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January 10, 1986

To: Members of the Executive Board

From: The Secretary

Subject: Surveillance over Exchange Rate Policies - Annual Review of  
Surveillance and Review of Proposals for Changes in Procedures

The attached paper provides background for discussion of the various proposals for changes in the procedures of surveillance and also provides the basis for the annual review of the implementation of surveillance.

This paper, together with the paper on surveillance over exchange rate policies - biennial review of the 1977 document (SM/86/3, 1/10/86) has been scheduled for Executive Board discussion on Wednesday, February 19, 1986.

Mr. Belanger (ext. 8671) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

Surveillance Over Exchange Rate Policies - Annual Review  
of Surveillance and Review of Proposals  
for Changes in Procedures

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

(In consultation with other departments)

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

January 9, 1986

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## I. Introduction

Several proposals have been made recently, notably in the reports of the G-10 and G-24 Deputies, 1/ to enhance the effectiveness of surveillance. Some of these proposals, in particular those involving target zones and the use of objective indicators, are discussed extensively in the companion papers "Review and Assessment of the System of Floating Exchange Rates" (SM/86/5, 1/10/86); "Target Zones" (SM/86/6, 1/10/86); and "Surveillance Over Exchange Rate Policies - Biennial Review of 1977 Document" (SM/86/3, 1/10/86). This paper provides background for a discussion of the various other proposals for changes in the procedures of surveillance and also provides the basis for the annual review of the implementation of surveillance. Detailed factual information on the implementation of surveillance in 1985 is presented in a separate background paper. 2/

Some of the proposals made by the G-10 and G-24 Deputies are less procedural (in a narrow sense) than substantive, in particular those dealing with the content or focus of surveillance, and those dealing with the enhancement of the multilateral setting of surveillance. In considering these proposals for changes in surveillance procedures, it is useful to review first the motivation which underlay such proposals, including developments in the international economy and in the perception of the functioning of the international financial system since the adoption of the document "Surveillance Over Exchange Rate Policies" 3/ in 1977. This is done briefly in Section II, drawing from the broader review and assessment of the functioning of the international financial system in companion papers and highlighting the implications for the implementation of surveillance procedures.

Section III reviews the formal surveillance procedures and the evolution in their implementation since 1977. A brief overview of the implementation of surveillance procedures in 1985 is included. Issues related to the frequency of consultations, which have been raised by some Directors on several occasions in recent years, are also discussed.

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1/ "The Functioning of the International Monetary System, A Report to the (G-10) Ministers and Governors by the Group of Deputies," June 1985, circulated as EBD/85/154, Supp. 1 (6/21/85); and "The Functioning and Improvement of the International Monetary System: Report of the Deputies of the Group of 24," 8/21/85, circulated as EBD/85/228, (8/30/85).

2/ "Surveillance Over Exchange Rate Policies--Annual Review: Background Material" (SM/86/4, Supp. 1).

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

The more recent proposals for changes in the procedures of surveillance in the reports of the G-10 and G-24 Deputies are discussed in Section IV against the background of the examination of possible changes in the surveillance document, <sup>1/</sup> earlier considerations of proposed changes in procedures by Executive Directors and current practices. The main issues addressed in this paper are summarized in Section V.

## II. Background

As discussed in the companion papers reviewing the experience with floating exchange rates and the surveillance document, the major surveillance objectives of promoting orderly underlying economic and financial conditions and a stable system of exchange rates require that, in assessing developments in members' exchange rates, close attention be paid not only to external but also to domestic economic and financial policies. For example, two critical areas of strain in the international economy in recent years have been the emergence of widespread debt servicing difficulties since mid-1982 and of a large and growing U.S. current account deficit. In both cases, policies adopted not for balance of payments purposes but primarily for domestic reasons underlay the build-up of substantial imbalances financed by international capital flows. In both cases, as well, the maintenance of such policies for an extended period greatly increased the eventual cost of adjustment.

These recent experiences have shown that the integration of capital markets and the increased availability of capital from commercial sources have made it possible for inappropriate policies to be pursued for an extended period. Capital flows have permitted countries (developing countries now facing severe debt servicing difficulties as well as some industrial countries) to finance excessive budget deficits for an extended period with a limited impact on domestic interest rates, thus deferring at least part of the domestic cost of such policies. The eventual increase in debt service and/or the curtailment of capital flows resulted in widespread and severe debt servicing difficulties. Also, continuing fiscal imbalances coupled with tighter monetary policies aimed at reducing inflation have contributed to the emergence and persistence of sharply higher real interest rates on world capital markets. <sup>2/</sup> Such pronounced swings in real interest rates, which contributed at times to excessive borrowing, brought sharply into focus the vulnerability of net debtors to sudden changes in the availability and cost of capital. In some cases, external payments positions which

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<sup>1/</sup> As discussed in "Surveillance Over Exchange Rate Policies - Biennial Review of 1977 Document," op. cit.

<sup>2/</sup> As noted in the World Economic Outlook, April 1985, "there is no fully satisfactory explanation for the behavior of interest rates ..., although ... monetary and fiscal policies ... were undoubtedly important factors" (p. 31). Several other considerations were examined, in particular in Supplementary Note 2.

could be financed when real interest rates were low or negative became unsustainable in circumstances characterized by high real rates.

The key lessons in this experience for the implementation of surveillance are: (i) the importance of focusing at an early stage not only on a country's overall balance of payments position but also on the sustainability of the structure of the balance of payments; (ii) against this background, the importance of paying particular attention in assessing developments in members' exchange rates to the broad range of members' domestic economic and financial policies as well as external policies; and (iii) the sensitivity of some countries' positions to conditions created in the world economy by other members' policies. All of this points to the need to strengthen the exercise and influence of surveillance.

### III. Implementation of Surveillance Procedures

#### 1. Formal procedures

The formal procedures for surveillance specified in the basic document include several components. These comprise the initial notification of members' exchange arrangements and of changes in such arrangements; regular consultations under Article IV; special discussions with members which may be initiated by the Managing Director; Executive Board reviews of broad developments in exchange rates, e.g., those coming within the purview of the World Economic Outlook (WEO) and other special assessments; and Board review of important exchange policy measures.

The general objective of these procedural arrangements was to ensure that the Fund exercised firm surveillance over the compliance of all members with the principles developed for the guidance of exchange rate policies. Since it was recognized that it would not be possible in practice for the principles guiding exchange rate policies to be very detailed, combining a broad form of guidance with a reasonably flexible and discretionary set of procedures appeared to offer the best prospect for a workable system of surveillance over exchange rate policies.

