shaw, H. Suzuki, P. S. Tjokronegoro, Zhang X.

1. SURVEILLANCE - REVIEW

The Executive Directors continued from the previous meeting (EBM/83/54, 3/28/83) their consideration of a staff paper on the annual review of the implementation of surveillance (SM/83/43, 3/1/83; Sup. 1, 3/21/83; and Cor. 1, 3/22/83).

Mr. Polak remarked that, while it was important to discuss the procedures relating to the implementation of surveillance in an annual review, his main concern was with the results of surveillance. His colleagues would no doubt generally agree that surveillance had not been very effective, especially as far as the major countries were concerned. In June 1982 certain arrangements had been made for more intensive multilateral surveillance among the five major countries, but little had been done under those arrangements, and he saw no real evidence of the stable system of exchange rates that was the objective of Article IV, Section 1, of the Articles of Agreement. The Fund should concentrate on ways of improving surveillance itself rather than introducing more or different procedures for its implementation.

While agreeing that protectionism and external debt were important subjects, he continued to feel that the primary focus of surveillance should be on exchange rates, Mr. Polak said. Pages 9-11 of the staff paper, however, devoted far more attention to protectionism and external debt than to exchange rates; the very brief section on experience with exchange rates, while outlining the special procedures adopted in the case of Sweden, made no reference at all to the problem of the undervalued yen and the overvalued dollar.

On the stability of exchange rates, three separate problems should be considered, Mr. Polak continued. The first was the increasingly serious risk of competitive devaluations. The second was the failure of countries to make timely adjustments in the exchange rate in the face of a rate of inflation that was much higher than that experienced in the rest of the world. The consequence of that failure for any country was an overvalued currency, an increase in restrictions, and then the need for sudden large adjustments. The third problem was the tendency of some countries to rely too much on continuous exchange rate adjustment without any effort to adjust the cost and demand mechanism. While such an approach did not necessarily lead to undervaluation or overvaluation of a member's currency, it did promote instability in the system.

In the past, the Executive Board had paid a great deal of attention to surveillance procedures other than regular country consultations and had, after much debate, introduced a number of new ones, Mr. Polak commented. However, those procedures had not been used to any great extent; most of them had been designed to deal with situations in which the period between consultations might exceed one year; the real problem was with annual consultations--particularly those with the major countries--which produced very little effect. The procedures also did not cover the problem of delayed consultations in cases in which the Fund's attention to a particular country would be useful. At times there seemed to be a direct correlation between a postponement of the consultation and a country's problems, and procedures were needed to deal with those cases. In the circumstances, he welcomed the staff proposal for a stricter schedule of consultations--which meant annual consultations with the great majority of countries--and for a decision to be taken at the time of a consultation on when the subsequent consultation would take place. An effort should then be made to hold to that date unless an overwhelming case for extending the period could be presented. For his own country, the Netherlands, two years had elapsed between the two most recent consultations because the staff had been unable to mount a mission on the normal 18-month schedule. The Netherlands would be happy under the changed procedures to move to annual consultations.

He was also in favor of the various proposals for reducing the amount of paperwork required for consultations, Mr. Polak remarked. For the time being, he saw no difficulty in eliminating annual reports on recent economic developments, so long as appropriate supplements could be issued on an annual basis. Also, there seemed to be a case for combining consultations with discussions on the use of Fund resources; in that regard, he tended to agree with Mr. Anson that, when the use of resources discussion was a review of an arrangement, it might be appropriate to combine it with the Article IV consultation; however, when a new request for use of Fund resources was being brought to the Board, it would be better to hold the Article IV consultation discussion first. The amount of time spent in Board discussion of consultations might be usefully reduced as well; Executive Directors would probably take the consultation process more seriously if interventions consisted of short, pertinent statements rather than a long and repetitious catalogue of information already included in the staff reports.

Regarding proposed changes in the notification procedure, Mr. Polak considered that pegging countries should continue to notify the Fund of exchange rate changes. When the changes were large, a staff paper on the matter should be produced, and Directors should discuss in the Executive Board whether the exchange rate change was justified and what accompanying measures the country had been taking. Management would continue to have the prerogative of calling for a special consultation if that seemed warranted.

An entirely separate issue was whether there was any way to select from the data available in International Financial Statistics (IFS) those exchange rate changes that indicated possible distortions in exchange rates, Mr. Polak said. Whatever approach was taken in that regard should relate to both fixed and floating rates and should cover changes in rates as well as situations in which there was no change in nominal rates but where the real effective rates moved sharply; i.e., the procedure should involve changes in prices as well as changes in rates. While he was willing to go along with something similar to what the staff had proposed, he was concerned that the staff approach perhaps reflected an excessive confidence in purchasing power parity and, for that reason, it should be adopted only on an experimental basis. He would nonetheless accept the indication of the price level that the staff had suggested, despite the recognition by all that it was not the only or optimal one available.

Another difficulty he had with the staff approach was the proposal to take as a reference point the most recent consultation, Mr. Polak said. A consultation held in April was usually based on a paper prepared in, say, January and containing statistics through October; thus, the starting point for different countries could never be uniform or precise. Moreover, as a matter of principle, he could not accept a consultation as a kind of "absolution," which wiped clean the past record of a given country and allowed it to start from scratch. The Executive Board had held a number of consultations--for example, those with Japan and the United States--in which Directors had been dissatisfied with the exchange rate; and he saw no reason why such consultations should serve as a starting point. A more practical and unpretentious way of dealing with the matter might be for the staff to produce a quarterly paper containing indices of real exchange rates for as many countries as possible, flagging those countries whose exchange rates had changed in one direction or another by, say, at least 5 per cent or 10 per cent. The paper could also contain a brief discussion of those cases that had been flagged, perhaps including recommendations for further action or an indication that the change had been nothing more than a correction of developments that had taken place in recent years. With the approach he had suggested the principle of equal treatment for all countries could be observed; at the same time, the system would serve to alert the Executive Board to possible exchange rate deviations without placing a great burden on the staff, whose main work should be devoted to individual countries.

Mr. Nimatallah considered that the need to improve surveillance procedures had become increasingly urgent in recent months. The hoped-for sustained recovery in the world economy had not yet materialized, and exchange rates for the major currencies continued to demonstrate substantial short-term volatility. International trade was subject to growing protective barriers, and many countries continued to face serious debt problems. That somber picture suggested that the Fund's surveillance activities had not yet encouraged members to live up to the obligations set out in Article IV, Section 1. Hence, the Board needed to consider how Fund surveillance could be improved and strengthened so that it could become more effective in reducing the problems he had outlined, particularly those related to the volatility of exchange rates.

Generally speaking, Fund surveillance could become more effective only with the full cooperation of the entire membership, Mr. Nimatallah continued. Members must be prepared to discuss their policy choices with the Fund and to take account of the international implications of those choices. Moreover, members should not expect too much too soon. The exercise of surveillance was still in an early stage of development, and progress would inevitably be slow; however, the 1977 decision on surveillance and the amended Articles of Agreement provided a reasonable framework that could be adapted in the light of experience. It was essential that any changes or adaptations in surveillance procedures--together with the Fund's policy advice stemming from them--should apply uniformly to all members.

The specific proposals in the staff paper represented a constructive and pragmatic attempt to close the gaps that had emerged under the current procedures, Mr. Nimatallah noted. Article IV consultation reports for all countries--not just those using Fund resources--should include more extensive and forward-looking analysis of the external debt situation. In present circumstances, such analysis was essential if the Fund was to be in a position to help to prevent potential debt crises. Also important were the related moves by the Bureau of Statistics to improve the availability of debt information and the efforts of the Central Banking Department to provide technical assistance in monitoring debt flows. In addition, the Article IV consultation papers should focus more on trade policy. The Fund should stand firmly against protectionist pressures; in that regard, he welcomed the proposed closer contacts with the General Agreement on Tariffs and Trade (GATT) and looked forward to the forthcoming study on the effects of exchange rate fluctuations on international trade, a study which should provide valuable guidance for the Fund's future surveillance activities.

An effort should be made to improve both the frequency and timing of Article IV consultations, Mr. Nimatallah considered. In 1982, the number of completed consultations had fallen far short of the 75 per cent target; and recently the average consultation cycle had lengthened to 20 months. More frequent consultations would be desirable because they could provide an additional means for early warning of potential problems. It was clearly important to hold annual consultations with the major countries and with those countries experiencing or more likely to experience problems. He hoped that delays could be kept to a minimum and that members would cooperate to the fullest extent possible in scheduling Article IV consultation missions. It also seemed sensible to have a less strict two-year cycle for small members that were not using Fund resources, although it would be important not to lose contact with those members, particularly since problems could arise quite quickly. The two-year consultation schedule should therefore be supplemented by informal contacts with those members, including staff visits and technical assistance missions in the off years.

Ideally, Mr. Nimatallah said, there should be annual consultations for all members with Fund programs. In practice, however, such an approach would impose a heavy burden on the staff unless a significant increase in the number of staff was contemplated. Since the Executive Board in any event had the opportunity to review the economies of such countries at regular, 6-month intervals, it might be more sensible if Article IV consultations with program countries could be held, say, every 18 months. Such a schedule would help to ease the pressures on the staff and the Executive Board without unduly weakening the surveillance process.

The proposals to extend or adapt current practices in order to ease the work load on the staff and the Executive Board seemed necessary and sensible, particularly as there was little prospect for a decline in the volume of country work in the foreseeable future, Mr. Nimatallah noted. It would of course be better to have separate missions and reports for Article IV consultations and requests for use of Fund resources; however, there was some merit in combining them. While such an approach might not be practical in all cases and should, as at present, be left to the discretion of management, the combination could make an important contribution to a more efficient use of Board time on country items. Even with the improvements he had suggested, there might be a case for increasing the size of the staff if the Fund was to adhere effectively to its new guidelines. Perhaps that issue could be reviewed on the occasion of the Executive Board discussion on the Administrative Budget for the financial year 1984.

Finally, regarding the staff's request for guidance on the issuance of information notices on large changes in real effective exchange rates, Mr. Nimatallah remarked that the idea clearly required more thought before it could be put into practice. Still, his preliminary reaction was that such notices could improve existing procedures. The current provisions for special or supplementary consultations were rarely invoked, and it was also rare to have separate Board discussions on exchange rate changes; moreover, when such discussions were held, it was difficult to avoid a crisis atmosphere, and legitimate concerns had been raised about equal treatment of members. Information notices would have the advantage of making those elements of Fund surveillance more routine, particularly if they included a short factual analysis linking the change in the exchange rate to the most recent staff paper and Board discussion on the country concerned. If that procedure were to be adopted, he would see merit in a higher, rather than a lower, cutoff point, which would direct the Board's attention to significant changes. It should be borne in mind, however, that the procedure should be applied uniformly to all members, whatever their exchange arrangements. In sum, since the staff proposals provided a useful framework for strengthening the current surveillance procedures, he could support the proposed decision.

Mr. Erb noted that the staff paper, which addressed a number of important issues and made several useful proposals, illustrated that progress was being made in the development of the Fund's surveillance activities; however, more needed to be done. The staff's suggestions for clearing the backlog of Article IV consultations seemed generally appropriate; and, once the backlog had been cleared away, there should be strict adherence to the consultation schedule, with a maximum three-month grace period. Consultations should be held on schedule even if the member was engaged in negotiations on the use of the Fund's resources or was in the process of formulating new policies; indeed, consultations would be most useful prior to or during the development of new policies. If it was not possible for the staff to describe the policy intentions of the authorities in certain consultation reports, it should concentrate on an analysis of the economic situation and an assessment of the needs for policy action.

