Appendix 1 Terms of Reference of the IEO

Purpose

The Independent Evaluation Office (IEO) has been established to systematically conduct objective and independent evaluations on issues, and on the basis of criteria, of relevance to the mandate of the Fund. It is intended to serve as a means to enhance the learning culture within the Fund, strengthen the Fund's external credibility, promote greater understanding of the work of the Fund throughout the membership, and support the Executive Board's institutional governance and oversight responsibilities. IEO has been designed to complement the review and evaluation work within the Fund and should, therefore, improve the institution's ability to draw lessons from its experience and more quickly integrate improvements into its future work.

Structure and Accountabilities

IEO will be independent of Fund management and staff and will operate at arm's length from the Fund's Executive Board. Its structure and modalities of operation must protect its operational independence—both actual and perceived.

A Director, to be appointed by the Executive Board, will head IEO. The Director's term of appointment will be for a period of four years renewable for a second term of up to three years. The Director's appointment may be terminated at any time with the approval of the Executive Board. At the end of the term of service, the Director will not be eligible for appointment or reappointment to the regular staff of the Fund. The Director will be responsible for the selection of IEO personnel (including external consultants) on terms and conditions to be determined by the Board with a view to ensuring that the office is staffed with independent and highly qualified personnel. The majority of full-time IEO personnel will come from outside the Fund.

Responsibilities

The Director of IEO will be responsible for the preparation of the Work Program. The content of the Work Program should focus on issues of importance to the Fund's membership and of relevance to the mandate of the Fund. It should take into account current institutional priorities, and be prepared in light of consultations with Executive Directors and management, as well as with informed and interested parties outside the Fund. The Director will present IEO's Work Program to the Executive Board for its review.

IEO, through its Director, will report regularly to the Executive Board, including through the preparation of an Annual Report. It is also expected that the IMFC will receive regular reports on the activities and findings of IEO.

With respect to individual evaluations, staff, management, and—when appropriate—the relevant country authorities will be given an opportunity to comment on the assessments being presented to the Executive Board.

The Director of IEO, in consultation with Executive Directors, will prepare a budget proposal for IEO for consideration and approval by the Executive Board. Its preparation will be independent of the budgetary process over which management and the Office of Budget and Planning have authority, but its implementation will be subject to the Fund's budgeting and expenditure control procedures. IEO's budget will be appended to that of the Executive Board within the Fund's Administrative Budget.

If requested by the Executive Board, IEO will provide technical and administrative support for any external evaluations launched directly by the Executive Board.

Consultation, Publication, and External Relations

In carrying out its mandate, including in the preparation of its Work Program, IEO will be free to consult with whomever and whichever groups it deems necessary, both within and outside the Fund.

IEO will have sole responsibility for drafting IEO evaluations, Annual Reports, press releases, and other IEO documents or public statements.

IEO's Work Program will be made public and there will be a strong presumption that IEO reports will be published promptly (within the constraints imposed by the need to respect the confidentiality of information provided to the Fund by its members), unless, in exceptional circumstances, the Executive Board were to decide otherwise.

Publication of evaluations will be accompanied by comments from management, staff, and others, including relevant country authorities, where appropriate, along with the conclusions reached by the Board in considering the evaluation report.

Relations with Fund Staff and Management

In conducting its work, IEO should avoid interfering with operational activities, including programs, or attempting to micro-manage the institution.

Review of Experience with IEO

Within three years of the launch of IEO operations, the Executive Board should initiate an external evaluation of IEO to assess its effectiveness and to consider possible improvements to its structure, mandate, operational modalities, or terms of reference. Without prejudging how that review would be conducted, it should be understood that the review would include the solicitation of broad-based input from outside the official community.

Appendix 2

Budget of the Independent Evaluation Office for FY2003 and FY2004[1]

(In U.S. dollars)

	FY2003		FY2004
	Budget	Actual	Approved budget
Regular staff	2,431,000	2,413,361	2,615,420
Total discretionary budget	1,121,100	934,403	1,202,222
Experts and contractuals	610,000	629,561	630,000
Business travel budget	319,000	243,937	344,000
Outreach seminars	180,000	54,618	190,000
Other	12,100	6,287	12,500
Total	3,552,100	3,347,764	3,817,642

[1]FY2003 is May 2002 to April 2003 and FY2004 is May 2003 to April 2004.

Appendix 3 Initial Broad Menu of Potential Topics for Evaluation by IEO

The following subjects were identified in the first stage of developing the work program.

Surveillance

1. The IMF's role and effectiveness in crisis prevention based on an examination of recent Article IV reports, including all the recent capital account crisis cases. Are "early warning" procedures effective, and do they influence the Fund's advice and countries' policies?

2. Review of Financial System Stability Assessments (FSSAs). What lessons can be learned from the experience of the first two years? Are they identifying the key vulnerabilities and proposing remedies in a cost-effective manner?

3. Follow-up to the 1999 external review of surveillance. Specifically, the review could focus on how the recommendations agreed to by the Executive Board have been implemented.

4. Effectiveness of IMF surveillance of industrial countries. Is the scope of surveillance appropriate and what is its value added?

5. The IMF's role in multilateral surveillance, including the World Economic Outlook and the International Capital Markets Report exercises.