The design of these procedures was based primarily on those in existence prior to the adoption of the Second Amendment, providing for periodic consultations with each member (similar to the previous regular consultations under Article VIII and Article XIV) and for additional consultations and reviews if, in the period between consultations, "the member's policies were thought to be in conflict with the principles." In addition to annual consultations with each member individually, discussions in the multilateral framework of the World Economic Outlook exercises provided the opportunity to deal with important exchange rate developments, especially for major currencies, at shorter intervals.

Extensive discussions preceded the adoption of these procedures and led to several changes in the formulation of the proposed components. One important change concerned the formulation of the procedure for additional special consultations (Procedure V) which the staff had originally proposed be linked to developments in indicators of real effective exchange rates, establishing an automatic counterpart to the requirement before the Second Amendment to consult before making a change in the level of the exchange rate. <sup>1/</sup> In the end, however, it was thought that specific quantitative triggers would not be appropriate because such triggers might not adequately reflect the wide spectrum of policies and developments that might indicate the need for a special consultation.

Except for the adoption of the supplemental surveillance procedure in 1979, no changes have been made to the formal surveillance procedures. The supplemental procedure adopted by the Executive Board in January 1979 (Decision No. 6026-(79/13), 1/22/79) authorized the Managing Director to initiate informal and confidential discussions with a member if he considered that a modification in the member's exchange arrangements or exchange rate policies or the behavior of the exchange rate might be important or might have important effects on other members. If, after prior discussion with the member, he considered that the matter was of importance, he was to initiate an ad hoc consultation. This procedure, which was modeled on the procedure followed when the United States informed the Fund of important exchange policy measures in late 1978, <sup>2/</sup> was intended to permit the Fund to look into exchange rate developments or situations of importance without the presumption that the member in question had not complied with its obligations under Article IV.

## 2. Evolution of the implementation of procedures

Although the formal surveillance procedures have remained unchanged since their adoption in 1977, there has been considerable evolution in their implementation. Major elements of this evolution have included, in particular, changes in the content of both the World Economic Outlook exercise and staff reports for Article IV consultations, in the frequency of consultations, and in the monitoring of policies and developments during the interval between consultations.

### a. World Economic Outlook

As envisaged in the Procedures, the World Economic Outlook has increasingly provided the basic analytical framework for the Fund's review of the world economy and the exchange rate system, and thus for the assessment of the exchange rate policies of individual members in a multilateral context. A major advance was made with the April 1982

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<sup>1/</sup> "Surveillance over Exchange Rate Policies" SM/76/235, (12/21/76).

<sup>2/</sup> EBD/78/241 (11/1/78) and EBS/78/657 (12/1/78).

Board discussion of the World Economic Outlook, which gave particular attention, on the basis of the staff's "Main Issues" paper (ID/82/1, 3/29/82), to policies and developments in the major industrial countries and the interactions among them. The approach adopted allowed special focus to be placed on the policy aims or actions of major countries. Since then, this type of analysis has become a key element of each World Economic Outlook exercise. The timing of World Economic Outlook discussions before the spring and fall meetings of the Interim Committee has provided the basic framework for the consideration by the Committee of economic developments and policies. 1/

Another important procedural change in the World Economic Outlook exercise has been the preparation and presentation of medium-term scenarios, providing the basis for a discussion of the global debt problem and, more generally, for a systematic assessment of the medium-term implications of a number of policy strategies in the various groups of Fund members. Successive World Economic Outlook reports have also devoted increasing attention to the sensitivity of the medium-term scenarios to changes in assumptions.

b. Article IV consultations

Several changes have also been introduced, in particular in recent years, in the conduct of Article IV consultations. The formal procedures specify that the consultations should in principle take place annually. In practice, it has not proven possible to meet this target. During the first few years following the adoption of the Second Amendment, a lower target was adopted for operational purposes of completing consultations with approximately 75 percent of members annually, while maintaining annual consultations with major countries and with countries that had Fund-supported programs. However, even this lower target was not achieved as the proportion of members with which consultations were completed fell from 77 percent in 1979 to 60 percent in 1981-82, although, in many cases, discussions for use of Fund resources or informal contacts allowed for continuity of discussions. The number of countries with which no consultation had been held for 24 months or more increased sharply during the same period, from 3 in 1979 to 19 in 1982.

With the emergence of severe debt servicing difficulties in 1982, it was recognized that a determined effort needed to be made to ensure more regular scheduling of Article IV consultations. The criteria for strict adherence to an annual interval between consultations for certain

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1/ In addition, following Board discussion on the occasion of the 1980 annual review of surveillance, publication of the World Economic Outlook has contributed to a fuller and more public reporting on the Fund's surveillance activities. Also, a more complete description of the implementation of surveillance and related issues has been included in the Annual Report, since the 1980 issue.



members were reaffirmed, 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. 1/ For members for which strict adherence to annual consultation cycles was not considered necessary, a permissible outer limit between consultations of two years was agreed. In order to promote stricter adherence to the consultation guidelines, the practice was adopted of specifying at the conclusion of each consultation the final date by which the next consultation with the member was expected to be concluded. The procedure was also adopted of preparing periodic reports for the Board on the status of members with respect to the observance of the consultation schedule and with an indication of any problems that might have been encountered. 2/ Following these modifications, there has been a sharp increase in the number of consultations concluded each year (see below).

The evolving nature of the consultation process has also been reflected both in the focus of Executive Directors' discussions in concluding consultations with individual members and in the content of staff reports. Major elements of this evolution have been the increased attention and sharper focus on exchange rate policies, the coverage of multilateral issues and the greater emphasis on the medium-term impact of members' policies. While it was recognized at the time of the adoption of the formal procedures for surveillance that additional emphasis would have to be given in staff reports to members' exchange rate policies, progress in this area was gradual. Initially, as reported in the 1978 review of the implementation of surveillance, only about one half of the reports referred to changes in effective exchange rates and very few presented information and analysis of changes in real effective rates. 3/ Since then, however, analysis of real effective exchange rates or other indicators of competitiveness has increased sharply. At present, most staff reports include quantified indicators of the evolution of competitiveness.

Another evolving aspect of the focus on exchange rate issues has been the more explicit assessment by staff and Executive Directors of the appropriateness of members' exchange rate policies. Initially, a rather cautious approach was adopted to the presentation of views on exchange rate matters in the consultation reports. In some cases, however, this cautious approach kept the scope and substance of the reports less forthcoming than would have been appropriate. During the course of successive annual reviews, while Directors encouraged continued care in the assessment of the sensitive subject of exchange rate policies, a more forthright treatment of the issue was considered

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1/ "Chairman's Summing Up at the Conclusion of the Annual Review of the Implementation of Surveillance," EBM/83/55, 3/28/83, p. 3.