He agreed with the proposal that the target date for the next consultations should be defined in the summing up of the most recent consultation discussion and he could endorse the suggestion that there should be periodic reports on the status of consultations, Mr. Erb continued. The reports could incorporate a list of all Fund members, indicating the dates on which the most recent consultation had been completed and flagging those cases for which consultations had been delayed beyond scheduled dates. When an Article IV consultation had not taken place for more than one year and a country was seeking to use Fund resources, the consultation should be completed before a request for use of Fund resources under a stand-by or extended arrangement was brought to the Executive Board. While he understood the arguments for combining consultation and use of Fund resources missions, he remained concerned that the Fund might lose some of its ability to conduct a detached and critical analysis of a government's policies if it did not step back periodically and hold a separate Article IV consultation. Hence, combining consultations with requests for use of Fund resources should be the exception rather than the rule. For those countries not on an annual consultation cycle, a two-year gap between consultations would seem to be acceptable, although it might be desirable if a mini-consultation were held at least once a year; then, if the staff found major changes in a country's economic circumstances, a full-scale consultation could be initiated.

The staff had suggested that it might not be essential in some cases during 1983 to issue full-scale reports on recent economic developments, Mr. Erb recalled. He recognized that some flexibility in the handling of the reports might be necessary; however, it should be remembered that, while their production absorbed scarce staff resources, the reports on recent economic developments did provide valuable information that enriched the understanding of economic developments and policies in member countries. It would be undesirable if they were to be produced only biennially for countries on the 12-month cycle, although some experimentation with selected topics and the usual tables might be appropriate. On a related point, he proposed that Article IV consultation papers and documents supporting requests for use of Fund resources under stand-by or extended arrangements should contain a table of contents, with a list of charts and tables, especially if the reports were to be expanded to include more material on debt, trade policies, and other issues.

Regarding the content of Article IV consultations, Mr. Erb considered that debt issues should be given fuller treatment, with particular emphasis on the compilation of better data from both country and noncountry sources. Recent experience showed that information about the size and structure of the external liabilities of individual countries was incomplete; he could therefore support the major effort currently under way to improve the coverage and timeliness of banking data. The financial difficulties of many countries indicated that external debt positions and changes in those positions should be an integral part of the analysis of the sustainability of a country's balance of payments position. Greater attention should thus be paid to short-term indebtedness. In addition, in order to provide a complete picture of a country's external balance sheet, more detailed information and analysis should be provided on each country's external assets, including official reserve holdings.

It was also necessary to improve the scope, consistency, and timeliness of economic and financial data collected and reported for each country, Mr. Erb stated. Where possible, information should be provided on planned government expenditures and revenues as well as on monetary targets. Such data were vital not only for analyzing the economic performance of an economy and the effectiveness with which it was using its external resources, but also for making judgments regarding future borrowing requirements and debt servicing capacity. More systematic analyses should be provided in all consultation reports on the medium-term prospects for an economy and its balance of payments, with attention paid to the domestic and external implications of the policy path being followed by the authorities. Although quantitative projections or simulations were helpful by themselves, it would be even more useful if they were supported by qualitative assessments of the major unknowns or uncertainties--either positive or negative--facing the economy and the country's balance of payments together with an indication of the policy and structural changes that might be necessary for the country to remain in or move toward a sustainable payments position.

Greater attention should also be paid to an individual member's trade policy, with special emphasis on those countries that had extensive trade subsidies or restrictions or had significantly increased such subsidies or restrictions, Mr. Erb said. In addition to having an effect on the global adjustment process, such policies affected resource allocation and a country's growth potential; in that respect, the close look at trade policy should not be limited to industrial countries.

Turning to more general issues concerning multilateral surveillance, especially in the context of the World Economic Outlook exercise, Mr. Erb urged that a greater effort be made to improve the coordination--if not the integration--of the Article IV consultations of major currency countries. It might be desirable to prepare on a more regular basis--perhaps in the context of the World Economic Outlook exercise--a single document analyzing the interrelationships and implications of policies and prospects in the major currency countries. Such a document could form the basis for an Executive Board session devoted solely to a discussion of the issues brought out in that paper. Current discussions on the World Economic Outlook covered such a wide range of issues and developments that critical issues concerning the interrelationships among the policies of the major currency countries received inadequate attention.

The Executive Board should engage in more frequent discussions of economic and exchange rate developments as well, perhaps based on oral presentations by members of the staff who were following current developments in the countries involved or who were following exchange market developments generally, Mr. Erb continued. Although exchange rate developments among the major currency countries deserved special attention, a closer look should also be taken at those of other countries of special concern to the staff. On a related point, it would be appropriate for the Executive Board to discuss the recent realignment of the European Monetary System, and he agreed with Mr. de Groote that the recently completed exchange market intervention study should be released. He could support the view of Mr. Anson that, in future, the Fund should conduct more work on exchange market intervention; in that connection, governments should make available to the Fund the detailed intervention data necessary for such analyses.

Although there was a tendency to blame growing protectionism on exchange rate developments, the relationship between the two elements was too complex to warrant such an assertion, Mr. Erb considered. Indeed, it might be more appropriate to state that restrictive trade measures and trade subsidies had had an adverse impact on exchange rates rather than vice versa. He hoped that the issue would be dealt with in greater detail in the paper to be prepared for the GATT regarding the impact of exchange rate fluctuations on international trade.

There should be more explicit and systematic discussions by the staff and the Executive Board regarding the analytical framework used to assess different economies and their interaction, especially their linkages through the exchange and financial markets, Mr. Erb said. As he had noted in the context of a number of Article IV discussions, the Fund did not have a consistent or complete analytical and empirical framework for evaluating the domestic and international consequences of a government's expenditure, revenue, and borrowing policies--including the impact of government borrowing; the level, the rate of change, and the composition of expenditures; and the level and structure of taxes. More analytical work was also needed on the relationship between monetary policies and exchange rates. While policy judgments should be made in the light of current knowledge, however incomplete, it was important for Directors continually to remind themselves of the analytical and empirical gaps and to devote a greater effort to closing them.

The Fund should be at the cutting edge in advancing the state of knowledge, given the breadth of data, analysis, and experience acquired by the Fund in the course of its surveillance activities, Mr. Erb stated. Illustrative of the lack of analytical precision applied during the previous two years--and repeated often in the staff papers--was the concept of "appropriate policy mix," which was based on the questionable notion that different combinations of fiscal and monetary policy--mainly in the United States--could accomplish the same inflation objectives without having "major disturbing effects on exchange rates." The concept had also been used by countries calling for different and often conflicting specific policy responses by the United States. If anything, the multiple and conflicting ways in which the policy prescription had been advocated tended to divert attention from more valid criticism of U.S. monetary and fiscal policy. Another expression that seemed to have little analytical or operational content was the phrase "room for maneuver," which seemed to whitewash rather than elucidate specific policy issues and choices. It would be better in the future to avoid those concepts that were not analytically precise and that could be interpreted or applied in different ways.

On a related point, Mr. Erb noted the proposition in the staff paper stated that "the principles of surveillance imply that...members will take into account the interests of other members." While the idea was a laudable one, he had difficulty determining what it meant. What was to be done if policy actions necessary to achieve some longer-term objective desired by other countries tended to create short-term difficulties for them? What if the policy actions of a country were consistent with the interests of one group of countries but not another? Such questions needed to be addressed more explicitly in future surveillance discussions, especially those concerning countries with large and diverse economic relations with other countries. As had been noted during the previous year's discussion of surveillance, the specific policy advice offered to the United States by other members through the Fund had often been quite diverse. Finally, in addition to examining the policies of the industrial countries in the context of the World Economic Outlook exercise, it would be desirable to examine policies and developments in a number of the major developing countries and to assess their impact on world trade and activity.

Turning to the specific procedures for surveillance suggested in the staff paper, Mr. Erb took note of the proposal that the Fund staff should notify the Board of all "large" changes in real effective exchange rates or, in other words, of large changes in competitiveness. If adopted the procedure would involve a notification of real exchange rate changes--whether appreciations or depreciations--greater than a specified numerical threshold. Such a symmetrical approach was a positive feature of the proposal, especially since the experience of the past few years suggested that many countries created exchange rate problems by allowing their real effective exchange rates to appreciate; at the same time, there was growing concern about the prospect of competitive devaluations. The staff had labeled a number of the difficulties relating to its proposal--including the level of the numerical threshold, the relevant starting point from which to measure the real effective exchange rate change, and the measurement of changes in competitiveness--"technical," but they were by no means minor, since the choice of threshold, indicators, and base periods could produce wide differences in judgment about whether a problem existed.

There were also some limitations to the staff proposal that the document did not consider, Mr. Erb said. First, the approach was implicitly based on the idea that exchange rates should be primarily determined by purchasing power parity calculations; however, exchange rate theory and past experience suggested that permanent and substantial changes in real exchange rates might be a more appropriate measure. Also, the range of data available to calculate purchasing power parity suggested that the concept was not an objective indicator. In practice, an exchange rate change might be justified by overall balance of payments considerations stemming from exchange rate pressures arising in either the current or capital accounts, even when real exchange rate calculations did not "justify" the size of the rate change. For example, if the financing available to match a current account deficit was reduced, then a smaller deficit--brought about by a real exchange rate change and not justified by competitiveness calculations--would be needed.

Despite his somewhat critical comments on certain aspects of the proposals, Mr. Erb continued, he continued to believe that it was desirable to develop analytical tools for conducting the Fund's surveillance responsibilities. However, before deciding on whether to adopt and apply some index of competitiveness on a regular basis, further analysis would be appropriate. For example, while the simulations in Supplement 1 to the staff paper were interesting, it would have been more helpful if the staff had also analyzed in retrospect how such indices would have improved the Fund's surveillance activities if they had been available in the past. More generally, surveillance over exchange rate policies could best be implemented by looking at policies on the basis of both quantitative indicators and qualitative judgment, as provided for in the Principles of Fund Surveillance. Those principles set forth a number of areas in which developments might indicate the need for discussion with a member: protracted large-scale intervention in one direction in the exchange market; unsustainable levels of official or quasi-official borrowing or excessive or prolonged short-term official or quasi-official lending for balance of payments purposes; and the introduction, substantial intensification, or prolonged maintenance for balance of payments purposes of restrictions on--or incentives for--current transactions or payments. Some of those factors suggested other types of indices that might be developed and applied on a more systematic basis to all countries.

The staff should continuously monitor economic and financial developments in member countries with the aforementioned principles of surveillance in mind, Mr. Erb remarked. When developments that "might indicate the need for discussion with a member" were present, staff and management should consider whether they were serious enough to warrant the initiation of discussions. In some cases, the discussions might lead to a special consultation with the member, although that should not in any way be interpreted to mean that the member was not observing the principles of surveillance. What was important was that the consultations could provide an early opportunity for review and discussion of the member's economic situation. In that context, he welcomed the use of special consultations as a means of strengthening the Fund's surveillance activities and enhancing the usefulness of the surveillance process by making it more timely. In order to facilitate prompt consultations where appropriate, the supplemental surveillance procedure agreed to in January 1979 (Decision No. 6026-(79/13) might also be used more frequently. As indicated by the staff, that procedure provided for the initiation--informally and confidentially--of discussions with a member if the Managing Director considered that "a modification in a member's exchange arrangements or exchange rate policies or the behavior of the exchange rate of its currency may be important or may have important effects on other members."

In sum, Mr. Erb concluded he would welcome a more active use of the special consultation procedure on the basis of the principles of Fund surveillance as well as on the basis of the broad interpretation of what was encompassed in "exchange rate policies" underlying Article IV of the Articles of Agreement. Both special and ad hoc consultations under the supplemental procedure must, of course, continue to be handled with great caution and confidentiality, paying due regard to the circumstances of members. However, if the approach were used effectively, the procedures under discussion could lead to a better implementation by the Fund of its surveillance responsibilities.

Mr. Tvedt reiterated the emphasis that his chair had on previous occasions attached to the development of measures or methods aimed at strengthening the surveillance activities of the Fund. There was an urgent need to intensify the surveillance process because of continued wide short-term exchange rate fluctuations, the risk of competitive devaluations, tensions in the international capital markets, and marked protectionist tendencies. He welcomed the staff's proposal for a more thorough analysis of the debt situation of members within the framework of Article IV consultations.

