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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 85/48

3:00 p.m., March 22, 1985

J. de Larosière, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	A. K. Diaby, Temporary
C. H. Dallara	M. K. Bush
	G. H. Schneider
B. de Maulde	X. Blandin
M. Finaish	T. Alhaimus
H. Fujino	M. Sugita
G. Grosche	
	Jaafar A.
R. K. Joyce	L. Leonard
	J. R. N. Almeida, Temporary
	H. Fugmann
E. I. M. Mtei	
F. L. Nebbia	
Y. A. Nimatallah	J. E. Suraisry
	G. Ortiz
J. J. Polak	J. de Beaufort Wijnholds
C. R. Rye	A. V. Romuáldez
G. Salehkhou	
A. K. Sengupta	
	T. A. Clark
S. Zecchini	N. Coumbis
	Wang E.

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

1. Surveillance - Annual Review, and Ways of Enhancing Effectiveness . . . . Page 3

Also Present

European Department: P. L. Hedfors. Exchange and Trade Relations Department: C. D. Finch, Director; W. A. Beveridge, Deputy Director; M. Guitián, Deputy Director; S. J. Anjaria, G. Belanger, J. T. Boorman, E. H. Brau, K. Flug, G. G. Johnson, M. R. Kelly, M. Nowak, R. Pownall, P. J. Quirk, R. L. Sheehy, C. M. Watson. External Relations Department: A. F. Mohammed, Director; C. S. Gardner, Deputy Director; I. S. McDonald. Fiscal Affairs Department: V. Tanzi, Director. Legal Department: G. P. Nicoletopoulos, Director; J. G. Evans, Jr., Deputy General Counsel; W. E. Holder, Ph. Lachman, A. O. Liuksila, S. A. Silard. Middle Eastern Department: M. A. El-Erian, B. A. Karamali. Research Department: W. C. Hood, Economic Counsellor and Director; R. R. Rhomberg, Deputy Director; J. Artus, J. M. Boughton, J. P. Horne, M. D. Knight, P. R. Masson. Secretary's Department: G. Djeddaoui, P. D. Péroz. Treasurer's Department: J. E. Blalock. Western Hemisphere Department: S. T. Beza, Associate Director. Bureau of Statistics: C. A. Patel. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: E. A. Ajayi, G. R. Castellanos, L. K. Doe, K. A. Hansen, G. E. L. Nguyen, J.-C. Obame, M. Z. M. Qureshi, T. Sirivedhin, A. Steinberg, E. M. Taha, D. C. Templeman, A. Vasudevan. Assistants to Executive Directors: E. M. Ainley, W.-R. Bengs, G. Biron, M. B. Chatah, Chen J., J. de la Herrán, J. J. Dreizzen, G. Ercel, V. Govindarajan, N. Haque, G. D. Hodgson, Z. b. Ismail, A. K. Juusela, H. Kobayashi, S. Kolb, M. Lundsager, K. Murakami, E. Olsen, J. Reddy, D. J. Robinson, J. E. Rodríguez, A. A. Scholten, A. J. Tregilgas, E. L. Walker, B. D. White, A. Yasseri.

1. SURVEILLANCE - ANNUAL REVIEW, AND WAYS OF ENHANCING EFFECTIVENESS

The Executive Directors resumed from the previous meeting their consideration of a paper prepared by the staff for the 1985 annual review of the implementation of surveillance, on ways of enhancing its effectiveness, together with background material (SM/85/64, 2/22/85; Sup. 1, 2/28/85; Cor. 1, 3/20/85, and Cor. 2, 3/22/85).

Mr. Jaafar commented that the conduct and effectiveness of surveillance activities were satisfactory at present. If sight was not lost of the fact that surveillance had to be conducted in a framework in which the Fund dealt with sovereign member countries, which had not only economic objectives but also certain social and political aspirations, it could be concluded that the Fund's surveillance activities had been successful. That success had come in no small measure from the high quality of the staff's analysis and understanding of members' economic problems and prospects, as well as from the close cooperation of members themselves.

There was somewhat limited scope for improving the effectiveness of the Fund's surveillance function, Mr. Jaafar continued. Indeed, if the refinements of the procedures were taken too far, the results could prove counterproductive. The additional resources that innovations would call for in terms of staff and Board time might not be commensurate with the contemplated improvements in effectiveness.

For surveillance to be effective, its focus should be on industrial countries whose policies had much greater international consequences, particularly for the functioning of the international monetary system, which was the major responsibility of the Fund, Mr. Jaafar considered. Therein lay the weakness of the system, or the frustration with it, that Mr. Finaish and other Directors had already touched upon. The weak leverage that the Fund had over major industrial countries was an important issue because of the overwhelming impact of their economies on the well-being of the rest of the world economy. For instance, while swings in exchange rates might not necessarily be the result of faulty domestic policies, the Executive Board's analysis of the U.S. and of other major economies made it possible to state with some confidence that a lack of convergence of policies was partly at fault. The Fund certainly had the potential for making the necessary multilateral input to achieve that objective but to date its impact had been limited. His perception was that the regular meetings of the top policymakers of the major industrial countries, at which they discussed their problems among themselves, had been more effective. The contribution that Fund surveillance could make would come more from concentrating the Fund's energy on bringing its opinion and judgments to bear on the deliberations of those bodies. In his opinion, persistence and quiet diplomacy rather than publicity would be the best course. The question was, of course, to what extent those countries listened to the Fund.

The information and analysis on external debt and trade policies contained in recent staff papers was both useful and appropriate and should continue to be provided by the staff, Mr. Jaafar noted.

A number of smaller developing countries found Article IV consultation discussions most useful from the point of view of both economic analysis and policy advice, Mr. Jaafar stated. Many of the recommendations made to such countries were implemented by the authorities. If it became necessary in order to reduce the staff work load, he would have no objection to less frequent consultations, if the member so preferred, but he emphasized that anything less than the standard cycle should not be forced upon a member. The current flexibility for setting consultation cycles should be retained.

Indicators for improving the effectiveness of surveillance would be largely judgmental and not easily quantifiable or objective, Mr. Jaafar noted. If such a technique were to be used for the membership as a whole, he foresaw that the staff would have to spend a great deal more of its time on its implementation, at least in the initial stages, and that it would encounter practical difficulties. Nevertheless, he appreciated that objective indicators could serve a valuable and useful purpose in guiding members in the conduct of policy. Therefore, he would have no objection to introducing the technique on an experimental basis for major industrial countries; its effectiveness could be evaluated when results became available.

There were arguments for and against greater publicity to achieve more effective surveillance, Mr. Jaafar considered. The results would vary from country to country, but on the whole, the proposal for greater publicity seemed to carry so many risks that it should be approached cautiously. The extraordinary candor of policy discussions for Article IV consultations, either in the Executive Board or with member countries, should be preserved at all costs: much of it could be lost if certain issues or findings were placed in the public domain. Posturing rather than substance might dominate the discussions, not to mention the uncertain reception that some of the Managing Director's published statements might be given by the public as well as by national authorities. In that connection, he felt the need for further clarification of the suggestion that the Managing Director could release statements on Article IV consultations on his own authority; as he understood it, in concluding an Article IV consultation, the Managing Director had to express the views of the Executive Board.

To highlight the concern of his chair over the usefulness of publicity, Mr. Jaafar cited a view that had been expressed on a previous occasion when the Executive Board had briefly discussed the question of publicity. As he recalled it, some Directors had strongly supported publicity but had almost in the same breath said that their authorities were so sensitive about the unemployment situation in their countries that unemployment statistics were not published. It was not difficult to imagine how hard it would be to agree on the contents of a staff report that was to be publicized. Therefore, he would prefer to maintain the status quo as far as publicity was concerned. However, like Mr. Lundstrom, he considered that the World Economic Outlook Surveys and the occasional statements by the Managing Director on general policy issues made an invaluable contribution to the conduct of surveillance. The analysis of the world economic outlook also constituted a major input in helping his authorities formulate their own policies.

In following up consultations, the views of the Executive Board should be brought to the attention of the authorities at the highest level, Mr. Jaafar commented, as no doubt they already were in many countries. He also agreed with the staff's proposal that management should communicate with ministers of finance, although if the benefits were not to be diluted, such contacts would have to be on a highly selective basis. An attempt should be made to communicate the staff's findings directly to the authorities responsible for trade policy and its impact on the balance of payments.

He could accept supplemental consultations and enhanced surveillance if they were restricted to major industrial countries because of their weight in the world economy and their influence on the international monetary system, Mr. Jaafar said. His chair supported Mr. Salehkhou's position on surveillance over the exchange rates of major countries, based on the relevant Articles of Agreement.

To sum up, Mr. Jaafar concluded, while surveillance activities were being conducted satisfactorily at present, the proposed improvements would yield some benefits if they were focused on the major economies. Because the additional costs inherent in the global application of the staff's proposals was out of proportion to the benefits, he urged great caution in implementing some of those proposals. Finally, he supported the proposed decision.

Mr. Fujino remarked that it had become an established opinion that in a world of growing interdependence, the policies and economic performance of one country could have a profound impact on the economies of other countries because of their effects on trade, the balance of payments, and the exchange rate. The floating rate system for major currencies had provided some flexibility in the international monetary system during a period of turbulent economic conditions; however, it had not relieved each country of the responsibility to pursue financial policies aimed at noninflationary and sustained growth. Differences in economic performance could result in volatile and disturbing exchange rate movements. Through the effective implementation of surveillance, the Fund could make a central contribution to the smooth functioning of the international monetary system.

As noted in the Executive Board's recent discussion of external indebtedness (EBM/85/45 and EBM/85/46, 3/20/85), Mr. Fujino recalled, if debtor countries were to restructure their economies over the medium term and restore normal relationships with creditors in financial markets, they would have to continue their efforts toward economic adjustment. Fund surveillance could play an important role in that respect as well: the effective implementation of surveillance would be instrumental in preventing new debt problems from emerging. Evenhandedness, which had been emphasized by many Directors, was indeed essential if the Fund's surveillance was to be strengthened. However, a distinction should be made between the role of surveillance on the one hand, and the conditionality attached to Fund-supported programs or the Fund's jurisdiction over exchange restrictions on the other hand. Surveillance was a mutual recognition by the Fund and its members of the existence of the problem and of the appropriate policy measures to deal with it. The Fund had accumulated 40 years of experience and expertise in analyzing the problem and was developing a convincing analysis and arguments about the direction that policy should take. Naturally, differences of view might arise, or there might be severe constraints on the actual implementation of policies. The exchange of views during consultation discussions and the Executive Board's deliberations were useful occasions for deepening mutual understanding.

Each member country, including his own, was sensitive and responsive to Fund surveillance, Mr. Fujino considered. In formulating fiscal and monetary policy or in carrying out structural measures, more than due regard was given to the impact on the international community. As he had mentioned on the occasion of the Executive Board's discussion of the 1984 Article IV consultation with Japan (EBM/85/33 and EBM/85/34, 3/4/85), even if the actual results might not be forthcoming immediately, it did not indicate a lack of policy response to surveillance but simply that there was little room for policy maneuver under existing circumstances. Also, in a large country with a complex political process, policy implementation took longer.

Commenting on the ideas put forward in Sections IV and V of SM/85/65, Mr. Fujino said that he could endorse in principle a longer consultation cycle for members with quotas below the median or SDR 100 million. At the same time, in view of the extremely heavy work load imposed on the Executive Board smaller members might be placed on longer cycles; any inconvenience on the part of member countries could be taken care of, for instance, by supplementing a two-year consultation cycle with staff visits in the off year, upon the request of the member, without the need for an accompanying discussion in the Executive Board.

Encouraging technical improvements had been made to the information notice system, Mr. Fujino considered, but further improvements were needed. Moreover, as his chair had repeatedly emphasized, focusing on changes in real effective exchange rates alone did not provide an adequate basis on which to assess exchange rates. The recent large movement in the exchange rates of major currencies had demonstrated that capital flows could be an important factor in influencing floating exchange rates. At the present stage, it was necessary to be cautious and to maintain the 10 percent threshold for issuing information notices. He wished to make it absolutely clear that his chair attached great importance to the role of the Fund in monitoring the exchange rates and exchange policies of its member countries.

He had taken note of the suggestion on page 28 of SM/85/65 for a separate discussion on developments and policies in major countries in connection with the Executive Board's discussion of the world economic outlook, Mr. Fujino added. However, in his view, a separate discussion of recent developments and short-term prospects for all members, accompanied by medium-term scenarios, would make a much more useful contribution, with due focus on specific and major points.

His authorities supported the suggestion that the Managing Director should publicly release a statement at the conclusion of each Article IV consultation, assessing briefly the country's policies and prospects; the statement might be as short as one page, Mr. Fujino remarked. If such statements did not include specific policy suggestions and if they were released on the Managing Director's own authority, the wording would not have to be negotiated.

The public release of staff reports for Article IV consultations, even upon the request of the member country concerned, would endanger the frankness and informality of the consultation discussions between the staff and the authorities of member countries, Mr. Fujino considered. He could go along with the general distribution or publication of reports on recent economic developments, on condition that the member concerned gave its prior approval and as long as the contents were limited to a description of the facts. Nevertheless, once reports on recent economic developments in certain member countries were generally distributed or published, other members that had chosen not to permit such reports to be distributed would come under pressure to do so. It would therefore be preferable for Executive Directors to reach a broad consensus among themselves on the issue. He had no difficulty in supporting a more limited release of reports on recent economic developments, for selected countries, based on general guidelines set by the Executive Board in order to ensure uniform treatment of all member countries.

He could also support direct communication between the management and finance ministers on the key findings of consultations, Mr. Fujino noted, although it should be left to management to judge when such contacts were necessary because of the demands that would be made on its time. He could also support a more extended evaluation in staff reports, or a follow-up report by the staff in cases where that was deemed necessary, of policy actions implemented since the previous consultation.

