

INTERNATIONAL MONETARY FUND

**Biennial Review of the Implementation of the Fund's Surveillance and of the 1977
Surveillance Decision—Overview**

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Research Departments

(In consultation with other departments)

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I. INTRODUCTION

1. **As mandated by the 1977 Surveillance Decision, this biennial review assesses the implementation of the Fund's surveillance and examines the continued validity of the principles of surveillance set forth in that decision.** It takes place against the background of a series of initiatives to strengthen Fund surveillance and adapt it to a changing global environment marked by growing economic integration through trade and, in particular, a rapid expansion of international capital flows. Many of these initiatives have been introduced in the wake of the capital account crises of the 1990s as part of a wider effort to enhance the architecture of the international financial system. Together with earlier adaptations, they have re-shaped the profile of surveillance, which has become broader in perspective, more keenly aware of interdependencies among economies, and more squarely focused on crisis prevention.

2. **The challenges posed by the broadened framework for surveillance define the first set of questions addressed in this review.** In particular, the review examines whether the Fund's surveillance activities have maintained a proper focus in the context of a significantly broadened agenda of potentially relevant issues—a concern that has been expressed by the Executive Board and the external evaluators of Fund surveillance.¹ Another important question is how surveillance has coped with the need for special expertise in areas outside the Fund's traditional focus on macroeconomics and the challenge of integrating these areas into a coherent assessment of a country's economic prospects, crisis vulnerabilities and policy challenges.

3. **The second set of questions addressed in this review concerns the modalities of surveillance, which have evolved significantly.** Reflecting growing economic and financial linkages among countries, multilateral surveillance has come to play an increasingly important role. Furthermore, integration of bilateral and multilateral surveillance has become critical. At the same time, Article IV consultations have remained the cornerstone of the Fund's bilateral surveillance and questions about consultations procedures have continued to arise out of concerns about strained resources—most recently in the context of proposals to reduce work pressures. Innovations in multilateral surveillance are reviewed and recent proposals to enhance the flexibility of consultation procedures are examined.

4. **Surveillance in countries with Fund-supported programs defines the third set of questions.** The role of surveillance in these countries has never been addressed explicitly by the Executive Board; past Board discussions have focused on procedural issues, such as consultation cycles and the practice of combining Article IV and program discussions. Recently, the effectiveness of surveillance in program countries has been questioned and greater independence of surveillance from program activities has been proposed to enhance

¹ See *External Evaluation of Fund Surveillance*, IMF Website, 9/14/1999.

its effectiveness.² Against this background, the review takes a closer look at surveillance in program countries and addresses three key questions: How does the implementation of surveillance in program countries differ from surveillance in non-program countries? What should be the role of surveillance in these countries? How can surveillance best fulfill this role?

5. **The fourth set of questions relates to the experience with staff-monitored programs.** Staff-monitored programs (SMPs) provide a flexible framework for members that desire closer monitoring of their policies to build a track record toward a Fund arrangement or to provide a signal to official and/or private creditors. However, this flexibility goes hand in hand with less demanding standards than those of Fund-supported programs. In view of concerns about the quality control of these monitoring arrangements, the compliance of recent SMPs with the draft guidelines discussed by the Executive Board in 1998 is assessed, and the continued appropriateness of these guidelines is examined.

6. **The review does not discuss the important issue of surveillance and transparency.** This issue will be addressed in the forthcoming paper on the Fund's transparency policy.

7. **This overview paper summarizes the key findings from in-depth studies on the questions outlined above and discusses the policy implications of the results.**³ The next section focuses on the lessons from the implementation of surveillance in a framework that has evolved significantly in recent years. This is followed by a discussion of the modalities of surveillance and recent proposals to inject greater flexibility into Article IV consultation procedures. Surveillance in program countries and staff-monitored programs are addressed in the next two sections. The paper concludes with issues for discussion and proposed further steps.

II. SURVEILLANCE IN 2000-01: FRAMEWORK AND IMPLEMENTATION

8. **Surveillance in 2000-01 has been implemented in a framework that differs substantially from that prevailing at the time of the Second Amendment to the Articles of Agreement and the 1977 Surveillance Decision.**⁴ While surveillance has adapted

² This view was expressed by the U.K. Chancellor Gordon Brown in an interview with the Financial Times (11/15/01), and in a speech to the Federal Reserve Bank of New York on November 16, 2001.

³ See *Biennial Review of the Fund's Surveillance and the 1977 Surveillance Decision: Framework and Conduct of Surveillance in 2000-01*; and *Biennial Review of the Fund's Surveillance and the 1977 Surveillance Decision: Surveillance in a Program Environment*.

⁴ While Fund surveillance existed before the Second Amendment to the Articles of Agreement and the 1977 Surveillance decision, its nature changed fundamentally after the breakdown of the par value system that led to the Second Amendment.

continuously in order to remain effective in a changing global environment, the pace of innovation has been particularly rapid in the last decade. Both the coverage and the tools of surveillance have evolved significantly. In view of these developments, it is useful to take stock of the broadened framework for surveillance, and to assess how surveillance has coped with the challenges presented by this framework.

A. The Broadened Framework for Surveillance

9. **While the framework for conducting surveillance has evolved, the purpose of surveillance has not changed.** Article IV of the Articles of Agreement enjoins the Fund to oversee the international monetary system and monitor members' compliance with their obligations, notably the obligation to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates. This general obligation entails a number of specific undertakings members are expected to pursue. In particular, members are required (i) to endeavor to direct economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability; (ii) to seek to foster orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions, and (iii) to avoid manipulating exchange rates to prevent effective balance of payments adjustment or gain an unfair competitive advantage. Crisis prevention—the pursuit of “orderly conditions” and the avoidance of “erratic disruptions”—has always been a key objective of Fund surveillance.

10. **In essence, the evolution of the framework for surveillance reflects a series of efforts to adapt surveillance to a changing global environment.** In particular, the enormous expansion of international capital flows in the past decade has changed the relative roles of current and capital account developments in the emergence of external crises and has focused attention on factors that may have a bearing on the capital account. Not surprisingly, crises have been an important catalyst in broadening the framework for Fund surveillance. Indeed, most additions to the surveillance agenda can be traced to lessons from crises (Box 1).