His authorities could also support the proposal to tighten the rules for the implementation of consultations, Mr. Tvedt continued. It did not seem appropriate to limit Article IV staff reports merely to an analysis of the economic situations of members; great weight should continue to be attached to the description of policy intentions, the inclusion of which should in no way prevent the consultations from being carried out in accordance with the new criteria for their implementation. On the other hand, reports on recent economic developments could be shortened, and in most cases it would be sufficient to prepare them only in connection with every other consultation. In the off year, the staff could provide shorter papers on special aspects or features of economic or institutional developments in the country in question.

With respect to notification procedures, Mr. Tvedt observed that most of his authorities could strongly support the idea of introducing an automatic mechanism requiring notification to the Board of changes in a country's competitiveness in excess of a certain limit. Such an approach would allow the Executive Board to discuss a country's exchange rate policy and economic policy in general in the period between Article IV consultations and would enhance the uniformity of application of the surveillance rules, irrespective of countries' exchange rate regimes. However, that did not mean that conventional methods of measuring a country's competitiveness were sufficient for assessing its exchange rate policy. His Danish authorities, while accepting that it would be desirable to strengthen the surveillance role of the Fund and to ensure greater uniformity of treatment, had some reservations about a trigger mechanism based on an automatic indicator approach. They based their reservations on the view expressed by the staff that "assessments of changes in competitiveness incorporate a significant element of judgment." If a trigger mechanism were to be agreed, however, it should perhaps be activated within the 5 to 10 per cent range.

Despite his authorities' concern for the principle of uniformity of treatment, Mr. Tvedt considered that a case could be made for a continuation of the existing system under which countries with pegged currencies should inform the Executive Board of all nominal exchange rate changes.

His authorities also agreed with the staff that the Fund should not automatically present a preliminary analysis of a country's economic situation at the time the mechanism was triggered, since such an approach could well complicate any subsequent discussions. Still, it would be desirable and useful if the Executive Board were to be provided with some factual and possibly standardized information that could serve as the basis for assessing the need for any follow-up action.

It seemed reasonable that the most recent consultation--whether regular or ad hoc--should be used as the base period for measuring changes subject to the trigger mechanism, since the primary purpose of the trigger was to bring those changes to the attention of the Executive Board between Article IV consultations, Mr. Tvedt commented. In the overall assessment of the economic situation, however, changes in competitiveness and in other relevant indicators over a longer period of time should be taken into account. It was important that the assessment of the exchange rate policy should be based on a comprehensive analysis of the economic situation and economic policy; in particular, the structural situation of a country should be taken into consideration. Finally, he welcomed the apparently renewed efforts of the staff to develop methods to identify inappropriate exchange rates. In that regard, the staff should resume its previous work on underlying current account balances, with special emphasis on data for the later half of the 1970s and the 1980s, on which basis medium-term equilibrium rates could be more easily assessed.

Miss Le Lorier stated that her authorities could fully support a strengthening of the surveillance process and the principle that surveillance should be implemented uniformly, irrespective of the exchange rate regimes chosen by member countries and whether or not they were making use of Fund resources. Before turning to the various suggestions for adapting current procedures for surveillance, she wished to comment on some of the principles embodied in the Fund's April 1977 decision on surveillance, which was to be reviewed no later than April 11, 1984. The paper under discussion (SM/83/43) alluded to the fact that a number of documents would be submitted to the Executive Board throughout the coming year, dealing notably with the difficult question of how to identify cases in which the exchange rate should be viewed with concern because its behavior appeared unrelated to underlying economic and financial conditions. The question of the appropriate scale and incidence of intervention to counteract disorderly conditions in exchange markets also required further study.

The staff had noted that, in practice, there were differences among member countries with respect to the circumstances that constituted the disorder that should trigger intervention, Miss Le Lorier said. It was to be hoped that the study proposed by the participants at the Versailles summit meeting would help to narrow those differences, particularly since there was little doubt that coordinated intervention policies would prove far more efficient than isolated actions. The Fund should certainly contribute to that study with a view to gaining insights that would enable it to formulate more concrete recommendations--other than those related to the mix of financial policies pursued in the relevant country--consistent with paragraphs B and C of the 1977 decision on surveillance. In the view of her authorities, the Fund should recommend firmly that the major countries act in conformity with the principles embodied in the 1977 decision.

Another fundamental feature of the surveillance process was the monitoring by the Fund of the rationale for and effects of changes in individual exchange rates, Miss Le Lorier continued. The special consultation held in 1982 with Sweden had been a welcome manifestation of such monitoring and she hoped that special consultations, together with the relevant staff papers on significant exchange rate changes introduced by members, would continue to develop in the current unstable world conditions. Adjustment could not be achieved through exchange rate actions designed to gain unfair competitive advantage. In that regard, she wished to reiterate the point expressed by her chair on a number of occasions that a study should be undertaken on the consistency of Fund recommendations on exchange rate actions when dealing with countries under Fund programs located in the same region and competing with one another to develop exports.

With respect to the suggested changes in the procedures for the implementation of surveillance, Miss Le Lorier remarked that she could fully support the approach designed to alert the Executive Board in a timely fashion to all large changes in real effective rates irrespective of the exchange arrangements in place. Such an approach raised a number of technical issues, as identified in the staff paper; but those issues should not prevent the Fund from improving the current procedures. A notification process did not need to be associated with a mechanistic interpretation of the information provided, and the criteria chosen to trigger the notification were certainly not the only ones on which the Fund should rely in reviewing real exchange rate changes. In any event, for a notification to lead to a special consultation or the use of the supplemental surveillance procedures, an element of judgment would continue to be required.

Like Mr. Polak, she found the symmetry underlying the proposed approach to notification to be attractive, Miss Le Lorier said. There should be no presumption that no action on nominal exchange rates meant good action; similarly, any positive action on nominal exchange rates should not by itself give rise to international concern. To some extent, the procedures suggested by the staff would defuse the temptation of relying on such simplistic premises. Given the purely informative character that such a notification procedure would have--at least before more reliable analytical tools were developed--she could accept using the most recent Board discussion on the economy as the starting point for measuring the changes in the real rate. The avoidance of any a priori time reference would underscore the purpose of the notification. Nonetheless, she had been impressed by some of the arguments put forward by Mr. Polak on that matter and would be listening with interest to the staff's response.

Regarding the threshold that should trigger notification, Miss Le Lorier considered that the 10 per cent change would be the more practical of those recommended, given the margin for error in any measurement of variations in competitiveness. However, she had no strong feelings on that point and could go along with the consensus of the Board. As to the extent to which the notification of exchange rate changes should be accompanied by staff analyses, her preference was to continue to pursue current practice. Also, her authorities saw no reason why the rules governing the notification of nominal changes for pegged currencies should be amended.

With regard to the scope of Article IV consultations, Miss Le Lorier observed that two subjects were deserving of greater prominence in the implementation of surveillance. The increased attention to be paid to trade policy developments was certainly useful, although it would be important to bear in mind the competence and jurisdictional responsibility of the GATT in those matters; perhaps the Fund should focus its attention mainly on nontariff restrictions and import practices in member countries. The matter of external debt had also begun to receive increased attention in Article IV consultations. Without wishing to prejudge the conclusions that might be reached at the end of the April 6 Board discussion on external debt, she expressed her full and warm support for an increase in technical assistance to member countries in the area of external debt and for the development of a more comprehensive data base in cooperation with other international organizations, which should provide a more efficient early warning system on external debt. In that regard, the Fund should be cognizant of the confidential nature of such data. It went without saying that the new emphasis given to the areas of trade and external debt should not in any respect detract from the essential focus on the assessment of the exchange rate, the consequences of policy mix, and the need for structural adjustment.

On the frequency of Article IV consultations, Miss Le Lorier said that her authorities welcomed the proposal to adhere to a stricter consultation cycle on the basis of current criteria. She had no difficulty with the suggestion for a three-month grace period, which seemed appropriate to deal with unexpected changes, and she could go along with the proposal to specify a target date for the next consultation at the end of the most recent consultation, although she was uncertain that great improvement would result from such advance notice. Finally, she could see that there might be a need for staff increases implicit in the proposal to adhere to a stricter consultation schedule. Hence, when that matter was reviewed on the occasion of the administrative budget discussion, she hoped that a close look would be taken at the possibilities for trimming the number of man-hours devoted to Article IV consultations, either through a change in treatment of the papers on recent economic developments papers or through a reduction in the number of staff members assigned to missions.

Mr. Feito, following the topics dealt with in Section VI of SM/83/43, said that he could fully support the idea of deepening and expanding the analysis of trade policy and external debt issues in staff reports for Article IV consultations. He could also agree with the staff that, after the backlog of overdue consultations was cleared a stricter approach should be followed based on current criteria; and he could go along with the idea of specifying, in the Chairman's summing up of consultations, a target date for the conclusion of the next consultation.

With regard to the contents of staff reports, Mr. Feito considered that the emphasis on analysis of a member's economic situation, however valuable, should not in any way reduce the needed analysis of policy intentions. He agreed with Mr. Erb that, regardless of the circumstances of a member, the staff should attempt to ascertain the probable course of economic policies. Even in the extreme case in which, for whatever reason, information on the intentions of policymakers did not exist, the staff should consider the possibility of describing probable courses of policy action open to the authorities.

While he could support the idea of shortening the papers on recent economic developments, Mr. Feito continued, he did not see a good case for issuing them only every two years. Such reports should aim at analyzing in greater detail those aspects of economic policies that warranted special attention; for example, it might happen that structural changes or institutional reforms had taken place in a particular field of economic policy in a given year, and the report should deal in detail with that branch of policy. Alternatively, the paper should provide detailed analysis of that area of economic policy that was bearing the main burden of adjustment or was leading to problems requiring adjustment. That additional detail could perhaps take the form of appendices, which could then be produced annually, with the full description of the macroeconomic accounts produced every two years.

A system was needed for signaling large changes in real exchange rates that might not be appropriate, Mr. Feito agreed. While he could go along with many of the proposals put forward by the staff in that regard, he did not feel that it was necessary to be concerned with the technicalities of the approach at the present stage. Mr. Erb had made a number of valid comments on certain technical aspects of the approach, although he had not appeared to be quarreling with the idea of providing some system to alert the Fund to potentially inappropriate movements of the exchange rate. The system could have all the positive aspects of the supplemental surveillance procedures while avoiding some of their inconveniences, particularly those related to the initiation of special consultations with member countries. If Executive Directors could accept the scheme for signaling changes in exchange rates in general, the staff could later provide another paper outlining various options for meeting the objectives of such a scheme.

Another area of surveillance in which much improvement was needed was analysis of the balance of payments in a medium-term setting, Mr. Feito remarked. A medium-term time horizon was the only one in which the external debt question could be adequately analyzed in current circumstances. He disagreed with the assertion at the bottom of page 4 of SM/83/43 that "as regards the need for analysis of the balance of payments in a medium-term setting, there has been some progress in recent years, especially in the context of the use of Fund resources, in the application of the concept of a 'sustainable balance of payments structure' as the goal of the adjustment of payments imbalances that the Fund seeks in its consultations with members." He had no knowledge of any Fund document produced in recent years that had been devoted to the elucidation of the concept of "a sustainable balance of payments structure," and he would appreciate hearing from the staff of any publication in which the concept was rigorously analyzed or defined. Perhaps it had been summed up in some internal document that had not been distributed to the Board, in which case he would hope to receive such a document. In any event, the attention of Executive Directors should be drawn to the need to clarify and analyze the concept of a "sustainable balance of payments structure" more thoroughly than had been done thus far.