2/ SM/83/210 (10/21/83), SM/84/227 (10/15/84), and SM/85/249 (8/28/85).

3/ "Annual Review of Regular Consultations and Other Issues Related to Article IV," SM/78/287 (12/11/78), p. 15.

desirable, especially in cases of inappropriate exchange rate policies or the existence of an unrealistic value of the exchange rate. <sup>1/</sup> Also on occasion, more forthright statements on these issues were included in the Chairman's Summing Up of the Board discussion concluding the consultation with individual members than in the staff appraisal, reflecting the more explicitly stated views of the Board. In recent years, most staff appraisals have included an explicit evaluation of exchange rate policies.

Other improvements in the content of staff reports have related to the expanded coverage of both policy and technical issues. In recent years, structural adjustment, fiscal policy, external indebtedness, and trade matters have increasingly been the focus of attention. The coverage of these issues in staff reports, the analytical basis of staff assessments and the nature of policy recommendations in staff reports for Article IV consultations concluded in 1985 are reviewed in detail in "Surveillance Over Exchange Rate Policies--Annual Review: Background Material".

As called for in the Executive Board's 1983 discussion of the Fund's approach to the problem of external indebtedness (EBM/83/58, 4/6/83), consultation reports for almost all countries where external indebtedness is a significant issue have included a description of the medium-term external debt outlook for the country concerned. More recently, the practice of including medium-term balance of payments scenarios has been extended to countries where external indebtedness is not seen as a major issue, including many industrial countries. Current practices in this regard, including the analysis of underlying policies and of the sensitivity of projections to changes in assumptions, are examined in the background paper.

Several other innovations in the content of staff reports have been introduced in recent years. These include (1) the review of developments and policies more explicitly against the background of the conclusions of the preceding consultation; (2) the inclusion of an appendix on statistical issues; and (3) the inclusion of material describing members' relations with the World Bank, in many cases including a discussion of the Bank's assessment of the investment or development program and other policy issues in the areas of expertise of the Bank.

c. Information notice system

An important procedural innovation introduced in recent years to strengthen surveillance outside the World Economic Outlook and Article IV consultations has been the system of monitoring developments

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<sup>1/</sup> See, for example, "The Chairman's Summing Up at the Conclusion of the Review of the Document "Surveillance over Exchange Rate Policies" and Annual Review of the Implementation of Surveillance," EBD/82/89 (4/13/82), Attachment, p. 4.

in real effective exchange rates. The monitoring system, which covers at present real effective exchange rates for the currencies of 125 members, makes it possible to bring significant changes in real effective rates to the attention of Executive Directors both through quarterly reports and, in cases of changes in real effective rates in excess of 10 percent since the last Board consideration of a member's exchange rate policy, through information notices which analyze and assess recent developments and policies.

More recently, information notices have also been prepared by the staff in order to bring to the attention of Executive Directors major new developments affecting trade. This practice, initiated following the March 1985 Board discussion of trade policies, has since led to the issuance of two information notices. As Directors noted in concluding the 1985 annual review of surveillance, such notifications as well as the exchange rate information notices could provide the basis to initiate supplemental consultations if the Board so requested.

### 3. Implementation of procedures in 1985 <sup>1/</sup>

Article IV consultations and discussions of the World Economic Outlook in 1985 continued to provide the main vehicles for the implementation of Fund surveillance over members' exchange rate policies. Discussions of the World Economic Outlook in April and September provided a comprehensive framework for the Executive Board's review of the world economy and the exchange rate system, and thus for multilateral surveillance over exchange rate policies of individual members. In addition to the usual documentation, and in support of the emphasis on medium-term prospects and the sensitivity of the medium-term outlook to changes in assumptions, supplementary background notes were prepared, inter alia, on developments and prospects in primary commodity prices, trends in capital flows to developing countries, structural policies and the growth potential of industrial countries.

The number of Article IV consultations continued to increase in 1985. A total of 131 consultations were concluded in 1985, involving 85 percent of Fund membership, compared to 120 consultations in each of 1983 and 1984. Consultations were concluded with all of the G-10 countries and with all but two of the non-G-10 industrial countries. Consultations were also concluded with 84 percent of the nonindustrial countries.

For members concluding consultations in 1985, the average period between consultations declined to less than 14 months, from 15 months in 1984 and from more than 19 months in both 1982 and 1983. The number of

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<sup>1/</sup> A detailed review of the implementation of procedures in 1985 is included in "Surveillance Over Exchange Rate Policies - Annual Review: Background Material," op. cit. Only a brief overview is presented in this section.

countries with seriously delayed consultations was also reduced further in 1985; only 4 countries had not had consultations within the past 24 months at the end of each of the last two years compared with 6 at the end of 1983 and 19 at the end of 1982. Twenty-two of the consultations which, on the basis of the interval specified, had been expected to be concluded in 1985 either have exceeded or are likely to exceed the specified interval by more than the three-month grace period. However, in contrast with the longer delays experienced earlier, recent delays have been a matter of a few days or weeks, or at most one or two months; as indicated in the background paper, these have generally been attributable either to continuing discussions on the use of Fund resources or to difficulties in fielding the staff mission (often as a result of staff involvement in missions to other countries).

The period from termination of initial discussions with members' authorities to conclusion of the consultation by the Executive Board which had averaged 104 days in the two preceding years fell to 97 days in 1985. This decline reflected in part shorter delays in cases requiring multiple missions or further discussions at headquarters, generally associated with concurrent discussions on the use of Fund resources. The shorter period required to conclude consultations was also reflected in a reduction in the number of extensions of the three-month period for the conclusion of consultations, from 27 in 1984 to 23 in 1985. <sup>1/</sup>

Publication of the World Economic Outlook and of the Annual Report and the public addresses of the Managing Director continued to provide the main vehicles for reporting publicly on the Fund's surveillance activities.

#### 4. Issues related to the frequency of consultations

The guidelines established by the Executive Board at the time of the 1933 Surveillance Review state that Article IV consultations should be conducted annually for members whose economic developments have a substantial impact on other countries, <sup>2/</sup> for members with programs involving use of Fund resources, and for members for which there are substantial doubts about medium-term balance of payments viability. For other countries, the interval between consultations may extend up to two years. Directors, however, have also considered that smaller members for which longer intervals between consultations would otherwise be appropriate should be entitled to request annual consultations.

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<sup>1/</sup> Under the Procedures for Surveillance (Procedure II), the Executive Board is required to conclude an Article IV consultation not later than three months after the termination of discussions between the member country and the staff.

