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To: Members of the Executive Board

From: The Secretary

Subject: **Surveillance During the COVID-19 Crisis—Engagement on Country and Thematic Issues**

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Questions:	Mr. Bornhorst, SPR (ext. 36120) Mr. Hart, SPR (ext. 36388)





June 12, 2020

## SURVEILLANCE DURING THE COVID-19 CRISIS— ENGAGEMENT ON COUNTRY AND THEMATIC ISSUES

### EXECUTIVE SUMMARY

**Following the suspension of staff work on Article IV consultations and mandatory FSAs due to the COVID-19 crisis, consideration needs to be given to how to maintain a structured policy dialogue with the membership.** There is an increasing appetite from the membership to engage with the Fund on policies for crisis management and recovery, and distill lessons learned from the diverse experiences so far. In this context, a prolonged absence of Board engagement on bilateral surveillance poses risks for the Fund in its role in supporting domestic and global stability, including with respect to risk monitoring and the consistency of bilateral and multilateral policy advice.

**The COVID-19 crisis will dominate the Fund's surveillance work in the near-term, calling for a gradual and flexible approach.** The uncertainty over the depth and duration of the pandemic suggests that the membership—and therefore the Fund's surveillance—will necessarily be focused on key crisis-related priorities: the immediate crisis response, measures to restore stability and lay the groundwork for a robust recovery, and policies to build a resilient economy. To provide the most value added to the membership, the Fund will need to be responsive to these priorities and help identify cross-cutting issues for the benefit of the wider membership. The surveillance priorities and broad direction of reform proposals outlined in the Comprehensive Surveillance Review (CSR) midpoint note are also relevant in this context.

**This paper outlines a proposed approach for resuming bilateral surveillance,** which consists of a gradual resumption of Article IV consultations focused primarily on the crisis and related issues combined with regular informal Board briefings on cross-cutting surveillance issues. If the Board supports this approach, additional Board decisions will be required to address the operational implications of the gradual resumption of Article IV consultations.

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## CONTEXT

1. **The Fund's work on Article IV consultations and mandatory Financial Stability Assessments (FSAs) has been temporarily suspended due to the COVID-19 crisis, with some exceptions.**<sup>1</sup> The significant uncertainty in the macro-financial landscape due to the crisis, combined with resource constraints on both member authorities and the Fund, has meant that engaging on policy issues beyond the near-term poses practical and operational challenges. In spite of these difficulties, Fund staff has remained intensively engaged in monitoring developments and discussing policy priorities with authorities, including in the context of emergency financing requests. Fund products such as the Policy Tracker, the Special Series on COVID-19, and other capacity development (CD) work have also been highly appreciated.
2. **There is growing demand from the membership for resuming a structured policy dialogue.** The crisis is global in nature but unfolding at different stages across the membership, with some countries still fully absorbed in crisis management while others are beginning to ease containment policies. This is reflected in an increasing appetite from member countries for deeper engagement on issues such as crisis management policies, the implications of relaxing containment measures, and drawing early cross-country lessons and best practices from the crisis response and reopening and recovery policies. The membership is also looking to the Fund for guidance on fostering a sustainable recovery, including on issues such as climate policies, inequality, and the digital transformation. Having structured policy discussions would improve the collective understanding of the effects and trade-offs of various policy combinations and their spillovers.
3. **This suggests that the Fund should consider when and how best to resume formal bilateral policy dialogue outside of the context of Fund financing.** A prolonged pause in the bilateral surveillance dialogue poses risks for the Fund in its role in maintaining domestic and global stability. For instance, multilateral surveillance greatly benefits from the bottom-up analysis generated by bilateral surveillance, particularly for systemic economies. Conversely, the risks of inconsistencies arising in policy advice between bilateral engagements and multilateral surveillance will grow as bilateral surveillance remains suspended while the latter continues as usual. Resuming bilateral surveillance would also allow the Fund to better monitor and limit the risks from cross-border spillovers due to asymmetric crisis effects, uncoordinated domestic policy responses, and asynchronized recovery paths.