6. Role and effectiveness of regional surveillance (e.g., European Community, other regional groupings).

7. The IMF's approach to liberalization of the capital account. Possible topics include whether the Fund's policy advice on the pace of capital account liberalization and its sequencing with other reforms, especially vis-à-vis the financial sector, have been appropriate and consistent across countries. How has policy changed in the light of experience with capital account crises?

8. The IMF's work on standards and codes of good practice (in collaboration with other agencies). Is the approach effective in building institutional capacity and reducing vulnerability in member countries?

IMF-Supported Programs and Related Issues

Review of individual country programs

1. Capital account crises (e.g., Argentina, Brazil, Ecuador, Indonesia, Korea, Thailand, Turkey). Some stakeholders have suggested that IEO should evaluate all programs where exceptionally large access to Fund resources is involved.

2. Low-income/highly indebted cases (possible cases include Bolivia, Burkina Faso, Cameroon, Honduras, Mozambique, Nicaragua, Niger, Senegal, Tanzania, Uganda, Vietnam, Zambia).

3. Transition countries (Bulgaria, Hungary, Poland, Russia, Ukraine, other FSU countries).

4. Selected countries that have had repeat programs could be chosen (e.g., Bolivia, Madagascar, Philippines, Zambia). Are there problems with program design that contribute to such repeat usage?

Review of broad policy issues cutting across programs

1. Exchange rate policies in IMF-supported programs and the Fund's policy advice on exchange rates as part of surveillance. Has the Fund's policy advice on exchange rate regimes and associated policies been consistent across countries? Has the design of exit strategies from exchange rate pegs been appropriate? Have the contractionary consequences of devaluations, stemming from their balance sheet consequences, been underestimated in program design? Has financial program design adapted effectively to inflation-targeting regimes?

2. Fiscal adjustment in IMF-supported programs. Does fiscal adjustment take sufficient account of longer-term goals (e.g., for growth, poverty reduction) and is it implemented in a sustainable manner? Has the potential, immediate adverse impact of programs on particular vulnerable groups been adequately assessed and taken into account in program design?

3. Policies toward financial sector stability and financial sector restructuring. In addition to the effectiveness of IMF policy advice in helping member countries avoid financial crises (also discussed above under surveillance), possible issues could include whether the design of financial sector restructuring packages has been appropriate, how the fiscal consequences have been handled, and how the macroeconomic consequences of corporate restructuring were taken into account in program design.

4. Debt reduction and debt sustainability issues. Possible issues (either in the context of the heavily indebted poor country (HIPC) cases or more generally) could include whether the approach to assessing the sustainability or unsustainability of debt positions (external or public debt) has been appropriate and consistent across countries; whether debt sustainability analyses in surveillance reports have been adequate; what use has been made of the sustainability analysis; and what can be learned from "best practice" approaches.

5. Has IMF support of a country's program had a positive "catalytic effect" in terms of generating additional external financing flows within a specific time frame? Are there objective measures of this catalytic effect? What factors influence the impact on market credibility?

6. The nature and effectiveness of conditionality and issues involving the "ownership" of national/IMF-supported programs. Also, IMF policy toward structural conditionality has been modified recently; a review of the impact of the new policy could be undertaken at the end of the first two-year experience (i.e., in FY2004).

7. Why do many IMF-supported programs remain uncompleted and what difference does it make? Are there particular aspects of program design (e.g., optimism of projections, extent of conditionality) that have a strong influence on the probability of completion? Do outcomes depend on the extent to which programs are completed and what lessons can be learned from incomplete programs?

8. Conditionality with respect to trade policies. Has the IMF adopted a consistent approach to trade policies in the design of conditionality? Is the approach consistent between the surveillance stage and the program stage?

9. Private sector involvement (PSI) in crisis resolution. This is a growing area of concern in which policy is still evolving but there are lessons to be learned from experience thus far. Does the existing experience suggest that some forms of PSI are likely to be more successful than others? Many of the questions involved are also closely related to the size of the IMF financial support, including through the Supplemental Reserve Facility (SRF) for countries undergoing crises that are centered primarily in the capital account.

10. Experience with privatization in IMF-supported programs. Possible questions to be addressed could include: was the sequencing with regard to implementation of regulatory frameworks appropriate? How realistic was the time frame for privatization? What was the impact on prices for services and investment in the privatized sectors? And what was the social impact?

Review of experience with particular lending facilities and related issues

1. The role of the Poverty Reduction and Growth Facility (PRGF) and the need to evolve special procedures to overcome problems in achieving stated objectives in countries with PRGF-supported programs have been much discussed. Although an internal review is currently under way, there is scope for an independent review beginning perhaps in late FY2003. The review could address such issues as: Have all of the lessons from the ESAF reviews and "best practices" on particular policy issues been incorporated into PRGF adjustment strategies? Has the increased emphasis on country ownership resulted in real changes in the approach to negotiations? Has program design effectively incorporated the analysis of the social impact of major reforms? Have program design and monitoring improved the targeting of spending in key sectors relevant to growth and poverty reduction? Have resources been effectively channeled to social sectors?

2. An external review of the enhanced HIPC Initiative would be important once a "critical mass" of countries reach their completion points.

3. The Contingent Credit Line (CCL) would also be a candidate for evaluation, but only after there is sufficient concrete operational experience with country cases.