Supplementary consultations would have to be undertaken more actively when the behavior of the exchange rate of member countries was likely to have important effects on other members, as stipulated by the 1979 decision of the Executive Board, Mr. Fujino considered. The case-by-case judgment on whether or not exchange rates might have major effects on other members should rest on an analysis of economic policies and performance--more specifically, balance of payments, inflation, and interest rate developments--of the affected member countries. However, he harbored a number of doubts about the extent to which objective indicators, especially quantified key indicators similar to those used in Fund programs, could be utilized to judge the performance of member countries not making use of the Fund's resources, particularly major industrial countries. It would not be practical to use such indicators as automatic triggers for supplementary consultations.

As he had mentioned during the Executive Board's discussion of developing countries' external indebtedness, the Fund had a role to play on enhanced surveillance, provided it was sufficiently cautious to avoid being regarded as accepting the responsibility of guaranteeing the obligation of member countries to commercial banks, Mr. Fujino stated. One procedural question was the desirability of giving the Executive Board an opportunity to discuss fully, on a case-by-case basis, whether the underlying economic program was appropriate and strong enough to restore confidence in the economy concerned over the medium term before the Fund formally agreed to engage in enhanced surveillance.

Finally, Mr. Fujino stated, the Executive Board should return to the matter of the work load before it took a decision on adopting any new procedures. Meanwhile, he was broadly in agreement with the thrust of the staff paper and supported the proposed decision.

Mr. Dallara made the following statement:

> As you know, the United States has attached considerable importance to the strengthening of IMF surveillance as a key means of encouraging the adoption and implementation of sound economic policies in member countries, which in turn can contribute to a more effective functioning of the international monetary system and an expanding world economy.
>
> The IMF's surveillance procedures, based as they are on members' obligations under the second amendment to the Articles of Agreement, have necessarily been evolutionary in nature, developing in response to the increasing need for international cooperation and understanding in the face of a rapidly changing global environment and increasing interdependence among countries and currencies. Current surveillance principles and procedures are based on the principles agreed upon in 1977, subsequently revised to a modest extent since that time during the biennial reviews of the principles. Although this is not the occasion for one of these biennial reviews--that will, I believe, occur next year around this time--I believe it is becoming apparent that the evolution of surveillance principles and procedures has perhaps lagged behind the evolution of global economic problems and conditions. Indeed, many of the problems which have plagued the world economy in recent years might have been avoided, or at

least the problems might have been less serious if IMF surveillance had been more effective during the period when underlying problems were initially emerging. Some of these problems we have discussed in some detail in this Board during the last week. In particular, I might note here the serious debt problems of many countries, as well as the divergencies underlying economic performance in major industrial countries which have contributed to exchange rate developments and which are a matter of serious concern to the United States and the international community.

Here it is important to point out that problems can obviously emerge from policy changes which go in the wrong direction, or from lack of policy change. These may, or may not, be accompanied by changes in circumstances or changes in market perceptions concerning the sustainability of a particular set of policies. The variety of ways through which questions may emerge regarding the effective compliance of members with their obligations under Article IV has implications, I believe, for how we implement surveillance. I shall return to this complex and important matter later in my statement.

I found the staff's paper to be excellent in summarizing recent developments in IMF surveillance and, most importantly, in outlining and mentioning various ways and ideas which have been put forward to strengthen the effectiveness of IMF surveillance in the future. As you have pointed out earlier today, many of these ideas have emerged from different sources, including work under way within the Group of Ten as part of the study being conducted by that group on possible improvements in the international monetary system. We expect this study to be completed by the middle of this year, and would hope for its subsequent consideration at an early, but not a special, meeting of the IMF Interim Committee. We are pleased that a number of the ideas which have been discussed in that group, as well as other suggestions which have emerged from the deliberations of this Board and the efforts of the staff and management over the past years, are being given attention more broadly and more generally today. We hope that this discussion will, indeed, prepare the ground for the adoption of concrete measures to strengthen IMF surveillance. It will be for our ministers and governors to discuss and consider the need for stronger surveillance and to have the opportunity to review and endorse these ideas prior to their actual implementation. Indeed, as the paper points out, one of the purposes of this particular paper is to serve as a basis for a discussion of some of these issues during the upcoming Interim Committee meeting. I believe that only by involving our ministers and governors directly in this exercise can we assure that surveillance consultations will be given the appropriate level of attention within member governments and that surveillance will, in the end, be more effective.

IMF surveillance does have an important role to play in supporting all members' efforts in pursuing noninflationary growth and external stability. These are developments and objectives which can be realized and achieved, we believe, fundamentally from sound and stable national economic policies and performance. This focus on underlying policies is, of course, embedded in the amended Article IV. I wonder if I may quote a section of the Article, because I feel that it is centrally relevant to the discussions which we have before us today.

Section 1 of amended Article IV states, under the heading, "General obligations of members,":

> Recognizing that the essential purpose of the international monetary system is to provide a framework that facilitates the exchange of goods, services and capital among countries and that sustains sound economic growth, and that a principal objective is the continuing development of the orderly underlying conditions that are necessary for financial and economic stability, each member undertakes to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates. In particular, each member shall:
>
> (i) endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability, with due regard to its circumstances;
>
> (ii) seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions;

There are other elements of this section of Article IV, but I shall not extend the Board's patience by reading further from the Articles, with which we are all familiiar. Rereading the Articles does, however, underscore that, in spite of the progress that has been achieved by members in their efforts to achieve orderly underlying economic conditions, and by the Fund in conducting surveillance over members' compliance with their obligations under the Articles, Directors are clearly correct when they say that we have not yet achieved these fundamental objectives set forth in Article IV. These obligations are, of course, central to much of the work of the Fund, and they underlie, as has been pointed out by other Directors, the principles and procedures which frame our surveillance efforts.

In my view, it is essential to develop further both the content and procedures of IMF surveillance in order to foster greater mutual understanding of our individual situations, to promote the development of a common analytical framework, and to enable the IMF to support, influence, and help shape the policies of member governments as they strive in their efforts to develop sound underlying policies that will promote noninflationary growth.

In discussing the initial sections of the IMF paper, regarding the effectiveness of surveillance and its analytical underpinnings, I would like to comment in particular on the question of exchange rate movements and structural adjustment.

First, in reading the general remarks on page 3 in the staff paper--"The Effectiveness of Surveillance"--I was struck by the fact that the staff has focused predominantly in that section on exchange rate developments and policies per se, rather than on the wide range of policies and other developments which can affect exchange rates and which may be better indicators, in some instances, of the success or lack of success of surveillance than exchange rate movements or the lack of such movements.

The 1977 decision on surveillance, as amended, explicitly emphasized that the Fund's appraisal of a member's exchange rate policies must be based on an evaluation of its balance of payments developments within the framework of a comprehensive analysis of its economic situation and its policy strategy. Indeed, this section of the "principles and procedures" is quoted, I believe, in the staff paper. Yet, I felt that the staff did not give due attention to the comprehensive nature of surveillance in their general analysis and assessment of surveillance. I might add a sentence or two from the "principles" which surround that particular quote. They lend even more support, I believe, to the view that these matters have to be viewed broadly, and have to take into account a range of policies and developments.

"The Fund's appraisal of a member's exchange rate policies shall be based on an evaluation of the developments in the member's balance of payments against the background of its reserve position and its external indebtedness." And then there is also reference to "...the framework of a comprehensive analysis of the general economic situation and economic policy strategy of the member...." It goes on to say that "the appraisal shall take into account the extent to which the policies of the member, including its exchange rate policies,"--placing those policies in the context of other policies--serve the objectives of the continuing development of the orderly underlying conditions that are necessary for financial stability, the promotion of sustained sound economic growth, and reasonable levels of employment." Those last variables are among those that I thought would have been considered in any overall effort to assess the progress of members and the institution under surveillance.

I believe that any approach which focuses primarily on exchange rates per se, and exchange rate policies narrowly defined, will not permit a comprehensive and balanced judgment of the country's policies and performance as a whole. This is not to minimize the importance attached to exchange rate developments, but it is to say that they are only a part of the overall picture.

We do agree with the statement in the staff paper that pronounced swings in exchange rates between major industrial countries are not necessarily the result of faulty policies, nor are they prima facie evidence of the lack of effectiveness of surveillance. Yet, as Mr. Jaafar put it very well, they, along with other developments, can certainly be an indication of the potential lack of convergence on the part of major industrial countries in their efforts to restore noninflationary growth. Although capital flows have become a very large component of international transactions, and can have a major impact on exchange rates, there is still only limited understanding of the longer-run determination of such capital flows. This does, indeed, complicate our efforts to obtain greater exchange rate stability. At the same time, it should not lead any of us to consider the question of capital controls. Indeed, differences in the degree of openness of capital markets may be a significant factor influencing capital flows. A movement toward more mutually open markets may increase exchange rate stability. In this context, we support the continuing attention being given to the damaging and harmful effects of exchange and trade restrictions as a substitute, in certain cases, for greater exchange rate flexibility.

I welcome the increased attention which the IMF has given to structural adjustment in industrial countries, covering such areas as unemployment, social expenditures, and wage and labor rigidities, common problems in many of the industrial countries. I would also stress the importance, as the staff has constantly done, of addressing structural and institutional problems in developing countries, in many cases in cooperation with the World Bank.

Referring to the question of fiscal deficits and structural rigidities in industrial countries, I felt that the background material provided us was very helpful and very useful. It outlined some of the potentially adverse implications of certain policies in both of these areas. However, I noted that the discussion on page 27 of Supplement 1 to SM/85/65 covered the question of changes in fiscal deficits and the effects the staff believe such changes may have on exchange rates. In contrast, the discussion of structural improvements in the second paragraph on page 27, on the functioning of goods and labor markets, related those improvements only to growth and employment.

Interestingly, it did not relate the need for change in these structural areas to exchange rate developments. Indeed, I think one of the more interesting phenomena that has been observed recently is the increased perception in exchange markets of the importance of these factors. Here I stress the word "perception," because it is not clear that the underlying policies or problems have either changed substantially, increased, or deteriorated. I would be interested if the staff might give consideration as to whether this particular link--between structural problems and exchange rate developments--might be usefully explored or studied, since it is not very easy to identify this relationship in the context of our more traditional theories of exchange rate and balance of payments determination.

Reviewing recent improvements in surveillance we commend the staff for the innovations which have been introduced or expanded upon during this past year as a result of earlier Board discussions of surveillance in general, as well as individual case-by-case experience. This covers such things as references in consultation reports to the conclusions and recommendations in previous reports, comments concerning the adequacy of data provided by member countries, and descriptions of relations with the World Bank. Here and elsewhere progress has been made. On this last point, we feel that additional progress can be made, not only in describing in a rather straightforward way what the status of a particular country's relations might be with the World Bank, but in discussing any analytical views which may have a particular bearing for the Fund's objectives in that country. In that context, reference could be made to any analytical differences which might arise in the cooperative efforts of the two institutions to support members' efforts to deal with their problems.

The brief histories which have been introduced concerning past relationships with the Fund are also helpful, as are basic data tables and the use of tables of contents. I mention all these only because they are much appreciated. They add to our ability to understand and analyze developments in member countries. We have also supported the idea of Executive Directors suggesting topics which might be raised with country authorities to staff missions prior to their consultation discussions. In fact, this occurred at the time of the United States' consultations last year. We wonder if, in fact, it has occurred in other cases.

Additionally, in reviewing the recent developments in surveillance, attention has been given in the staff paper, appropriately so, to the increased importance attached to multilateral forms of surveillance. Here I might make a rather small and perhaps pedantic point. I have considerable difficulty with the concept of "bilateral" surveillance, as it has been put forward in these documents, because I have difficulty in viewing any efforts involving the IMF and a particular member country as a "bilateral" form of surveillance. It happens to be country-specific, but it is, nevertheless, multilateral. This is because all of us have a chance, from time to time, to review and discuss the policies of any particular member country.

That aside, let me turn to more important issues. In the context of multilateral surveillance, we do believe that the various mechanisms and fora mentioned here can play a useful role. This includes the World Economic Outlook exercise, G-10 discussions among industrial countries, the Working Party-3 of the OECD, and the G-5 discussions. In the last example, you, yourself, played an important role, in facilitating a discussion among the financial authorities of the five major industrial countries.

Let me now turn to another aspect of surveillance which is discussed in the paper, the question of evenhandedness of IMF policy. As the paper notes, a number of countries have expressed concerns--and we heard some of those concerns echoed here this morning--about the evenhandedness of IMF surveillance. They assert that it appears to be tougher, in some sense more rigorous, for those nations which have borrowing arrangements with the Fund, than for the industrial countries. We believe that the staff has properly and effectively responded to those concerns, making it clear that conditionality, which applies to countries which may use Fund resources, and which derives, I believe, from Article V, is not the same function as surveillance, which derives from Article IV.

IMF surveillance activities apply to all members. Of course, there have been references in the Board, and there is a discussion in the paper, concerning the differences in frequency of consultations. For some of the smaller members which are not experiencing particularly acute payments problems or arrears problems with the Fund, longer cycles may be appropriate. I have noted with interest the comments of many of my colleagues, however, suggesting that they do not wish those cycles to be stretched out too far because of the importance attached to consultations by their authorities. We need to be sensitive to their needs and considerations.

The policies of the industrial countries and the larger developing nations receive more pronounced attention in cross-country deliberations of the Board, and in deliberations which involve policy interactions, notably in the World Economic Outlook. This is precisely because of their greater impact on the world economy. We see nothing inappropriate about this, and nothing that poses serious questions for uniformity of treatment.

In the case of the United States, of course, our policies inevitably receive attention, and sometimes considerable attention, during Article IV consultations with other countries, as the recent U.K. and Japanese consultations demonstrate.