Box 1. External Crises and Surveillance Initiatives

Major external crises have typically led to intensive soul-searching on the causes of the crises and on the actions that could be taken to reduce the risks of similar crises in the future. Several initiatives to strengthen surveillance can be linked directly to the evaluation of the debt crisis of the 1980s, the Mexican crisis of 1994/95, and the Asian crisis of 1997/98.

The Debt Crisis (early 1980s)

The severe external debt-servicing difficulties experienced by a number of members, including Mexico, were at the center of the 1983 surveillance review. Considering the lessons of the crisis for surveillance, the Executive Board focused on two issues: the *frequency of Article IV consultations* and the *coverage of external debt developments* in consultation reports. In view of the speed at which debt-servicing problems had spread and past delays in conducting Article IV consultations (in Mexico, the two Article IV consultation prior to the outbreak of the debt crisis had been 27 months apart) Directors agreed on procedural changes to help guarantee a stricter approach to the scheduling of consultations. In addition, Directors indicated that Article IV consultation reports should contain improved reporting of external debt developments in individual member countries and include a description of the medium-term external debt outlook for the country concerned.

The Mexican Crisis (1994/95)

The 1995 biennial surveillance review took place shortly after the external crisis that erupted in Mexico in late 1994. The Executive Board stressed that the growth in cross-border capital flows had presented new challenges to surveillance, that events in Mexico had illustrated the speed and intensity with which international capital markets could react to developments in one country and spread their impact to others, and that the episode underscored the importance of improving surveillance so as to try to prevent such crises from occurring. The Board discussions on enhancing the effectiveness of surveillance focused on the importance of *timely and comprehensive information from member countries*, the need for greater *continuity in the surveillance process*, the quality of exchange rate policy discussions, the need to take into account *financial market developments*, and the candor of staff's policy appraisals. The Executive Board agreed on the inclusion of explicit references to the size and sustainability of capital flows in the 1977 Surveillance Decision, more frequent informal meetings on country matters, and the implementation of a strategy to strengthen data provision to the Fund. In this context, the Executive Board also discussed a possible code of conduct for publication of economic and financial information. These discussions eventually led to the establishment of the Special Data Dissemination Standard in March 1996, which turned out to be the first element of the Fund's work in the area of standards and codes.

The Asian Crisis (1997/98)

In April 1998, the Executive Board reviewed economic developments and policies in a selected number of emerging market economies in 1996/97 and drew five main lessons for Fund surveillance: the effectiveness of surveillance depended critically on the *timely availability of accurate information*, including data on reserve-related liabilities and short-term debt; the focus of surveillance needed to extend beyond the core short-term macroeconomic issues, while remaining appropriately selective—in particular, close *surveillance over financial sector and capital account issues* was necessary; greater attention needed to be paid to the risks of contagion and policy interdependence; the crucial role of policy credibility in the restoration of market confidence underlined the importance of *transparency*; and effectiveness of Fund surveillance depended critically on the willingness of members to take its advice. The Asian crisis spurred a broad array of initiatives to strengthen the architecture of the international monetary system, which were expected to have profound consequences for the conduct of surveillance. These initiatives included strengthened data provision to the Fund, particularly regarding data on reserves, reserve-related liabilities, and short-term debt; the Financial Sector Assessment Program and the development of macro prudential indicators; the development of standards and codes, the creation of Reports on Observance of Standards and Codes, and the development of guidelines on public and external debt management; new publication policies for Fund country-related documents; and the introduction of high-frequency assessments of vulnerability in emerging markets.

11. **Coverage of surveillance has expanded beyond the original focus on exchange rate, monetary and fiscal policies, the exchange regime and relevant trade issues** (Box 2).⁵

- **Structural policies** were added to the agenda in the 1980s as attention to growth increased in the wake of the second oil price shock and the debt crisis in developing countries; they gained further importance with the accession to the Fund of a significant number of transition economies.
- **Financial sector surveillance** came to play an increasingly important role in the 1990s, following banking crises in the Nordic countries and other countries and, in particular, the subsequent currency crises in emerging market countries, which highlighted the links between domestic financial crises and currency crises.
- **Institutional issues** gained prominence in the Asian crisis, which revealed serious institutional weaknesses in the corporate sectors of the affected countries. Equally important for the expanded coverage of these issues have been the challenges of systemic transformation in the transition economies and the experience in countries with severe public sector governance problems.
- **Assessments of crisis vulnerabilities** became more explicit and more comprehensive after the emerging market crises of the 1990s, notably after the Asian crisis. In particular, coverage expanded beyond the traditional focus—current account sustainability and the consistency of macroeconomic policies and exchange rate regimes—to encompass the factors influencing the capital account and private sector debt, as well as balance sheet exposure to exchange rate and interest rate shocks.

⁵ *Executive Board Reviews IMF's Experience in Governance Issues*, PIN No. 01/20, 3/8/01.

Box 2. Evolution of Surveillance—A Summary

Coverage of Surveillance

In addition to focus on exchange rate, fiscal and monetary policies, exchange regime and relevant trade issues

- Coverage of selected structural policies
- Coverage of vulnerabilities to balance of payments or currency crises, with special emphasis on external debt and capital account developments
- Coverage of financial sector issues
- Coverage of selected institutional issues

Tools of Surveillance

Better information collection

- Strengthened data provision to the Fund
- Access to capital market intelligence
- Use of expertise of other international institutions on issues beyond the Fund's traditional areas of expertise

Tools for financial sector surveillance

- Financial Sector Assessment Program
- Financial soundness indicators (ex-macroprudential indicators)

Tools for analysis of crisis vulnerabilities

- Early warning systems
- External vulnerability indicators
- Financing requirement projections
- Analysis of spreads and other financial market information

Tools for analysis of institutional strength

- Reports on Observance of Standards and Codes
- Guidelines on public debt management and foreign exchange reserve management

Tools for exchange rate analysis

- CGER assessments
- INS real effective exchange rates

Modalities of Surveillance

In addition to Article IV consultations at the bilateral level and World Economic Outlook and capital markets reports at the multilateral level