4. The strategy vis-à-vis member country arrears to the IMF.

5. The IMF's role in countries emerging from conflict.

Technical Assistance and Training

1. A follow-up to the 1999 internal review of technical assistance. This could include an assessment of whether there are effective and consistent inter-

nal systems for evaluating technical assistance advice and for setting priorities.

2. Does technical assistance help improve national ownership of Fund-supported programs? Has it been effective in improving program implementation or in enhancing crisis prevention?
3. Assessment of the effectiveness of technical assistance in areas such as:
   - Tax policy and revenue administration;
   - Expenditure policy and expenditure management;
   - Banking supervision/financial stability; and
   - Debt and external reserve management.

Internal IMF Processes and Governance

1. Are the IMF's internal review systems adequate? For example, are there adequate mechanisms for early internal reassessments of the adequacy of program design?
2. Is World Bank–IMF collaboration effective? How can it be improved, given their distinct operational approaches and objectives? Is the division of labor/degree of overlap between the two institutions appropriate?
3. Do staff papers on country programs contain the necessary information and analysis for the Board to make an informed judgment on the probability of success?

Research

Since the Research Department was being restructured when the work program was prepared, this was not viewed as a high-priority area for review. However, a follow-up on the recommendations of the 1999 External Evaluation of Research Activities could be considered for the longer term.

Appendix 4 IEO Outreach Seminars and Workshops

August 2001, London, United Kingdom
Consultations on IEO's work program with nongovernmental organizations (NGOs), academics, and other stakeholders.

September 10–12, 2001, Dakar, Senegal
Meetings on IEO's work program at PRSP/PRGF seminar.

September 13, 2001, Paris, France
Meeting on IEO's work program with NGO representatives.

January 28, 2002, Tokyo, Japan
Outreach seminar on the IEO with Tokyo-based academics, NGOs, and government officials.

January 29, 2002, Tokyo, Japan
Workshop on the capital account crises evaluation with Tokyo-based experts.

February 9–10, 2003, Rome, Italy
Briefings on the IEO with various officials.

April 18, 2002, Washington, D.C., United States
Briefing on the IEO with NGO representatives.

July 1 and 2, 2002, Berlin, Germany
Joint IEO/German Foundation for International Development (DSE) workshop, including academics and various NGOs on the three initial evaluation projects.

August 5, 2002, Recife, Brazil
Meeting on the capital account crises evaluation with NGO representatives.

September 30, 2002, Washington, D.C., United States
Briefing on the IEO with NGO representatives.

October 29, 2002, Cambridge, Massachusetts, United States
Workshop with the National Bureau of Economic Research on all three projects.

November 7, 2002, Tokyo, Japan
Workshop at the ADB Institute on the prolonged use of IMF resources evaluation and the capital account crises evaluation.

November 8, 2002, Chiba, Japan
Outreach seminar at the Institute for Developing Economies on the prolonged use of IMF resources evaluation.

November 25, 2002, London, United Kingdom
Workshop with the Overseas Development Institute on both the prolonged use of IMF resources and PRSP/PRGF evaluations.

January 23, 2003, Manila, Philippines
Workshops on the Philippine case study in connection with the prolonged use of IMF resources evaluation with the Asian Institute of Management and government officials.

April 9, 2003, Washington, D.C., United States
Meeting on the update of the IEO work program with NGO representatives.

May 6, 2003, Dakar, Senegal
Outreach workshop on the prolonged use of IMF resources and PRSP/PRGF evaluations with government officials, civil society, and donors.

Appendix 5

Evaluation of Prolonged Use of IMF Resources: Recommendations, Executive Board Response, and Subsequent Follow-Up

IEO Recommendation	Executive Board Response[1]	Staff Task Force Recommendations[2]	Follow-Up[3]
Institutional arrangements and rationale for IMF involvement			
Adopt an operational definition of prolonged use, as a trigger for enhanced "due diligence" (i.e., ex post assessments and forward-looking consider-ation of "exit" strategies). The criterion could distinguish between general and concessional resources.	Directors saw merit in a definition to trigger greater due diligence. Many Directors noted that a definition should carefully differentiate low-income countries relying on concessional resources. Several Directors cautioned that a definition should not be inter-preted as creating a new classification of member countries and that there should not be an a priori judgment that prolonged use necessarily implies a problem.	For general resources cases, prolonged users should be defined as countries that have spent seven or more of the last ten years under stand-by or extended arrangements, including precautionary arrangements, which was the definition used in the IEO evaluation. For concessional resources, enhanced assessment and strategy procedures would be triggered after a country has gone through two multiyear arrange-ments under concessional facilities.	Definition adopted. Semiannual reporting of the incidence of prolonged use to take place on this basis.
Make greater efforts to judge whether countries are ready to implement credible programs and be more selective in extending financial support. Use of Fund resources proposals should contain an explicit and frank assessment of the readiness of borrowers to implement programs.	Directors supported the recommenda-tion that staff papers be more candid in assessing institutional capacity and ownership. They emphasized the im-portance of explaining downside risks and avoiding any bias towards over-optimism. Implementation of initiatives relating to ownership would be an on-going process, sometimes involving difficult judgments, in particular regard-ing more selectivity in the provision of IMF financial assistance, where strong country ownership is lacking. A number of Directors stressed that greater selectivity should not imply giving up on difficult cases.	Efforts to improve program design should be accompanied by greater selectivity in extending IMF financial support, based in part on the assess-ment of implementation capacity and ownership.	Principal case-by-case follow-up will be through the internal review process and Board review of individual country cases, with periodic assessments as part of the regular conditional-ity review.
Aim to provide the international community with credible alternatives to IMF lending arrangements as a condition for other official flows.	Directors noted that it would be desir-able to develop credible alternatives to indicate to the outside world the IMF's approval of members' policies and looked forward to a discussion of the signaling function. They noted need for care in preparation and consultation, including with the Paris Club.	The IMF should have effective ways to signal its views on policies to a country's donors and creditors outside a Fund-supported program. Article IV staff reports, Public Information Notices, and "assessment letters" provide important vehicles. This topic should be taken further in the review of the IMF's role in low-income countries. Donors' and other lenders' concerns about burden sharing should not lead to inappropriate lending decisions by the IMF.	The issue of signaling was taken up in the Board's subsequent discussion on "Signaling Assessments of Members' Policies," although this did not address all the relevant issues addressed by the evaluation. This review resulted in the discontinuation of Staff Monitored Programs for signaling purposes. The broader role of signaling in low-income cases is being addressed as part of the ongoing review of the IMF's role in low-income countries. Directors encouraged staff to continue to explore the scope for alternative signaling mechanisms.