I realize that some of you, indeed many of you, may be skeptical that surveillance can have an effect on the policies of major countries, including, but not limited to, the United States. It is true that surveillance as currently implemented, does not have the "teeth," in a sense, that conditionality in borrowing arrangements does. But again we believe that this confuses the issue. The two are distinctly different functions, and properly so. That being said, it is possible--and in our view essential--to improve the effectiveness of IMF surveillance through procedural and substantive changes which can apply to all countries and, hopefully, enhance its effectiveness vis-à-vis all countries.

As far as the United States is concerned, we cannot guarantee that IMF advice will always be accepted. Indeed, in some cases, there may be analytical disagreements regarding the implications or desirability of particular policies. I would not, however, like to stress those disagreements. This is because it is clear on the basis of our most recent consultations that there are many areas of agreement between my authorities and the IMF, concerning the need for policy changes in certain areas. Where there are anlytical disagreements, however, surveillance can help clarify and perhaps reduce those differences, and that can have a beneficial effect. In addition, strengthening surveillance for all members, including for the United States, cannot help but assure that international concerns regarding domestic policies are heard and taken into account in national decision making.

We strongly support most of the proposals suggested in this paper. Indeed we would put perhaps even stronger emphasis on certain proposals, particularly those which could increase both public and official awareness of the international ramifications of domestic economic policies. However, I believe that in some instances, such as the use of quantified indicators for consultations, the staff is suggesting an approach which may not be the most appropriate or constructive. I will comment more specifically on that later in my statement.

To follow the order of discussion proposed in the paper, let me just say a word further about implementation issues, which I have already commented upon earlier. Our work load may indeed make it necessary to expand somewhat the number of countries where Article IV consultation cycles exceed 12 months if, of course, that does not run counter to the interest and needs of particular members, as mentioned earlier. And, or course, there are certain cases where, regardless of the size of the country, the seriousness of the problem or perhaps the existence of arrears to the Fund may make it necessary to have a more frequent cycle. Particularly in light of the progress that has been made in improving the frequency of consultations, we believe that we are at a stage where increased management flexibility is appropriate.

Now let me turn to the question of objective indicators and supplemental consultations, as well as possible modifications in the reporting of exchange rate changes. It strikes me that these suggestions, whether lowering the current 10 percent threshold for information notices to 5 percent, or extending the period of currency change to 12 months, reflect efforts to put more attention on exchange rate changes as a possible automatic trigger, not just for notifications, but possibly for supplemental consultations as well. I would contend, that these efforts, however well intended, go in the wrong direction. The use of real effective exchange rates to measure the appropriateness of a country's policies is akin, in some respects, to determining misalignments of currencies based on purchasing power parity. It does not adequately take account of the widely recognized and growing importance of capital flows in exchange rate movements. And, it does not reflect the need for exchange rate changes to be viewed, not only in the context of the current account, but the capital account as well.

In this connection I would note that the principles for surveillance adopted in 1977 contained a range of criteria that would be considered in determining whether supplemental or "special" consultations were warranted. This included protracted intervention, excessive external borrowing, imposition of trade and/or capital controls, as well as exchange rate developments. I do not think it is particularly feasible--or even necessary--to try to quantify these indicators as a basis for Board discussions or supplemental consultations. But I do think that it is critical that they be, in a judgmental and analytical sense, taken into account.

The proposal to develop indicators of policy implementation or economic developments for the major industrial countries, similar to those used in Fund programs and perhaps in IMF enhanced surveillance, presumes that the IMF would be able to negotiate a "quantified policy strategy" with a country. Such a country may have no need to draw at that point on IMF resources, and may have no interest in or need for an IMF statement or assessment of its policies in relation to private sector financing. It is not clear to us that such a presumption, or such an approach, is particularly feasible or realistic.

We support more frequent use of the supplemental consultation mechanism. The stigma which is currently associated with such consultations, to which some of my colleagues referred earlier, must be overcome. That can only be accomplished if you sense that there is a broad consensus in the Board in support of such consultations. If that consensus emerges, then I believe that a substantial improvement in the effectiveness of surveillance activities could occur through the use of such supplemental consultations.

The question that remains is on what basis such consultations might be initiated. It would refer again to the 1977 decision, which contains an array of economic developments and policies which might give rise to the potential need for a supplemental consultation. Clearly those policies already go beyond just exchange rate policies and developments. Perhaps we need to consider extending them even further to include more explicitly fiscal, monetary, pricing, trade, labor market, financial market, and other economic and financial policies and developments. Next year's review of the principles may be the appropriate time to do that, unless our ministers wish more rapid actions.

We recognize that this puts a substantial burden on the management and staff. Perhaps, there may be instances where consultation with the Board would be appropriate before initiating supplemental consultations, although I believe that the procedures for supplemental surveillance now provide some flexibility and discretion in this area. There are difficulties inherent in such an approach, which is not based on quantitative indicators relating to a particular exchange rate movement or on a particular deviation of monetary aggregates from agreed targets, but on analysis of a broad range of factors and developments. However, with careful analysis and judgment, we believe it is possible to recognize when developments in a member's policies or prospects raise concerns for the international community.

I should mention in this connection, that the notice which has just been issued on the real effective exchange rate movement of the U.S dollar is, in my view, indicative of the difficulties and problems inherent in any approach based on movements in selective, particular "objective" indicators. The notice is clearly not the basis for a supplemental consultation, but it does constitute an important information notice to the Board. In my view, there are both procedural and substantive problems with this approach. This example may illuminate some of those.

First, there is the question of whether there should be accompanying staff analysis and appraisal. We notice that the guidelines established for these notifications are not entirely explicit or clear in this regard, although they certainly leave open the scope for a staff appraisal. Indeed, it is exceedingly difficult to view any exchange rate movement, in particular the movement of the dollar, in isolation from underlying developments. But staff appraisals and accompanying analysis without consultation with the member concerned do not always provide for a balanced analysis which takes into account the views of the authorities.

In connection with this particular document, there are some concerns on my part about the analysis. I question whether it is a fully balanced approach, particularly with regard to the factors which underlie recent movements of the dollar. There is the statement, for example, on page 5 of the notice that the large U.S. current account deficit is a reflection of an imbalance between saving and investment in the United States. Well, in a certain sense any current account deficit is a reflection of an imbalance between savings and investment. But there is an implication in that statement which I believe is not entirely accurate. The staff appraisal, while acknowledging that there are other factors outside the United States which have a bearing and have had a bearing on the value of the dollar, does not, in our view, give those factors adequate attention.

The action-oriented part of the staff appraisal focuses on the U.S. federal deficit and its reduction as a key to creating "the conditions for an orderly and effective adjustment of the U.S. external current account deficit and of the exchange value of the U.S. dollar." Leaving aside the question of what effect a reduction in the federal deficit would actually have on the dollar, this does not offer a comprehensive approach toward dealing with current exchange rate problems among major industrial countries.

Indeed, when considering exchange rate and other developments of the major industrial countries, any approach dealing with only one country will be somewhat lacking because of the inevitable problem of trying to assess a particular country's exchange rate in the context of only that country's underlying policies and conditions. If we look at exchange rate movements over the last few months, it is not terribly difficult to see that a variety of factors, including developments in the United States have played a role. But, it is also important to acknowledge and to understand the policy implications of other factors involved in recent exchange rate developments. In my view, this includes the increased perception of the problem of inflexibility in European economies, and recent developments in the monetary policies of other major industrial countries. All of these factors have a bearing on recent exchange rate movements of monetary policies of other major industrial countries. All of these factors have a bearing on recent exchange rate movements of the dollar vis-à-vis the deutsche mark, pound sterling, French franc, and the yen. This suggests that, if exchange rates or, more likely, developments in underlying conditions, call for special consultations, perhaps simultaneous consultations with a number of key members might not be entirely inappropriate. Indeed they might be worth consideration, if the Board and the institution are to gain a broad and comprehensive sense of how problems emerged and how they can be dealt with.

Let me return, if I may, to a number of other surveillance measures which have been mentioned and put forward in the paper before us. We believe that the following should be adopted:

First: a confidential, personal meeting between the Managing Director and the Finance Minister of those industrial and developing countries whose policies and performances are of greatest concern to the international monetary system. Of course, we recognize that, through your relationship with the senior financial officials of countries which are using Fund resources, such meetings may inevitably occur without their being specified in the context of Article IV consultations. Yet, we do believe that it could enhance and strengthen surveillance, generally, if the twenty or so industrial and developing countries whose performance are of most importance to the system as a whole were to work with you in arranging personal meetings between you and the Finance Minister to discuss overall policies and economic developments. We recognize that this may pose a difficult burden on you. But we do think this is important.

On this question, we noticed the references in the staff paper to "communications," which suggest perhaps the use of correspondence instead of meetings. While we would not want to minimize the importance which that could play in the surveillance process, we do believe that, personal, confidential meetings between you and Finance Ministers of major industrial and developing countries could be extremely important.

Second, we would support a general elevation of the level of participation in Article IV consultations. I read with interest and concern of the inverse correlation between the size of IMF members and the degree to which IMF missions appear to see the senior officials in governments. It strikes me that that is a particular responsibility of the large industrial and developing country members, and one which we should work to address.

Third, we support efforts by members of the Fund to ensure that staff reports, summings up, and other key documents of the consultation processes are disseminated widely and at senior levels in governments.

Fourth, we would support the public release of an abbreviated version of your summing up of Board discussions. We would also support a general approach which would allow for the release of Article IV documents if the member involved agreed to such a release. I would like to return to this question of publicity because it is a key one.

Let me say at this point, however, that we would also support more candid IMF assessments and proposals for specific policy changes. Furthermore, we support the concept of follow-up reports to the Board by the member country on actions taken to respond to IMF policy suggestions. Here again, being realistic and keeping in mind the principle of uniformity, we may not wish to have follow-up reports from all members of the Fund. In particular, it may not be necessary for those involved with use of Fund resources. Perhaps there are twenty or so members of the institution, large industrial and developing countries, whose economic policies and performance have particularly important roles in the world economy, which might be among those who should submit follow-up reports to the Fund. This could occur within a period of, say, six months following the consultation, outlining measures that have been taken and developments that have occurred.

Now, whether or not this would be the occasion for another discussion in the Board is a difficult question and one that, perhaps, could be viewed as a matter of judgment by management. In some cases, such a follow-up report may serve a useful function on its own. In other cases, management may wish to bring the follow-up report to the attention of the Board.

Turning to some of the other measures to strengthen surveillance, we would support more information and analysis of the capital account, including external assets and liabilities. We note the improvement that has been made in the context of Article IV consultations in this area. But, reserve management and related capital account issues are extremely important, and we would support more attention to those matters, including financial market and capital market policies of industrial and developing countries. Additionally, we support greater focus on policy interactions among countries within the context of the World Economic Outlook.

We also support enhanced surveillance of member countries in certain cases where the member has a demonstrated record of adjustment, but where for one reason or another a continued important advisory and monitoring role by the IMF may be sought and may be appropriate. We also believe that enhanced surveillance has a potential role to play in helping the Fund deal with the problem of prolonged use. I have noticed the reluctance of the staff and my colleagues in conceiving of the application of enhanced surveillance to this latter category of countries.

We do not wish, in any way, to diminish the differences between countries, on the one hand, with proven adjustment records which may be returning to a greater degree of market creditworthiness,

and countries which, on the other hand, which may not have made quite as much progress in their adjustment efforts. Nevertheless, as we grapple as an institution with the problem of prolonged use, we feel that some potential exists here to help in our effort to preserve the revolving character of IMF resources.

On the question of publicity, which has received so much attention, I do not see the inherent conflict which some of my colleagues see between the need for confidentiality with regard to certain matters and improvement in public awareness of what the Fund thinks about the policies of member countries. We must and can protect confidentiality with regard to many aspects of the Article IV process, while still moving toward more publicity.

We have placed special emphasis on the importance of enhancing the Fund's influence, both directly through consultations with member countries, and indirectly through increased public awareness of international views and concerns. In particular, as I mentioned earlier, we would support the idea that you could publicly release a statement at the conclusion of the Article IV consultations. The statement could provide a brief assessment of a member country's policies and prospects, reflecting key points emerging from the consultation process, the staff document, and the discussion in the Board. As other Directors have pointed out, publicity is accomplished in a less direct way through your speeches. We believe these statements have an important role to play in the surveillance process, but they do not substitute for publicity in connection with individual Article IV consultations.

We recognize that there is legitimate concern that this approach could create the impression that you or the Fund may be attempting to use the media to force unwanted policy changes on member countries. However, we do believe that well-reasoned critiques of policy can be a healthy and essential part of the decision-making process. If made public in a prudent fashion, they can be a complementary form of the so-called "internal publicity" in encouraging needed policy changes, particularly for those countries which might not be relying upon use of IMF resources. We believe that, if such an approach were supported, you would need to have the discretion to highlight those issues which you perceive to be most important, based on the Board discussion, documentation and analysis, in a way which you believe would be most useful in encouraging the adoption of sound, stable policies. We do not believe that, handled in this fashion, such statements would necessarily politicize Board discussions, nor weaken the thrust of Article IV consultation reports, including staff appraisals.

In this connection we agree with two points which were brought out in the paper. The first is that, if such an approach were adopted, quality and frankness in the consultation process should remain the rule. And, second, we agree that the statement which you might issue on the conclusion of a consultation would not be the subject of negotiation between you and the individual member concerned.

Now let me turn to the last issue on which I have further comments, "enhanced surveillance." This is an important concept, in particular where additional IMF financing may not be appropriate or may not be desired, but where a continued Fund presence is important to the individual member, to its potential creditors, and to the system as a whole. The Fund has already accepted a monitoring role in connection with some private sector multiyear rescheduling arrangements. As I mentioned earlier, we believe that enhanced surveillance can play a role not only there, but also in connection with certain cases involving prolonged use of IMF resources.