- Staff visits between Article IV consultations
- Frequent informal Board sessions on country matters
- Frequent meetings on World Economic and Financial Market Developments
- High-frequency assessments of vulnerabilities of emerging market countries
- Surveillance at the regional level (e.g., currency unions)

Dissemination of Surveillance Assessments

In addition to peer review by the Board

- Contribution to peer surveillance reviews in regional fora
- Voluntary publication of Public Information Notices (ex-Press Information Notices)
- Voluntary publication of Article IV consultation reports
- Increased contacts with broader set of economic stakeholders and local media

12. **The broadening of the coverage of surveillance has been accompanied by efforts to strengthen its tools.** At the most basic level, the quality of data provision has received growing attention.⁶ In addition, the staff has been encouraged to make use of other sources of information, notably the relevant work by other institutions—such as the World Bank and the OECD—on structural policy issues, and information on market sentiment for the assessment of crisis vulnerabilities. Indicators have been developed to help guide the analysis in "old" areas—such as indicators of effective exchange rates and estimates of equilibrium exchange rates⁷—as well as in "new" areas—such as financial soundness indicators and debt- and reserve-related indicators of external vulnerability. Finally, the joint World Bank-IMF Financial Sector Assessment Program (FSAP) and the work on standards and codes have provided tools to support the coverage of financial sector and institutional issues in Fund surveillance.⁸

13. **The conduct of surveillance under this broadened framework has presented considerable challenges.** A key question is how surveillance has coped with these challenges.

- With the broadening of the range of *potentially* relevant issues, maintaining a proper focus on those issues that are the most critical from an individual country's perspective has become more challenging.
- With the extension of coverage to areas outside the Fund's traditional focus on macroeconomics, ensuring adequate quality of coverage has become more difficult.
- With surveillance covering a greater diversity of issues, integration into a coherent overall assessment has become more taxing.

14. **The importance of maintaining a proper focus has been underscored by the Executive Board and by the external evaluators of surveillance.**⁹ At the 2000 biennial surveillance review, Directors concluded that "macroeconomic relevance remains a pertinent test for the inclusion of issues in Article IV staff reports." Specifically, many Directors saw a hierarchy of concerns relevant for Fund surveillance. While placement of specific issues on

⁶IMF Executive Board Reviews Data Provisions for Surveillance, PIN No. 00/59, 8/11, 2000. IMF Executive Board Reviews Data Standards, PIN No. 01/101, 9/27/01.

⁷ See, for example, *Methodology of Current Account and Exchange Rate Assessments*, Isard, P., et al, Occasional Paper No. 209, 12/18/2001.

⁸IMF Reviews Experience with the Financial Sector Assessment Program (FSAP) and Reaches Conclusion on Issues going Forward, PIN No. 01/11, 2/5/01. Assessing the Implementation of Standards – An IMF Review of Experience and Next Steps, PIN No. 01/17, 3/5/01.

⁹ External Evaluation of Fund Surveillance, IMF Website, 9/14/99.

this hierarchy could vary over time and from country to country, issues related to external sustainability and vulnerability to balance of payments or currency crises would always be at the apex.

15. The Executive Board has also addressed the role of new tools in ensuring adequate coverage of various “new” areas in surveillance.

- **On the role of FSAPs**, Directors agreed that “the full exercise remains the preferred vehicle for conducting financial sector assessments as input to Fund surveillance,” and recommended reinforcing Article IV mission teams with financial sector expertise for countries that cannot be accommodated immediately or chose not to participate in the program.¹⁰
- **On the role of standards and codes**, many Directors agreed that information on the observance of standards in the 11 areas identified as useful for the Fund’s operational work was important for the conduct of comprehensive analysis under surveillance.¹¹
- **On inputs for vulnerability assessments**, Directors considered debt- and reserve-related indicators, as well as other quantitative indicators, to be important tools; they also agreed that it was important “to obtain more adequate information on the financial and nonfinancial corporate sectors.”¹²

Against this background, the question of how surveillance in 2000-01 has dealt with the challenges of the broadened framework is addressed in the next section.

B. The Conduct of Surveillance in 2000-01

16. Surveillance has embraced the broadened framework without losing focus. The review of the conduct of surveillance in 2000-01 suggests that the broadened framework has generally been applied selectively according to country-specific circumstances.¹³

¹⁰ *IMF Reviews Experience with the Financial Sector Assessment Program (FSAP) and Reaches Conclusion on Issues Going Forward*, PIN No. 01/11, 2/5/01.

¹¹ *Assessing the Implementation of Standards – IMF Review of Experience and Next Steps*, PIN No. 01/17, 3/5/01.

¹² *Debt and Reserve-Related Indicators of External Vulnerability*, PIN No. 00/37, 5/19/00

¹³ The review was based on the 2000 and 2001 Article IV consultation reports for a sample of 70 non-program countries, comprising 6 country groups: major advanced economies, other advanced economies, emerging market countries, small developing countries, oil-exporting developing countries, and other developing countries. In addition, regional surveillance reports for the euro area and the Eastern Caribbean Currency Union, and the 2000 and 2001 World Economic Outlook and International Capital Markets reports were reviewed. For a summary of the methodology, definitions of country groups, and a detailed discussion of the results from this review, see *Biennial Review of the Fund’s Surveillance and the 1977 Surveillance Decision: Framework and Conduct of Surveillance in 2000-01*.

Maintaining an appropriate focus in surveillance activities appears to have been the lesser challenge.

- Analysis of **macroeconomic and exchange rate issues** has remained the mainstay of Fund surveillance, although the questions addressed have, naturally, varied widely (Box 3).
- Coverage of **financial sector issues** has become a standard element of surveillance, both at the bilateral and at the multilateral level.¹⁴
- While nearly all reports address some **structural issues**, the focus and extent of coverage vary widely. Structural reforms related to fiscal sustainability are a theme in many countries. Trade issues are nearly always addressed, albeit often in a routine way, with deeper coverage in countries where market access is of systemic importance, and partially in those that have serious distortions.
- Coverage of **institutional issues** has increased where appropriate and has varied in its focus, with areas covered ranging from fiscal frameworks to corporate governance and insolvency regimes.
- **Assessments of vulnerabilities** to balance of payments or currency crises have been most comprehensive and detailed in emerging market countries, reflecting their exposure to changing market sentiment. In most developing countries with limited or no access to international capital markets, the assessment of vulnerabilities has appropriately focused on the current account outlook, particular influences on the balance of payments, and the consistency of macroeconomic policies with the exchange rate regime, but conclusions have typically been less explicit.