<sup>2/</sup> Interpretation of this criterion was made more specific at the time of the 1985 annual review of surveillance by noting that it should apply to "at least the 25 largest members" (SUR/85/36, 3/28/85).

A standard 12-month interval between consultations had been specified for 127 countries as of the end of 1985, 87 percent of the cases for which the interval until the next consultation had been established. <sup>1/</sup> Standard 12-month intervals had been specified for 85 percent of the industrial countries and for 87 percent of the developing countries. In addition to countries with the largest Fund quotas, <sup>2/</sup> a standard 12-month interval had been specified for one country considered important at the regional level; 51 countries with a Fund stand-by or extended arrangement, or for which such an arrangement has either recently ended or is being considered; 46 countries whose situation indicates a need for close scrutiny; and 5 countries for which an interval of 12 months was specified at the request of the authorities. Of the 19 cases in which longer intervals had been specified, 16- to 19-month intervals had been specified in 17 cases while 24-month intervals had been specified in two cases.

In contrast, the original proposal for implementing a system to specify the interval between consultations had suggested that some 75 to 80 percent of members could be expected to be on a standard annual cycle. The greater incidence of members for which an interval of 12 months has been specified reflects in part the deterioration in the external position of a wide range of members for which it was thought originally that longer intervals between consultations would be appropriate. Many of these countries have a Fund stand-by or extended arrangement. For example, an interval longer than 12 months applies at present for only one country in the African Department, while it had been thought in late 1982-early 1983 that longer intervals would be appropriate for about 20 African members. Also, consistent with the reaffirmation of annual consultations as the norm, longer intervals between consultations have been considered exceptional, used only in circumstances clearly outside the scope of the guidelines for scheduling annual consultations.

While desirable on its own merits, this trend toward more frequent consultations has increased the workload of the Board and staff, prompting a number of Directors to make several recommendations to reduce this workload. <sup>3/</sup> As regards the frequency of consultations, Directors have noted the desirability of focusing efforts on those situations most in need of attention and have suggested that more differentiation in the

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<sup>1/</sup> Includes Netherlands Antilles for which a separate consultation is specified.

<sup>2/</sup> At present, the criterion applies to members with the 24 largest quotas. In the case of Norway, which has the 25th largest quota, a 19-month interval until the next consultation was specified at the conclusion of the most recent Article IV consultation in December 1984.

<sup>3/</sup> Most recently, at the time of the annual review of the implementation of surveillance (EBM/85/49, 3/25/85) and during the discussions of the work program (EBM/85/81 and EBM/85/82, 5/29/85; EBM/85/163 and EBM/85/164, 11/12/85).

specification of the interval between consultations would be appropriate. One possibility would be to lengthen the interval between consultations for those countries already on longer cycles. Providing for a 24-month interval for countries for which annual consultations are not currently indicated could sometimes facilitate consultations by scheduling discussions with the authorities at the same time of year and would reduce the total number of consultations by a few each year. Another possibility would be to increase the number of countries for which intervals longer than 12 months are specified. As noted in the background paper, the consultation cycle was lengthened in 1985 in two cases for which 12-month intervals had applied earlier. The rationale for recommending Board approval of standard 12-month intervals for countries not using Fund resources is being examined carefully on a case-by-case basis. It is expected, on present indications, that it may be appropriate to recommend a longer interval in a few cases. As suggested by some Directors in completing the 1985 annual review of surveillance, it may be useful in some of these cases to introduce informal staff visits (without staff report for discussion by the Board) for policy discussions midway between full consultations.

#### IV. Proposals for Changes in Procedures

Several proposals have been made recently to enhance the implementation of surveillance procedures, most prominently in the reports of the G-10 and G-24 Deputies. These proposals, summarized in Table 1, <sup>1/</sup> can be grouped broadly into three categories: proposals to improve the analytical basis of surveillance, proposals to enhance the multilateral setting of surveillance, and proposals to strengthen the influence of the consultation process. Several of these proposals have already received some attention from Executive Directors on the occasion of earlier annual reviews, in particular the 1980 and 1985 annual reviews. Earlier discussions by Executive Directors are summarized briefly below in connection with related proposals of the G-10 and G-24 Deputies.

Some of the proposals examined in this section could increase substantially demands on Board and staff resources. While related costs cannot be estimated precisely at this time, until a clearer picture emerges of the nature and scope of possible changes, the implications for the Fund's workload may need to be considered more carefully at a later stage.

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<sup>1/</sup> Not including enhanced surveillance. Issues related to enhanced surveillance are not reviewed in the present paper since they were discussed extensively at EBM/85/130 (8/30/85) based on "The Role of the Fund in Assisting Members with Commercial Banks and Official Creditors" EBS/85/173 (7/23/85). The Chairman's Summing Up of the discussion noted that a review of the policy of enhanced surveillance would be held in about one year.

Table 1. Summary of G-10/G-24 Proposals to Enhance Surveillance Procedures

	G-10	G-24
<u>Analytical basis of surveillance</u>		
Data	Identify necessary improvements in scope, quality, timeliness.	
Policy coverage	All policies affecting trade, capital movements, external adjustment and the effective functioning of the international monetary system, including microeconomic policies and structural features that could weaken performance and induce exchange rate instability.	Thorough assessment of the national economic policies of major industrial countries.
Time horizon	Analysis and recommendations should be viewed in a medium-term framework. Improve techniques to analyze medium-term external debt and debt service scenarios.	Seek to establish a consistent set of targets, that appear to be sustainable in the medium term.
Policy assessments	Provide more candid assessments, making clear the empirical and analytical basis of policy judgments. Differences of view with the authorities should be spelled out and discussed.	
Policy recommendations	Provide precise suggestions for policy changes.	Identify policies to achieve agreed objectives and appropriate measures when actual outcomes deviate from agreed objectives.
<u>Multilateral setting of surveillance</u>		
	Separate chapter of WEO, for review by G-10 Ministers and Governors, providing a framework to discuss the international repercussions and interaction of the national policies of G-10 countries.	Two stage procedure: - against the background of the WEO, discussion and negotiation of mutually consistent objectives and policies for major industrial countries; - follow-up reports on achievement of policies.
<u>Strengthening the influence of the consultation process</u>		
Follow up to consultations	Review implementation and effects of policy recommendations in subsequent reports. Request members to indicate measures introduced or considered to address problems identified, and respond to specific policy suggestions. Confidential (selective) exchange of views between the Managing Director and the Finance Minister.	References to previous policy recommendations and related measures undertaken. Information notices on deviations in implementing suggested policy changes.  Following Board consideration of reasons for noncompliance, discussion between the Managing Director and the member's authorities. Further Board consideration.
Publicity	Basic confidentiality should be preserved. Some Deputies supported certain forms of greater publicity, in particular, public statements by the Managing Director at the end of the consultation process and the release of consultation documents at the member's request.	Confidentiality should be preserved. No statement or document should be released.
Supplemental consultations	Review existing arrangements with a view to making greater use of supplement surveillance.	Greater use of supplemental surveillance.