We believe it would be advisable for the Board to develop some general guidelines for the use of such surveillance to assure a degree of consistency, although I would not like to lay too much stress on such guidelines. As we observe the interests which are emerging on the part of members, official creditors and private creditors in various forms of surveillance or monitoring, it occurs to us that what many of them appear to be looking for are, really, stand-by arrangements under another name. Indeed, if creditors are looking for some form of monitoring or some form of assurances and confidence that a member country is following an appropriate set of policies, there are a number of different ways this could be accomplished. We believe that the Fund should continue to proceed cautiously, as it has been doing, in this area. The Fund needs to continue to be aware of the risks and benefits of enhanced surveillance.

Here I must note among the risks the possibility that the Fund could, in one way or another be seen as endorsing a set of policies which it may not consider to be entirely appropriate or fully consistent with the need to restore a sustainable payments position in the context of medium-term growth. That risk must clearly be borne in mind. At the same time, there are clearly benefits involved as the international system evolves and as private lending decisions gradually become more self-reliant.

As I look back on the evolution of stand-by arrangements themselves, and the fact that it was 1952 before the seeds of stand-by arrangements clearly emerged in the Board, it is evident that they developed in a very evolutionary way. They developed through discussions of conditionality, consideration of the limitations and authority derived from the Articles, and by means of decisions taken in the early 1950s. This leads me to two reactions. One is that we have a process, a system, techniques and modalities, which have emerged from over thirty years of effort and experience in the Fund. We should not put these arrangements aside very quickly. At the same time, I have the seemingly contradictory sense that evolution in modalities and in legal frameworks is an inevitable part of the Fund's relations with its members. We should not close off options, as long as we can protect the interests of the institution, while serving the interest of members and the system as a whole.

In concluding, I would like to make a few final points. One is that my comments on the exchange rate information notice concerning the dollar should not be viewed as an indication of the lack of fundamental support by the United States for strengthened surveillance over all members, including the United States. Nor should my comments be seen as an indication that we do not believe that enhanced effectiveness of surveillance can extend to the United States, as well as to all members. Indeed, enhanced effectiveness of surveillance over the United States seems to be of such importance--almost of paramount importance--to many of my colleagues that I cannot help but hope that they will join in the broad application of techniques and arrangements that will enable us to improve surveillance generally. My comments are, perhaps, an indication of the complexity and the difficulty associated with this process, and the requirement for close cooperation and coordination between the Fund and national authorities if surveillance is to be effective.

In concluding, let me say that we continue to believe and stress that enhanced and strengthened surveillance is vital to the IMF as an institution. It is vital to members of the Fund, individually and collectively, and vital more broadly to the effective functioning of the international monetary system. I have an abiding faith in the ability of this institution to rise to the challenges which are presented to it. That faith has been reaffirmed and strengthened as a result of the ability of the IMF to respond to the challenges of the debt problems of the last few years. I am hopeful that we can all work together in looking for ways to increase the effectiveness of surveillance in order that the Fund can also meet the other challenges which may lie ahead.

Mr. Zecchini said that he wished to emphasize at the outset that his authorities attributed special importance to the surveillance role of the Fund and that they looked forward to member countries collaborating more closely to strengthen the effectiveness of surveillance. They were aware that that would of necessity entail some reduction of national autonomy in implementing policy. However, they were also convinced that, if surveilthe costs should be outweighed by the benefits to be derived from greater compatibility of policies, reduced recourse to protectionist measures, and financial stability, all of which would lead to stronger economic growth.

A central issue in the implementation of surveillance was even-handedness, and one that presented considerable practical difficulties, Mr. Zecchini considered. The issue was important because it bore directly on the Fund's credibility and ability to secure the full collaboration of all members. Evenhandedness was difficult to ensure because the Fund's influence on the conduct of economic policies at the national level obviously depended on a number of factors, including whether the country was a creditor or a debtor, or whether it depended on the Fund for technical advice, and so on. Although he agreed with the staff that Fund conditionality had not systematically been more strict or less strict for any category of countries, the Fund had inevitably had some leeway in the application of surveillance. Means would have to be devised to enhance the effectiveness of surveillance vis-à-vis creditor countries and countries having balance of payments surpluses, an objective that would not be easy to achieve.

He tended to question the advisability of publicizing Fund documents, either in full or in part, to achieve that objective, Mr. Zecchini continued. The staff had made the convincing point that publicity would tend to dilute the content of the documents, making them the object of negotiation, whereas it was of the utmost importance that they retain their frank and informal character. Instead, a potentially useful first step would be to increase the emphasis given in staff reports for Article IV consultations and in their discussion in the Executive Board to the extent to which policy actions following previous consultations had broadly reflected the Board's recommendations and the Chairman's summing ups. Even without going so far as to encourage authorities "to reply to the recommendations in staff appraisals," as suggested on page 34 of SM/85/65, a broad discussion on policy implementation would in most cases stimulate comments by both the Director representing the country concerned and by other Directors. Such a procedure would constitute a useful exercise in moral suasion, which was the strongest form of pressure that could be exerted on members in the context of surveillance under Article IV.

A different set of questions related to the problem of how to conduct enhanced surveillance, particularly with those debtor countries at a fairly advanced stage in the adjustment process, Mr. Zecchini noted. The concept of enhanced surveillance was relatively new, in that it involved countries that had already negotiated multiyear rescheduling arrangements of their external debt and that were implementing economic programs which did not necessarily call for financial support by the Fund. In those cases, he saw no compelling reasons for conducting surveillance largely outside the regular annual consultation process. The evaluation of those countries' own programs and the assessment of progress under them could most easily be done within the usual consultation framework. Biannual consultations could take place in exceptional cases, without there being any reason for making them a rule. Similar considerations applied to the proposal for the staff to prepare special reports for creditor banks; the preparation of such reports should not become a permanent policy of the Fund.

A further point stressed in the staff papers concerned the way in which the information system on real exchange rate changes was implemented and the possibility of extending the system to other key macroeconomic indicators, Mr. Zecchini commented. The scope for monitoring selected macroeconomic variables would differ depending on whether or not a member had a Fund-supported program. The use of such variables, within the framework of a program, would usefully complement performance criteria, as had been noted during the Executive Board's recent discussion on conditionality, while helping to ensure that the final objectives of the program were met; the performance criteria themselves were more in the nature of intermediate targets. Deviations from the program objectives should trigger an effort to redesign part of the program and revise some of the performance criteria. The usefulness of such variables outside stand-by or extended arrangements was however much less clear: but would action be advised in case of deviation from the key macroeconomic objectives? Would an ad hoc consultation be helpful? Although he tended to be skeptical on specific aspects of the use of such indicators, he was open-minded on the overall subject of enhancing surveillance and was listening with interest to the views and proposals put forward during the discussion.

The staff had made appropriate comments on the important problem of the work load, Mr. Zecchini considered. Many divisions in the Fund, and the offices of Executive Directors as well, had been under heavy and growing work pressures recently. The point might soon be reached at which those pressures began to be reflected in the quality of work. The proposals by the staff to reduce the frequency of consultations and the size of some reports on recent economic developments in selected countries seemed acceptable. However, he wondered whether those proposals would effectively contribute to the solution of the problem. If not, the time might come in future to reconsider the size and distribution of staff in the Fund in light of the new responsibilities that the institution would face.

Mr. Polak remarked that the staff paper was refreshingly frank and to the point on a subject that was usually dealt with in generalities. In present circumstances, the purpose of surveillance was twofold: to assist individual countries in the process of adjustment and in appropriately fulfilling their obligations under Article IV and to increase the contribution of major countries to the global adjustment process. Clearly, surveillance had to go well beyond the exchange rate. In that connection, he had been interested in the statement on page 4 of the staff paper that "pronounced swings in exchange rates are not necessarily the result of faulty policies," and that "countries may be unable to, or even should refrain from, smoothing out some of the exchange rate swings...."

The staff went on to emphasize the implications of large fiscal deficits and high interest rates for developing countries, although it tended to some extent to shield the exchange rate from its analysis. Yet it was important to recall that countries accepting the discipline of a fixed exchange rate and its influence on their domestic policies thereby automatically contributed to the international coordination of policy that made such an exchange rate system possible for them.

It was clear from recent experience that a great deal of theoretical work still had to be done to promote an understanding of the exchange rate mechanism as it functioned among those countries whose economic developments had a substantial impact on other countries on a global or on a regional basis--the primary criterion for the 12-month Article IV consultation cycle, Mr. Polak stated. There was, of course, widespread dissatisfaction with the scope and frequency of consultations with such countries under the Fund's surveillance process. It had not proved easy to influence the policies of large countries--nor indeed of small countries as the Article IV consultation with Suriname, the first item on the agenda that day--had shown. At the same time, it should not be assumed that because the Fund could not achieve its objectives by deepening surveillance, it could achieve them by simply broadening the process of surveillance. Incidentally, he had been taken aback by the statement on page 7 of SM/85/65--which seemed not to have been cleared with the Legal Department--that members were "...only committed to consult with the Fund regarding their policies." Following Mr. Dallara, he cited not only Section 1(i) and (ii) of Article IV, which it should be noted was entitled "obligations regarding exchange arrangements," but Section 1(iii) and (iv), which required members to "avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members; and to follow exchange policies compatible with the undertakings under this section."

He had no difficulty accepting the continuation of the present exchange rate monitoring system, or in cutting the trigger from 10 percent to 5 percent for industrial countries, Mr. Polak observed. At the same time, he did not place a great value on the system. The information notices circulated recently, for instance, for Suriname and the United States, contained no surprises. Moreover, he had reservations about the mass production by the staff of indices of competitiveness because it tended to give area departments an excuse for not looking carefully at the indices they used for competitiveness, and in fact on occasion to produce figures for the Executive Board without knowing what they meant.

Supplementary consultations should be held only in rare cases, and under no circumstances should they be provoked by any kind of formula, Mr. Polak said. He was willing to look at staff proposals for new indicators, despite his concern that the Executive Board would receive a flood of notices about, say, the money supply in country A or the quarterly budget deficit in country B exceeding certain inevitably arbitrary criteria.

He was reminded of a serious banking crisis in the Netherlands in 1925, when a large bank on the point of collapse instituted a system of ringing a warning bell whenever any account was overdrawn; the noise soon ended the experiment. Likewise, the Fund could not watch developments in all its member countries all the time; nor were Executive Directors themselves desk officers, needing to be alerted constantly to changing developments. Indicators were needed in stand-by arrangements, and possibly in enhanced surveillance, but for most countries, they were a second best tool to much more thorough analysis. If such analysis revealed unexpected problems, there were many ways of dealing with them without automatically involving the Executive Board. A senior staff member could pay an unofficial visit to the country; the Managing Director might either talk to or write to the finance minister; the Executive Director might be induced to write to the finance minister; if the Article IV consultation with the member was on a long cycle, the cycle could be shortened.

The staff should be given a choice between using external debt scenarios and public debt scenarios, Mr. Polak added. In some countries, one type of scenario would be more important than the other; in some countries, both scenarios might be important.

He joined others in believing that it would be undesirable for the Fund to publish any part of consultation reports, Mr. Polak continued. He would have no objection to occasional use by a member itself, as sometimes happened, of a consultation report or the staff's closing statement for purposes of domestic publicity.

It had been a good idea for the staff to pay great attention to the degree of participation by policymakers in consultation discussions, Mr. Polak considered. It would be useful for all consultation missions to have a substantive discussion with the president of the central bank, or with a high-ranking member of the government, who might be the minister of finance, the prime minister, or the president. He had been particularly glad to learn that Mr. Dallara agreed with that proposition. He also welcomed the emphasis given by the staff to internal publicity, for instance, the extent to which the results of consultations were made available, say, to the cabinet or to parliamentary commissions.

As to the extent to which consultations should take place with certain member countries on the regular annual cycle, on the grounds that developments in the economies and policies of those countries had an important impact on other countries, the staff suggestion that half the Fund's members--over 70 countries--fell into that category seemed unrealistic, Mr. Polak said. Mr. Finaish had mentioned one third of the membership as falling into that category; he himself would be inclined to agree with Mr. Dallara's figure of 20 or 25 member countries. For the remaining, say, 120 members of the Fund, he saw no need for annual consultations on the sole ground of their importance to the world economy and to other members. On the major issue of how to proceed with consultations with members whose economies had such a global impact, he agreed fully with Mr. Finaish's views.

The nature of enhanced surveillance was not yet fully understood, Mr. Polak considered, and it might be too early to reach definitive views. For instance, two points that had not been adequately covered in the description of enhanced surveillance were whether or not the Executive Board would discuss the half-yearly paper to be prepared by the staff and how the Fund would deal with triggers in programs submitted by countries that had asked for enhanced surveillance. He understood that there were no such triggers in Mexico's program, but enhanced surveillance for at least one other country was being discussed on a trigger basis. Like others, he saw some risk in the enhanced surveillance procedure. One question was whether all debtors would be required eventually to show all Fund reports to the banks; there was a danger of tensions between members and banks if the procedure lasted too long and covered too many countries. As a beginning, it would be desirable for the Fund to make enhanced surveillance a limited experiment, holding the number of countries down to those cases where such surveillance was absolutely essential and productive in connection with the countries' relations with banks. The period of enhanced surveillance should also be limited wherever possible. He would be concerned if a country and the banks reached an agreement on enhanced surveillance for, say, as long as 10 years, during which too many events could make such an agreement unwise. The Fund would also have to consider carefully whether or not such limited distribution of reports to the banks might not affect the frankness with which the staff formulated the documents.