¹⁴ At the multilateral level, financial sector issues have been covered regularly in International Capital Markets reports.

Box 3. The Focus of Surveillance in 2000-01

- **Major Advanced Economies.** Surveillance in all major advanced economies placed a strong emphasis on macroeconomic developments and policies. In addition, the Article IV consultations with France, Germany, Italy, and Japan included a very substantial discussion of structural policies. In all countries, financial sector issues were addressed, albeit with different intensity. Coverage of capital account developments and external sustainability (e.g., capital inflows in the United States) and treatment of institutional issues (e.g., fiscal framework in continental European countries) was selective. Discussions of external vulnerability, data issues, and systemic issues were brief. Substantial attention was devoted to the impact of economic conditions, prospects, and policies of the largest economies (United States, euro area, and Japan) on the global economy, to the factors underlying the movements of the three major currencies, and to the issue of market access for developing countries.
- **Other Advanced Economies.** Surveillance in the other advanced economies concentrated on macroeconomic and structural policies. For most countries in this group, particular emphasis was placed on growth-enhancing policies and structural policies needed for medium-term fiscal sustainability. Financial sector issues, capital account developments, and external vulnerability received substantial attention in reports for Australia and New Zealand. Coverage of these matters in the reports for other countries was generally limited, except for countries that had participated in the FSAP (e.g., Finland and Ireland) and Switzerland. Institutional issues were selectively addressed, and systemic and data issues were briefly discussed.
- **Emerging Market Economies.** Macroeconomic policies, external vulnerabilities, and financial sector issues were at the center of surveillance in emerging market economies, with explicit discussion of exchange rate regimes only in countries with soft pegs. Coverage of structural and institutional issues was selective, depending upon individual country circumstances, and treatment of systemic issues was limited. A key difference in the presentation, if not the conduct, of surveillance activities among emerging-market countries was the place given to the analysis of external and domestic (financial and corporate sector) vulnerabilities. In some reports, particularly but not exclusively those for countries affected by the Asian crisis, key vulnerability assessments served as the organizing principles for discussions of macroeconomic policies, structural reforms, and institutional reforms. In other reports, vulnerability assessments were less conspicuous.
- **Developing Countries—Small States.** In this group of countries with predominantly pegged exchange rate regimes, macroeconomic policies—especially, fiscal policy—and structural reforms were at the center of surveillance. Trade liberalization and financial sector issues, mainly those related to off-shore activities, also received a fair amount of attention. Reflecting the absence of market access, coverage of capital account developments was generally limited; assessments of external vulnerabilities were subsumed in the discussion of the current account outlook and the consistency of macroeconomic policies with the exchange rate regime, with little questioning of the latter. In a few countries, environmental issues were discussed, given their importance for economic developments.
- **Developing Countries—Oil Exporters.** Surveillance in these countries focused on fiscal policy and structural reforms, as progress on these two fronts was seen as key to achieving two principal objectives, namely reducing macroeconomic vulnerability to oil price fluctuations and accelerating growth of the non-oil sector. Coverage of institutional issues was closely related to fiscal policy discussions. The financial sector received substantial attention, particularly for countries that had participated in the FSAP, while systemic issues were rarely covered. Given long-standing exchange rate pegs and the net creditor status of these countries, monetary policy, exchange rate and capital account issues received limited attention.
- **Other Developing Countries.** The focus of surveillance varied in this diverse group. In a first sub-group, where the main challenge remained transition to a market economy, Article IV consultations addressed exchange, price, and trade liberalization, with fiscal consolidation and other structural reforms constituting the other main pillars. In a second sub-group, where the key issue was to achieve macroeconomic stability with particular emphasis on fiscal sustainability, surveillance focused on fiscal consolidation and public finance reform. In a third sub-group, where higher growth was the key objective, focus was on fiscal policies and structural reforms (including public sector reforms, financial sector reforms, and trade policies). Poverty alleviation and, in a few countries, the economic impact of the AIDS epidemic were also important elements of surveillance.

- **“Systemic issues,”** —i.e., issues that are of broad interest to the Fund membership as a whole, such as efforts to combat money laundering, or the OECD-led Anti-Foreign Bribery Initiative—are also covered regularly, but often superficially.

17. **Ensuring adequate depth of coverage in the “new” areas appears to have been a more difficult task.** Coverage of the financial sector, institutional issues, and crisis vulnerabilities has varied considerably. While some of this variation is justified by country-specific circumstances, the depth of coverage has also differed significantly across countries with similar features.

18. **FSAP participation seems to have been the most important factor accounting for differences in the coverage of financial sector issues.** Participation in the FSAP has generally been reflected in greater data availability, better assessments of financial system fragility (or strength), and sounder analyses of the potential impact of a financial crisis on macroeconomic conditions (Table 1). In countries that have not participated in the FSAP, a similar depth of analysis has been achieved in only a few cases, typically where previous financial crises had prompted extensive work by the Fund, the World Bank, and other institutions, or where serious financial sector problems had been evident for some time.

19. **Reports on the observance of standards and codes (ROSCs) have provided useful input for the coverage of institutional issues, but availability has varied considerably.** ROSCs are most readily available in areas such as fiscal transparency, monetary and financial policy transparency, bank supervision and data dissemination. In some other areas—for instance those related to the corporate sector where special expertise is particularly important—very few ROSCs have been completed to date (Table 2).

20. **Assessments of crisis vulnerabilities in emerging market countries have become more comprehensive and detailed—notably in Asia—but data availability appears to have been an important constraint.** Vulnerability assessments are particularly important in these countries because of their exposure to changing market sentiment and the speed at which vulnerabilities can develop into full-fledged crises. But they are also particularly challenging because of the role of private capital flows and the need for information on private sector debt and balance sheet exposure to exchange rate and interest rate risk. Aggregate debt- and reserve-related indicators have been commonly used in vulnerability assessments, but data on the private sector, particularly the nonfinancial corporate sector, appear to have been difficult to obtain.