Programs for identified prolonged users should include an explicit exit strategy.	Directors stressed the desirability, where appropriate, of the elaboration of corrective measures as part of a conscious "exit strategy."	The proposed assessment and strategic planning exercises (see below) would include an explicit "exit strategy" where appropriate for ending prolonged use. An element of such a strategy would include helping countries widen their options for external financing.	Policy adopted, with an explicit definition of prolonged use as the trigger (see above).
Introduce a differentiated rate of charge for prolonged users as a signaling device.	The Board did not support a differentiated rate of charge for prolonged users.	Not recommended.	Recommendation rejected. No follow-up necessary.
Program design			
Specific operational procedures should be developed to ensure greater emphasis in program design on the domestic policy formulation process, in order to maximize ownership: (1) modify procedures towards the authorities having the initial responsibility for proposing a reform program; (2) encourage a process whereby core program elements are subject first to a policy debate within the member's own political institutions; (3) surveillance should help create a better understanding of what would be expected if a program should become necessary; and (4) more explicit discussion of major uncertainties and how policies would be adapted if things turn out differently.	Directors broadly agreed with the recommendations. Many Directors underscored that they should be seen as part of a broader effort to ensure greater effectiveness of programs. They saw a need for continuing effort at improving program design, which would draw on the fresh perspectives provided by the report.	IEO's recommendations were consistent with lessons emerging from recent country experience. The revised conditionality guidelines[4] incorporate many of the recommendations and provide the appropriate vehicle to put them into practice.	The regular conditionality reviews will be the main vehicle for monitoring progress on this and other recommendations on program design.
Programs should emphasize key institutional changes and strengthening implementation capacity more.	Directors underscored the importance of increasing the effectiveness of technical assistance in support of institutional capacity building.	The Task Force recommended that ongoing efforts to address these issues in operational work should be enriched by future work on program design, including the research effort, focusing on links between structural reforms and program objectives.	Regular conditionality reviews will monitor progress.
Greater selectivity in program content with: (1) further strengthening collaboration with the World Bank; (2) a more differentiated use of conditionality; (3) greater efforts to tailor the time frame of program design to a foreseeable length of reform and adjustment; and (4) more in-depth analysis of real economy responses to key policy elements and less attention to fine-tuning financial programming.	Directors were encouraged that recommendations on streamlining of Fund conditionality and need for more effective collaboration with the World Bank were already being internalized as part of the review of conditionality.	Agreed with recommendations, many of which were already incorporated into the revised conditionality guidelines.	Directors stressed importance of continued efforts to improve program design, including improved collaboration with the World Bank. Directors looked forward to further work by the staff on the relationship between external financing, adjustment, and sustainability; on the analytic framework for program design; on trade-offs between macroeconomic and structural policies; and on the parameters for assessing program success. Principal case-by-case follow-up will be through the internal review process and Board review, with periodic assessments of progress as part of the regular conditionality reviews.