He had no comments on the other aspects of Fund surveillance mentioned in SM/85/65, Mr. Polak concluded. His final remark was to welcome the Managing Director's speeches as an integral part of the surveillance conducted by the Fund, an organization that otherwise tried, and properly so, to maintain a low profile in the media.

Mr. Nimatallah observed that the growing awareness by all members of the important contribution that Fund surveillance could make to the smooth functioning of the international monetary system had been apparent at the 1984 Annual Meeting and was sure to be a central theme at the forthcoming meeting of the Interim Committee. Surveillance was a means of realizing the important objective of making the system work better, as was clearly necessary in present circumstances. Despite the recent improvement in the world economy, exchange rates for the major currencies continued to show substantial, short-term volatility. International trade was subject to growing protectionist barriers, and many countries still faced difficult debt problems.

The question, therefore, was not whether, but how, to make Fund surveillance more effective, Mr. Nimatallah continued. The essential requirement was a realization by members that their desire to make the system work better required them to cooperate more closely with the Fund. Given the cooperative basis of surveillance, the Fund would have to improve its effectiveness gradually, working within the framework of the 1977 decision and building on experience. It went without saying that surveillance should be applied in an evenhanded manner, which would not be easy. The Fund's direct influence was inevitably greater over borrowing members, yet the success of some programs depended in large part on the adoption of appropriate policies by the major industrial countries, particularly with respect to interest rates, exchange rates, trade, and capital flows. If evenhandedness was to mean anything in practice, the Fund should use every means at its disposal to encourage the major industrial countries to fulfill their special responsibilities for facilitating the smooth functioning of the system.

He welcomed the recent improvements in the analytical tools underpinning surveillance, Mr. Nimatallah said. The growing emphasis on the interdependence of members' economies, both in the World Economic Outlook and in Article IV consultation reports, together with the increasing use of medium-term scenarios, had made the Fund better placed to advise members on the consistency of international implications of their policies. He also welcomed the recent emphasis on debt problems, trade barriers, and structural adjustment in all staff reports for Article IV consultations and not just those for developing countries. Those were important issues, and a positive, outward-looking response to them by the major industrial countries would have a bearing on the success or otherwise of the international adjustment process.

He had an open mind with respect to the frequency of consultations with members, Mr. Nimatallah commented, as long as sight was not lost of the already heavy pressure of work on management, staff, and the Executive Board.

The information notice system for exchange rate monitoring, was a useful way of bringing major changes to the Board's attention, Mr. Nimatallah considered. The notice issued on the previous day on the real effective exchange rate of the U.S. dollar was a case in point. He encouraged the management to continue the work on expanding the coverage of the system and improving the data on which it was based. He was open-minded about the suggestion to lower the threshold for issuing the information notices, which could perhaps become more useful over time, especially if they were to lead, on appropriate occasions, to discussions in the Executive Board on exchange rate changes in major countries.

The Executive Board should be cautious in introducing additional procedures for making surveillance more effective, especially if they appeared to be far-reaching, Mr. Nimatallah said. He reiterated that surveillance was only a means to a more important end--namely, the commitment of members to make the system work better. More specifically, he saw merit in principle in using objective indicators as a basis for discussing a quantified policy strategy in Article IV consultations but only in certain special cases. As a general policy, he could imagine that such indicators would pose considerable practical problems although they could be useful in selected cases--for instance, if a member found it helpful to discuss a quantified strategy with the Fund.

It was difficult for the Fund to combine the role of a private, confidential advisor with a more public role, Mr. Nimatallah noted. The Fund would also need to be sure that greater publicity would be helpful in persuading countries to change their economic policies in a way that might, or might not, be acceptable to the member concerned. He could not see that public statements by the Fund would convince a member where private persuasion had failed. For those reasons, he was not in favor of the Managing Director issuing a public statement after Article IV consultations. Similarly, he was also not in favor of releasing staff reports for Article IV consultations or of a wider circulation for reports on recent economic developments, except in rare cases and only with the express consent of the member concerned. However, the Managing Director's well articulated speeches had been very useful in indicating the Fund's position on major policy issues and had made a helpful contribution to public understanding.

As for the follow-up on Article IV consultations, Mr. Nimatallah said that he supported the new practice of referring in staff reports to the summing up of the Executive Board's discussion of the previous Article IV consultation as a helpful way of focusing the Board's attention on areas of particular concern. However, it was difficult to generalize about the need for more internal publicity. He had no objection to reviewing in staff reports the extent and level of participation by the authorities in the Article IV discussions. It was important for the minister of finance or his equivalent to be involved at some stage, as had already happened in most developing countries like his own. On the other hand, he saw no general need for the Managing Director to communicate directly with a finance minister about the key findings of Article IV consultations. Direct communication between the Managing Director and the member should be limited to special cases, as necessary; for example, it could be helpful if there was a serious policy difference between the Fund and a member on an issue affecting the system as a whole, or in difficult cases of overdue obligations. In such circumstances, members might be encouraged to reply to the Fund's recommendations.

Supplemental consultations could play a useful role in selected cases, Mr. Nimatallah considered. If they became more frequent, the crisis atmosphere that surrounded them at present would disappear. But he saw no need to establish criteria for automatically holding supplemental consultations. Rather, it should be up to the Executive Board to judge whether or not such consultations were necessary, on a case-by-case basis, perhaps following an information notice, or because of a major policy change or growing arrears to the Fund.

If enhanced surveillance helped members to normalize their relations with commercial creditors, he would have no problem with the procedures established for that purpose, Mr. Nimatallah remarked. Again, he agreed with the staff that a case-by-case approach was both appropriate and sensible.

In conclusion, Mr. Nimatallah stated, because surveillance was not an end in itself but rather a means to enable the Fund to coordinate members' efforts to strengthen the system, thereby helping to resolve the difficult problems in the world economy, it would be more productive for the Fund to proceed cautiously and to introduce workable procedures that all members could support. On that basis, he felt sure that all members would cooperate with the Fund. He endorsed the proposed decision.

Mr. de Maulde said that his answer to the general question whether surveillance should be strengthened was an affirmative one. He did not share the view, expressed from time to time in the Group of Ten, that surveillance was the remedy for all the evils in the international monetary system and that it could take the place of the structural reforms that were needed. Nevertheless, surveillance played a useful and even indispensable role, even if only for want of a better solution.

He strongly supported the idea of introducing objective indicators in the process of surveillance for countries that did not use the Fund's resources, Mr. de Maulde said. The behavior of the exchange rate, which was at the heart of the Fund's jurisdiction, was the most important variable to be monitored through such a technique, and he regretted the pettifogging in the staff report on that point. Unlike Mr. Polak, he believed that such objective indicators could be put in place smoothly and quietly, and without great expense; in fact, they were already used for a limited number of countries, and a few more could be introduced without any special difficulty.

On publicity, the proposals in SM/85/65 would generally be counterproductive, for reasons that were extremely well summarized on page 31, namely, "...that it is difficult for one institution to successfully combine the role of private confidential advisor with a more public role. The Fund's main contribution comes from the intensity and frankness of the dialogue it has with its members, which reflects the fact that as an institution it has a financial relationship with its members and is legally empowered to conduct surveillance. In this respect there is some complementarity with the OECD, which has discussions with its members, but also makes an important contribution to surveillance over its members' policies through publishing reports on them and providing an intergovernmental forum for exchange of views among policymakers."

His authorities were a notch less firm on the question of publicity than he was and did not reject entirely the idea of making public the text of a statement by the Managing Director at the conclusion of the Executive Board's discussion on a consultation report, Mr. de Maulde reported. His own personal view was that even that procedure would diminish rather than improve the effectiveness of surveillance because the language would have to be very guarded and more or less negotiated with the country concerned, possibly weakening such statements to the point of uselessness. Moreover, questions would arise when no such statements were made. The Managing Director was currently succeeding in giving wide publicity to the main issues of surveillance through his frequent addresses to various groups in the United States and in other parts of the world. Moreover, politicians sometimes made public various parts of the Fund's documentation when it served their purposes, a practice to which he would turn a blind eye because it was after all a discreet form of publicity that helped the Fund to aid its members.

He had been amused by the apparent frustration of certain heads of consultation missions at not meeting members of governments but only their deputies, Mr. de Maulde commented. Countries had different traditions and procedures; in France, the Government was well aware of the Fund mission's thinking, even if the head of the mission had not met formally with the Minister. On a more serious note, he firmly supported the idea of selective communications to ministers of finance by the Chairman following the Executive Board discussion of Article IV consultation reports. Those communications would be all the more effective because they would be confidential and made by the Chairman of the Board, expressing views which were not only the result of technical work but had been supported by the authorized representatives of the Fund's members. The telephone could be a useful instrument in the hands of the Chairman, enabling him to discharge his leadership role, which could go much farther toward making surveillance more effective than hundreds of pages of reports.

He also supported supplemental consultations, which in his opinion were well overdue in one or two cases, Mr. de Maulde stated. As he had already mentioned, he also strongly supported some form of automatic triggering of consultations by objective indicators, in particular exchange rate indicators.

He had already mentioned his doubts about the procedures currently envisaged for enhanced surveillance during the recent Executive Board discussion of developing countries' external indebtedness, Mr. de Maulde recalled. As he had noted, his preference was for a series of stand-by arrangements that would have a catalytic effect. He would be interested in hearing the reasons against such an approach.

Finally, concerning the work load, Mr. de Maulde considered that the proposals he stood ready to accept would involve only a modest increase of work to put together the objective indicators and carry out a limited number of supplemental consultations. He suggested that, in order to keep the Fund's striking forces in different geographical regions lean and efficient, no increase in staff be authorized but that the modest increase in the work load be offset by savings in less essential areas. He had no objection to a lengthening of the standard consultation cycle for countries whose policies did not have a systemic impact or that did not themselves request a shorter cycle for reasons of their own. He would also greatly favor a systematic effort at pruning staff reports and reports on recent economic developments of all that was not indispensable to a clear understanding of a country's policies.

Mr. Sengupta said that he welcomed the discussion on the somewhat modified annual review of the implementation of surveillance, focusing as it did on the Fund's effectiveness in discharging its surveillance responsibilities. The concerns about the effectiveness of surveillance would rightly persist as long as the purposes of the Fund, as stated in Article I, were not fully met. It must be emphasized that the role surveillance should, or could, play could be viewed in the context of the Fund's primary objectives, inter alia, "to facilitate the expansion and balanced growth of international trade and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy." The promotion of exchange rate stability and the correction of balance of payments disequilibria were ways of achieving those primary objectives.

The purview of Fund surveillance had to extend over all economic policies having an effect on the international community, Mr. Sengupta continued. However, if the world economy remained plagued by a number of severe problems, it was at least partly because major industrial countries sometimes found it convenient to adopt inward-looking policies with little regard to their implications for and repercussions on the rest of the world. The Fund's effectiveness in correcting that situation left much to be desired. He did not share the staff view that pronounced swings in exchange rates were not necessarily the result of faulty policies or that the countries concerned might be unable to or should even refrain from smoothing out some of the exchange rate swings induced by capital flows. The flow of capital across national borders, speculative or otherwise, could be influenced by the pursuit of a judicious mix of monetary and fiscal policies by major industrial countries. Thus, to the extent that unwelcome large movements in exchange rates were directly or indirectly attributable to monetary, fiscal, or other domestic policies of the countries concerned, effective monitoring of such policies should be an essential element of Fund surveillance.

If volatility in exchange rates was leading to uncertainties and distorting investment decisions, thereby eventually retarding growth, it was imperative for the major industrial countries to intervene in the market to smooth out large swings, Mr. Sengupta considered. No doubt such intervention by itself would provide only temporary relief; to have an enduring effect, intervention would have to be buttressed by a coordinated policy mix to be pursued by the major industrial countries. The Fund would have to do more than merely point out or highlight the unfavorable consequences of those countries' policies on other countries.

The effectiveness of surveillance depended on whether or not countries modified or attempted to modify their policies in accordance with the analysis and recommendations of the Fund, Mr. Sengupta remarked. And member countries' responses would depend on the Fund's leverage over them individually. In that context, the attempt in the staff paper to distinguish between the effectiveness of surveillance and of conditionality and jurisdiction over exchange restrictions, seemed rather artificial. Analytically, they were interdependent aspects of the Fund's work and were different only in terms of the Fund's ability to influence a country's policies. Only those countries using or likely to use the Fund's resources were subject to the Fund's sanctions and therefore to effective surveillance. Countries not using the Fund's resources could go on ignoring surveillance; yet those were the countries whose policies had the greatest effect on the world economy in general, and the purposes of the Fund to which he had referred, in particular. He had noted from the record of the Executive Board's discussion on the 1984 Article IV consultation with the United States that Mr. de Maulde had mentioned his dismay at the apparent failure of the U.S. Administration to pay attention to the recommendations of the Executive Board, in 1982 as well as in 1983, to deal with its budget deficit, thereby casting doubt on the credibility of the United States in propounding the idea that the Fund's surveillance was the cornerstone of the smooth functioning of the international monetary system. Mr. Dallara had just reiterated his authorities' commitment to the Fund's surveillance, and he hoped that the outcome of the 1985 Article IV consultation with the United States would reflect that commitment. The real dilemma was the basic asymmetry in the effectiveness of the Fund's surveillance arising from the asymmetry in its leverage in influencing member countries. The issue should be clearly recognized and posed by the Fund so that the world community could deliberate on it in the future, especially in the Development and Interim Committees.

In the case of countries maintaining pegged exchange rates, which happened to be mainly the developing countries, the Fund sought agreement on possible policy changes in the event that their exchange rate policies were considered inappropriate in the global context, Mr. Sengupta remarked. Yet it should be emphasized that most exchange and trade restrictions imposed by developing countries had their origins in balance of payments difficulties. The special problems of developing countries had to be kept in mind before judgment was passed on the desirability or otherwise of such restrictions.