That concept played a central role in both the design and negotiation of Fund programs and in some cases had been the major point of disagreement between the staff and the authorities, Mr. Feito considered. It should be added that, in such cases, the staff had not had a clear-cut approach to the concept even though the definition of a sustainable balance of payments position should underlie any judgment on the appropriateness of a member's exchange rate. The concept was only the flow formulation of the concept of a "sustainable external debt structure," which was the corresponding stock formulation on which Executive Directors were supposed to comment in the forthcoming discussion on external debt issues. If the staff was going to make any meaningful observations on the external debt of members in future Article IV consultations, it should have some analytical basis on which to do so. In passing, he wished to echo Mr. Erb's comments on the need for more explicit and systematic discussions by the staff and the Executive Board regarding the framework used in the different analyses embodied in the Article IV consultation papers. Special attention should at least be devoted to the subject of a sustainable balance of payments position, with a thorough discussion of the matter in some future Board session.

Mr. Tshishimbi remarked that, while the World Economic Outlook exercise provided a comprehensive framework for a review of the world economy and surveillance, with particular emphasis on the exchange rate policies of the major industrial countries, and the Fund's management played a special role in encouraging members to review their overall economic and financial policies, it was an accepted fact that the Article IV consultation was the best vehicle for the exercise of surveillance over members' exchange rate policies, restrictions, and multiple currency practices. The advantages of conducting regular consultations were clearly explained in the staff paper. The current guidelines and proposed improvements designed to ensure that 75-80 per cent of the membership was covered by a consultation each year should be endorsed, and he could accept the suggestion that a grace period of 3 months should be established to take account of unforeseen circumstances that might arise in scheduling consultations on a 12-month cycle. He had no difficulty accepting the criteria set out in Section IV, 3(a) of the staff paper for the implementation of a strict annual consultation cycle.

For members not on a strict cycle, the average period between consultations should not exceed 24 months, Mr. Tshishimbi continued. Even for members in that category, however, it might be best to hold a consultation somewhat earlier; in that connection, he could agree to the 6-month review period envisaged for members with a Fund program, or contemplating one, and for members considered to be facing more serious problems. In determining the consultation cycle for individual members, there was merit in the proposal to set an approximate target date for consultations on the occasion of the latest consultation discussion. Incorporating the agreed date in the staff report and/or in the Chairman's summing up could be effective in reminding both the staff and the authorities concerned to adhere to the predetermined schedule. For the new procedure to work effectively, members should consider it an obligation promptly to inform the Fund of their intention to suggest a different schedule if their situations called for such a change.

With respect to the procedures for dealing with delays in consultations, Mr. Tshishimbi remarked that the grace period of 3 months in the annual cycle should be used mainly to accommodate delays that were likely to arise because of sudden political upheavals, electoral problems, or protracted negotiations on the use of Fund resources. Like Mr. Laske, he could agree that every effort should be made to urge members that would be tempted to delay consultations because of an ongoing process of formulating new economic policies to hold to the consultation schedule.

The practice of combining consultations with the use of Fund resources missions should be widened in order to help clear the backlog of uncompleted consultations, produce an improvement in the frequency of consultations, and pave the way for adopting the new procedures necessary for a more effective implementation of surveillance, Mr. Tshishimbi considered. During the transitional period, the staff should continue to request information and data for updating reports on recent economic developments while aiming at producing a revised report each year for member countries on a strict one-year cycle and every second year for other countries.

The staff should continue to exercise caution in the treatment of the sensitive question of exchange rates in the Article IV consultations, Mr. Tshishimbi continued. Nonetheless, the views of the staff should be expressed clearly and, in cases where it was evident that exchange rate policies were inappropriate or that rates were being maintained at unrealistically high or low levels compared with the equilibrium rate, the staff should treat the issues involved with the necessary forthrightness. In that regard, the treatment of countries, whether or not they were users of Fund resources, should be evenhanded, and the Fund should take a very clear position in cases where the exchange rate policies of members might have serious consequences for the economies of other countries. On that point, in particular, he could strongly support comments made earlier by Mr. Polak, who had pointed out the lack of information in the staff paper on the dollar/yen misalignment.

On other matters, Mr. Tshishimbi welcomed the intention to expand the coverage of trade policy and to provide more extensive analysis of the external debt situation. Unlike Mr. Polak, he was not worried that the proposed extension of such coverage in consultation reports would be achieved at the cost of an adequate analysis of exchange rate issues. He supported the idea put forward by Mr. Anson that greater analysis should be devoted to the question of private capital inflows in the developing countries, although such an approach should not imply a shift in emphasis away from the review of the policies on official assistance to the less developed countries. The Article IV consultation was an appropriate occasion on which to remind industrial countries of their responsibilities vis-à-vis the rest of the world.

While an effort was being made to widen the focus of staff reports, attention should continue to be paid to keeping the reports as concise as possible, Mr. Tshishimbi said. On a related point, he noted that large portions of the reports on recent economic developments described the institutional settings and basic structure of the economies of members. Since those descriptions should be retained--because they were often the only economic background references for many of the small countries in his constituency--it might not be possible to achieve significant reductions in the size of the reports.

Mr. Sangare observed that the difficult world economic situation in 1982 had highlighted the need for the Fund to be vigilant in exercising its surveillance duties. He was in broad agreement with the proposals in SM/83/43, which reflected the Fund's effort to intensify its surveillance activities through Article IV consultations, the World Economic Outlook exercise, special consultations, and so on. However, it was not sufficient for the Fund to be perceived as exercising surveillance; it was also important that the exercise of surveillance be perceived as effective. It was clear that the Fund was in a position to influence members making use of Fund resources, since the policies of such countries must be endorsed by the Fund before stand-by or extended arrangements were approved. But it was difficult to tell how effective the Fund had been in influencing those members--some of which were very influential in the international economy--that did not approach the Fund for the use of its resources. His authorities considered that it was crucial to the effectiveness of Fund surveillance that the institution, as overseer of the international monetary system, should exercise surveillance on a uniform basis over all members, regardless of their need to make use of the Fund's resources.

The time was right for the Executive Board to ask whether the measures it had been recommending to countries in need of balance of payments support were in fact carrying those countries toward their goals of adjustment, Mr. Sangare considered. While in many countries there were local economic management problems that could be solved by local policy measures--such as the abandonment of subsidies and the adoption of better fiscal policies, exchange rate adjustments, remunerative producer prices, and efficient public enterprises--most problems required longer-term solutions. Perhaps the Fund should review the relevance of its policy prescriptions in light of the evolving international financial environment. For example, it seemed reasonable to question the practicality of asking a country to restrain imports when, at current import levels, food, medicine, and educational materials were not in sufficient supply. He also wondered whether control of the government budget deficit was of much significance in the less developed countries, many of which attempted to bridge the gap through the flow of external financing, in the form either of grants or of long-term low-interest credits. The purpose of the Fund was to provide short-term assistance to members, but it should perhaps be more active in assisting them to mobilize their long-term finances when it was obvious that the Fund's short-term policy prescriptions were not relevant to members' particular situations.

The seminars conducted in the Fund during 1982 had been useful, providing a basis for an exchange of views on some of the more topical issues regarding the application of Fund policies, Mr. Sangare observed. Of particular note had been the discussions on exchange rate and interest rate policies in developing countries and on the Fund's approach to centrally planned economies. It was clear from those discussions that further work was needed before the many questions surrounding such issues could be answered.

The problem of exchange rate volatility in 1982 had been serious, Mr. Sangare considered. Hence, the question of the appropriate scale and incidence of intervention to deal with disorderly conditions in exchange markets had been a major topic in surveillance discussions in the first half of the year. Perhaps the Fund should have undertaken a special study of the matter with a view to clarifying the issues involved and helping members to formulate policies aimed at preventing disorderly exchange market conditions. The staff had made reference to a study under preparation on the efficacy of exchange market intervention as agreed by participants of the Versailles summit meeting in June 1982. He wondered what role, if any, the Fund staff was playing in the preparation of that study.

Noting that the Fund should intensify its efforts to discourage protectionism, Mr. Sangare welcomed the proposal to provide expanded analysis of trade policy in Article IV consultation papers. He also welcomed the steps that the Fund was taking to provide technical assistance to members to improve their data collection and to help them set up an effective means of monitoring external borrowing. Expanded coverage of the external debt situation in consultation reports would also be helpful, although, as was the case with exchange rate policies, the matter would have to be handled with care because the misuse of information could create problems for countries intending to mobilize funds in the international capital markets.

Regarding the frequency of Article IV consultations, Mr. Sangare agreed that it was important to maintain an annual cycle. Nonetheless, he saw many potential problems that could affect the ability of some countries to hold yearly consultations with the Fund; too formal an approach could lead to a situation in which members were forced to seek waivers from the Executive Board to change the dates for consultations. His preference was for a more flexible approach based on the cooperation and understanding of both the Fund and the member concerned.

Finally, while limiting Article IV consultation reports mainly to an analysis of the economic situation--with somewhat less emphasis on policy intentions--might help to ease the work of the staff, it would also be less useful, Mr. Sangare commented. An analysis of the economy might indicate the emergence or existence of a problem, but it was only through knowledge of the policy intentions of the authorities that the Executive Board would be able to determine whether the authorities viewed the situation in the same light as did the staff.

Mr. Kafka agreed that there should be improved surveillance of debt and trade policies and that delays in consultations should be reduced. However, he hoped that the quality and timeliness of staff papers would not suffer because of the effort to maintain a tighter consultation schedule. In that regard, he was concerned about the proposal to issue recent economic development papers only every two years; it might be better to issue most papers every year, perhaps in loose-leaf book form so that they could be appropriately updated.

The staff's proposals for monitoring exchange rate changes were useful because it was important to sound an alert, but the procedures should be implemented in a way that did not create alarm, Mr. Kafka said. On a more substantive point, the purchasing power parity approach to the notification of exchange rate changes could be distorting, as Mr. Erb had shown; hence, he preferred a flagging of all changes of at least 5 per cent. The starting point for such changes should be the most recent discussion of the member's economy, although he recognized the problems raised by Mr. Polak in that regard. The indicators and criteria for judging both qualitatively and quantitatively what was happening with respect to the exchange rate changes should be described in the consultation papers, and the staff should flag nominal changes in the rate, but without prejudice to a member's obligation formally to notify changes in pegging. The staff should also alert the Board to real changes in the rate, even if there was no nominal change. He saw merit in Mr. Polak's idea to provide quarterly or half-yearly statements of real effective exchange rate changes for all members; he was open-minded about whether the flagged changes were accompanied by analyses, so long as a uniform procedure was followed for all countries that had been flagged.

On other matters, Mr. Kafka considered that it would be important to improve procedures with respect to the confidentiality of consultations, particularly in the area of exchange rate surveillance. He did not favor a rule that consultations should precede the discussion of requests for use of Fund resources, since that might hamper the Fund too much in its effort to attend promptly to members' needs.

He had been impressed by some of Mr. Anson's suggestions for broadening the scope of consultations in future, Mr. Kafka continued, but he found it difficult to see the practicality of including GATT personnel on IMF missions. Also, he would not favor the practice of underlining the non-approval of restrictions until a narrower definition of restrictions was established. Finally, he agreed with those who felt it would be important to hire more staff to carry out the Fund's surveillance responsibilities, including both young professionals and more experienced personnel.

Mr. Zhang considered that the staff had made a number of useful technical proposals regarding the implementation of surveillance procedures. The suggestions for providing an extensive analysis of trade and debt problems, undertaking consultations on an annual basis, combining consultation missions with negotiations for borrowing, and shortening the length of recent economic developments papers were all acceptable. As for the problem of surveillance over exchange rate changes, he agreed with the staff that the Fund should exercise surveillance uniformly over all members, irrespective of their exchange arrangements. In that regard, he could accept the proposal to adopt a 5 or 10 per cent change as the numerical threshold for triggering further action. He could also accept any other threshold agreed by the majority of the Board.