Appendix 5 *(concluded)*

IEO Recommendation	Executive Board Response[1]	Staff Task Force Recommendations[2]	Follow-Up[3]
Systematic ex post assessment of programs, with priority to identified prolonged users and key messages reported to the Board. Key internal database on program targets and outcomes (MONA) should be upgraded to facilitate such assessments.	Directors endorsed the recommendations.	The Task Force proposed that a process of ex post assessment and strategic planning would take place for all prolonged users, with lessons presented to the Executive Board.	The operational guidance note on assessment of countries with a longer-term program engagement has been posted on the Internet and about five or six ex post assessments are projected to be completed by end-2003. The MONA database is being upgraded.
Surveillance			
Steps should be taken to further strengthen surveillance in program cases. A case exists for greater institutional separation between surveillance and programs, especially in the context of prolonged use.	Regular IMF surveillance of program countries should reassess economic developments and strategy from a fresh perspective.	Agreed with the overall thrust of IEO recommendations. Best addressed through continuing implementation and refinement of recently revised surveillance guidelines. These proposed that surveillance should assess more carefully social and political realities; reach out more widely to legislative bodies and line ministries and ensure that timing of consultations is such as to enable them to influence policy.	Directors concurred with the priority given to increasing effectiveness of surveillance, including the need to combine clarity and candor with recognition of social and political realities. They highlighted the importance of efforts to ensure that Article IV consultations in program countries "step back" from program context. Progress in strengthening surveillance, including by introduction of a fresh perspective, will also be addressed as part of the Board's work program for FY2004.
Internal governance issues			
The ability of staff to analyze political economy issues should be strengthened.	Most Directors encouraged the staff to enhance its analysis and reporting of political economy issues in staff reports. Some Directors cautioned that IMF should be careful in venturing into this area, given its comparative advantage in technical analysis and the need to avoid intruding on internal political matters.	Task Force recommended an effort to enhance reporting and analysis of political issues, when it has important implications for economic policy. Stafff capacities could be strengthened through a modest investment in training.	Training courses in political economy have now been established.
Procedures should be evolved to help avoid the appearance of political interference in determining whether programs deserve support. All programs should be prefaced by an explicit assessment of implementation risks. When management suggests risks are high, the Executive Board should be given an opportunity to express on the record its own assessment of the trade-offs.	Directors underscored the importance of distinguishing clearly between technical and political judgments and that staff should be candid in its assessment of risks.	Task Force noted that there can be no question about the responsibility of management for recommending, and the Executive Board for considering and approving, all requests for the use of Fund resources. Staff nonetheless has an important responsibility for providing candid technical assessment of risks and trade-offs, and should continue to strengthen both substance and presentation of this material.	Some indication that greater candor on risks is being adopted in presentations to the Executive Board. For example, the Managing Director's statement for the 2003 transitional program with Argentina emphasized the risks to the IMF, including the political risks to implementation.

A review of internal incentives facing staff should be undertaken with a view to minimizing turnover of staff working on countries and to foster increased candor and accountability.	Recommendations are largely management responsibility. They have important implications for internal governance and deserve careful consideration.	While overall personnel policies do not need to be changed, management should consider guidelines and incentives to reduce excessive mobility in country teams. The best way to guard against excessive mobility would be to reestablish spare staff capacity to absorb changing demands.	The Human Resources Department (HRD), at the request of management, is developing a more centralized approach to mobility. As part of an effort to ensure appropriate incentives, HRD, in collaboration with departmental senior personnel managers, provides career counseling that emphasizes the acquisition of new competencies rather than frequent mobility.

[1]This column summarizes the reaction of the Executive Board on each recommendation as reported in the summing up by the Acting Chair. Although care has been taken to ensure accuracy, readers are invited to refer to the full text of the summary of the discussion which is included in the published version of the report and can be accessed from the IEO website (www.imf.org/ieo).

[2]Conclusions of the Task Force on Prolonged Use of Fund Resources, February 4, 2003. Available at www.imf.org/external/np/pdr/ufr/2003/020403.htm.

[3]Including Board Discussion of Task Force conclusions. The column on follow-up is meant to provide factual information on additional steps taken after the Board discussion. It is not intended to be an evaluation of any follow-up by management or the Executive Board.

[4]"Guidelines on Conditionality," September 2002. Available at www.imf.org/External/np/pdr/cond/2002/eng/guid/092302.htm.

Appendix 6

Evaluation of the Role of the IMF in Recent Capital Account Crises: Recommendations, Executive Board Response, and Subsequent Follow-Up

IEO Recommendation	Executive Board Response[1]	Follow-Up[2]
Precrisis surveillance		
Article IV consultations should take a stress-testing approach to a country's exposure to a potential capital account crisis, extending and systematizing existing approaches. Staff should assess the potential impact of itemized risks. Staff should develop greater understanding of political constraints on policy, in part through wider dialogue. Market views and political economy analysis should be reflected in staff reports.	Directors concurred with the overriding message of the report for surveillance: to strengthen the effectiveness of IMF surveillance by extending and systematizing current guidelines for assessing vulnerabilities. They supported the call to itemize major potential shocks. Directors emphasized that stress testing should not be overgeneralized and mechanical, but should focus on key risks facing a particular country. Most agreed that the IMF should develop greater understanding of political constraints on policy while cautioning that this should not lead to interference in domestic affairs. A number cautioned that this could be counterproductive if it causes staff to lose focus and press for policies and reforms that are not macro-critical. Most Directors saw great value in systematic discussions with the domestic and the international financial and business communities—but emphasized that the staff would need to assess private sector views critically.	Ongoing Board discussions of strengthening surveillance will revisit specific operational aspects. Biennial review of surveillance will be the main vehicle for assessing what has been done to address these and other surveillance-related recommendations.
Management and the Executive Board should take additional steps to increase the impact of surveillance, including through making staff assessments more candid and more accessible to the public. In particular, there should be a presumption of publication for Article IV staff reports. A clear presumption of publication for country-related staff working papers should also be established. Biennial reviews of surveillance should focus on assessing the impact of surveillance on key systemic issues in major emerging market economies.	Directors strongly supported greater candor in the assessment of country risks and vulnerabilities in staff reports, building on the increase in candor that has already occurred. Nevertheless, Directors expressed a range of views regarding the potential conflict between candor and transparency, and the implications of the proposed shift from voluntary to presumed publication of staff reports. Many Directors warned that greater candor could adversely affect both the Fund's dialogue with countries and market confidence in the context of the publication of staff reports. Some of these Directors felt that what really matters is candor in face-to-face consultations with the key decision makers in a country, rather than in the staff report. Many other Directors strongly supported presumed publication. These Directors believed that concerns about candor are overstated, and that surveillance would be more effective in building ownership and influencing policy if Fund analyses and recommendations are made public. It was agreed that the Board would return to the issue of presumed publication of staff reports during the discussion on transparency. Many Directors were not in favor of shifting from voluntary to presumed publication of staff reports, but a number strongly supported presumed publication.	The Board had a subsequent discussion of strengthening surveillance on August 20, 2003. Directors took note of efforts to boost publication of staff reports, indicating that transparency was critical to allowing the public to develop informed views on the Fund's activities, which could then feed back into the Fund's work. However, some Directors drew attention to the potential trade-offs between transparency and candor.