21. **Besides data constraints, the coverage of medium-term debt sustainability issues has been inadequate in many vulnerability assessments.** The medium-term balance of payments scenarios introduced in the wake of the 1980s debt crisis are usually included in staff reports; but without adequate attention to the sensitivity of the projections to exchange rate and interest rate movements, they are little more than token exercises.

Table 1. FSAPs Completed as of December 31,2001

Country	Main FSAP Mission 1/	Article IV Consultation Mission	Fund Board Article IV Discussion
FSAP Pilot			
Lebanon	May 1999	June 1999	Sep. 1999
Colombia	June 1999	Oct. 1999	Dec. 1999
Canada	Oct. 1999	Nov. 1999	Feb. 2000
South Africa	Oct. 1999	Sep. 1999	Feb. 2000
Cameroon	Feb. 2000	Mar. 2000	June 2000
Hungary	Feb. 2000	Nov. 2000	May 2001
Iran	Feb. 2000	May 2000	Aug. 2000
Ireland	Feb. 2000	May 2000	Aug. 2000
Kazakhstan	Feb. 2000	Apr. 2000	Dec. 2000
Estonia	Mar. 2000	Apr. 2000	June 2000
India	Mar. 2000	Mar. 2001	June 2001
El Salvador	Apr. 2000	Mar. 2001	Jul. 2001
FSAP Post-Pilot			
Ghana	Jul. 2000	Nov. 2000	Jun. 2001
Armenia	Sep. 2000	Jan. 2001	May 2001
Guatemala	Sep. 2000	Nov. 2000	May 2001
Israel	Sep. 2000	May 2001	Jul. 2001
Peru	Sep. 2000	Oct. 2000	Mar. 2001
Poland	Sep. 2000	Dec. 2000	Mar. 2001
Iceland	Nov. 2000	Jan. 2001	May 2001
Senegal	Nov. 2000	May 2001	Sep. 2001
Slovenia	Nov. 2000	Jan. 2001	May 2001
Yemen	Nov. 2000	Sep. 2000	Feb. 2001
Czech Republic	Feb. 2001	Apr. 2001	Jul. 2001
Finland	Apr. 2001	Jun. 2001	Nov. 2001
United Arab Emirates	Apr. 2001	May 2001	Oct. 2001
Mexico	Mar. 2001	May 2001	Aug. 2001
Georgia	Jul. 2001	Jul. 2001	Oct. 2001

Sources: Monetary and Exchange Affairs Department, Policy Development and Review Department.

1/ In several cases, mission work comprised a main mission and a preparatory staff visit. In cases where the FSAP mission could not take place sufficiently far ahead of the Article IV mission, the findings of the FSAP mission were discussed with the authorities during a subsequent staff visit, involving the Article IV consultation mission chief.

2/ FSSA updated Feb. 2001

3/ FSSA updated Feb. 2001

Table 2. ROSC Modules Completed by December 31, 2001 1/

Data Dissemination	Fiscal Transparency	Monetary and Financial Policy Transparency	Banking Supervision	Insurance Regulation	Securities Market Regulation	Payments Systems	Corporate Governance	Accounting and Auditing ^{2/}	Insolvency and Creditor Rights	Total
Albania + Argentina + Armenia Australia + Bangladesh Bulgaria + Cameroon + Chile + Czech Republic + Estonia + Hong Kong SAR of China + Hungary + Korea, Republic of Mongolia + Romania + Russia South Africa + Sri Lanka Sweden + Tunisia + Uganda + United Kingdom + Uruguay +	Argentina + Australia + Azerbaijan + Brazil + Bulgaria + Cameroon + Canada Czech Republic + Egypt Estonia + France + Greece + Hong Kong SAR of China + Hungary + India + Japan + Korea, Republic of + Kyrgyz Republic Latvia + Mongolia + Mozambique + Pakistan + Papua New Guinea + Poland + Russia Sweden + Tunisia + Turkey + Uganda + Ukraine + United Kingdom + Uruguay + Zambia	Argentina + Armenia * Australia + Bulgaria + Cameroon +* Canada * Colombia * Czech Republic +* El Salvador * Estonia +* Finland +* France + Georgia +* Ghana * Guatemala * Hong Kong SAR of China + Hungary +* Iceland +* India* Iran * Ireland +* Israel +* Kazakhstan * Lebanon * Mexico +* Peru * Poland +* Russia Senegal +* South Africa * Tunisia + Uganda + United Arab Emirates * United Kingdom + Yemen * Euro Area +	Algeria + Armenia * Argentina + Australia + Bahrain Bulgaria + Cameroon +* Canada +* Colombia * Czech Republic +* El Salvador * Estonia +* Georgia +* Ghana * Hungary +* Ireland +* Israel +* Kazakhstan * Mexico +* Poland +* Senegal +* Slovenia +* South Africa * of China + Hungary +* Iceland +* India* Iran * Ireland +* Israel +* Kazakhstan * Lebanon * Mexico +* Peru * Poland +* Senegal +*# Slovenia +* South Africa* Tunisia + United Arab Emirates * United Kingdom + Yemen * Yemen *	Bulgaria + Cameroon +* Canada +* Czech Republic +* Estonia +* Finland +* Georgia +* Ghana * Hungary +* Iceland +* Ireland +* Israel +* Kazakhstan * Mexico +* Poland +* Senegal +* Slovenia +* South Africa *	Canada +* Czech Republic +* Estonia +* Finland +* Ghana * Hungary +* Iceland +* India* Ireland +* Kazakhstan * Mexico +* Poland +* Senegal +* Slovenia +* South Africa*	Armenia * Cameroon +* Canada +* Czech Republic +* Finland +* Ghana * El Salvador * Estonia +* Finland +* Georgia +* Ghana * Guatemala * Hungary +* Iceland +* India* Ireland +* Israel +* Kazakhstan * Mexico +* Poland +* Senegal +* Slovenia +* South Africa * Kazakhstan * Mexico +* Peru * Poland +* Slovenia +* South Africa * United Arab Emirates * Yemen * Euro Area +	Brazil Croatia + Czech Republic +* Egypt + Georgia +* India + Malaysia + Philippines + Poland + Turkey + Zimbabwe +	Kenya Philippines Slovak Rep.	Czech Republic	
Total Completed										
23	33	36	36	18	16	24	11	3	1	201
Total Published										
18	28	22	22	15	12	14	10	0	0	141

Source: Staff estimates.