<sup>1</sup> See *Extension of Consultation Cycles Due to Covid-19 Pandemic*, Policy Paper No. 20/027. Exceptions include nearly completed FSAs and countries for which the completion of the Article IV consultation is a pre-requisite for an FCL/PLL/SLL request or review, or the Executive Board's extension of a SLL offer.

## IMPLICATIONS FOR BILATERAL SURVEILLANCE<sup>2</sup>

**4. Surveillance is a core obligation for both the Fund and its membership.** Legally, bilateral surveillance is the Fund's (i.e., the Executive Board's) assessment of each member's compliance with its obligations under Article IV. Article IV consultations must cover the core elements necessary for surveillance as laid out in the 2012 Integrated Surveillance Decision (ISD), which includes an appraisal of fiscal, monetary, financial and exchange rate policies.<sup>3</sup> The Board's involvement in bilateral surveillance promotes the evenhandedness of Fund advice, which in turn supports traction. Moreover, Article IV consultations and FSAs are vehicles for both bilateral and multilateral surveillance, allowing for a discussion of the full range of spillovers from a member's policies on global stability.

**5. The pervasiveness of the COVID-19 crisis implies that surveillance will need to be focused on the fallout from the pandemic for the foreseeable future.** The crisis has already resulted in deep macroeconomic dislocations for some members, while for others the full impact may still lie ahead. There remains considerable uncertainty over the pace and path of the recovery, which remains contingent on, *inter alia*, policy space, the effectiveness of the policy response, and medical advances (e.g., the development and rollout of an effective vaccine). In this context, surveillance will necessarily be focused on crisis-related priorities such as the immediate policy response and policies to prepare for downside scenarios (e.g., multiple waves of the pandemic), policies restoring stability and limiting the scarring effects of the crisis, and laying the groundwork for a sustainable and resilient economic recovery. It will also be an opportunity to assess CD priorities and strategies for individual countries. While in-depth coverage of longer-term issues not immediately relevant to the crisis or recovery may need to be postponed until a recovery is more firmly established, for low-income countries in particular it will be important for surveillance to consider strengthening institutions to address crisis-related priorities.

**6. The Fund's surveillance should also seek to draw out cross-cutting lessons for the benefit of the wider membership.** Feedback from the membership suggests that staff's policy dialogue with country authorities would be greatly enhanced by drawing on cross-country experiences that inform lessons learned and best practices (the success of the Fund's Policy Tracker is a testament to this sentiment). A structured dialogue with the Board on such cross-cutting issues would help improve the quality and consistency of Fund policy advice to the membership.

**7. Bilateral surveillance will need to be flexible to adapt to a rapidly evolving context.** Due to the resource constraints noted above, the typical once-a-year comprehensive Article IV

<sup>2</sup> The term "bilateral surveillance" in this paper is sometimes used interchangeably with "Article IV consultation and mandatory FSAs". Article IV consultations and mandatory FSAs are a vehicle of both bilateral and multilateral surveillance.

<sup>3</sup> Decision No. 15203. Article IV consultations must also cover other policies to the extent that they significantly influence present or prospective balance of payments or domestic stability. From a multilateral surveillance perspective, Article IV consultations must cover spillovers arising from policies of individual members that may significantly influence the effective operation of the international monetary system.

assessment may not be feasible during the immediate crisis for all countries. Moreover, in the event of a further deterioration in the economic outlook, the Fund will need to be prepared to once again re-balance its focus towards crisis resolution (i.e., Fund financing) while retaining the flexibility to provide the core elements of bilateral surveillance.

**8. There is merit in considering ways to reflect these developments in the way in which the Fund engages in bilateral surveillance for the duration of the COVID-19 crisis.** Depending on how the pandemic unfolds, it may take at least until sometime in 2021 before regular Article IV consultations and mandatory FSAs resume for the full membership. In the meantime, introducing some interim arrangements informed by the principles outlined above would help strengthen the policy dialogue between the Fund and the membership and mitigate surveillance risks. The next section provides considerations along these lines.