While he could support the proposed decision on procedures, Mr. Zhang continued, he noted that the staff report had not dealt with a number of related substantive issues, a full discussion of which might have been appropriate. Two of those issues were recent changes in exchange rates and prospective developments in economically closely linked countries. Recent experience suggested that the issues related to surveillance of exchange rate policies in member countries were not always treated the same way in developed and developing countries. The exchange rate policies of individual developed countries were of course regularly reviewed in consultation reports; however, in spite of those reports, there was a lack of synthesis of interconnected issues. What was needed was a report with a more policy-oriented approach than could normally be undertaken in the World Economic Outlook exercise. Such a report could provide Executive Directors with a properly focused and realistic analysis of the problems and policy issues in the developed countries that would enable the Board to study the impact of those policies on the world economy. Only in that way could the effectiveness of the Fund's surveillance over the developed countries be properly appraised.

Regarding the Fund's surveillance of exchange rate policies in the developing countries--with particular emphasis on the Fund's advice to those countries on changes in exchange rates--Mr. Zhang wondered how the appropriate exchange rate for a country was determined and how the actual numerical value of a proposed devaluation was calculated. He wondered whether, when a devaluation was recommended to a country, its impact on import performance and domestic economic developments was assessed, and whether the particular circumstances of the relevant country were taken into account. He also wondered about the extent to which the views of the authorities affected the final decision and how differences between the Fund staff and the authorities were resolved, particularly in cases where a request for use of Fund resources was being negotiated.

On surveillance of policy developments in economically closely linked countries--such as the group of major industrial countries--Mr. Zhang noted that consultation reports for individual major industrial countries generally did not analyze or focus sufficiently on the interactions of economic policy within the countries or on the impact of policy changes on the world economy. When he had raised a similar point on an earlier occasion, the staff had suggested that such questions were dealt with in the World Economic Outlook discussion; in his view, however, the World Economic Outlook exercise was intended to serve a different purpose, namely, to provide an all-embracing review of the latest data for forecasting prospective developments of world trade and payments balances.

The World Economic Outlook papers and the Board discussion necessarily focused on methods of preparing the estimates, their reasonableness, and their implications for particular countries or groups of countries, Mr. Zhang commented, and the World Economic Outlook exercise was thus not the appropriate vehicle for a careful and exhaustive review of the interdependence or possible conflicts between the policies pursued in economically closely linked industrial countries. What he had in mind was to include in upcoming consultation reports analyses and recommendations on, for example, the recent realignment of the currencies of the European Monetary System (EMS) or on the currently optimistic forecast for a revival of economic activity in the United States in 1983. It might be useful for the staff to discuss such questions as what shifts of policy emphasis might be required in other major industrial countries as a result of the forecast for recovery in the United States. Finally, he hoped that future reviews of the implementation of surveillance could be greatly shortened, particularly if the recommendations were to be limited to procedural changes.

Mr. Hirao agreed with others that a more extensive analysis of the external debt situation might be useful in future Article IV consultation reports. The staff had already made progress in improving the coverage of external debt developments, although more could be done on analysis of debt management policies, which would help to identify the potential difficulties of members at an early stage. He could also accept greater emphasis on trade matters as part of the Fund's opposition to protectionism, so long as the competence and responsibilities of the GATT in that area were kept in mind.

Regarding the frequency of Article IV consultations, Mr. Hirao considered the current criteria to be broadly appropriate. He could agree with the staff that a stricter approach might be important for certain countries, with a more pragmatic approach for smaller and basically stable economies. He welcomed the intention to focus on the possibilities of combining review and consultation missions as well as those missions' reports.

On the proposal for balance of payments analysis in a medium-term setting, Mr. Hirao noted that balance of payments developments depended on a number of uncertain factors, so that any medium-term analysis of those developments would of necessity have to be based on an array of assumptions. Since changes in any of the assumptions could result in a drastic change in outcome, the risk was great that policies based on the analysis might be misguided. Hence, when assumptions were made, they should be clearly presented so that any misleading impressions could be avoided.

With respect to the proposal to provide an information notice on changes in real effective exchange rates, Mr. Hirao observed that there had been various attempts over the years to develop measures to capture changes in international competitiveness. The difficulty was that the indicators tended to vary greatly depending on the deflators adopted, the weights used for calculating real effective exchange rates, and the choice of a starting point. It should also be borne in mind that various factors other than real effective exchange rates were relevant in assessing competitiveness. Those included marketing efforts and responsiveness to changes in consumers' needs, which suggested that great care should be taken in the effort to assess competitiveness.

It was also difficult to evaluate the appropriateness of a given level of exchange rates, Mr. Hirao considered. Current exchange rates were the composite result of a variety of factors affecting the exchange market, including not only trade balances but invisible account changes and capital flows, especially in those countries where capital transactions were fully liberalized. Capital flows reflected interest rate differentials, speculative forces motivated by political developments, and the expectation of exchange rate strength. Given those considerations, his authorities wondered whether the proposed information notice would in fact be particularly helpful to the Fund's surveillance procedures. He was open-minded on the proposed procedure at the present stage; however, if it were to be adopted, the considerations he had mentioned would lead him to prefer a higher rather than a lower threshold for triggering action.

Mr. Salehkhou remarked that the implementation of surveillance had to a large extent been satisfactory in 1982, despite the lower than expected percentage of the membership covered by Article IV consultations and the undesirable time lapses that had arisen between the termination of consultation missions in the field and the discussions in the Executive Board. Surveillance activity in 1982 had included the examination of a number of studies not dealt with satisfactorily in the World Economic Outlook reports, including those on exchange rate and interest rate policies in developing countries, the Fund's approach to centrally planned economies, and the energy crisis and payments imbalances. It had also included a more active public role for the Managing Director, a role that had become necessary in the face of declining world trade and the rising threat of protectionism. Finally, 1982 had been characterized by more active surveillance with regard to the changes in exchange arrangements, outside the examination of general policies under Article IV consultations or the use of Fund resources.

The industrial countries' struggle against inflation had resulted in a deeper international economic recession in 1982 and in a great expansion of unemployment, both of which had encouraged member governments to seek unfair competitive advantages--despite the adverse effects in the medium term of such an approach--and more and more protectionist measures, Mr. Salehkhou observed. A series of recent competitive devaluations had been particularly threatening to the international economy, and the developing countries had, to a great extent, been adversely affected by them. The Fund should therefore be more outspoken in encouraging the industrial countries in particular to adopt more coherent financial policies and to pay greater attention to the effects of their policies on the adjustment efforts of the developing countries as well as on the prospects for world economic recovery.

The Fund's concern with the expansion of external debt, particularly in the developing countries, and the efforts to improve the coverage of debt developments and policies in Article IV consultation reports were important elements in the surveillance exercise, Mr. Salehkhou commented. Particularly welcome was the cooperation between the Fund and other international organizations such as the World Bank, the Organization for Economic Cooperation and Development, and the Bank for International Settlements. The coverage of debt developments in consultation reports should not, however, be confined to reports on users of Fund resources, and no publication or communication of the collected data should take place without the authorization of the relevant country.

Like other Directors, Mr. Salehkhou said, he was concerned about suggestions to lengthen the consultation cycle for some members, particularly for small developing countries. Article IV consultations provided such countries with valuable technical assistance in defining and implementing their economic policies, and the Fund should thus expand its relations with such countries, regardless of their actual or potential use of Fund resources, and should enhance the preventive dimension of consultations. Obviously, such an expansion would require more staff in the area departments, some of which were already hard pressed to cope with the current frequency of consultations.

While he could go along with the proposal to determine the target date for consultations in the Chairman's summing up of the most recent consultation discussion, he continued to believe that flexibility should prevail and that special attention should be paid to members' peculiar conditions and circumstances, Mr. Salehkhou remarked. He doubted the usefulness of issuing a periodic report to the Executive Board on the status of consultations, since it might give the impression that members on the list were not meeting all their obligations to the Fund. The risk of giving such an impression was all the more undesirable, considering that delays in the consultations generally stemmed from special problems of members, and that those problems were in most cases beyond the control of the authorities.

The practice of combining consultation missions with negotiations on the use of Fund resources should be continued and perhaps extended to a larger group of members, Mr. Salehkhou considered. The proposal that aimed at concluding Article IV consultations before the negotiation of programs to be supported by the use of Fund resources would certainly give the staff the benefit of comments by the Executive Directors; however, such a sequence would add to the already heavy work load of the Executive Board and could seriously undermine the Fund's objective of providing timely assistance to members in difficulty. In any event, the proposed sequence seemed to be unnecessary, since most stand-by arrangements provided for at least one review to reassess members' policies under the program.

With regard to proposals related to the notification of changes in the exchange arrangements of members, Mr. Salehkhou observed that an evenhanded implementation of surveillance was very important, and some sort of criteria should be established to ensure uniformity of treatment of all members. However, he was not convinced that the same procedure and criteria should be established for countries maintaining flexible exchange arrangements as for the large number of countries with pegged rates. Those with pegged rates were often developing countries, and changes in their exchange rates tended to reflect movements in the currency to which they were pegged rather than developments in their own economies.

Mr. Finaish stated that he could support the expansion of coverage of debt and trade policies in the Article IV consultation reports. It was particularly important that emphasis be placed on trade developments in the major industrial countries because the increased protectionist tendencies in those countries constituted a serious threat to the expansion of world trade and the success of adjustment efforts by many of the developing countries using Fund resources. The Fund was generally in a position to persuade the users of its resources to accept its advice on trade liberalization; but it was unclear what pressure the Fund could exert on the large industrial countries, and that matter deserved greater attention.

Regarding the frequency of consultations, Mr. Finaish considered that not all countries should necessarily be covered under the one-year cycle. Certainly, the smaller members that were not using Fund resources could be placed on a two-year cycle, which would reduce the number of consultations on the Board's agenda and permit some interdepartmental redeployment of staff during off-cycle years to help out with countries on annual consultation cycles or those requesting use of Fund resources. The "active" countries were unevenly distributed among area departments; hence, in some cases, the frequency of consultations seemed to be based on the availability of staff rather than on a planned schedule. He wondered whether there was any coordination among departments to share staff, including those from functional departments, when the pressure of consultations was heavy.

Another way to ease the burden on the staff might be through a more careful planning of missions other than Article IV consultation missions, Mr. Finaish went on. The Central Banking Department, for example, sent people to visit resident experts, and senior staff in various departments in both the Fund and the World Bank often paid visits to member countries for other reasons. The number of key country officials available for such meetings in the smaller countries was limited, and it might be worth reviewing the necessity and timing of such visits, from the point of view both of the staff and of the country concerned.

On a matter of procedure, Mr. Finaish wondered how the criteria for determining whether a member should be on a one-year or two-year cycle would be decided. It seemed that the issue should perhaps be discussed by the staff and the relevant Executive Director. It would also be useful, particularly for those Directors with large constituencies, for the staff to discuss with them well in advance its scheduling and travel plans. The Executive Directors, after all, were usually in a better position to know the schedules of their authorities and their preferences for meeting times. Such an approach would also help Executive Directors to plan their travel if they wished to take part in the missions, particularly those on the use of Fund resources.

The proposed inclusion in summings up of the target date for the next Article IV consultation might be useful for countries where developments were occurring rapidly that had a significant impact on the world economy, Mr. Finaish said. Clearly, the Board should discuss such developments before they became too serious. However, those countries using Fund resources already had target dates for reviews and additional consultations embodied in the staff paper and in the program itself; hence, the inclusion in the summing up of the target date for Article IV consultations might not be necessary for all countries.

On the notification of exchange rate changes, Mr. Finaish agreed that the objective of evenhandedness in the treatment of members was important. However, the achievement of that objective raised a number of technical issues--some of which had been noted in the staff paper--that needed to be addressed. In the circumstances, some experimentation with the proposed procedures might be useful before a firm decision was reached.

As some speakers had rightly noted, the reports on recent economic developments were very important for some countries, particularly those for which references were limited, Mr. Finaish said. Hence, he would favor continuing with present practice regarding the production of those reports or selectively experimenting with shortened reports in certain cases.