+ Countries for which modules have been published. In some cases, the authorities have not yet indicated their publication intentions, or ROSCs are expected to be published in the future.

* Indicates the module was derived from an FSAP. # Preliminary assessment included in FSSA.

@ Regional assessment conducted for the regional insurance supervision council CRCA (Commission Régionale de Contrôle d'Assurance).

1/ Data, Fiscal, and Bank-led Corporate governance modules are considered complete on clearance by Management. ROSCs derived from FSAPs are complete only after the FSSA has been discussed by the Executive Board. New assessments and updates of previous ROSC modules are not counted separately.

2/ Accounting and auditing, which are grouped together in these tables, are two separate areas under the standards and codes initiative.

22. **In some “old” areas, notably exchange rate policy, candor has been an important factor affecting the quality of treatment.** In some instances, notably in emerging market countries with “soft” pegs, the discussion of these issues has become considerably more candid; this has appreciably strengthened the quality of coverage. But in many other cases, exchange rate arrangements have not been questioned.

23. **Integration of the “new” areas into a coherent overall assessment has often been incomplete.** This is not surprising, given the difficulties of ensuring adequate depth of coverage in many of these areas. Without a thorough understanding of the individual elements, their integration into an overall assessment of a country’s macroeconomic prospects, external vulnerabilities and policy issues is inevitably difficult. In some countries where the quality of coverage has been high in all areas, integration has typically not been a problem. This suggests that the quality of Fund surveillance under the broadened framework may depend primarily on the quality of coverage of its elements, and that strengthening the coverage of the “new” elements will likely be critical for the overall effectiveness of surveillance.

24. **The experience with the conduct of surveillance in the broadened framework offers a number of conclusions that could help enhance its effectiveness.**

- **While surveillance activities have been quite well focused on average, there is room for greater selectivity in individual cases and areas.** For instance: in covering **trade issues**, selectivity could simultaneously strengthen the focus of surveillance and the depth of coverage, especially if it were buttressed by greater reliance on the expertise of other institutions. Addressing trade issues may not be required in all countries, but it is an essential part of surveillance in countries with serious trade distortions that hamper macroeconomic prospects, and, in particular, in the large advanced economies whose trade policies have severe implications for developing countries’ market access.
- **While coverage of financial sector issues has expanded substantially, there is a need to ensure a more even depth of coverage for the latter to measure up to the coverage of other core areas.** The experience with financial sector surveillance suggests that an adequate depth of analysis is generally not possible within the scope of the staff resources usually devoted to Article IV consultations. FSAPs have been, and remain, the preferred tool for bringing the necessary expertise to surveillance, but there is a need to clarify possible modalities for covering financial sector issues between FSAPs or when an FSAPs cannot be accommodated.
- **Coverage of institutional issues has significantly benefited from ROSCs, but limited availability of ROSCs—particularly for the corporate sector—remains a constraint.** While this constraint will ease as the coverage of ROSCs expands, modalities for bringing the necessary expertise to the treatment of critical institutional problems in the absence of ROSCs need to be considered.

- **While assessments of crisis vulnerabilities have become more elaborate, the constraints imposed by inadequate data need to be addressed.** Data on the nonfinancial corporate sector have been particularly scant; yet, such information has proven critical in recent emerging market crises. Indeed, these crises have shown that the assessment of financial sector vulnerabilities remains incomplete without adequate data on the nonfinancial corporate sector. While obtaining this information is not costless, adequate coverage of crisis vulnerabilities in Fund surveillance is difficult without it.
- **Analysis of debt sustainability needs to be strengthened.** Such analyses are a key ingredient of vulnerability assessments, both in countries with access to international capital markets and in countries that rely primarily on official financing.
- **More explicit and candid discussions on exchange rate regimes would strengthen surveillance in many countries.** The benefits of such discussions for the quality of surveillance have been apparent in a number of emerging market countries where exchange rate regimes have been addressed.

III. MODALITIES OF SURVEILLANCE

25. **In parallel with the coverage and the tools of surveillance, its modalities have evolved.** At the bilateral level, informal staff visits and country matters sessions at the Board have been introduced to enhance continuity. Regional surveillance, for instance in the euro area, sought to fill the gap in surveillance procedures that had emerged as a result of growing regional integration among members. More recently, as a reflection of the rapid expansion of economic and financial linkages among countries, multilateral surveillance has undergone significant changes.

A. Innovations in Multilateral Surveillance

26. **Increasing trade and financial linkages have raised the profile of multilateral surveillance and have prompted a number of innovations in its conduct.** With the rapid growth of capital flows, multilateral surveillance of financial markets has expanded significantly. Growing interdependencies among countries have underscored the importance of integrating bilateral and multilateral surveillance.

27. **Semi-annual discussions on the World Economic Outlook (WEO), often supplemented by interim assessments, have been one of the two main pillars of the Fund's multilateral surveillance since its inception.** They have remained the primary forum for addressing interlinkages among countries, the impact of common global shocks, broad cross-country themes, and the systemic impact of economic developments and policies in the major advanced economies. For instance, the issues addressed by the WEO in 2000-01 have included business cycle linkages among major advanced economies, the impact of economic conditions in advanced economies on developing countries, the prospects for

catch-up in the poorest countries, the world trading system, the policy issues raised by fiscal consolidation in advanced economies, safeguarding low inflation in emerging market countries, and the global impact of the events of September 11.¹⁵

28. **Continuity of multilateral surveillance has been enhanced by six-weekly World Economic and Financial Market Developments (WEMD) sessions.** These sessions were introduced in 1993 and have kept Directors apprised of key economic and financial market developments, and, increasingly, of systemic risks and vulnerabilities in emerging markets emanating from financial market developments. Following the events of September 11, two special sessions provided assessments of the global implications and policy requirements. Discussions in the Executive Board on multilateral surveillance issues have been complemented by regular participation in, and preparatory work for, fora such as the G-7, G-10, and various regional groupings, such as APEC and the Manila Framework Group.