Source: "The Functioning of the International Monetary System, A Report to the (G-10) Ministers and Governors by the Group of Deputies," June 1985, circulated as EBD/85/154, Supp. 1 (6/21/85); and "The Functioning and Improvement of the International Monetary System: Report of the Deputies of the Group of 24," 8/21/85, circulated as EBD/85/228, (8/30/85).

1. Proposals related to the analytical basis of surveillance

The proposals related to the analytical basis of surveillance, which are spelled out in some detail in the report of the G-10 Deputies, seek to strengthen the framework for the implementation of surveillance. The first proposal, the identification of necessary improvements in data, has already attracted significant attention on the occasion of earlier annual reviews. At the request of the Executive Board, the staff in early 1984 began to include statements on statistical issues in staff reports. Following the Board meeting on "Review of Fund Statistics" (EBM/85/71, 5/6/85), staff reports for Article IV consultations have included an appendix on statistical issues covering the status of the country's data in IFS. In addition, staff reports have made explicit reference to the quality of statistics used in reports and to major statistical problems affecting the analysis. The timely availability of reliable data clearly is essential to an assessment of developments and policy intentions. Substantial progress is still needed in this area for many members and regular consultations will continue to provide a useful opportunity to assess the adequacy of available data and stress main areas for improvement, and allow the staff to assist the authorities in identifying means to improve statistics, including technical assistance from the Fund.

Other proposals relate to the analytical focus or content of staff reports for Article IV consultations. The reports emphasize the need for a comprehensive policy coverage and for analyses to be presented in a medium-term framework, the provision of more candid assessments of policies (making clear the empirical and analytical basis of judgments and differences of view with the authorities), and the inclusion of specific suggestions for policy changes.

An extensive survey of current practices in these areas is presented in the background paper which reviews in detail the implementation of surveillance in 1985. A conclusion of that survey is that the policy coverage of staff reports for Article IV consultations has typically been quite extensive. In recent years, problems of external debt and protectionism have increasingly been important elements of staff discussions with members. Most consultation reports, in particular reports for almost all countries where external debt is a significant issue, include a description of the medium-term external debt or payments outlook for the country concerned. Problems of fiscal policy and structural adjustment, including in particular the pressing need to increase the efficiency of labor markets, are also being stressed in many consultations. Frequently, however, economy in discussion and reporting requires that the depth of discussions (and related reporting) be tailored to reflect the relative importance or the urgency of corrective actions in various areas of policy.



The reports of both the G-10 and G-24 Deputies stress the importance of presenting analyses and assessments in a medium-term framework. As was discussed in Section II above, the integration of capital markets and the availability of capital from commercial sources may allow inappropriate policies to be pursued for an extended period, leading eventually to the build-up of substantial internal and external imbalances. Thus, the effective implementation of surveillance has increasingly required that the assessment of policies focus on their sustainability and, from this perspective, on their impact on international integration and on the promotion of stable economic and financial conditions, not only in the short term but also in the medium term. Reflecting this concern, the practice of including medium-term balance of payments scenarios in staff reports has been extended in recent years to countries, including industrial countries, where external debt may not immediately be seen as a major issue. In 1985, medium-term scenarios were included in 87 percent of staff reports.

In some cases, however, available medium-term projections have provided only an incomplete basis for assessing the sustainability of members' policies and their consistency with those of other members. Despite the increasing emphasis in many countries on the formulation of policies in a medium-term framework, few countries prepare detailed and quantified medium-term policy plans. This is reflected in the medium-term scenarios presented in staff reports for Article IV consultations, which do not always specify the basic policy stance underlying the assumed rates of growth, inflation and savings/investment balances. In principle, projections are based on the current policy stance of the authorities (including planned changes when these are known). On occasion, however, some change from the set of policies that is in place (or currently being planned) is assumed. The discussion of medium-term prospects in such cases needs to identify clearly the areas in which such modifications or adaptations to the current stance of policies have been assumed. Precision is sometimes also lacking as well, although less frequently and to a lesser extent, in the analysis of shorter-term policy intentions.

Unless key policy instruments are analyzed in a reasonably fully specified and quantified framework, the issues of consistency (internally and with the policies of other members) and sustainability cannot be fully assessed. While neither greater precision nor greater attention to the medium-term sustainability of policies are always necessary to identify major policy inconsistencies internally or with the policies of other members, they may help highlight at an earlier stage the possible emergence of such inconsistencies. Progress in recent years in the analysis of medium-term prospects thus needs to be carried forward, although the balance of emphasis on medium-term issues ought not be shifted so much as to dilute the focus on fundamental short-term policy issues. Further improvements in this area, recommended by both G-10 and G-24 Deputies, will require increased efforts on the part of both members' authorities and the staff. In some cases, there will need to be a greater willingness on the part of members to

enter into a detailed and quantified dialogue with the staff on the basis of staff projections in those cases where such projections may not be prepared by the authorities.

Equally as important, the analytical foundation or structural model underlying short- and medium-term projections on which judgments are based is frequently left implicit. This is sometimes appropriate. However, it would be useful in certain cases to make more explicit the critical parameter assumptions and underlying relations assumed in making these projections. Although judgments as regards the nature and size of policy adjustments are difficult and often leave room for substantial debate, the reasons for differences of view more often than not reflect different assumptions on external conditions or behavioral responses. Clearly spelling out the analytical and empirical basis for such differences would help focus discussions with the authorities and perhaps narrow the range of differences.

The G-10 Deputies also recommend that assessments be more candid, that policy recommendations be specific and that differences of view with the authorities be spelled out and discussed. <sup>1/</sup> A conclusion of the survey of current practices in the background paper for the annual review of surveillance is that assessments, while expressed so as to take account of the sensitive nature of the issues involved, were frequently candid. In some cases, however, a more forceful presentation may have helped highlight the importance of the problems identified. Reports also typically indicate whether the authorities agree with staff assessments. To the extent that the analytical and empirical basis of assessments can be made more explicit, the source and nature of differences of view will also be clearer. However, while assessments and the reporting of differences should be sufficiently forthright to be clearly understood, the cooperative nature of the relationship between the Fund and its members would not benefit from the adoption of an overtly confrontational approach. Smooth and productive relations with members will continue to require that differences be handled with discretion and diplomacy.