The staff paper asserted that the Fund was evenhanded in surveillance, Mr. Sengupta observed. Evenhandedness meant not only uniform treatment of those deficit countries that approached the Fund for assistance but of surplus countries or even of those deficit countries which could afford to be independent of Fund resources. Evenhandedness implied ensuring that the cost of the global adjustment process was shared equitably by all countries, both those in deficit and those in surplus. The consideration in the Executive Board or in the World Economic Outlook Survey of the policies of the Group of Five countries did not always justify the claim in SM/85/65 that "...the standards applied in surveillance over the policies of industrial countries are at least as stringent as those applied to developing countries." There were nuances in the staff paper that were not consistent with the claim of evenhandedness. In most staff papers, a consistent and deliberate attempt was made to reflect the point of view of developing countries also. There was a factual reference on page 9 to the absence of any counterpart to conditionality or to pressures to eliminate restrictions for countries that respectively made no use of Fund resources or maintained no restrictions. In addition, there was a subsequent reference to the fact that there could be no question of encouraging inflationary policies in low-inflation countries to ease the adjustment problems of countries that had not succeeded in controlling inflation, a nuance that did not reflect developing countries' views. Surely, to state that the adjustment programs of developing countries would be effective if developed countries allowed their GNP and markets to grow was not tantamount to asking the latter to follow inflationary policies; in fact, opening their markets to imports might actually bring down the rate of inflation.

As Mr. Lundstrom had remarked, equal treatment of countries did not rule out different treatment of countries in different situations, Mr. Sengupta noted. That was particularly true of surveillance. Measures for improving the effectiveness of surveillance should be directed at those countries over which the Fund had little leverage. Unless major industrial countries, particulary the G-5, agreed to frame their domestic economic policies in a global context, Fund surveillance would remain ineffective in fostering orderly economic growth. Until that happened, any improvement in the effectiveness of surveillance would only lead to greater pressure on those deficit countries approaching the Fund for assistance. Surveillance of members with a program or with serious balance of payments problems was already quite effective. There was not much need to change existing surveillance procedures with respect to those countries; what was needed was to find ways of ensuring that the major industrial countries would also fall in line. Both Mr. Dallara and Mr. Polak had mentioned that most of the additional measures under consideration should be limited in application to 20 or so countries. His own view was that most of those measures should apply to countries over which the Fund could exercise little effective leverage in terms of sanctions, mainly the big currency countries and a few others whose policies had a large impact on the international economy. If that approach was generally accepted, he could go along with most of the suggestions in the staff paper.

For instance, with respect to the frequency of consultations, countries where developments had widespread international repercussions or that had a Fund program, should be placed on longer consultation cycles, with many more coming under the two-year cycle, Mr. Sengupta considered. Similarly, on the monitoring of exchange rates, the threshold for issuing information notices should be lowered to 5 percent for industrial countries, particularly the G-5 countries. Objective indicators could also be useful for the surveillance of members not using Fund resources. The movement of indicators outside the limits specified should lead to more than an examination by the staff, and possibly to a special discussion in the Board, so that pressure was brought to bear on members to appropriate changes in policies. However, as Mr. Dallara had noted, some kind of prior agreement might have to be reached with the countries concerned on the precise trigger points. Analysis would still be necessary, as Mr. Polak had mentioned, because the indicators alone could not fully illuminate the reasons underlying the movement in the variables being monitored.

More internal publicity should be given to the Fund's views, which needed to be brought to the attention of high-level authorities, Mr. Sengupta noted. However, it was the countries themselves that would have to exercise discretion in that respect, not the Fund. It was not clear to him what was meant by the desirability of active participation at the ministerial level in all cases, particularly with respect to the discussion of the mission's closing statement.

He was not sure what purpose supplemental consultations would serve, Mr. Sengupta remarked, if countries chose to ignore the regular Article IV consultations. As for enhanced surveillance, he agreed with the staff that it would be better to explore carefully with members, on a case-by-case basis, the relevance of such surveillance to their needs rather than trying to establish precise criteria.

Any form of publicity in relation to Article IV consultations would be counterproductive, Mr. Sengupta considered. Publicity would affect not only the confidentiality of the Fund's relations with member countries but would also make its discussions with members less forthright and would thus impair the effectiveness of consultations. He would have no objection to a wider circulation of reports on recent economic developments, provided they were carefully edited to ensure that they contained no information provided by the member to the Fund in confidence, any reference to policy discussions between the Fund and the member, or any projections. However, he doubted whether the publication of such edited reports on recent economic developments would in any way improve the effectiveness of surveillance. At the same time, he recognized the existence of a problem, and he sympathized with management in its desire to have the authority for publicity. Otherwise, the Fund's only leverage over major countries that were not affected by the Fund's sanctions and ignored its recommendations was moral suasion and appeal to public opinion. The Managing Director was doing a commendable job of focusing on major international issues in public speeches. Greater publicity for the Fund's concerns about a country that ignored the implications of its national policy on the international economy might help to galvanize public opinion.

According to Section 8 of Article XII, the Fund could apparently "decide, by a 70 percent majority of the total voting power, to publish a report made to a member regarding its monetary or economic conditions and developments which directly tend to produce a serious disequilibrium in the international balance of payments of members," Mr. Sengupta remarked. In that light, he suggested that if there was any difference of view for any length of time between the analysis and recommendations of the Fund and of the authorities of a "key currency" country during Article IV consultations or one arising from any other aspect of surveillance, a separate report should be brought to the Executive Board that would be released to the public, with the approval of a 70 percent majority.

He also suggested that because major countries might be more amenable to discussions among themselves rather than to so-called public opinion, it might be useful if the Executive Board discussed the international implications of the policies of such key currency countries at some time preceding the annual summit meeting of those countries, Mr. Sengupta added. The Managing Director could report to the summit meetings about the discussions in the Board, the exact form of the report being left to the Managing Director. A paper prepared by the staff for consideration by the Executive Board on those countries' policies and their implications might strengthen the forces of reason that were often displayed by some member countries at those summit meetings.

He asked for careful consideration of his suggestions, Mr. Sengupta concluded. He also suggested that the proposed decision, asking for approval of the continuation of the surveillance procedures, in the light of the Managing Director's summing up, should be amended to delete the reference to summings up. While the Managing Director had always taken care to capture the basic thrust and spirit of the discussions in the Executive Board, it was always desirable to have in place definite decisions in order to provide proper guidance and to avoid leaving room for differences in interpretation.

Mr. Wang noted that the Fund had improved many of the procedures for exercising surveillance during recent years and some of them could be continued. However, the world economy was still beset by a number of severe problems, most of which were attributable to disorderly economic and financial conditions among the major industrial countries and the misalignment of major currencies. Therefore, much remained to be done, and it was understandable why concern about the effectiveness of surveillance had been a recurring subject for discussion. Surveillance was a complex process involving a multiplicity of factors and interest, and effective surveillance called for strenuous efforts on the part of the institution as well as full understanding and cooperation among its member countries. The commitments made by member countries at the various meetings of the Fund to strengthen surveillance were not enough because surveillance was a weak instrument having no sanctions behind it. What was needed was the political will to translate those commitments into policy decisions and concrete action. That was particularly true of the major industrial countries insofar as their policy action had a decisive impact on the evolution of the world economy as a whole and on the economies of developing countries in particular.

In order to make surveillance more effective, the Fund should continue to carry it out evenhandedly, placing emphasis primarily on the policies of the industrial countries, especially the major industrial countries that had so far been outside the reach of conditionality, Mr. Wang continued. Developing countries had good reasons to expect those industrial countries to contribute to a stable financial system in a major way. On the other hand, the main industrial countries should themselves recognize the whole problem and adopt policies and measures not only to sustain their own external positions but also, and more importantly, take into account their effect on developing countries, given the increasing degree of interdependence among the industrial countries themselves as well as between the industrial and developing countries. Only in that way would the Fund's surveillance move a step forward from cogent analysis and persuasion.

The existing guidelines for determining the frequency of the consultation cycle should in general be maintained, Mr. Wang considered. In order to improve the effectiveness of surveillance, objective indicators could be used over members not using Fund resources, but since those indicators were largely judgmental and not easy to quantify, prior agreement might have to be reached with member countries on their use.

It was hard to grasp the direct relationship between publicity and the effectiveness of surveillance, Mr. Wang remarked, but he was rather concerned about the inevitable loss of confidentiality that would result from greater publicity--both to the general public and to the private financial institutions--which could only be counterproductive.

Active participation by the authorities in regular consultations should be encouraged, Mr. Wang said, and he saw no reason why they should not be kept informed, at the highest level, of substantive matters relating to the consultation. Supplementary consultations could be held on a selective basis if they proved beneficial to member countries concerned and improved the effectiveness of surveillance. Enhanced surveillance was a special kind of surveillance being used at present by countries undertaking programs, with a view to facilitating debt rescheduling. He supported the staff's view that no criteria should be set up for determining whether enhanced surveillance was appropriate for a member and that the Fund should explore carefully the relevance of such surveillance to an individual country's needs. Again, release of staff reports in connection with enhanced surveillance should be weighed cautiously against the disadvantages of the loss of confidentiality.

Mr. Ortiz observed that by its very nature the Fund's surveillance, in its implementation, was subject to a rather wide range of interpretations. The power of the Fund to influence policy decisions varied from country to country, depending on whether or not they were making use of the Fund's resources. Although conditionality could not be viewed as surveillance carried to a higher degree--since both concepts had different origins and applications--the Fund's direct action through conditionality clearly implied surveillance over a country's economic policies. The Fund, due to its different powers of enforcement with respect to conditionality and surveillance, had a special responsibility to try to increase its sphere of influence by exercising surveillance over those countries that had a greater effect on developments in the world economy.

It was suggested in the staff paper that difficulties in assessing the effectiveness of surveillance was due to the persistence of problems relating to those aspects of the world economy for which the Fund had the greatest responsibility, Mr. Ortiz remarked. In particular, although the pronounced swings in exchange rates between major industrial countries and the high interest rates that had prevailed had been cited as prima facie evidence of the lack of effective surveillance, the phenomenon itself posed great difficulties of perception and understanding and the ensuing problems did not necessarily derive from faulty economic policies. Specifically, pronounced exchange rate swings were mainly the result of capital flows reflecting the greater integration of financial markets.

The impression left by the staff paper was that the Fund considered that it could do little to contribute to greater exchange rate stability because the remedies commonly suggested--sterilizing intervention and capital controls--could not have lasting effects and in any event might do more harm than good in the long run, Mr. Ortiz commented. He took a more positive view. For instance, there was no mention in the staff paper of the Fund's potential role in promoting greater cooperation among industrial countries with a view to coordinating their monetary and fiscal policies, thereby smoothing interest and exchange rate movements and promoting economic activity.

Without wishing to enter into an academic discussion, Mr. Ortiz continued, he agreed with Mr. Polak that professional economists had not made definitive progress in understanding exchange rate movements. It had become widely accepted that the system of generalized floating exchange rates left countries with much less independence to carry out domestic policies than had previously been thought. Therefore, coordination among those members whose currencies had more of an impact on the world's money supply was an issue in which the Fund had a vital interest. Thus, the important question was perhaps not the evenhandedness of surveillance, which seemed to be assured in the rather narrow sense by the current procedural arrangements, but in the Fund's final influence over the policy actions of countries that were not under the discipline of conditionality. In that sense, he welcomed the staff's efforts to reinforce existing mechanisms as well as the recognition by many Directors of the need for major countries to pay more attention to the impact of their policies on the world economy.

Consequently, a satisfactory result of the present discussion would be agreement on specific measures to strengthen the Fund's ability to have a positive influence on those industrial economies that affected the international community at large, Mr. Ortiz stated. He recalled that Mr. Finaish had mentioned during the previous meeting that the staff appeared to be more willing to take a firmer stance on the policies followed by smaller countries in comparison with those of countries having a strong impact on the international economy. That point was well taken and could be confirmed not only by comparing staff reports for Article IV consultations but by examining the first pages of the staff paper under discussion. In other words, as he had already mentioned, the staff had taken a rather timid approach to the analysis of pronounced swings in exchange rates and high real interest rates, which, it considered, did not derive from the inadequate economic policies of industrial countries.

If one of the main objectives in improving Fund surveillance was to prevent the negative consequences of inadequate policies in major countries and to encourage closer cooperation among the monetary authorities in those countries, then the use of objective indicators would be highly advisable, Mr. Ortiz went on. An appropriate method would be to quantify, if possible, targets for key indicators and to design mechanisms that would enable the staff to consult with the authorities when a predetermined departure from the target had taken place. Even though deviations from targets would not have the same consequences in major countries as in countries having Fund-supported programs, it would at least be possible to observe the response of the authorities of major countries to signals that differed from those in the domestic economy.

He fully agreed with the reasons given by the staff for maintaining confidentiality, Mr. Ortiz remarked. The analysis contained in staff reports for Article IV consultations reflected a view of a member country's policy actions that if it were made public, would either have to be carefully negotiated with the authorities, thereby weakening its content, or otherwise risk triggering reactions on the part of the authorities that might complicate future relations with the Fund. Excluding the appraisal from the staff report before it was made public would not make a great difference, in his opinion. The ideas expressed in the appraisal were usually a reflection of the text of the consultation discussions and thus of the staff report.

As for the release of a statement by the Managing Director on Article IV consultations, Mr. Ortiz added, he agreed with the view of the majority of Directors that the problems posed would clearly outweigh the possible advantages.

However, giving publicity to reports on recent economic developments was a different matter, Mr. Ortiz considered. If the confidential information contained in those reports was excluded, he could go along with wider distribution or publication, assuming that the authorities of the country concerned had given their prior approval.