Turning to more general matters, Mr. Finaish observed that, while the Fund's influence was generally clear in the case of members using Fund resources, it was less evident in other cases, particularly the major industrial countries, where the influence of the Board depended upon the willingness of the member to cooperate. The discrepancy in influence seemed to point to the desirability of increased emphasis, in the context of Article IV consultations, on the need for an assessment of policy changes in light of the recommendations made by the Board--and included in the Managing Director's summing up--in previous consultation discussions. Such an approach would make the surveillance exercise more meaningful and effective and would help to promote the principle of uniform treatment of members.

The staff often produced fairly firm conclusions on policy interrelationships and causes and effects of economic phenomena for members that were users of Fund resources, Mr. Finaish noted; but such clarity of assessment was generally lacking in Article IV consultation reports on countries, particularly the large industrial countries, that were not using Fund resources. To the extent possible, such asymmetry should be avoided, and the staff should produce as clear an assessment as was allowed by its analysis, irrespective of whether the country in question was a user or nonuser of Fund resources. In fact, clearer conclusions were perhaps more important with respect to the large industrial countries, whose policies had a much greater impact on other countries. Taking as an example the case of exchange rate policy, he noted from the bottom of page 2 of SM/83/43 that "the Fund's surveillance over members' exchange rate policies continues to face the difficult problem of how to identify cases where the exchange rate is viewed with concern from a national or an international standpoint because the behavior of the rate appears unrelated to underlying economic and financial conditions." The paper went on to note that "in 1982, this difficult problem came to the forefront for both floating exchange rates, such as the U.S. dollar and the yen, and pegged exchange rates, such as the Swedish krona." In the case of users of Fund resources, particularly the developing countries, the staff had been generally very clear in its assessment not only of the direction of the needed change in the exchange rate but also of the magnitude of the change. He would appreciate hearing why it was so much easier to come up with recommendations for exchange rate changes in some cases than in others.

Mr. Morrell considered that surveillance was an important Fund function, and that it was appropriate that the necessary staff and Board time should be devoted to it. However, the Fund itself could do only so much to ensure the effectiveness of surveillance; ultimately, it had to depend on the readiness of the national authorities to heed the Fund's advice and to take appropriate account of the effects of their policy actions on other members. He therefore welcomed the intention to produce staff papers dealing with the question of exchange rate fluctuations that were apparently unrelated to underlying economic and financial conditions as well as the intention to give renewed emphasis to the assessment of medium-term balance of payments prospects.

He could fully support the view that the Fund should become more active in encouraging countries to reduce, or avoid recourse to, protective measures, Mr. Morrell continued. Greater coverage of trade issues in Article IV staff reports was thus welcome; and public statements by the Managing Director had been particularly helpful in focusing attention on the question of protectionism. He could also support the proposal to increase coverage of external debt developments in the consultation papers, and he looked forward to the scheduled Board discussion on Fund policies and external debt servicing problems, which should allow for an in-depth analysis of external debt.

He could endorse proposals for stricter adherence to an annual cycle of Article IV consultations for those countries currently on such a cycle, Mr. Morrell said. Also, except in special circumstances, the interval between consultations should never exceed 24 months. The suggested procedure for determining the consultation cycle for individual countries and for dealing with delays was appropriate, and the idea that the Board and the authorities should reach an understanding in a given consultation on the target date for the next consultation seemed useful, although there should be scope for flexibility in that regard.

The idea of a periodic report to the Board on the status of consultations was useful, Mr. Morrell remarked. The report should perhaps include not only an indication of a delayed consultation but also some comment on the reasons for the delay; it might help, for example, to know whether the delay was due to problems in mounting a mission or to difficulties within the country itself. While it might be necessary to delay a consultation for electoral or political reasons, delays should not be accepted simply because policies were in the process of being formed. In fact, it might in many cases be more useful for the staff to hold a consultation while policies were undetermined because, once the policies had been agreed, the authorities might be unwilling to be perceived as heeding advice from external sources.

A number of Directors had commented on procedures for dealing with reports on recent economic developments, Mr. Morrell recalled. Providing a full report at every second consultation for those countries on a 12-month cycle might facilitate the consultation timetable and ease the burden on the staff; however, it would then be very important to adhere to the 12-month cycle because, with any slippage, three years could easily elapse between reports. Moreover, he tended to agree with Mr. Laske and Mr. Finaish that the statistical reports on recent economic developments in certain countries--even some of those on a 12-month cycle--were the only useful reference available and should therefore be produced annually. It should be left to the management and staff, perhaps in consultation with the Executive Director concerned, to decide which countries required yearly recent economic development reports.

He could support a nondiscriminatory exercise of surveillance over the exchange rates of all members, regardless of their exchange arrangements, Mr. Morrell continued; and the staff proposals seemed to be consistent with that objective. A 5 per cent threshold, while perhaps adding to the number of notifications, would be more in line with present practice in relation to discrete nominal changes, and he could agree that the most recent Board discussion of a member's economy was an appropriate starting point for measurement of cumulative changes, although he was interested in some of the pertinent remarks made by Mr. Polak. In some cases, regardless of the starting point chosen, it would be difficult to define the appropriate exchange rate, but the element of judgment needed to assess changes in competitiveness or limitations in the data was not so great as to justify changing the nondiscriminatory character of the proposed procedures. The only real danger was that there might be too much notification and not enough surveillance, and it was difficult to know how much commentary on each notification to the Board would be useful. He recalled the case of the recent EMS realignment, which had been duly notified to the Executive Board but had produced no action. He wondered in that regard what it took to generate a Board discussion, beyond the notification of an exchange rate change. Notifications of nominal changes in exchange rates needed to be made only when they involved cumulative changes in real effective terms that were clearly in excess of the threshold; however, he expected that large discrete nominal changes would continue to trigger notifications in virtually all cases. Mainly on grounds of uniformity, he would favor notification of real effective cumulative changes in pegged currencies even when nominal rates with respect to the reference currency did not change. It might be helpful in many cases if the effect of nonpolicy actions were drawn to the attention of the authorities, and he could therefore go along with the suggestions for analysis of exchange rate changes.

Mr. Caranicas remarked that it was clear that the Article IV consultation was the best vehicle for the exercise of surveillance. He agreed that consultation reports should devote more attention to external debt developments and trade policies in member countries, and he could support the proposal for clearing the backlog of delayed consultations with members. In that regard, the combination of consultations and missions regarding use of Fund resources might be helpful, although the consultation report should perhaps be issued before the paper on a request for use of Fund resources. Combining consultation reports with program reviews, on the other hand, should present no problem.

Regarding the frequency of Article IV consultations, Mr. Caranicas considered that a two-year cycle was appropriate for certain members and was consistent with the effort to ease the work load of the Executive Board. For others, an annual cycle would be best, and he could accept some increase in Fund staff as a way of ensuring adherence to a stricter consultation cycle for all members. On a number of occasions in the past, he had supported the idea that full-scale reports on recent economic developments should be issued only every two years, and he continued to feel that such an approach was worthwhile. If that was not considered desirable, he could accept shorter reports containing analyses of selected topics and some updated statistics, an approach that would help to reduce the burden on the staff of writing repetitive reports on a yearly basis.

He strongly supported the continuation of the supplemental or special consultation procedures, which the Managing Director could initiate at his discretion, Mr. Caranicas continued. Recently, an important country had decided to devalue, and the Board had discussed that change. In future, Executive Directors should be alert to such impending changes, and he hoped that Fund members would approach the Fund, either in advance of the decision or immediately after it, with a complete analysis of the reasons on which the decision was based.

Regarding the notification of real effective exchange rate changes, Mr. Caranicas agreed that the Board needed to be provided with adequate information and that there should be a clear numerical threshold beyond which some action would be triggered; a 5 per cent threshold would seem to be appropriate for that purpose. He could also accept the most recent Board discussion of a member's economy as a starting point for measuring changes. It was understandable that there would be margin for error in the measurement of changes in competitiveness, especially since the concept could be based on a number of indicators; if the staff were to use all of them, the data might not be manageable, and it would therefore be important for the staff carefully to select from among the available data for judging competitiveness.

Nominal exchange rate movements--as distinct from real movements--were important and should continue to be notified to the Board, Mr. Caranicas observed. An indication of nominal movements helped to identify changes in policies pursued by individual countries and should be recorded in any event--because of the intrinsic value that the Fund attached to exchange rate stability--irrespective of the specific exchange arrangements followed by members. The Board should also be informed of real exchange rate changes when the nominal rates did not change, and that rule should be applied to all countries. Informal arrangements could perhaps be worked out whereby the staff could determine whether changes in nominal rates or in relative prices and costs would warrant a special discussion by the Board.

Commenting on the effectiveness of the surveillance exercise, Mr. Caranicas noted from page 8 of the staff report that "members will wish to choose the mix of policies which they believe is most appropriate to their circumstances...but the principles of surveillance imply that, in doing so, members will take into account the interests of other members." In his view, the Fund was a long way from achieving an appropriate balance between those two ideas. Governments tended to pay lip service to monetary cooperation and to the virtues of surveillance and international coordination of policies, but they were unlikely to give up their sovereign right to take action on their currencies on short notice whenever, in their view, such action was in their national interest. Still, the Fund should not be discouraged from continuing its efforts constantly to improve its surveillance function.

Mr. Malhotra stated that the basic problem with Fund surveillance was its asymmetry. That was not to say that the Fund management was unwilling to exercise symmetrical surveillance but only that the effects had been asymmetrical. It might be useful if a meaningful dialogue could be promoted between the Fund and various national authorities, particularly those of countries that were not using Fund resources but whose economies were important and whose policies affected the rest of the world. If a fruitful understanding of the problem could not be developed, the Fund would continue to influence policy mainly in the developing countries and would be unable to address the larger problems that arose from the policies of stronger countries not using Fund resources. While noting the staff's skepticism about the potential for developing tools with which surveillance could be more effectively and uniformly exercised, he shared Mr. Finaish's observation that the Fund seemed very clear about policy prescriptions when financial support from the institution was involved and vague about its recommendations in other cases.

Turning to the procedures for the implementation of surveillance, Mr. Malhotra observed that little had been said about the lag between the preparation of staff reports and the consideration of those reports by the Executive Board. That lag was perhaps more serious than delays in consultations caused by members' unwillingness to accept staff missions at a particular time. It was his impression that delays by any member country in agreeing to consultations were essentially related to political difficulties within the country. If so, he wondered whether setting a target date for a subsequent consultation would serve any useful purpose. Over the years, the Fund had proceeded on the basis of cooperation and understanding with national authorities, and he hoped that that flexible approach would continue.

Regarding the suggestion that consultations would be most useful prior to or during the development of new policies, Mr. Malhotra said that he doubted the wisdom of scheduling Fund missions when, for example, a country's budget was about to be framed or an election was pending. The Fund had approached the matter of scheduling with flexibility in the past, and he hoped that staff and management would continue to weigh seriously the wisdom of the staff's presence in a member country at certain difficult or delicate times. He also supported Mr. Finaish's point that the small size of the civil service in some countries made it difficult for officials to meet with the various Fund and Bank missions.

On the notification of changes in exchange rates, Mr. Malhotra considered that, for real effective changes in exchange rates, a 5 per cent threshold figure would be more appropriate than one of 10 per cent.

Regarding suggestions for expanding the coverage of external debt developments in Article IV consultation papers, Mr. Malhotra observed that it was important for national authorities to monitor debt, perhaps with Fund technical assistance where necessary, and to take a medium-term and a long-term view of how their debt situation was evolving. With respect to the confidentiality of debt data, it was up to the member country concerned to decide whether any information should be provided to the banking community. If the member did not wish it to be furnished, the Fund would need to take particular care to protect the confidentiality of the debt data, especially if the intention was to undertake some form of forward analysis. It was not difficult to conceive of situations in which leakage of information could harden the terms on which some countries might otherwise legitimately borrow from the commercial banks.