## RESUMING BILATERAL SURVEILLANCE

**9. Mindful of the context and constraints outlined above, a two-pronged approach to resuming bilateral surveillance work is proposed.**

### *Gradually resuming crisis-focused Article IV consultations and mandatory FSAs*

**10. To best support the membership in the current context, the gradual resumption of Article IV consultations would be focused on the crisis and related challenges.** Staff reports will be expected to be short and succinct. They will discuss near- and medium-term macroeconomic and financial implications and policy priorities diagnosed through the lens of the COVID-19 crisis. This could include, for instance, three interrelated themes: the immediate crisis-management policy responses, measures to restore stability, and steps to foster a sustainable and resilient recovery.<sup>4</sup> Topics that do not have a bearing on the crisis response and recovery would be set aside for now. Country teams would have flexibility in how Article IV consultations are presented, provided the report includes an assessment of the issues mandated by the ISD (coverage of fiscal, monetary, financial, and exchange rate policies, domestic policies that significantly influence present or prospective balance of payments or domestic stability, and spillovers). Standard policies and processes would apply, but there would be a pragmatic approach to the precise form and format.<sup>5</sup>

**11. Some selectivity will be required in terms of country sequencing for Article IV consultations.** Consideration could be given to focusing initially on countries whose policies have global or regional systemic implications, have significant vulnerabilities, or have not been recently discussed at the Board in the context of Fund financing. The number of Article IV consultations

<sup>4</sup> The specific issues would necessarily reflect country circumstances and be agreed with country authorities. They could include pre-existing vulnerabilities or structural barriers to a sustainable recovery (e.g., climate resilience, reducing inequality, and digital transformation).

<sup>5</sup> A pragmatic application of the Staff Guidance Note on Surveillance could allow for some deviations from established presentational formats, with prior agreement with relevant review departments to ensure evenhandedness.

would be gradually expanded in a flexible manner, reflecting prioritization, resource constraints, and authorities' capacity and readiness to engage. Area Departments would determine the order and priority of Article IV candidates from their regions, which in turn would be informed by discussions with member authorities. Staff estimates that this approach would cover about 30-40 countries in total, including 20-30 completed Article IV consultations by the end of 2020. Consultations would be expected to be conducted virtually at least until missions can resume safely, and where and when warranted, this may continue as an option for the duration of the pandemic. The Board would periodically be informed about which countries are scheduled for the period ahead.

**12. The resumption of work on FSAs would also need to reflect the new realities.** As the crisis is unfolding at different stages across the membership, some country authorities prefer a deeper engagement on crisis-related financial sector issues with IMF staff and drawing early cross-country lessons from the crisis response. Accordingly, the resumption of FSAs should broadly mirror the plan to restart Article IV consultations, i.e. gradual, with an initial focus on countries with systemically important financial sectors or where significant vulnerabilities warrant close attention.

### ***Surveillance Issues Briefings***

**13. Surveillance issues briefings would be informal-to-brief Board meetings on cross-cutting surveillance issues that would not necessarily be captured by the flagships or regional presentations.** The briefings would allow for more timely engagement with the Board on emerging policy challenges and related Fund advice. The format would be kept flexible to accommodate surveillance issues applicable across the membership (e.g., Developments and Challenges in Emerging Markets, or the Implications for Surveillance from the Fund's CD activities on COVID-19 topics), as well as surveillance issues relevant for a subset of members presented through country case studies (e.g., the impact of the pandemic on tourism dependent economies or oil exporters, approaches to economic re-opening, or policies to manage the return of migrant workers from abroad). The consideration of multiple country cases spanning across geographic regions at once would also help enhance the consistency of Fund policy advice, strengthen peer learning, and potentially bolster traction. The country case studies would focus in particular on members where an Article IV consultation is not feasible in the short-term or where lending papers have not recently been prepared for the Board's consideration. In keeping with their informal nature, and to minimize the burden on authorities and staff, there would be no requirement for an "Authorities' Views" section, but staff would be expected to reflect on any relevant discussions with authorities, where applicable.

