**FOR AGENDA**

SM/14/224
Correction 1

September 25, 2014

To: Members of the Executive Board

From: The Secretary

Subject: **2014 Triennial Surveillance Review—External Study—Structural Policies in Fund Surveillance**

The attached corrections to SM/14/224 (7/30/14) have been provided by the staff:

**Factual Errors Not Affecting the Presentation of Staff's Analysis or Views**

**Page 26, paragraph 90, lines 1-4:** for **"India's unexpected slide from double-digit growth rates during much of the past decade to below 4 percent over the past couple of years** shows remarkable macroeconomic fragility and the risk of divergence from peer economies in Asia, particularly China, and from reasonable expectations (Figure 4)."
read **"India's unexpected slide from near double-digit growth rates during much of the past decade to below 5 percent over the past couple of years** shows remarkable macroeconomic fragility and the risk of divergence from peer economies in Asia, particularly China, and from reasonable expectations (Figure 4)."

**Page 26, Figure 4, China and India: Real GDP Growth:** Data updated to the April 2014 vintage of the WEO.

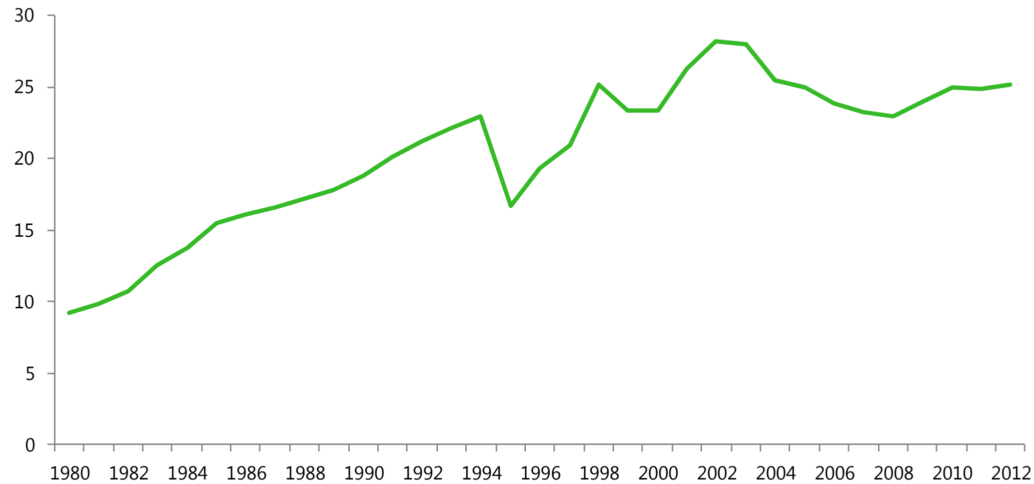
Questions may be referred to Ms. Koranchelian (ext. 38592), Mr. Weisfeld (ext. 37482), and Mr. Dwight (ext. 39518) in SPR.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

Att: (1)

Other Distribution:
Department Heads

**Figure 3. South Africa Unemployment Rate**
(Percent)




**Source**: International Monetary Fund, October 2013 WEO

**87. Fund surveillance has had a mixed record from a policy perspective. On the one hand, South Africa has made considerable economic and social progress.** The policy framework and institutions have delivered a globally integrated and diversified economy, with growth rates that have increased GDP per capita by 40 percent. In addition, social assistance has helped reduce the poverty rate by 10 percentage points to 31 percent in 2013. The Fund and the authorities have developed a convergence of views on what are 'optimal' macroeconomic policies; this has bolstered market confidence and underscores the power of influence.