The Executive Board should agree on a systematic plan to provide institutional incentives for greater candor in the assessment of country risks and vulnerabilities, possibly including measures to give greater independence to surveillance teams.

Directors encouraged the provision of institutional incentives to the staff to facilitate candor.

Biennial reviews of surveillance will be the main vehicle for assessing progress.

Escalated signaling should be used when key vulnerabilities identified over several rounds of surveillance are not addressed. Such a policy would help strike the necessary balance between the role of the IMF as confidential advisor and its role as a vehicle for transmitting peer reviews on members' policies and for providing quality information to markets.

Many Directors considered escalated signaling to be an idea worth pursuing. A number of these Directors reserved judgment on the suggestion until they had more information about how it would work. A few Directors felt that escalated signaling would undermine the Fund's role as confidential advisor, and doubted that it would help in preventing crises or designing more effective programs.

Management and the Board should explore the possibility of seeking "second opinions" from outside the IMF as part of the surveillance process when the authorities disagree with the staff's assessment on issues that are judged to be of systemic importance. This would also serve as a building block for the idea of escalated signaling.

Many Directors were not in favor of inviting second opinions from outside the Fund. Whereas some Directors considered that a second opinion would bring a fresh perspective that could help resolve differences of opinions with the authorities, many were concerned that it could encroach on the role of the Board, and undermine the work of the staff. A few Directors also noted that this approach has been tried and has failed.

Program design

A comprehensive review of the IMF's approach to program design in capital account crises should be undertaken. In particular (1) greater attention should be paid to balance sheet interactions and their consequences for aggregate demand; (2) program design should allow for a flexible response, in case unfavorable outcomes materialize; (3) conventional financial programming-based conditionality should be reviewed, and possibly adapted for capital account crisis circumstances; (4) parsimony and focus should be basic principles of structural conditionality, and crises should not be used for pushing reforms that are not critical to crisis resolution, however desirable they may be in the long run; and (5) there should be an agreed communications strategy, characterized by a high degree of transparency.

Directors endorsed these recommendations and hoped forthcoming staff papers on program design and balance sheet effects would give due attention to them. They endorsed the report's focus on the restoration of confidence, and the importance of balance sheet effects on key macroeconomic variables. The balance sheet approach should be closely linked to debt sustainability analysis. There should also be more work on twin (banking and capital account) crises. Directors agreed that design should allow for a flexible response to unfavorable developments; that the conventional financial programming conditionality should be reviewed; and that there should be an agreed communications strategy. Nevertheless, a few Directors cautioned against excessive emphasis on risks and alternative scenarios in program documents, since it would be difficult to know all risks up front and since such emphasis could erode the program's effectiveness in building confidence in the chosen action plan.

A sequence of staff papers on program design and conditionality is planned for discussion at the Executive Board during the next few months.