**14. Mindful of resource implications, surveillance issues briefings would draw on existing or ongoing staff analysis.** Staff estimate that there would be 1-2 such briefs per quarter. Buff and Gray Statements would be expected to be rare. Although not considered bilateral surveillance,<sup>6</sup> the

<sup>6</sup> Legally, surveillance requires the Board to provide an assessment of compliance of a member's policies vis-à-vis its obligations under the relevant Articles of Agreement. In practice, this is achieved through a summing up that reflects the discussion at a Board meeting based on the staff report. Since these briefings would be informal in nature, no formal Board assessment would be provided.



briefings could be used as background for Article IV consultations once the latter are fully resumed. Material for the briefings would not be published.

**15. The above proposals assume that the COVID-19 crisis gradually wanes, followed by an incremental reduction in economic and social restrictions and a modest economic recovery starting in 2021.** This would suggest that these proposals could be pursued for at least the remainder of 2020 and that regular bilateral surveillance activities would systematically resume sometime in 2021. That said, until the repercussions of the crisis are fully resolved, even if Article IV consultations were to resume for all countries, they would be expected to focus on the crisis and its legacy issues for the next several years. Conversely, should the global outlook deteriorate significantly or cause further severe economic dislocations for member countries, a much slower process in resuming regular bilateral surveillance modalities would need to be considered.

### ***Resource Implications***

**16. The resource implications of this proposal depend on implementation.** The suspension of Article IV consultations will result in temporary savings, most of which have been reallocated already. Preliminary estimates suggest that around 30 fewer Article IV consultations will be held in FY 21 compared to FY 20. This would result in temporary savings of around \$11-13 million in FY 21.<sup>7</sup> As Article IVs resume, there will be some catch up in spending in FY 22. The additional cost of surveillance issues briefings is estimated to be around \$100-120K (0.3-0.4 FTEs) per meeting, mainly representing coordination costs of deciding on topics to present and preparing the materials for the informal Board discussion. The total cost will depend on how many topics and how many meetings take place.

## **NEXT STEPS**

**17. The approach outlined above would require additional formal decisions from the Board to address the operational implications from the gradual resumption of Article IV consultations:**

- The more gradual resumption in bilateral surveillance will mean that many members will be unable to complete their previously scheduled Article IV consultations and mandatory FSAs within earlier established timeframes. This implies that a further extension to consultation cycles—beyond the six months recently agreed by the Board<sup>8</sup>—will be required. Staff

<sup>7</sup> The main components of savings include travel and staff time. Savings on Article IV travel have already been partly reallocated as part of broader travel savings reallocation. Staff time on surveillance countries has shifted from preparing for Article IV consultations/conducting regular surveillance to preparing emergency financing requests and engaging intensively with authorities on the Covid-19 crisis response and have thus been directly reallocated to surveillance and program work.

<sup>8</sup> *Extension of Consultation Cycles Due to Covid-19 Pandemic*, Policy Paper No. 20/027.

recommends pursuing a further extension of consultation cycles by six months, which would prolong the extension from October 22, 2020 until April 22, 2021.

- The temporary suspension of Article IV consultation cycles also impacts the delayed Article IV consultations framework, including sending notifications to members, informally briefing the Board on economic developments in delayed members, publishing the semi-annual lists of members with delayed consultations, and circulating the annual report on delayed consultations.<sup>9</sup> In practice, the accumulation of delays for members with past due consultation deadlines has been paused following the Board's decision to extend the Article IV consultations cycles for all members.<sup>10</sup> In this context, implementing the framework and publishing a list of members with delayed Article IVs would be of limited value. Accordingly, staff recommends that the Board adopt a decision to suspend the framework for delayed Article IV consultations through April 22, 2021.