The survey of current practices in the background paper shows that, while typically clear about the direction of adjustment, assessments of the size of the adjustment needed are often not quantified. Clearly, quantification is neither always possible (in particular, as concerns the various areas of structural policies) nor appropriate (e.g., the size of a required adjustment of the exchange rate; or, unless clearly related to the efficiency of resource use, detailed recommendations on items of expenditure to be reduced or taxes to be raised). However, quantified staff assessments of the size of required adjustments in main

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<sup>1/</sup> Several Executive Directors similarly recommended that differences of view with the authorities should be spelled out when they discussed the content of staff reports to be made available to commercial creditors under enhanced surveillance procedures (EBM/85/130, 8/30/85).

areas of policy (including, as appropriate, trade-offs) could help focus the attention of the authorities on the need for and size of adjustment in specific areas of policy.

2. Proposals related to the multilateral setting of surveillance

A recurrent theme of successive annual reviews of the implementation of surveillance has been the need to make surveillance more effective. Particular attention has been devoted in this context to issues related to the symmetry and multilateral nature of surveillance. The reports of the G-10 and G-24 Deputies both stress the essential nature of the multilateral approach to surveillance, ensuring that the appraisal of members' policies appropriately takes into account the effects of these policies on other members. Most recently, the central role of a multilateral approach to policy formulation and assessment, especially for key currency countries, was stressed in the September 22 announcement of the G-5 Ministers and Governors, and its special focus on the consistency of underlying policies in promoting a more satisfactory and stable configuration of exchange rates.

The specific mechanisms recommended by the G-10 and G-24 Deputies to enhance the multilateral approach to surveillance, however, clearly differ. G-10 Deputies recommend the preparation of a separate chapter in the World Economic Outlook, for the review of G-10 Ministers and Governors, providing a framework to discuss the international repercussions and interaction of the national policies of G-10 countries. G-24 Deputies recommend the establishment of a formal two-stage procedure: the first stage involving discussion and negotiation, against the background of the World Economic Outlook, of mutually consistent objectives and policies for major industrial countries; the implementation of policies and achievement of objectives being reviewed in follow-up reports in a second stage.

In addition to the various improvements in the implementation of surveillance procedures since 1977, several other proposals have been considered by Executive Directors on the occasion of annual reviews. In particular, some proposals discussed during the 1980 annual review are closely related to the proposals of the G-10 and G-24 Deputies to strengthen the multilateral setting of surveillance. <sup>1/</sup> These proposals and related discussions are summarized briefly in the next few paragraphs to provide background for the discussion of further proposed changes in procedures.

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<sup>1/</sup> At EBM/80/19 and EBM/80/20 on 2/6/80, and EBM/80/89 on 6/11/80 based on "Review of the Implementation of the Fund's Surveillance Over Members' Exchange Rate Policies" SM/79/292 (12/21/79) and Supp. 1 (5/13/80).

A first proposal considered in 1980 envisaged that the authorities of members with large imbalances would be expected in the course of consultations to describe in as precise terms as possible their external and domestic policies, including monetary and fiscal policies, by which the imbalance would be corrected. 1/ These policies were to be described either as part of the staff's reporting or, at the discretion of the authorities, through a written statement appended to the consultation report. A sufficient number of Executive Directors (though not a majority) strongly objected, preventing formal approval of the procedure, 2/ although it was understood that staff discussions with members' authorities for Article IV consultations and staff reports were to pay particular attention to the issues involved.

A second proposal envisaged inviting the seven major industrial countries to submit to the Fund, in preparation for the first major World Economic Outlook of each year, a quantified statement of the economic and financial policies that they intended to pursue in the year ahead. 3/ It was considered, after experience had been gained, to expand the coverage of this innovation beyond the seven major countries initially involved. In their discussion of this proposal, Executive Directors raised a number of doubts, in particular on the possibility of agreeing on a strategy for developments in the world economy. Executive Directors were inclined to the view that any global "strategy" should be conceived in fairly general terms, and that the number of countries whose performance should be assessed in the World Economic Outlook itself should be limited. An agreed change, nevertheless, involved an extension of the World Economic Outlook through inclusion of a more complete description of the policy approach envisaged by major countries, providing a basis for the discussion by Executive Directors of the broad principles of a global "strategy."

These earlier proposals as well as current proposals from the G-10 and G-24 Deputies recognize that, if it is to be effective, surveillance must involve an examination of members' policies in a multilateral framework. This, in turn, requires a common view or understanding among

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1/ Specifically, "that any nation with an exceptionally large payments imbalance--deficit or surplus--submit for Fund review an analysis showing how it proposes to deal with that imbalance," (SM/79/292, p. 7).

2/ Although a decision could have been taken by simple majority, the Chairman concluded that "if the feeling is that (the proposal) was to be implemented in a compulsory fashion, to extract commitments and engagements from member countries, we would have made absolutely no progress. On the contrary, we would perhaps have lastingly damaged our relations with a great number of countries." EBM/80/89, p. 32.

3/ Specifically, "that the Fund could assess the performance of individual countries against an agreed global strategy for growth, adjustment and price stability developed in World Economic Outlook reviews," (SM/79/292, p. 8).

members of the effect of various policies on the evolution of the world economy. Analysis in the World Economic Outlook of the international repercussions of the policies of major countries should provide the analytical basis for a consideration of the nature of international interactions. The presentation, in the context of Article IV consultations with major countries, of more detailed and quantified short- and medium-term policy plans would help strengthen the analysis of the consistency and sustainability of policies from a multilateral perspective as well. For major countries for which the timing of consultations differs from the cycle for the preparation of the World Economic Outlook, mini-consultations could again be used to ascertain changes both in the economic outlook and in the stance of the authorities' policies as well as to elicit views on the international interaction of policies and developments. Directors may wish to review in this context whether the proposal considered in 1980 of requesting the authorities of major members (e.g., G-7 or G-10) to prepare a quantified statement of their policies in connection with the World Economic Outlook exercise would help promote this process.