**88. On the other hand, Fund advice on a wide range of structural issues and specifically on labor and product market reforms including wage bargaining, labor taxation, and trade unions,** has had but limited influence as assessed in the latest round of the Surveillance exercise. We take this to mean that influence has not gone much beyond analysis and recommendations and into significant policy actions

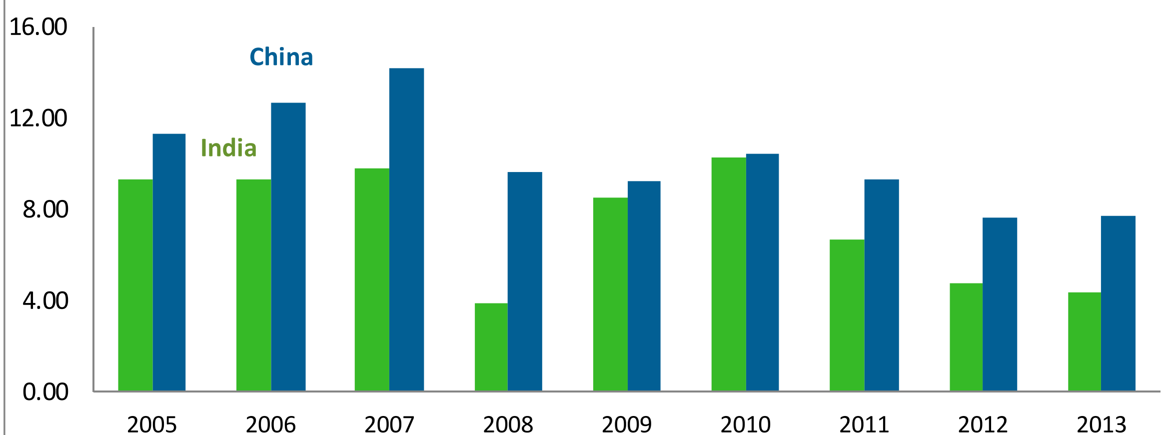
**89. This case, in our view, illustrates an involvement in a structural policy area—labor market reform— where the Fund is not strategically well-positioned to be effective.** The issues involved are complex and deeply embedded in the social and economic fabric, which insider stakeholders have a strong interest to preserve. The Fund could exercise influence on reform in this area, if at all, not so much by the traditional consultation process, but by facilitating the engagement of interested parties in a dialogue to build domestic consensus for change. Using our menu approach we would offer two options. First, the Fund could agree to exclude formal discussion and advice on labor and employment issues but report the authorities' views candidly in the Surveillance exercise. We believe that approach would focus attention consciously on the authorities' own policies on the issues. Second, the Fund could provide concerted support, in cooperation with expert groups, to seek a negotiated domestic solution to what is fundamentally a political problem and to catalyze financing for it, if needed, in a way analogous to financing macro-policy adjustments. Choosing the first option would remove any perception that Fund endorsement of domestic macro policies, when views are seen to converge, might also suggest that the Fund considers the stark divergences within the country are of a much lesser macro-significant risk. Choosing the second would strongly signal the importance that the Fund attaches to mitigating the huge risk that persistent divergence on the scale still prevailing in the country poses for the sustainability of policies.

## F. India Post 2010: Sharp Growth Slowdown to Below Acceptable Rate of Growth

**90. India's unexpected slide from near double-digit growth rates during much of the past decade to below 5 percent over the past couple of years** shows remarkable macroeconomic fragility and the risk of divergence from peer economies in Asia, particularly China, and from reasonable expectations (Figure 4). These relatively low rates of growth are not sustainable. Neither the political system nor financial markets, who until recently praised India as part of the fast-growing BRIC group of countries, will tolerate persistently low growth.

**Figure 4. China and India: Real GDP Growth**

(Percent)




Source: International Monetary Fund, April 2014 WEO

**91. This slowdown is attributed to a combination of external and homegrown causes. On the domestic front,** the Indian authorities prevaricated on structural reform despite advance warning in the context of Fund surveillance and pressures from the financial markets. Second, investor confidence was damaged by uncertainty over future policies resulting from maneuvering of political parties looking for electoral advantage. Third, commentators point to an ongoing measure of dysfunction in governance. All these factors are thought to have acted as a brake on building a consensus to push through critical reforms to raise the growth of potential output (for example, by