**18. Subject to the Board's feedback, staff will prepare a short Board paper containing these two decisions, to be circulated on a LOT basis in the coming weeks.**

#### **Box 1. Implications for the CSR**

**The impact of the COVID-19 crisis on surveillance will inevitably shape the Comprehensive Surveillance Review (CSR), having already reinforced its main messages.** Several of the challenges that the pandemic poses for surveillance were anticipated by the CSR midpoint note (FO/DIS/19/192). With the pre-COVID-19 global economic landscape already characterized by subdued growth, uneven prospects for economic convergence, and limited policy space, the paper highlighted the importance of non-economic trends shaping the surveillance landscape. The CSR midpoint note argued that Fund policy advice needed to better incorporate risks and uncertainty, plan for possible contingencies, pre-empt and mitigate spillovers, design coherent policy measures, and foster sustainable economic outcomes.

**The CSR midpoint concluded that Fund surveillance needed to adapt to the types of surveillance challenges outlined in this paper.** With the aim of strengthening the relevance and traction of Fund advice, the midpoint note argued that surveillance needs to be nimble and responsive to emerging priorities at the country-level, and supported by deeper CD-surveillance integration. It also needs to better surface issues of strategic and cross-cutting importance so that the international community, as represented by the Board, can offer its collective views on issues central to domestic and global stability. To accomplish this, the midpoint paper noted that some rebalancing of comprehensiveness and selectivity in surveillance may be required. The midpoint note further suggested that there may be scope to supplement formal bilateral surveillance with short, timely country updates and more frequent discussions of strategic cross-cutting issues that would not otherwise be captured by multilateral surveillance products.

<sup>9</sup> Decision No. 15106, as amended. The semi-annual lists, which are published on the Fund's external website, list members with Article IV consultations delayed by 18 months or more as of June 15 and December 15. The annual report (required by Decision No. 15765), which is circulated to the Board for information only and not published, lists all members with delayed Article IV consultations as of December 31.

<sup>10</sup> Effective for six months, as of April 22, 2020.

**Box 1. Implications for the CSR (concluded)**

**The rapidly evolving nature of the COVID-19 crisis shows that the CSR surveillance priorities remain relevant.** Uncertainty about the duration of the pandemic and the size of the corresponding policy response make it essential to consider risks around the baseline, supported by contingency planning for adverse outcomes. The pervasive nature of the crisis means that the policies need to take into account potential spillover effects and the synergies and tradeoffs between different policies in order to have a strong and coherent response to the crisis. Moreover, issues around sustainability—for instance, ensuring that the policy response to immediate challenges are also consistent with long-run economic sustainability in the face of large-scale climate change—will be front and center as members begin laying the groundwork for a recovery, with the crisis potentially representing an opportunity to pursue necessary but politically difficult reforms.

**Notwithstanding the above, staff expects the COVID-19 crisis to significantly shape the surveillance landscape over the medium-term in new and important ways.** The uncertainty and scarring effects associated with the pandemic will likely persist for some time, and the importance of addressing long-term structural challenges (e.g., climate, inequality, digitization) may only increase. Therefore, staff's initial experience with the approach to bilateral surveillance recommended in this paper, if pursued, will usefully inform the CSR's final proposals, including revisiting the focus and frequency of Article IV consultations after the crisis ends.

## QUESTIONS FOR DIRECTORS

- Do Directors agree with this paper's assessment of the implications of the COVID-19 crisis on Fund surveillance?
- Do Directors agree that the Fund's bilateral surveillance should gradually resume in a way that is mindful of the time and resource pressures on both the member authorities and staff?
- Do Directors agree with the recommended way forward of selectively resuming focused Article IV consultations and FSAs, combined with more frequent informal briefings on emerging surveillance issues related to the crisis?
- Do Directors agree with the proposal to extend the Article IV consultation cycle by an additional six months for all members and temporarily suspend the framework for delayed Article IV consultations?