As for the proposals to place coverage of trade matters within the ambit of the Fund's jurisdiction, the main concern of the developing countries was the potential for further asymmetry--as between the developed and developing world--with regard to trade policies, Mr. Malhotra noted. Trade was essentially the concern of the GATT, and it was important to respect the jurisdiction of that specialized body. However, to the extent that the Fund did focus on trade, it would be necessary for the staff to bear in mind that certain policies adopted within the framework of the GATT gave special preference to the developing countries.

He had found little discussion in the staff papers on one major concern of the developing countries--their desire to diversify their economies, and especially to industrialize, Mr. Malhotra continued. A number of countries categorized at present as industrial economies had relied for a long time on protection for their growing industries. It would therefore be necessary to pay special regard to the requirements of developing countries that are in the process of industrializing; that matter was already under consideration by the GATT and the United Nations Industrial Development Organization. While he welcomed cooperation between the Fund and the GATT on general trade issues and the Fund's opposition to protectionism, he believed that it was important that international institutions should stay within their respective jurisdictions while keeping the special needs of developing countries in mind.

Finally, Mr. Malhotra said, most of the developing countries were experiencing weakness in their balance of payments and were finding it difficult to follow policies that would enable them to achieve a sustainable balance of payments while opening up their economies. Normally, in providing assistance, the Fund pursued the practice of writing into the relevant arrangements a condition to the effect that the borrowing country would not further intensify trade restrictions for balance of payments reasons. That approach was a fair one and should continue to be followed, but for more important policy prescriptions, it would be vital to take into account the need for avoiding asymmetry and some of the other problems he had mentioned.

Mr. Joyce stated that he too could strongly support the introduction of more extensive analysis on external debt and expanded coverage of trade issues in Article IV consultation papers. It was important to focus in particular on the accumulation of short-term debt and its related effects on future debt servicing capacity. With regard to the coverage of trade issues, he had been interested in Mr. Anson's suggestion that staff members of the GATT might in some cases be invited to accompany Fund missions. While he would be willing to try such an approach on an experimental basis, he did wish to point out that there were members of the Fund that were not members of the GATT, which could be a complicating factor.

Like others, he was concerned about the delays that had occurred in concluding Article IV consultations with members, Mr. Joyce continued. Since not all the delays were attributable to staff overload, some action needed to be taken to tighten the consultation schedule. He could accept the criteria for choosing countries that should be on an annual consultation cycle and agreed that a strict approach in those cases needed to be adopted, with a grace period not to exceed three months. For other countries, it was essential that consultations be completed within an outside limit of 24 months. The staff suggestions for dealing with the current backlog of consultations seemed reasonable, and he agreed that, in present circumstances, it might be helpful to combine discussions on Article IV consultations with negotiations on the use of Fund resources. However, such combinations should be pursued only on an exceptional basis. Ordinarily, Article IV discussions in the Executive Board should precede the initial consideration of a Fund program, but he was prepared to consider holding Article IV discussions jointly with discussions of, say, a midyear program review or a review in connection with the second or third year of a program.

With regard to proposals for reducing the paperwork associated with consultations, Mr. Joyce said that he could accept shorter reports on recent economic developments documents in alternate years for some countries provided, first, that there had been no fundamental change in the structural situation of the country concerned, second, that the shorter report dealt with any significant policy developments, and third, that the basic data and charts were updated.

He could also support the suggestion for taking the opportunity at the end of each Article IV consultation discussion to set a target date for the next consultation with that country, Mr. Joyce said. Of course, the setting of the date should not prevent earlier consultations if either the country or the Fund deemed that such an approach was appropriate; in fact, some leeway should also be given to the country and the Fund if delays beyond the date became necessary for, say, security reasons. Electoral considerations or difficulties in completing program negotiations should not, in his view, be allowed to lengthen the grace period. Moreover, when a target date was not met, the Executive Board should be notified of the reasons for the delay and what action was being taken to remedy the situation. On related matters, he could accept the fact that a strengthening of the consultation and surveillance procedures might require an increase in staff, and he had taken note of the point raised by Mr. Finaish concerning the problems of Directors with multicountry constituencies and their need to have advance information on travel plans.

With regard to notification procedures, Mr. Joyce agreed that the staff should monitor and notify the Executive Board of major changes in real effective exchange rates for all countries provided three conditions were met. First, the Fund should retain the present notification procedures for significant changes in nominal exchange rates; such information was important and was often likely to be available somewhat earlier than information on real exchange rates. In the case of large discrete changes for a pegged currency, it might be necessary to initiate consultations or discussions in the Board even before it was possible to calculate what the real exchange rate change had been. Second, the new procedures should be regarded as experimental and introduced initially only for one year. As had been recognized by his colleagues, there were serious technical problems involved in the notification procedures, and some Directors might have reservations about the implications of using the recommended approach.

Third, Mr. Joyce continued, it was clear that notification could not be taken to imply that policy action was called for or even that further discussion or consultations with the country concerned were required. Such a judgment should generally be left to the Managing Director, although there might be exceptional cases in which an Executive Director felt the need to request a discussion in the Board. Like Mr. Polak, he had been somewhat concerned about the possibly undue emphasis that the use of real exchange rates could give to purchasing power parity considerations in Fund surveillance activities. Also, he agreed with Mr. Erb that exchange rate changes might be justified by overall balance of payments considerations stemming from pressures on either the current or capital accounts, even when real exchange rate calculations did not justify the size of the rate change. Unlike Mr. Erb, however, he was prepared to see whether real exchange rate changes could be used effectively as a warning device without, as Mr. Kafka had remarked, raising a full-scale alarm.

Finally, with respect to the specific procedures for notification, Mr. Joyce considered that the calculations normally should be based on the date of the conclusion of the most recent Article IV discussion, that a 10 per cent threshold was appropriate, and that, ordinarily, the notification need not be accompanied by analysis unless the Managing Director judged that the occasion was one requiring prompt consideration or where consideration was likely to be called for in the Executive Board.

The Director of the Exchange and Trade Relations Department observed that, when the staff spoke of combining reports for Article IV consultations and for use of Fund resources, it was not intending to encourage the adoption of such an approach as a general practice; rather, the procedure had been suggested as one way of preventing delays in the Article IV consultation schedule when a request for use of Fund resources was received at about the same time. If it became necessary to bring a proposal for use of resources to the Board because of a member's need, the Article IV consultation discussion could also be held; normally, however, the intention was to hold the Article IV consultation on a regular schedule before discussions on the use of resources.

As to the possibility that a rigid formula for consultation scheduling might mean a Board discussion of a country's economy at a time when policies were not fully formed, the Director observed that, since problems tended to accumulate over time, it would be useful if the Executive Board had an opportunity to make policy recommendations on the basis of those problems. The staff was by no means looking for an opportunity to criticize the authorities for not having yet adopted a policy response to problems; the idea was to hold to a regular timetable for consultations in order to avoid the long delays that had occurred in some cases in the past.

Regarding notification of changes in exchange rates, the Director said that there was no intention to eliminate notification to the Board of nominal changes. The staff had simply been attempting to make the notification procedure more uniform between those with floating currencies and those with pegged currencies. He would agree with Mr. Erb that purchasing power parity was not the ideal indicator of the appropriateness of an exchange rate, but real effective exchange rate indices could be used to alert the Board to changes in that aspect of the exchange market. Difficulties relating to the use of the index could be avoided through the provision of analysis on the exchange rate changes notified to the Board. In that regard, the staff would look closely at Mr. Polak's idea of a quarterly report as a way of avoiding the impression that the notifications were sounding an alarm. The staff was in no way setting a standard for exchange rates that would imply that the staff felt that countries had departed from the path they should have taken; if an adequate definition of the equilibrium rate were available, such an approach could be taken; but that was a matter that would be addressed in future efforts to develop a more systematic treatment of surveillance.

The intention was to discuss the index on which it would base its competitiveness comparisons with the relevant country in the course of the consultation, so that the authorities would be clear about the approach the staff was planning to take, the Director observed. It might appear that the staff was discriminating by employing different indices for different countries, but since the choice of index would be agreed in advance with the authorities, the potential for discrimination was eliminated. Besides, the entire notification procedure was to be handled on an experimental basis, and if problems should arise they would be reported to the Board.

A question had been raised by Mr. Feito about whether any staff papers had been issued that analyzed or defined the concept of "a sustainable balance of payments position," the Director recalled. A paper dealing directly with that matter in connection with adjustment programs had been issued in June 1982 (EBS/82/98) and had also been referred to in the papers on external debt that had more recently been circulated to Executive Directors. Ideally, the staff should be able clearly to identify the concept of a sustainable balance of payments position and thus more easily meet Mr. Finaish's concern that the staff was often more precise with its recommendations on exchange rate changes in connection with some Fund programs than it was in its judgments on some of the market economies of the larger countries. In that regard, it should be noted that there were at present differences in the various economies that allowed the staff to be more definite in its judgments in some cases. Where restrictions and arrears were evident, it was easy to see that those problems were limiting the effectiveness of a particular economy and should therefore be resolved; in other cases, the staff had to determine the degree to which capital flows should be encouraged one way or the other--matters that necessarily involved a greater element of judgment.

On Mr. Finaish's comments regarding departmental cooperation in cases in which staff resources available for mission work were limited, the Director remarked that missions frequently included staff from other departments, including on occasion staff from other area departments. However, the use of other area department staff was not widespread, as there was relatively little excess capacity in other area departments. Consequently, the preferred approach to the problem--as a number of Directors had suggested--was to increase the size of the staff in those areas with increasing mission loads. Finally, while the staff had discussed with the GATT the possibility of GATT staff joining Fund missions, it was recognized that such a course of action would not be possible in the immediate future. The GATT did not specialize by country, mainly because of staff limitations, so that the cooperation between the Fund and the GATT would probably continue to be limited for some time to an exchange of information.

The Economic Counsellor said that he had taken note of the various observations of Executive Directors, including the importance that had been attached to the Board's focusing from time to time on the interrelationships among the policies of the major industrial countries and their impact on one another. In many ways, such a focus was the raison d'être for surveillance, and the staff was certainly conscious of its importance. Indeed, in the spring of 1982, the Executive Board had focused the discussion of the World Economic Outlook precisely on the interrelationships among the policies of the major countries. Moreover, it was anticipated that the same matter would once again be emphasized in the World Economic Outlook discussions scheduled for June 1. The staff would be reviewing the assistance that it provided to the Executive Board for such discussions.

Another topic given emphasis by Directors in the current discussion was the need for analysis that would allow for a determination of appropriate exchange rates for the medium term, the Economic Counsellor noted. It was difficult to articulate or set such a standard, but the staff would attempt to provide the requested analysis and discuss the pitfalls involved in determining appropriate exchange rates for the medium term before the 1984 discussion on surveillance. Mr. Feito had suggested that little or no progress had been made thus far by the staff toward that end; his own feeling was that some progress had been achieved with medium-term scenarios, including projections of current account balances, capital flows, and external debt for about 40 of the largest developing countries within an integrated statistical and analytical framework.

A number of Directors had remarked on the importance of defining the concept of a "sustainable balance of payments," the Economic Counsellor recalled. While the concept was at the heart of the Fund's approach to balance of payments problems, it was a very old idea and was closely associated with the original concept of fundamental equilibrium or disequilibrium. Those who dealt with the Fund's business needed to review their understanding of such concepts from time to time, and the staff would be presenting a paper to the Board later in 1983 that would address those matters.

He tended to agree with those who felt that the notification procedure for exchange rate changes should be an experimental one, at least initially, the Economic Counsellor remarked. There were a number of technical difficulties related to the proposed approach, including those that would arise with the emphasis on purchasing power parity and the choice of the most recent consultation as a starting point for measuring changes in exchange rates. However, by experimenting, the staff would have a clearer idea of the best direction in which to move over time.