Appendix 6 *(concluded)*

IEO Recommendation	Executive Board Response[1]	Follow-Up[2]
The IMF as crisis coordinator		
The IMF should ensure that financing packages provided in response to capital account crises are sufficient to generate confidence and be of credible quality. In particular (1) packages should not rely on parallel official financing unless the terms of access are transparently linked to the IMF-supported strategy; and (2) terms for the involvement of other institutions providing parallel financing should be specified at the outset.	The Board agreed with the recommendation, while noting that there are limitations on the IMF's influence on other sources of financing. The Board stressed that the recently revised access policy must be observed and emphasized the importance of program credibility, not large financing packages, as the heart of IMF involvement. Directors fully supported the idea of moving toward more explicit procedures for collaboration with regional development banks and others and clear delineation of responsibilities, while noting that such procedures do not by themselves guarantee effective coordination.	
The IMF should be proactive in its role as crisis coordinator. In particular (1) management should provide a candid assessment of the probability of success to the Executive Board and shareholders; (2) management should ensure that the technical judgment of staff is protected from excessive political interference; and (3) the nature of private sector involvement should be determined on a case-by-case basis. The IMF should play a central role in identifying circumstances where concerted efforts can help overcome "collective action" problems, based on meaningful dialogue with the private sector.	The Board endorsed the recommendations. Political judgments and decisions should be the exclusive domain of the Board. While Directors were in favor of early involvement of the Board in program discussions, a number of them observed that the Board and major members should not seek to micro-manage the operational details of programs or influence Fund missions in the field. Directors attached particular importance to the early involvement of the private sector as an integral element of crisis resolution.	Staff noted that the recommendations of the IEO are consistent with ongoing steps to strengthen the capacity of the IMF in this area. For example, the new framework for exceptional access decisions provides a mechanism for encouraging more systematic early consideration of circumstances in which the success of a program would be enhanced by voluntary efforts to address collective action problems among private creditors and where steps to address an unsustainable debt burden need to be part of a strategy to restore growth and financial viability.
Internal governance issues		
Human resource management should be adapted to develop and better utilize country expertise, including political economy skills, and to establish "centers of expertise" on crisis management issues. In particular (1) the length of staff assignments should be monitored to ensure continuity of staff expertise, and a critical mass of country expertise in each systemically important emerging market economy should be developed; (2) Resident Representatives should play a more central role in surveillance and program design; and (3) internal procedures should protect those who raise uncomfortable issues through proper channels, but consequently attract complaints from the authorities.	The Board generally agreed on the need for institutional change to ensure that the IMF is in a position to respond rapidly to member countries facing crises. Some Directors supported the creation of centers of expertise in crisis management, whereas others put greater emphasis on mechanisms for drawing upon available expertise and experience in the event of a crisis. A number of Directors favored longer country desk assignments, while others noted the importance of staff mobility in broadening the experience and perspectives of the staff and maintaining its impartiality. Most Directors favored a greater role for Resident Representatives, with a few noting that only relatively senior Resident Representatives would be sufficiently acceptable to the authorities to play such a role; Directors supported modification of internal guidelines and human resource procedures. They also noted that human resource issues are management's responsibility.	The Monetary and Financial Systems Department (formerly Monetary and Exchange Affairs Department) has been reorganized, with steps taken to provide a center of expertise on banking crisis resolution issues. An Internal Task Force has been established to review broad strategic issues relating to the IMF's Resident Representative program.

[1]This column summarizes the reaction of the Executive Board on each recommendation as reported in the summing up by the Acting Chair. Although care has been taken to ensure accuracy, readers are invited to refer to the full text of the summary of the discussion which is included in the published version of the report and can be accessed from the IEO website (www.imf.org/ieo).

[2]The column on follow-up is meant to provide factual information on additional steps taken after the Board discussion. It is not intended to be an evaluation of any follow-up by management or the Executive Board.

Appendix 7

Evaluation of Fiscal Adjustment in IMF-Supported Programs: Recommendations, Executive Board Response, and Subsequent Follow-Up

IEO Recommendation	Executive Board Response[1]	Follow-Up[2]
Program design and internal review		
Program documentation should provide a more in-depth and coherent justification for the magnitude and pace of programmed fiscal adjustment and how it is linked with assumptions about the recovery of private sector activity and growth. It will also facilitate the review process and discussions at the Board, as well as provide external audiences with a more convincing explanation for the rationale for the program and identify possible risks and subsequent corrective measures.	Directors supported this recommendation, and deemed that this initiative would instill greater discipline in program design, enhance transparency, and provide the public and the private sector with a more convincing rationale for the program, thereby helping to overcome political obstacles to implementation. Nevertheless, they recognized that uncertainties regarding key macroeconomic variables, particularly in countries in crisis, and concern about the implementation of policy measures and reforms complicate this task. A few Directors cautioned against spurious precision in such justifications, and others noted that the magnitude and pace of programmed fiscal adjustment may also reflect political constraints. Several Directors stressed the importance of better integrating debt sustainability analyses into program work. Directors looked forward to further staff analysis of growth projections in the context of program design discussions.	IMF management has indicated that a report will be submitted to the Executive Board on how the IEO's recommendations might be addressed and followed up in the period ahead.
The internal review mechanism should place more emphasis on the early stages of the process. A more intensive process of brainstorming is needed at the time of the initial brief, and the brief should also articulate more clearly the basis for the fiscal program, and its links with debt sustainability issues.	Directors supported this recommendation. They welcomed management's recent initiative aimed at enhancing the effectiveness of the review process, which, inter alia, encourages early consultation between departments.	See above.
Programs should give greater emphasis to the formulation and implementation of key institutional reforms in the fiscal area, even if (as is likely) they cannot be fully implemented during the program period. Programs should make stronger efforts to specify those structural reforms which should be carried out during the program horizon as part of a broader road map of priority reforms. This road map, and its prioritization, should ideally have emerged in the course of surveillance and be updated regularly as outlined below.	Directors agreed that key institutional reforms can be more critical for fiscal sustainability than short-term expenditure and revenue measures. However, they recognized that short-term measures are hard to avoid in many cases, especially if the immediate objective is economic stabilization. Medium-term institutional reform may be of particular relevance in countries that have achieved macroeconomic stability and where "second generation" reforms are necessary to foster growth and reduce longer-term vulnerabilities. Some Directors agreed with the report's suggestion that reforms should be broken down into those that require executive action, legislation, and capacity building. Directors, however, pointed out that in crisis situations, the pressing need to resolve the crisis may pose serious constraints on a medium-term approach. They reiterated the conclusion of the discussion on the Evaluation of the Role of the Fund in Recent Capital Account Crises (BUFF/03/125) that a crisis should not be used as an opportunity to force long-awaited reforms, however desirable they may be, in areas that are not critical to the resolution of the crisis or to address vulnerability to future crises. Careful judgment will	See above.