29. **Surveillance of financial markets—the second pillar of the Fund's multilateral surveillance—has expanded substantially.** Annual International Capital Markets (ICM) reports, complemented by quarterly Emerging Market Financing reports, have focused attention on various aspects of financial market developments, such as the reappraisal of risk prompted by the global slowdown, potential disruptions in financial markets, and the implications of developments in mature markets for capital flows to emerging markets. ICM reports have also addressed cross-country themes, such as financial innovations, and the role of foreign-owned banks in emerging markets.¹⁶

30. **The establishment of the International Capital Markets Department in 2001 has enhanced the scope for multilateral surveillance of capital markets.** The recent merging of the ICM report and the quarterly Emerging Market Financing report into the quarterly Global Financial Stability (GFS) report allows more continuous monitoring and more frequent reporting to the Board. Intensified gathering of market information and the broadening of the Fund's liaison with private capital market participants, including through the organization of the Capital Markets Consultative Group and participation in various fora, have strengthened the tools and channels of multilateral surveillance of capital markets.

31. **Integration of multilateral and bilateral surveillance has evolved significantly.** Information from multilateral surveillance plays a critical role in the high frequency assessments of crisis vulnerabilities in emerging market countries that were established in 2001 to ensure continuity of surveillance in countries that are vulnerable to changing

¹⁵ See *World Economic Outlook, May 2000, October 2000, May 2001, and October 2001*.

¹⁶ See *International Capital Markets Reports 2000 and 2001*.

conditions in international capital markets. Both information from the WEO on global economic developments and prospects as well as information from ICM on market conditions and contagion risk constitute key inputs for these vulnerability assessments. Furthermore, the WEO and increasingly also ICM provide background information on global economic developments and financial market conditions for Article IV consultations.

B. Article IV Consultation Procedures

32. **While the modalities of bilateral surveillance have evolved, Article IV consultations have remained its cornerstone.** Given the central role of these consultations in the surveillance process, consultation procedures have repeatedly been subjected to intense scrutiny. The motivations for these discussions have alternated between concerns about strained staff resources and concerns about the continuity of surveillance (Box 4).

33. **Consultation procedures have recently been examined in the context of the work on proposals for reducing work pressures.** The proposals that emerged from this work were:

- To move program countries to a 24-month consultation cycle.
- To introduce streamlined consultation procedures, which would (i) focus on a few key issues and produce a short and focused staff report; (ii) produce no background documentation; and (iii) allow for (optional) conclusion by the Board on a lapse-of-time basis.
- To modify requirements for the preparation of Statistical Appendices.
- To eliminate REDs, subject to the provision that staff would incorporate, as needed, appropriate information on recent economic developments in Selected Issues papers as analytical background for key policy issues.

Following a discussion in June 2001, several of the proposals were discussed again by the Executive Board on January 22, 2002, and the proposal to eliminate REDs was adopted. Consideration of the other proposals was to be incorporated in this biennial surveillance review. The proposal to move program countries to longer consultation cycles is examined in the broader context of the experience with surveillance in program countries; the remaining two proposals are considered below against the background of existing policies and the experience with the implementation of these policies in 2000-01.

Box 4. The Evolution of Article IV Consultation Procedures, 1983-1997

1983: Against the background of the debt crisis, prominent cases of long lags between Article IV consultations, and a generalized fall in coverage of consultations, the Executive Board agreed to implement procedural changes to guarantee a stricter approach to the scheduling of consultations. These changes included: establishing criteria (economies with a substantial impact on other countries; countries where there are substantial doubts about external viability; and countries with a Fund program) for placing countries on a “strict cycle” (12-month with a 3-month grace period); setting a permissible outer limit of 2 years for the interval between consultations for countries not on the strict cycle; and circumscribing circumstances where delays could be justified.

1987: Motivated by pressures on staff and Board resources, the bicyclic consultation procedure was introduced. This procedure involved the conduct of a simplified consultation every second year, with a shorter staff report, no background documentation, and issuance of the staff report to the Board for information only. Initially, the bicyclic consultation procedure was applied to 23 countries.

1991: In response to the severe pressure on staff resources stemming from work in Central and Eastern Europe and the U.S.S.R., all members except the seven largest industrial countries, program countries, and arrears cases were temporarily moved to longer consultation cycles.

1993: On the occasion of the 1993 biennial review of surveillance, Executive Directors concluded that the intensification of work load pressures had adversely affected surveillance-related activities and that there was a need for greater continuity of surveillance. Given this conclusion and the perception that the bicyclic procedure had not resulted in substantial resource savings, the bicycle procedure was abolished and most countries were placed on the annual consultation cycle.

1995: Requirements for background documentation were relaxed.

1996: A lapse-of-time procedure for concluding Article IV consultations was approved by the Board, with the understanding that the procedure would be used sparingly.

1997: Noting the need to ensure an effective focus of surveillance in the context of strained resources, Executive Directors encouraged flexibility regarding consultation frequency, mission size, and documentation. In particular, Directors agreed that the staff and management should periodically identify those countries for which annual consultations will be held and those countries for which consultations were not expected to be held within the next year. The following countries were expected to have annual consultations: (i) countries of systemic and regional importance; (ii) program countries; (iii) countries having implemented a Fund arrangement within the past year and countries with outstanding Fund credit above a minimum threshold; and (iv) countries seen to be at some risk because of policy imbalances or particular threats from exogenous developments, or countries facing pressing policy issues of broad interest to the Fund membership. In cases of consultations on a longer than annual cycle, the Executive Director for the country concerned would be consulted and the consent of the country would be required. In the wake of these decisions, 15 countries were moved to a longer consultation cycle.