His chair placed a high value on the public statements by the Managing Director on major policy issues, Mr. Ortiz remarked. Those statements were a major channel through which the Fund could make public its views on important issues. Such statements did not weaken the confidential relationship between the Fund and members, and they provided valuable guidance on key issues.

The staff had made persuasive arguments in favor of increasing the so-called internal publicity given to Article IV consultations by the administration of some member countries as a way of enhancing the effectiveness of surveillance, Mr. Ortiz considered. He fully supported the idea that senior national officials should participate actively in Article IV consultations, especially those ministers directly involved in areas of great concern to the Fund. The short references at the beginning of staff reports to the nature of the discussions with national authorities could be expanded somewhat, without there being any need to include an additional section on staff reports. It would obviously be difficult to lessen the asymmetry in the relationship between the Fund and its members, but communication by the staff with senior national officials and a follow-up by a dialogue between the Managing Director and the authorities of the member country would be steps in the right direction. As for the suggestion that members should respond to recommendations in staff appraisals, it seemed to him that the statements made by Executive Directors at the outset of an Article IV consultation discussion in the Board already contained the views of their authorities with respect to such recommendations.

His Mexican and Venezuelan authorities had asked the Fund to implement a special kind of surveillance procedure, which had been referred to as enhanced surveillance, Mr. Ortiz said. That request had facilitated the process of multiyear debt restructuring aimed at normalizing debtor/creditor relations. His authorities had felt that the monitoring of their countries' economic programs should be carried out in a multilateral context and in the framework of existing institutional arrangements. It would have been inefficient to expect economic missions manned by commercial banks to replicate the work of the Fund staff because they would not have had the Fund's expertise. Nevertheless, as he had mentioned during the Executive Board's recent discussion of external indebtedness, enhanced surveillance should not be interpreted as giving the Fund the commercial banks' role of evaluating credit risk.

In the case of Mexico, Mr. Ortiz added, it was understood that during the Article IV consultations the Fund would review the authorities' financial program for the year and the annual budget submitted to Congress, analyzing them for internal consistency with the policy objectives of the authorities. The midyear review would consist of an evaluation of the progress made by that time. His authorities realized, however, that the Fund must strike a delicate balance in helping the banks to monitor economic activity without inducing the banks to take credit or debt restructuring decisions. As other Directors had pointed out, banks might otherwise come to expect such signaling. Nonetheless, he fully agreed with the staff that, rather than establishing guidelines and precise criteria for access by members to enhanced surveillance, it would be better for the Fund to explore the appropriateness of such an approach with each individual member.

Finally, Mr. Ortiz considered that participation by the Fund in other forums could potentially enhance surveillance in an indirect but fruitful manner. The increasing prestige of the Fund should be used to full advantage, and one way would be to transmit directly to the major countries--the G-5 and G-10 countries--the Executive Board's views on issues of fundamental importance.

Mr. Clark noted that his authorities believed that the implementation of surveillance had been continuously improved over recent years, thanks to the efforts of the staff. They also welcomed the fact that around

80 percent of the membership was at present on an annual Article IV consultation. One important remaining weakness was the relatively thin coverage in some staff reports for Article IV consultations of the international impact of individual countries' domestic policies. That was particularly important for major industrial countries, whose policies had a great influence on international interest rates and on exchange rates; but it was also significant for large regional economies and for members of currency unions.

He noted and endorsed the distinction drawn by the staff between the application of conditionality as one element ensuring the revolving nature of Fund resources and the surveillance function under Article IV, Mr. Clark continued. He saw scope for increasing the effectiveness of surveillance in the sense of making sure that the Fund's views were given due weight in the formulation of domestic policy. But in doing so, three general considerations would have to be kept in mind. It was essential that the Fund maintain its traditionally objective approach and that the frankness of staff judgments not be undermined. The process should be one of consensus in order to maintain the cooperative relationship between the Fund and its members. Furthermore, it would be essential to keep the overall work load of the staff, management, and, indeed, the Executive Board within reasonable bounds. The quantity of surveillance should not compromise the quality. The issue of surveillance was, of course, being considered in other forums, notably in the Group of Ten, and for that reason, his remarks would be somewhat preliminary. It might be helpful for the Executive Board to discuss the issue again after the April meetings of the Interim and Development Committees and upon the completion of the G-10 work. At that time, the implications of various proposals could be considered further.

He would comment specifically on the topics listed by the staff for discussion relating to the implementation of surveillance, Mr. Clark said. Exchange rate developments and policies and their interaction with other macroeconomic policies should be the main focus of surveillance. As noted in the annex to the background material in SM/85/65, Supplement 1, an effective exchange rate policy was essential to effective adjustment, a point that he hoped would be emphasized in the spring meetings. The economic arguments were complex but the failure or partial success of adjustment programs often seemed to reflect an inadequate shift in the exchange rate. Thus, wherever possible, the Fund should give not only clear but quantitative guidance on exchange rate policy in the course of Article IV consultations, especially if a country was likely to be negotiating a Fund program within the near future. His second point was that the information notice system seemed to be working well and did not need any change. Two such notices on major currencies had been issued so far.

The criteria for determining the length of consultation cycles remained appropriate, Mr. Clark added. Regular surveillance was in the interests of all members and most countries were rightly on an annual cycle. However, he saw no need at present to increase the frequency of consultations for those members not presently on an annual cycle unless their authorities so requested or their circumstances changed. It was helpful to have the opportunity to suggest questions that the staff might take up in its consultation discussions. It would also be useful if the format of the indicators selected for the basic data tables could be further standardized across countries and thus of course across departments of the Fund. The lack of data in particular cases would in itself be of interest. There should be further analysis of capital flows and of the fiscal position of the entire public sector and not just of the central government. It would also be interesting to have more analysis of underlying stocks as well as of flows although he recognized that data was a problem. He greatly welcomed and would like to see carried further the use of medium-term scenarios in conjunction with variants for sensitivity analyses. It might be helpful to discuss not just supply-side measures but their impact on the supply capacity of the economy.

His final point was the scope for economy in producing reports on recent economic developments, Mr. Clark said. Much interesting and worthwhile material had been presented to the Executive Board recently in reports on recent economic developments, which could, however, in some cases be limited to a basic economic synopsis together with updating of statistics.

He saw merit in exploring the idea of objective indicators for enhancing the effectiveness of surveillance, Mr. Clark said, that would establish criteria in advance that might prompt a fuller discussion of certain economies. Yet as the staff and a number of Directors had pointed out, serious difficulties would have to be overcome before the idea could be put in practice. He reiterated the importance to the surveillance process of ensuring a candid exchange of views and the full provision of data. It would be a retrograde step to jeopardize those views by publicity. However, he saw no difficulty in preparing and publishing special reports or in publishing reports on recent economic developments if that could usefully contribute to negotiations with creditors. The release of staff reports for Article IV consultations raised delicate issues but he could accept it, at the request of a country, if management and staff judged that no significant erosion of the underlying surveillance function would result. He saw similar reasons for caution in the Managing Director issuing public statements at the conclusion of an Article IV consultation. He would again be content to leave the matter to the management's judgment.

He could support the staff's suggestions for following up consultations, Mr. Clark remarked. If surveillance was to be fully effective, the involvement of high-level officials was of importance, and voluntary replies to the recommendations in staff appraisals could also be a constructive way of improving the dialogue between the Fund and the authorities. He agreed with the staff that extended follow-up should be undertaken only in exceptional cases and on the initiative of the Executive Board. It would be useful to experiment with a limited number of supplementary Article IV consultations, either triggered by objective indicators or by particular concern on the part of the Executive Board about a country's policy stance.

Enhanced surveillance could make a helpful contribution to improving debtor/creditor relations in appropriate cases, Mr. Clark considered. But as he had stated during the Executive Board's discussion of developing countries' external indebtedness, the Fund's involvement in such surveillance should not discourage commercial banks from improving their techniques of credit assessment because in the last analysis they must take their own lending decisions. Requests for enhanced surveillance should be dealt with case by case. Certainly, enhanced surveillance should not be seen as a substitute for a program in countries where considerable further adjustment remained to be achieved; rather, it should be seen as a method of monitoring the progress of countries whose economic performance, policies, and prospects were already on a sustainable path. So far as procedures were concerned, other Directors had raised a number of important issues.

Finally, Mr. Clark observed, the work load was a crucial question not just from the point of view of the internal management of the Fund but also in ensuring that the quality of the Fund's work was maintained. It was obvious that some areas of the Fund had been under heavy strain, but the issues to which that gave rise might be better addressed in the context of the Executive Board's discussion of the administrative budget.

Mr. Joyce noted that conditions in the world economy had shown marked improvement during the past year. The provision by the Fund of conditional resources to many countries in balance of payments difficulties had contributed to the progress, and he also liked to think that the Fund's more active surveillance in recent years had made a contribution. He welcomed in particular the more extensive role played by the Managing Director in broadening multilateral surveillance activities. The success of many countries in reducing inflation, restoring economic growth, and dealing effectively with balance of payments and debt problems suggested to him that the present surveillance techniques were essentially sound and probably needed only minor adjustment, with perhaps one major exception. Indeed, unless there were to be a substantial change of heart on the part of many members, he doubted whether a major tightening of surveillance procedures would command wide support at the present stage.

Following the outline provided by the staff and taking up the questions raised in Section VIII of SM/85/65, Mr. Joyce went on, it had been suggested--outside the Fund and even in the Executive Board, as during the present meeting--that the surveillance process had not been symmetrical. He did not agree. He felt that the Fund had in general been evenhanded in its treatment of members although he admitted that on occasion the Fund had sometimes seemed to be more effective in influencing policy in smaller than in larger countries, especially where the smaller countries were using Fund resources. As long as that was so, there would inevitably be concern about the possibility of the Fund's standing being undermined and about its role in encouraging adjustment being hampered. Although conscious of those dangers, everything possible would have to be done to avoid lengthening perceptions that were sometimes exaggerated and poorly founded.

In terms of the analytical underpinnings of the surveillance process, the staff had given added emphasis--both in the World Economic Outlook and in Article IV consultations--to linkages between countries and to policy interactions generally, an approach that he supported, Mr. Joyce observed. The staff noted that concerns had been expressed about a possible deflationary bias in Fund-supported programs; he looked forward to the results of the study under way on that issue. Assertions of that type, or assertions that the Fund had overemphasized the need for countries to increase their exports, had to be taken seriously and should be subjected to thorough research and analysis. He also strongly supported the increased emphasis on the medium term in recent consultations, both with respect to the implications for members' balance of payments prospects but also for their present and future polices. The added emphasis on trade issues and structural adjustment was equally welcome. Indeed, structural adjustment measures were the natural corollary to aggregate demand management and it was wholly legitimate for the Fund to be concerned with structural aspects of members' economies.

He was concerned about the work load being imposed on the Fund staff and upon the authorities in member countries through the adoption of shorter consultation cycles for most members, especially at a time when a large number of members had programs that often required semiannual or even quarterly reviews, Mr. Joyce continued. While he agreed that specifying the length of the cycle in advance provided a greater degree of certainty, he would be prepared to see cycles of up to 1 1/2 to 2 years for members that had not used or were unlikely to require Fund assistance. Of course, annual consultations should continue to be required for larger members and for those countries in which developments could have a significant impact on the international economy. Allowance should also be made for a one-year cycle for smaller countries that felt in need of staff assistance in designing economic policies.

His remarks on the specific suggestions for improving surveillance would have to be preliminary, Mr. Joyce remarked. His Canadian authorities would await the outcome of the G-10 discussions on surveillance before reaching firm conclusions on possible changes in the surveillance process.

Objective indicators would have to be selected carefully and possibly vary from country to country to be meaningful, Mr. Joyce considered. Judgment would also have to be exercised in assessing the significance of movements in the indicators used. Moreover, significant movements should simply lead to an examination of the overall situation by the staff and by the authorities of the country concerned. That examination could in turn lead to further consultations if that was judged advisable in the circumstances, but there should be no question of the movement in the indicators automatically requiring policy changes by a member.

Like other Directors, he had serious doubts about the proposals to heighten the external publicity given to the conclusions of the Fund's surveillance activities, Mr. Joyce remarked. Statements or assessments had to be prepared with an eye to public distribution, and the consultative process could suffer. The authorities--and perhaps even the Fund staff--might become less open and frank in consultation discussions. The suggestion that a diluted or edited country assessment should be prepared for public release was also not without pitfalls. It would be time consuming and could lead to embarrassment if the unsanitized version were to be leaked. His conclusion was that the costs would generally outweigh the benefits. That said, he would not preclude considering the wider distribution of the information contained in reports on recent economic developments or of other special studies where appropriate. In addition, if there was a disposition on the part of the five largest members to have a wider dissemination of the results of their bilateral consultations with the Fund or of the results of the G-5 multilateral surveillance process, he was sure that none of his authorities would object. In any event, he supported the courageous and valuable efforts of the Managing Director in his public speeches and through his participation at conferences to focus public attention on some of the key policy questions of the day.

With respect to internal publicity, he could envisage benefits flowing from direct communications between the Managing Director and ministers of finance, Mr. Joyce commented. To avoid debasing the value of communications from the Managing Director, they should be made selectively. The traditional channel of Executive Directors' offices had served well and should continue to be used in most cases. A letter or a telephone call from the Managing Director to a minister should remain a signal event--at times even a traumatic one--demanding attention.

Supplemental consultations might be useful, especially if the Fund was to make use of objective indicators or if the normal consultation cycle for some members was to be extended, Mr. Joyce stated. But to call for supplemental consultations on top of the existing work load would, he feared, overstrain the system. There would have to be a trade-off.

He would probably be prepared to go along with a lowering of the threshold for issuing information notices where the monitoring of real effective exchange rates was based on unit labor costs, Mr. Joyce commented. Again, his chair would probably want to delay a final decision until the G-10 had completed its discussions. Notices of exchange rate changes provided useful information; similarly, information notices on major policy changes--for instance, on budgets, along the lines of Mr. Wicks's recent notice about the U.K. budget--could be helpful, and countries should be encouraged to provide such information on a timely basis.