The formal proposal to implement surveillance in a two-stage process, including the specification and monitoring of objective indicators for major industrial countries, is discussed more fully in the companion papers on the review of experience with the system of floating exchange rates and for the biennial review of the surveillance document. 1/ Executive Directors also already had an opportunity for a first discussion of objective indicators on the occasion of the 1985 annual review of the implementation of surveillance. Such a proposal had been anticipated to some extent both in the early discussion of the use of real exchange rate indicators to trigger special consultations (under Procedure V) and in a subsequent proposal considered in the context of the 1980 annual review to trigger supplemental consultations if developments or policies differed significantly from those expected at the time of the preceding annual consultation. 2/

It is clear that larger members with key currencies have a special responsibility to adopt policies consistent with the establishment and maintenance of stable economic and financial conditions for those countries closely linked to them through trade and financial relations. For the international economy as a whole, it has become increasingly accepted that this implies a special need for larger members with key currencies to achieve a closer coordination of their policies. The exercise of Fund surveillance, through the World Economic Outlook discussions and Article IV consultations, can provide a primary forum for the assessment of the consistency and sustainability of members'

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1/ SM/86/5 and SM/86/3, op. cit.

2/ "Review of the Implementation of the Fund's Surveillance Over Member's Exchange Rate Policies," SM/79/292 (12/21/79), p. 10. Few Directors addressed this proposal explicitly. Those who did, however, did not favor the implied automaticity.

policies. Whether policies of major industrial countries are negotiated (as envisaged by G-24 Deputies) or not, such an assessment could bring out clearly and forcefully the concerns of the membership with the policies of individual members and the effects of these policies on other members. The follow-up to such an assessment in the form of a review by G-10 Ministers and Governors, as envisaged by G-10 Deputies, would, if adopted, follow a first consideration in the Fund's Executive Board. Directors may wish to consider in this context the form in which they may want the results of their considerations communicated to G-10 Ministers and Governors. Other aspects of the follow-up to the assessment of members' policies in the context of the World Economic Outlook and Article IV consultations are discussed further below.

3. Proposals related to strengthening the influence of the consultation process

Several of the proposals examined in the reports of the G-10 and G-24 Deputies related to the follow-up to consultations, publicity and supplemental surveillance were considered by Executive Directors during the 1985 annual review of the implementation of surveillance. At that time, Directors indicated that there was considerable scope for expanded follow-up to consultations and also encouraged a greater use of supplemental surveillance in selected circumstances. However, on the issue of publicity, most Directors expressed strong reservations similar to those in the reports of the G-10 and G-24 Deputies.

As regards the follow-up to consultations, Executive Directors had already endorsed earlier the strengthening of the continuity of the consultation process through the inclusion of a review of developments against the background of the conclusion of the previous consultation. This has been reflected in the inclusion in staff reports for Article IV consultations of references to the discussion by Executive Directors in concluding an earlier consultation. During the 1985 annual review of surveillance, Directors considered that the review of developments against the background of the previous consultation in Article IV staff reports should be further developed by giving indications of the weight the authorities attached to the views of the Fund. Directors also strongly supported more "internal publicity" among the authorities of member countries for the findings of the Fund and considered it desirable that Management communicate directly with Ministers of Finance regarding the Fund's review in those selected cases where the Executive Board felt high-level consideration to be particularly important because of the urgency of the policy views expressed. Specific reviews of the implementation and effects of policy recommendations by the Fund, as was suggested by both G-10 and G-24 Deputies, could help strengthen further the continuity of the consultation process. Here again, however, smooth and productive relations with members require some degree of discretion and diplomacy.

Several suggestions were considered in last year's review of surveillance with regard to publicity: the release of a public statement by the Managing Director at the conclusion of each Article IV consultation, based on his summing up of the Board discussion, giving a brief assessment of a country's policies and prospects; the release of Article IV staff reports upon the request of the member involved; and wider circulation of Recent Economic Developments papers. Few Directors supported the idea of a major move toward greater publicity in connection with the policy content of Article IV consultations. Directors considered, as had been also stressed in the staff paper, that making discussions between the Fund and its members public could have serious consequences for the candor and frankness of policy discussions with members. Most Directors, however, were open to the wider release, including publication, of REDs with the approval of the member concerned.

Two other proposals were put forward in the reports of the G-10 and G-24 Deputies. The first proposal, by the G-10 Deputies, is to request that members indicate measures introduced or considered to address the problems identified through the consultation process and respond to specific policy suggestions. The staff paper for the 1985 annual review of surveillance suggested that it would not be productive to formally require such replies in all cases. <sup>1/</sup> In cases when the authorities do not agree with the assessment or recommendations in the staff report, the usual buff statement of the member's Executive Director provides an opportunity for laying out clearly the reasons for such disagreements. A more explicit presentation in staff reports of differences of view with the authorities, and of underlying reasons, would also facilitate this process. As indicated earlier, continued disagreements with a member's authorities at the conclusion of the consultation process, in cases where the Executive Board considered the matter of sufficient importance, could lead to a direct communication between the Managing Director and the Minister of Finance. Alternatively, or in addition, as Executive Directors agreed in concluding the 1985 annual review of surveillance, a supplemental consultation could be appropriate if the conclusion of an Article IV consultation left serious doubts about the appropriateness of a member's policies.

The second proposal, by the G-24 Deputies, envisages the preparation of information notices in the event of deviations in implementing suggested policy changes. Formally, this procedure is envisaged as a follow-up to the negotiation of policies in the first stage of the surveillance process in a multilateral setting, outlined by the G-24 Deputies. Abstracting from the relationship of the proposed procedure to the two-stage negotiation/review process, information notices or interim staff reports on certain aspects of policies could provide an

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<sup>1/</sup> SM/85/65, op. cit., p. 34.

opportunity for closer monitoring of main policy developments. Such a procedure is examined further below as a means to strengthen the supplemental surveillance procedure.

Both the G-10 and G-24 Deputies' reports endorse a greater use of supplemental surveillance. While, when adopted, the supplemental surveillance procedure was intended to provide a more flexible mechanism for closer and more frequent scrutiny of important changes in members' policies, in practice the initiation of formal supplemental consultations has been rare. <sup>1/</sup> This rarity has been to a large extent self-reinforcing, as it has implied that supplemental consultations take place only under highly exceptional circumstances. Instead, informal discussions with members' authorities during the period between formal consultations have provided an opportunity on several occasions for the management and staff to keep informed of important ongoing developments, to ascertain the members' reasons for specific policy actions, and to convey Management's views to the authorities. Subsequent regular consultation reports have reflected the information received as well as views formed during such informal contacts.

A wide range of views were expressed by Directors during the 1985 annual review of surveillance in encouraging the use of supplemental consultations in appropriate circumstances. Several Directors suggested that supplemental consultations might be appropriate for members in arrears to the Fund, members without current programs but with large financial obligations to the Fund and members making prolonged use of Fund resources. Several Directors noted that supplemental consultations could be triggered as a result of major policy actions or following Board consideration of information notices on exchange rates or changes in trade policies. Also, as noted above, a supplemental consultation could take place if the conclusion of an Article IV consultation left serious doubts about the appropriateness of a member's policies.