Appendix 7 *(concluded)*

IEO Recommendation	Executive Board Response[1]	Follow-Up[2]
	continue to be needed to focus conditionality on those reforms judged critical while at the same time ensuring that adequate progress is made in addressing vulnerabilities and achieving the program's goals during the period of the arrangement, thus safeguarding the Fund's resources.	
Surveillance		
The surveillance process should be used more explicitly to provide a longer-term road map for fiscal reforms and to assess progress achieved. • In collaboration with the authorities, the IMF should clearly identify in surveillance reports the most critical distortions in a country's public finances from the perspectives of equity and efficiency. • Such an analysis would provide a road map for fiscal reform in the future, with a clear sense of priorities. It would help to provide the basis for identifying critical reforms—particularly in areas where these reforms have been lagging—that would need to be addressed should IMF financing be required in the future. • The identification in advance of areas considered critical will allow the authorities flexibility in the timing and packaging of reforms which is often lost if these reforms are flagged at the last minute in the context of a crisis situation. This approach would also help foster greater domestic debate on key reforms and hence would encourage homegrown solutions and greater ownership. Early and clear prioritization of reforms is also consistent with streamlining objectives—it will avoid last-minute bunching of reforms under crisis situations. • The analysis of fiscal reform priorities should be accompanied by an assessment of why certain important distortions were not addressed in the past and what lessons have been learned from past experience. This should include an effort to identify and unbundle the various constraints to critical reforms, including lack of technical capacity, areas where additional legislative action is necessary, and areas where key decisions from the executive branch are required. • Surveillance should include more systematic efforts to estimate the extent of tax evasion and tax exemptions, including the use of cross-country comparisons. • Public debt sustainability could help anchor the road map of fiscal reform priorities proposed above and to assess trade-offs over time. At the same time, debt analysis provides a check of cumulative progress in improving fiscal systems that could also be reported in successive surveillance reports.	Most Directors agreed that Article IV consultations should play a stronger role in identifying longer-term reform priorities and the causes of past failures in addressing fiscal problems, and that these analyses should inform subsequent program design. In this respect, the various initiatives to distinguish Article IV surveillance from program work are aimed at providing fresh perspectives. Some Directors considered the current framework of surveillance to be adequate for achieving the objectives of the IEO's recommendation. Directors also called for staff reports to set out in more detail the progress in implementing the recommendations of ROSC and technical assistance missions, as well as key reform priorities. Nevertheless, they underscored that the ultimate responsibility to develop a fiscal reform agenda resides with the individual country authorities, while the Fund should stand ready to provide advice. Directors also stressed that, consistent with the Fund's mandate, surveillance needs to focus on key issues of macroeconomic relevance, which will be different in each country, and should draw on the expertise of other institutions as appropriate. They encouraged the use of cross-country experiences and comparisons, including inputs from regional and multilateral surveillance, to assist in program design. Most Directors viewed Article IV consultations as the appropriate vehicle for staff to identify countries in need of an in-depth fiscal review, stressing that this identification process should be applied uniformly to all member countries of the Fund. In most cases, these needs could be accommodated through technical assistance and ROSCs.	See above.

Role of the IMF in social protection		
The IMF should clearly delineate the operational framework in which social issues will be addressed within program design in non-PRGF countries. This should include a clear indication of the IMF's responsibilities and activities in this area. The objective should be to assist middle-income countries to prepare and improve their institutional framework to allocate resources to critical social programs and to establish mechanisms to protect the most vulnerable groups in the face of external shocks and budgetary retrenchment. • The IMF could invite the authorities regularly during Article IV consultations to identify the existing critical social programs and social services that they would like to see protected in the event of adverse shocks. Participation on the part of the authorities would clearly be voluntary. • Successful implementation will depend heavily on having better and more transparent expenditure monitoring systems. On the basis of the priorities identified by the authorities, the IMF and the World Bank could join their accelerated efforts to reform public expenditure management (PEM) systems, specifically geared toward the social area, with a view to protecting the specified programs and spending categories. • This concrete application of the PEM initiative is particularly important because in many cases where there is an IMF-supported program the World Bank is also active with adjustment lending supporting the budget. • Surveillance would routinely report on these initiatives and their progress over time.	Directors agreed that an important aim of program design should be to protect critical social expenditures. However, they stressed, as recognized in the report, that the Fund should not become involved in the detailed selection and design of social policy; this task is outside both the Fund's mandate and its expertise. A number of Directors supported the IEO's call for updating of the 1997 guidelines that direct IMF work in the social area, in order to improve their clarity and effectiveness as an operational tool in protecting the most vulnerable from economic shocks and budgetary retrenchment. Other Directors, however, viewed the existing guidelines as adequate, and a few considered that the annual and medium-term budgets of non-PRGF countries already adequately identify critical social sector programs. These Directors recalled that the new framework for Bank-Fund collaboration on public expenditure issues should enhance countries' public expenditure reform strategies, including measures to protect critical social spending. A majority of Directors agreed with the recommendation that staff should inquire, during Article IV consultations, whether the authorities have identified social programs that they would like to protect in the event of a crisis, as they believed this would help dispel the criticism that Fund-supported programs unduly curtail social spending. A few others considered this recommendation impractical, as it would create significant costs and pressures for the authorities with little benefit.	See above.

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[2]The column on follow-up is meant to provide factual information on additional steps taken after the Board discussion. It is not intended to be an evaluation of any follow-up by management or the Executive Board.