As he had mentioned during the recent discussion of external indebtedness, he was not opposed a priori to enhanced Article IV consultations in particular cases, Mr. Joyce added. But the proposal for enhanced surveillance raised a number of questions that needed clarification before the Fund went too far down that road. For instance, it was not at all clear, at least to him, in what way enhanced surveillance would differ from regular Article IV consultations. The staff papers on surveillance and commercial bank lending seemed to suggest that the authorities might present a quantified program on which the staff would then comment, an idea that also prompted a number of questions. How frequently would such consultations be held? At what point would the normal Article IV consultation process resume? Would the staff comments be as extensive and as frank as in regular Article IV consultations, given the wider anticipated readership of the reports, or would the staff feel limited in how far it could or should go in making such assessments? Would the staff be able, for example, to comment on the adequacy or inadequacy of policies in areas not covered by the program? Would enhanced Article IV consultations include medium-term scenarios? Would the staff reports express views on the need for or likelihood of World Bank assistance to the country, or on the magnitude of debt rescheduling required? And finally, how would the Fund avoid leaving the impression that it was making the basic judgments about risk and adequacy of the program, judgments that more properly should be made by the donors or lenders themselves?

His concerns were real although speaking personally he believed that there was a role for enhanced surveillance, Mr. Joyce added. But for the process to work properly, the member would have to be committed to making the necessary adjustments and be prepared to accept public dissemination of adverse as well as supportive comments on its policy stance and to adjust or defend its policies accordingly.

In conclusion, Mr. Joyce observed that a number of interesting options and adjustments to the surveillance procedures had been submitted for consideration. Some would require additional work and thought by members and by staff before firm decisions could be taken. He hoped that the present discussion would move the process forward and permit the Fund to hone and strengthen its existing surveillance procedures. He supported Mr. Clark's suggestion that the Executive Board should return to the issue after the April meetings of the Interim and Development Committees and following the completion of the G-10 deliberations.

Mr. Nebbia stated that surveillance was at the core of the Fund; it was an instrument which, used properly, could--and indeed should--play an important part in achieving a more balanced global adjustment process. The title of the staff paper--enhancing the effectiveness of surveillance--suggested a degree of dissatisfaction with the asymmetric effects and limited effectiveness of the Fund's surveillance, despite the improvements introduced lately, as reflected in particular in the larger number of Article IV consultations.

As had been stated by other Executive Directors, the impact of Fund surveillance activities so far had been felt almost exclusively by the users of Fund resources under the conditionality of stand-by arrangements, Mr. Nebbia remarked. Although conditionality differed from surveillance, the latter was inherent in conditionality. The absence of effective surveillance over countries not in need of Fund assistance meant that a group of other countries had had to face much harsher adjustment and the world economy lower activity. On the whole, the external environment remained unfavorable to all countries, especially because of the high real interest rates in international capital markets, the protectionist measures adopted in industrial countries, and--it had to be added--the deterioration of the terms of trade of developing countries. Thus, further improvements in the underlying economic and financial conditions in the major industrial countries would greatly benefit those countries themselves, easing at the same time the adjustment problems of developing countries by fostering the demand for their exports and reducing interest rates on their foreign debt.

It was essential to seek more effective means whereby the Fund could influence the policies of member countries not needing to use its resources, Mr. Nebbia considered, in order to attain more stable economic development in all member countries and at the same time reduce the demand for Fund assistance. Efforts to devise new ways to strengthen surveillance would come to naught without the political will in major countries to implement the commitments they made at summit meetings and other international groups.

Referring to the five topics covered in Section VI, "Avenues for Improving the Effectiveness of Surveillance," Mr. Nebbia mentioned that if the objective was a more evenhanded system, he could agree with others who had noted that if countries were to be treated equally, the application of surveillance would have to differ. For that reason, his chair supported the idea of introducing objective indicators to assess the economic performance and policies of countries without Fund-supported programs or that were not subject to enhanced surveillance. The procedure would be particularly beneficial in dealing with major industrial countries whose policies directly affected world economic developments. The measures to be taken in case of deviations from quantified indicators should be carefully discussed in the Executive Board. The quantification process would not be easy but an effort should be made to test the usefulness of such a system.

Appropriate publicity could contribute to more effective surveillance by bringing members' policies and the Fund's opinion about them to the attention of the public, Mr. Nebbia said. However, it should not be forgotten that, as many Directors had stressed, and as the staff had mentioned in its paper, the confidentiality characterizing the Fund's bilateral relationship with its members was crucial to the success of the Article IV consultation process. To preserve that process intact, he would not encourage any modification in current procedures with respect to publicity. The only exception might be publicity in the event of deviations from objective indicators in the case of major industrial countries in an effort to help improve the performance of the world economy.

He joined other Executive Directors in their view that the Managing Director could continue to make an important contribution to surveillance in his public statements, Mr. Nebbia remarked.

In relation to the staff proposals for following up consultations, Mr. Nebbia continued, it would be difficult to apply rules governing the attitude of member authorities toward Fund missions, even though it would be desirable to ensure the participation in consultations of the highest possible level officials, particularly in industrial countries, where such officials were seldom actively involved. He accepted the staff suggestion that the Fund's management should communicate directly with the ministers of finance of the major countries when serious policy differences existed between the staff and the member or when their policies might have disruptive effects on other countries. In the latter event, it would also be useful to encourage members to reply to recommendations in staff appraisals and in the Managing Director's summinga up.

He could not accept an automatic procedure for calling for formal supplemental consultations, Mr. Nebbia stated. Such consultations should take place only in exceptional circumstances and should first be approved by the Executive Board, triggered perhaps by the objective indicators or by the need to analyze more fully the economic situation of countries having overdue obligations to the Fund. The specific procedures for implementing enhanced surveillance should be a matter for discussion between the individual country and the Fund, taking into account that the country itself was requesting enhanced surveillance in order to facilitate its relations with the banks.

Finally, Mr. Nebbia said that he could support the proposed decision, with the exception of the phrase "in the light of the Managing Director's summing up," which could lead to misunderstandings about the new procedures to be adopted on the important matter of surveillance.

Mr. Mtei noted that there was general agreement on the real need to strengthen the implementation of Fund surveillance, that need having been central to various reviews of the subject in the past. The Fund had quite an impressive array of instruments for conducting surveillance, ranging from Article IV consultations to detailed research papers such as those on the World Economic Outlook and others on specific subjects like trade and debt. It was usually not too difficult to discern the nature and causes of problems from those papers, but more often than not, governments refused to acknowledge that their economic and financial policies contributed to the economic problems confronting other countries. For instance, high real interest rates rooted in huge fiscal deficits and in a policy of monetary restraint in a key currency country, resulting in real effective appreciation of the exchange rate and capital inflows, could inflict untold economic and financial hardships on other countries. The staff had rightly pointed out that it was in recognition of the severity of such hardships that "the Fund had stressed that, while they should continue their adjustment efforts, developing countries had the right to expect developed countries--in particular the major industrial countries--to contribute to the global adjustment process in a major way." But despite the genuine surveillance efforts of the Fund, the world had witnessed increased protectionism in key countries during recent years. The staff paper on trade policy issues and developments, which the Executive Board had recently discussed (SM/85/60, 2/19/84; EBM/85/43 and EBM/85/44, 3/18/85), had brought into focus the increased recourse to bilateralism and other protectionist measures in developed countries at about the same time as many developing countries were unilaterally adopting measures of liberalization in the context of Fund-supported programs.

The staff had dwelt at length on the matter of the evenhandedness of surveillance, Mr. Mtei commented. The attempt to separate the Fund's responsibilities for overseeing members' economies from their financial policies was impressive but not sufficiently convincing because the dividing line was inevitably blurred. It made little difference whether the responsibility was carried out in the form of conditionality in the context of use of Fund resources, by verifying across the board that members did not apply exchange restrictions or multiple currency practices, or by requiring the compliance of members with the general obligations of Article IV, which applied to virtually the whole range of members' external and domestic macroeconomic policies. The end objective was the same. The lack of evenhandedness should be viewed not in the sense of deliberate discrimination by the Fund against countries in weak positions and those using its resources but in the context of the overall effectiveness of surveillance. By and large, it was common knowledge that the Fund had not thus far devised a mechanism to make surveillance effective over the economic policies of the large industrial countries and other surplus countries even though what happened in those countries determined the smooth functioning of the international monetary system. The use of supplementary consultations would not alter that basic fact. The isolated case of Sweden had, it was generally agreed, been made possible by the relatively small size of that industrial country and the perceived loss to it of competitiveness by other industrial countries.

The frequency of Article IV consultations was a matter for judgment, Mr. Mtei considered. There was no downplaying the usefulness of those consultations and the need for the Fund to continue to conduct them as effectively as possible. It might not be possible to hold consultations as often as might be desired in all countries, but efforts should be made to maintain the annual consultation cycle with all the major industrial countries whose policies had far-reaching repercussions outside their national boundaries, and with other members to the extent possible. The existing procedures for exchange rate monitoring seemed adequate although there might be some room for improvement, particularly with respect to how to deal with a floating major currency that was constantly appreciating.

The key to improving the effectiveness of surveillance was to be found in the extent to which members could be persuaded to pay greater attention to the international ramifications of their policy decisions, Mr. Mtei went on. The use of objective indicators enabling the Fund and countries themselves to monitor adherence to the rules of the game might be of assistance in that respect. Trigger points would have to be negotiated with members, and the difficulties in doing so could not be overemphasized. If agreement on the indicators could be reached, however, movements outside the agreed limits might call for automatic consultation with the authorities that could lead to a Board discussion. Further studies on possible objective indicators and the triggering mechanism might be needed before a definitive decision could be taken.

The proposals relating to publicity were not necessarily likely to produce the desired results, Mr. Mtei stated. The staff had mentioned the difficulty of the Fund successfully combining the role of a private confidential advisor with a more public one. Sight should also not be lost of the ultimate responsibility of the Fund to member governments--its shareholders--or of the confidentiality with which the Fund should conduct its relations with them. Despite the perceived benefits of publicity, particularly for staff reports for Article IV consultations, the accompanying disadvantages might be overwhelming. Public statements by the Managing Director immediately following the Board's completion of the Article IV consultation would seem equally inappropriate. The Fund should not go out of its way to promote the effectiveness of its surveillance functions by appealing to public opinion over the head of the member country's government. Direct appeals to public opinion could be counterproductive. The government might become alienated from the Fund, and the authorities might not be forthright in future discussions with the staff, withholding information for fear of its subsequent use by the Managing Director against the interests of the country. Should the practice become widespread, the effectiveness of the Fund would be seriously circumscribed. Unless the statement was negotiated and agreed with the authorities concerned, the affected country was likely to make a rebuttal; it was difficult to envisage governments giving the Managing Director a blank check. In the same vein, the proposal to release staff reports was unacceptable, with the exception of cases in which the member gave its express approval. The current procedures governing the release of reports on recent economic developments should remain unchanged.

He had no problem with the proposal to make a specific report prepared at the request of a member available, to banks in particular, at the wish of the member, Mr. Mtei added. He also had no objection to public speeches by the Managing Director drawing attention to policy problems, as had been done effectively on several occasions--for instance, on the issue of the U.S. budget deficit. As long as such statements did not rely on confidential information supplied by a member, they could contribute to the public understanding of key issues and become an important factor in the effectiveness of the surveillance process.

While there was scope for giving greater internal publicity to the Fund's views in member countries, especially for bringing them to the attention of authorities at the highest levels, he was not sure whether the Fund should give directives on how far up the ladder of authority its reports should go and with what force, Mr. Mtei said. It would be unusual for an Article IV consultation mission to visit a country without the knowledge of the powers that be, who were also unlikely not to want to know the outcome of the discussions. It was to be expected that the Governor for the Fund, who was the channel of communication between the Fund and his government, would go about securing the necessary internal publicity in the most appropriate manner. Most heads of state were too busy to pay much attention to Fund reports, and sending reports to parliaments was not certain to enhance the acceptance of Fund views. He was equally unclear about the utility of the proposal to include in staff reports a brief review of the extent of the authorities' active participation in consultations because it might vary from country to country. As long as senior officials, including governors of central banks or their immediate assistants were involved, he saw no cause for concern. It would be expecting too much to ask ministers to be in attendance most of the time during a consultation, and politicians might not fully appreciate the technicalities of consultations or staff reports.

The suggestion to focus more attention on policy action or inaction following consultations might be worthwhile considering, Mr. Mtei noted, particularly if consultation reports were frank and bold, embodying detailed analysis and identification of policies which might cause problems for underdeveloped countries. Such policies were identified in preceding reports, and statements of good intentions could be measured against subsequent concrete action. Supplemental consultations might also be useful, particularly with a major country whose policy actions had a far-reaching impact on others. Their usefulness for developing countries was doubtful; in fact, they might stretch the administrative machinery of those countries to the limit. He saw no need for automatic supplemental consultations midway between annual consultations, even for members with large financial obligations to the Fund but no current program, unless the member was not current in its repurchase obligations. In the latter case, the staff would in any event be in constant touch with the member to find a solution to the problem, possibly undertaking technical missions.

He had no problem with enhanced surveillance at the request of a member, Mr. Mtei remarked, provided the Fund was certain at the outset that it would serve a useful purpose and not be used to rubber stamp policies aimed at attracting other assistance from creditors.

Finally, the implications of the staff's proposals for the workload could not be ascertained until it was known which of them would be accepted; only then could the staff present an appropriate set of proposals to the Executive Board for its consideration.

The Executive Directors agreed to resume the discussion at their next meeting.

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Secretary