In addition to its acquired exceptional character, two basic reasons underlay the lack of use of the supplemental surveillance procedure. First, its explicit focus on exchange rate policies or the behavior of the exchange rate make it less amenable to use in cases where issues arise that are not explicitly or immediately connected with external policies but rather with domestic economic and financial policies, the effects of which may be reflected only at a later stage in a movement of the exchange rate or may prevent an appropriate realignment of exchange rates. Second, the reliance on judgment that the procedure is needed, at the time it is invoked, tends to focus attention on identifiable actions rather than lack of action.

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<sup>1/</sup> Under the supplemental surveillance procedure; there have been no "supplemental" consultations under paragraph V of the procedures for surveillance.



A first area of improvement would be to recognize explicitly the broader range of policies which could trigger supplemental surveillance. The issues involved are similar to those raised in the companion paper for the biennial review of surveillance in reviewing the appropriateness of the Principles for the Guidance of the Fund and reflect the fact that the key areas of strain in the international financial system have resulted not from external but from domestic policies which, maintained for extended periods, have led to the emergence of large internal and external imbalances.

A second area of improvement would be to make the procedure more automatically usable in relation to developments not necessarily involving specific actions.

First, as indicated earlier, the need for supplemental surveillance may already be apparent at the conclusion of a consultation with a member. Second, a failure to implement within a set period (say, three or six months) policy actions of the kind considered essential and identified as such at the conclusion of a consultation with a member could automatically trigger a supplemental consultation. Third, Directors may consider a matter to be of sufficient importance to warrant more frequent scrutiny than would be provided through the normal consultation process. In those cases, Executive Directors could indicate in concluding the consultation those specific areas of policy on which they would expect an interim report from the staff (say, in three or six months). Following the consideration of such reports, the Executive Board could call for a supplemental consultation.

Interim staff reports could be appropriate, for example, if Executive Directors considered in concluding a consultation that developments or policies were near the threshold beyond which specific follow-up action would be indicated. Another example would be if the assessment at the time the consultation is concluded depended to a significant extent on policy intentions recently announced by the member's authorities but not yet fully articulated or implemented. In considering whether such a procedure would help strengthen the continuity of surveillance, Executive Directors may also wish to consider whether staff appraisals should recommend interim reports in appropriate cases or whether the initiative should be left to the Executive Board.

#### V. Summary of Main Issues

1. Apart from the several issues arising in connection with the proposals of the G-10 and G-24 Deputies to strengthen the implementation of surveillance procedures, the issue has been raised by several Directors of the need for more differentiation in the frequency of consultations. Specific options examined in the paper are the lengthening of the interval between consultations for members already on longer cycles

and the specification of intervals longer than 12 months (possibly, with interim staff visits) for those members not falling strictly within the guidelines for consultations at annual intervals.

2. Major lessons for the implementation of surveillance procedures highlighted by the experience since 1977 included: (i) the importance of focusing at an early stage not only on a country's overall balance of payments position but also on the sustainability of the structure of the balance of payments; (ii) against this background, the importance of paying particular attention in assessing members' exchange rate policies to the sustainability of a broad range of members' external and domestic economic and financial policies; (iii) the sensitivity of some countries' positions to conditions created in the world economy by other members' policies. In general, these developments all highlight the need to strengthen the exercise and influence of surveillance.

3. Proposals of the G-10 and G-24 Deputies relating to the implementation of surveillance procedures can be grouped broadly in three categories: proposals to improve the analytical basis of surveillance, proposals to enhance the multilateral setting of surveillance, and proposals to strengthen the influence of the consultation process.

4. The central issue highlighted as regards the analytical basis of surveillance concerns the need to focus the assessment of policies on their sustainability and, from this perspective, on their impact on growth, international integration and the promotion of stable economic and financial conditions, both in the short term and over the medium term. Related concerns provide the basis for the several proposals in the reports of the G-10 and G-24 Deputies concerning the focus of surveillance on the full range of policies affecting external developments, on the timeframe of analysis and the need to improve the underlying data base and on the presentation of the empirical and analytical basis of policy judgments. G-10 Deputies also recommend that policy assessments be more candid, that the analytical and empirical basis of assessments be made more evident, that policy recommendations be specific, and that differences of view between the staff and the authorities be spelled out and discussed.

5. Larger members with key currencies have a special responsibility to adopt policies consistent with the establishment and maintenance of stable economic and financial conditions for those countries closely linked to them through trade and financial relations. For the international economy as a whole, it has become increasingly accepted that this implies a special need for larger members with key currencies to achieve a closer coordination of their policies. Specific mechanisms to enhance the multilateral setting of surveillance are suggested by both G-10 and G-24 Deputies: the preparation of a special chapter of the World Economic Outlook, highlighting international interactions and repercussions, for the subsequent review

of G-10 Ministers and Governors (by G-10 Deputies); the discussion and negotiation, against the background of the World Economic Outlook, of mutually consistent objectives and policies (by G-24 Deputies).

6. The reports of G-10 and G-24 Deputies review several proposals related to the follow-up to consultations, publicity and supplemental surveillance: reviewing explicitly the implementation and effects of policy recommendations; requesting members to indicate measures which have been introduced or considered to address problems identified and to respond to specific policy suggestions; confidential (selective) exchange of views between the Managing Director and the Finance Minister; and greater publicity for the consultation process itself. Executive Directors' views on this subject, on the occasion of earlier reviews of the implementation of surveillance, were summarized briefly to provide a basis for further discussion.

7. Both the G-10 and G-24 Deputies encouraged greater use of supplemental surveillance. Related proposals highlighted in this and the companion paper for the biennial review of the surveillance document include: the initiation of a more automatic process of supplemental surveillance; explicit recognition of the broader range of policies which could trigger supplemental surveillance; the initiation of supplemental surveillance in the case of failure by a member to implement (within a set period) policy actions of the kind considered essential and identified as such at the conclusion of a consultation; review by Executive Directors of the need for a supplemental consultation on the basis of interim staff reports on developments in areas of policy identified by Directors (in concluding a consultation) as requiring close and frequent scrutiny.

8. As specified in Decision No. 7939-(85/49) taken March 25, 1985, the annual review of the implementation of Fund surveillance over members' exchange rate policies, including the procedures for the conduct of consultations under Article IV, is to be conducted not later than April 1, 1986. Draft decisions will be proposed for adoption following Board consideration of the reports for the biennial review of the surveillance document and the annual review of the implementation of surveillance. Such decisions are necessary to complete the two concurrent reviews by April 1, 1986. Also, these draft decisions will identify matters for consideration at a later date.