The Chairman made the following summing up in concluding the discussion:

In general, our review has confirmed that Directors attach great importance to the Fund's role in the surveillance area, particularly during a period when the payments positions of a number of large members have come under stress and when there has been concern about the implications of the problems of those members for the international monetary system as a whole.

Directors emphasized that effective surveillance requires the full cooperation of members, and they referred to the importance that Governors and Ministers in the most recent Interim Committee meeting attached to reinforcing surveillance and to making it more effective and more evenhanded.

The summing up of the particulars of our discussion will be organized under three broad headings: general remarks; frequency of Article IV consultations; and methods of surveillance over exchange rate changes and notification procedures.

General remarks

Directors considered that Article IV consultation reports should continue to deal with exchange rate questions in a forthright fashion while taking into account the sensitivities involved; several Directors felt that more attention should be paid to exchange rate issues outside the regular consultation process.

A number of Directors observed that Fund surveillance was not sufficiently symmetrical. They noted that precise prescriptions regarding exchange rate movements or changes are often given to small countries or countries making use of Fund resources; at the same time, quite large discrepancies between exchange rates and fundamental underlying conditions draw little attention from the Fund staff when they relate to major currencies, despite the fact that those currencies play a greater role in the working of the international monetary and financial system. In this context, several Directors stressed the importance of more frequent and more analytical Board discussions on exchange rate developments generally, and on the interrelationship and implication of policies and prospects in the major currency countries in particular. A number of Directors also called for a discussion in the Executive Board on the recent EMS realignment.

Important questions regarding the setting of financial policies and the relationship of exchange rates to underlying economic and financial conditions remain to be answered. Also to be considered is the need to develop a medium-term framework for the assessment of balance of payments developments. Directors welcomed the work in progress in the Fund in these areas, including the forthcoming paper, "Issues in the Assessment of Exchange Rates of the Industrial Countries in the Context of their Economic Policies." Such studies are expected to provide useful background for the biennial review of the principles of surveillance, which is to take place by April 1, 1984.

Many Directors emphasized the need for the Fund clearly to address the dangers associated with the growth of protectionism, and they encouraged the staff to expand the coverage and analysis of trade policy matters in Article IV consultation reports, while avoiding overlap into the areas of responsibility of other institutions, particularly the GATT. In this regard, they said, the focus should be on the impact of trade measures on domestic adjustment and the exchange rate of the relevant country and on its trading partners.

It was noted that, during 1982, debt service difficulties had become a focal point for concern. Most Directors considered it to be extremely important for the staff to do its utmost to improve the coverage of external debt developments--particularly their short-term aspects--and policies related to external debt in Article IV consultation reports. More specific proposals on that matter would be discussed in the Board meeting on external debt issues, scheduled for April 6. Some Directors also indicated that the Fund should be in a position to provide better coverage of the "liability" side of the banking sectors in member countries and their reserve management policies.

Frequency of Article IV consultations

Directors agreed that the consultation process is at the heart of surveillance and that, in view of the problems experienced by members in 1982 and the speed with which these problems have spread, a very determined effort needs to be made to ensure more regular scheduling of Article IV consultations. There have been cases, Directors noted, where members have run into serious external and internal imbalances during periods in which the Executive Board has not had an opportunity to analyze the issues and to offer the member the benefit of its advice. Directors indicated that such cases were unfortunate and should not be repeated in the future.

There was general agreement among Directors that some procedural changes would help to guarantee a stricter approach to the scheduling of consultations. Most agreed that the approach of establishing, at the conclusion of each consultation, a final date for the discussion of the next consultation with the member would be helpful, although specification of the cycle in this fashion should not be so rigid as to detract from management's prerogative, in consultation with the member country and the Executive Director concerned, to change the scheduling. To the extent that stricter scheduling was desirable, however, it could be enhanced by periodic reports to the Board on the status of members with respect to the observation of the consultation schedule and with an indication of any problems that might have been encountered in adhering to it. In that regard, there was no intention to lay blame on the country concerned; the purpose of the report would be to inform the Board of the causes for the delay, such as insufficient staff, or a problem in local policital conditions.

The criteria for determining the countries under a strict cycle were agreed, i.e., economies having a substantial impact on other countries, members with Fund-supported programs, and situations where there are substantial doubts about medium-term viability. For the large majority of members for which a stricter cycle should apply, most Directors considered that the objective should be to limit the interval between consultations to no more than 12 months, with a grace period of, say, 3 months beyond the specified date. For members not on a strict cycle, the permissible outer limit would be two years. Management was encouraged to experiment with 6-month reviews or miniconsultations--as had been done recently in some cases--where the economic situation of the member was changing rapidly.

In considering the circumstances that might justify delays in consultations, Directors noted that military hostilities, for example, would warrant a delay; however, it was to be understood that, once the special circumstances had passed, the consultation should be held quickly. Delays for political reasons, such as elections, or delays because the member was engaged in a process of reformulating its economic policies were less clear-cut. Most Directors judged that consultations should not be delayed because of the political timetable in member countries; indeed, they observed that it was precisely in such periods of uncertainty that financial problems could emerge or become more acute. Moreover, as pointed out in the staff paper, consultations would be particularly useful and timely when a member was in the process of developing new policies. Delays should, where possible, be fitted into the grace period of three months; if that meant that the policies envisaged by the authorities could not be fully specified in the staff report, however, it might be appropriate to hold follow-up discussions at an early date, when the policies had been formulated.

Directors agreed that a number of adaptations to existing procedures might be necessary to maintain the higher average frequency of consultations that was implied by adherence to strict annual consultation cycles for most members, at least in current circumstances. Given the large number of requests for use of Fund resources expected in the coming year, it was accepted that consultation missions might sometimes be combined with negotiations on the use of Fund resources. However, a number of Directors considered that, where an annual consultation was due, its discussion in the Board should precede the Board discussion of a program. Some believed that combining consultations with requests for use of Fund resources should be the exception rather than the rule, but a number of Directors considered that consultations could appropriately be combined with reviews of existing Fund programs.

Directors stressed the importance of the reports on recent economic developments, which they considered to be a valuable and often unique source of economic and financial information on member countries. Directors agreed that, if necessary for logistical reasons, the reports might be shortened on a selective basis and perhaps merely updated each second year; however, they stressed that changes of substance in economic policies and institutional settings should always be incorporated in the yearly report. In practice, therefore, it was likely that most reports on recent economic developments would have to be prepared annually.

Methods of surveillance over exchange rate changes, and notification procedures

All Directors asked for an evenhanded aspproach to surveillance and indicated that the Fund needed to play a more active role with respect to exchange rate changes. Some stressed the importance of more detailed and forthright discussions on exchange rate issues in Article IV consultations and in discussions on the World Economic Outlook, particularly when a stricter consultation schedule was being observed. In those exceptional circumstances where additional discussions with members seemed warranted, the existing procedures for dealing with such questions could be invoked.

To give effect to a more active role for the Fund and to help to ensure uniformity of treatment, most Directors saw merit in the "threshold" approach described in the staff paper, and there was broad support for implementing the approach on an experimental basis. Directors made a number of interesting and penetrating observations about the approach in the course of the discussion and some indicated that they would be providing further, more detailed observations later. On the technical issue of the size of the numerical threshold, some Directors felt that a 5 per cent threshold would result in too large a number of information notices for such notices to be meaningful. Others felt that any change as large as 5 per cent in real effective terms was important and should be subject to an information notice. On balance, particularly since the approach is to be adopted on an experimental basis, I would propose that we initially use a threshold of 10 per cent.

Another technical issue concerns the appropriate starting point for the measurement of cumulative changes. Most Directors, while noting that there were weaknesses in the recommended approach, indicated a willingness to experiment with a starting point that was the latest occasion on which the Board had had an opportunity to discuss the member's exchange rate policy, which in most cases would be the most recent Article IV consultation.

On another matter, there was general agreement that, during the trial period, the staff should use its best judgment on the indicator of competitiveness to be employed and should incorporate a description of that indicator, with relevant data, in the Article IV consultation reports. The views of member countries on the measurement to be used would of course be taken into account.

On the content of information notices, Directors recommended a flexible approach and invited management to exercise discretion in deciding when to provide analysis and an appraisal. They agreed that the existing practice of notifying the Board of large discrete changes in nominal exchange rates should be continued, because it was important both for surveillance and for the general information of other members.

The management and staff will carefully examine and attempt to implement the proposal made by Mr. Polak for a periodic--perhaps quarterly--staff paper containing an indication of real effective exchange rates of members, flagging those cases where changes in the rate are particularly large. While it will be necessary to address a number of questions on the appropriate time perspective to be used, an effort will be made to provide a permanent flow of figures in a periodic brochure. Again, Directors indicated a willingness to rely on management's judgment of whether or not comments on those indicators should be provided or whether particular cases should be discussed in the Board.

In concluding, I feel that we should not in future focus exclusively on procedures, as we have done this time, but should look at ways of making surveillance more effective. I sometimes wonder whether efforts to improve or add to the procedures for implementing surveillance do not make the exercise of surveillance more difficult than it might otherwise be. In that regard, I propose that we should accept the changes we have agreed today as the basis for the implementation of surveillance for, say, three to four years, and devote the next few reviews to matters of substance and to discussions on the extent to which the countries that have a strong influence on the international monetary system are following policies that are compatible and consistent. The studies to be conducted in the framework of the Versailles decision should be helpful in this regard.

Mr. Erb observed that the Chairman's summing up had served to remind him of a comment that he had wanted to make on the summing up process itself, particularly when related to Article IV consultations. He understood that, once the Chairman's summing up had been delivered in the Board, the relevant Executive Director was given the opportunity to review the text of the summing up and, perhaps, to make changes in it. He was unclear to what extent changes were in fact made before the summing up was circulated, but he wished to propose that, if there were changes, the Executive Board should be informed of them in advance. Perhaps those for which changes had been proposed could be circulated to the Executive Board--with the suggested changes underlined--on a lapse-of-time basis.

The Secretary observed that, according to practice, the summing up of an Article IV consultation discussion was circulated to the Executive Director concerned for review. Often no changes in the text were suggested; but when amendments were proposed and it was determined that those amendments were substantive, they were brought back to the Board. The definition of a substantive change was of course a matter of judgment, and in most cases it had been determined that the proposed changes were only stylistic. However, if Executive Directors had no objection, the procedure could be tightened along the lines suggested by Mr. Erb.

Mr. Kafka recalled that, when the Executive Directors had met recently to discuss ways of improving the efficiency of Executive Board discussions, the matter of the summing up process had been considered. At that time, the suggestion had been put forward to delay the summing up for a day and, while that suggestion had not received full support at the time, it might now be seen as a useful way of dealing in advance with the reactions of the Executive Director concerned.

The Chairman replied that such an approach might weaken the spontaneity of the summing up and could lead to an undesirable negotiation of the text. Perhaps it was best to pick up Mr. Erb's suggestion and circulate the text of the summing up to the Executive Board with an indication of what changes had been proposed. It would, of course, be understood that, if any Executive Director had difficulty with the proposed changes, he would raise the matter immediately so that it could be addressed without undue delay to the consultation process.

The Executive Board then adopted the following decision on procedures for surveillance:

> The Executive Board has reviewed the general implementation of the Fund's surveillance over members' exchange rate policies, as required by paragraph VI of Procedures for Surveillance attached to Decision No. 5392-(77/63), adopted April 29, 1977, including the procedures for the conduct of consultations under Article IV, which consultations shall comprehend the consultations under Article VIII and Article XIV, and approves the continuation of the procedures as described in SM/83/43, in the light of the Managing Director's summing up, until the next annual review, which shall be conducted not later than April 1, 1984.

Decision No. 7374-(83/55), adopted
March 28, 1983

APPROVED: August 30, 1983

ALAN WRIGHT
Acting Secretary