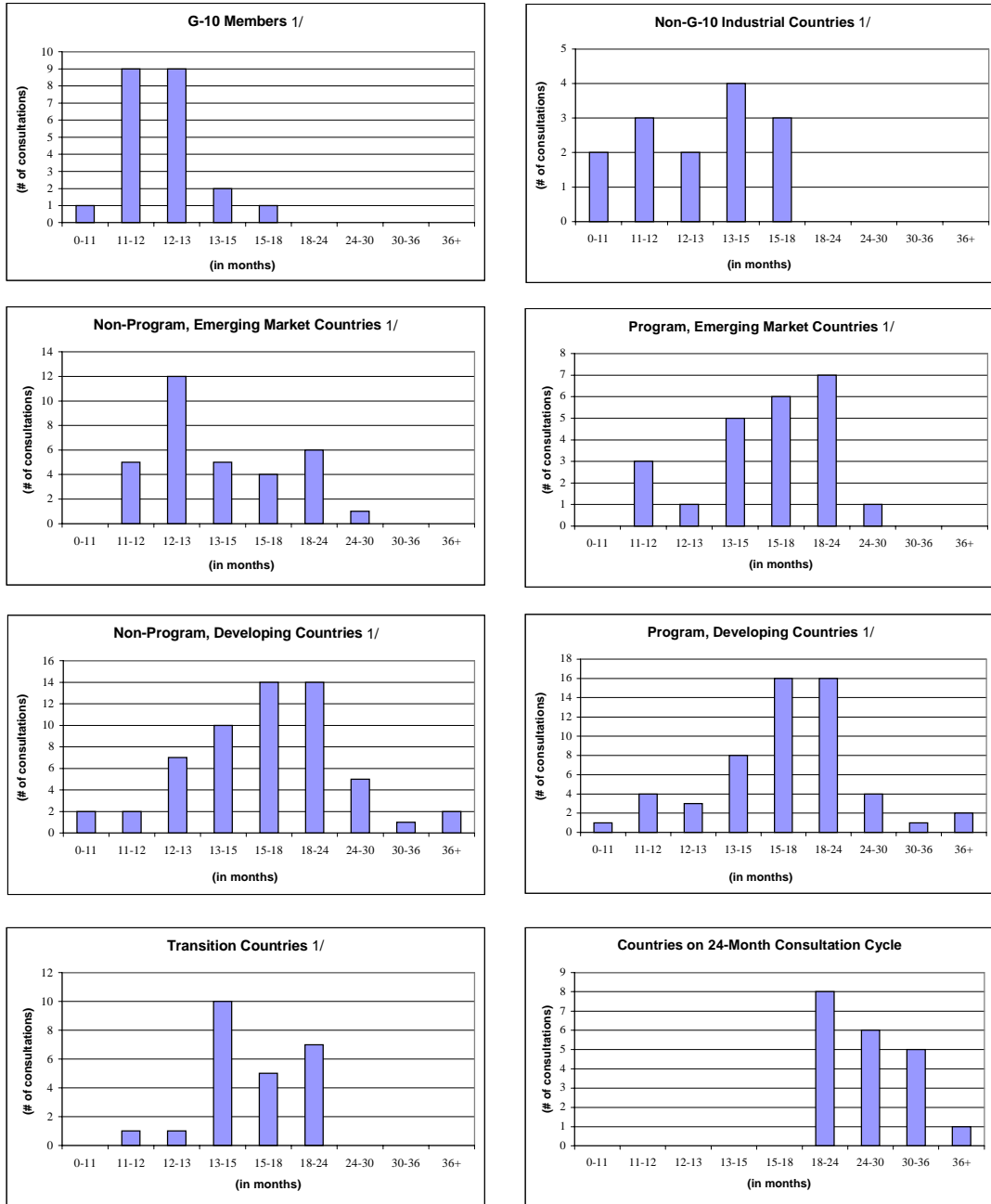
34. **Current policies on consultation procedures were shaped by the last comprehensive discussion of these issues at the 1997 biennial surveillance review.** At the time, the Executive Board sought to address concerns about resource constraints by encouraging greater flexibility on (i) consultation frequency, (ii) mission size, and (iii) staff reports and background documentation. Flexibility was to be used “particularly when economic developments appeared to be on a positive track.” At the 2000 biennial surveillance review, the Executive Board endorsed these recommendations, while confirming the principle of annual consultations.

35. **Developments in consultation procedures in 2000-01 suggest that application of the Board’s recommendations has varied.** Reliance on longer de jure consultation cycles (18 or 24 months) declined to just 10 percent of the membership as several countries were moved to annual cycles out of concerns about economic developments; at the same time, effective consultation cycles have lengthened further due to increased delays (Figure 1). Average mission size has declined, as have total staff resources devoted to Article IV consultations. Background documentation has remained substantial, although in a few cases no background documentation was produced.¹⁷

36. **Another element of current policies on consultation procedures is the policy on lapse-of-time (LOT) conclusions of Article IV consultations.** When this issue was discussed by the Executive Board in 1996, Directors considered that, while LOT conclusions of Article IV consultations might be appropriate in view of the Board’s heavy workload, they should be used only rarely—and not for two consecutive Article IV consultations—as the Executive Board assessment constituted a critical element of the consultation process and, in principle, all Article IV consultations should be discussed by the Board. In the case of an LOT conclusion, the authorities would be informed that the consultation had been completed without a meeting and with the adoption of a decision endorsing the thrust of the staff appraisal, which would be transmitted to them. In practice, application of the LOT procedure has been rare, with only 6 consultations in 2000-01 concluded on a LOT basis.

¹⁷ For detailed information on developments in consultation procedures, see *Biennial Review of the Fund’s Surveillance and the 1977 Surveillance Decision: Framework and Conduct of Surveillance in 2000-01*.

Figure 1. Intervals between Article IV Consultations in 2000-01



Source: Policy Development and Review Department.

1/ Covering only countries on the 12-month consultation cycle.

37. **The proposed streamlined consultation procedure essentially combines various elements of the flexibility afforded by the current policy.** Concluding a consultation on a LOT basis—an optional element of the proposed streamlined procedure—is possible under current rules. Flexibility on mission size, the coverage of the staff report, and background documentation was encouraged by the Board at the 1997 and 2000 biennial surveillance reviews. However, while the flexibility on background documentation offered by the current policy includes the option of not producing any background documentation, this option is constrained by the current policy on Statistical Appendices, and has rarely been used.

38. **Rather than introducing a special consultation procedure, it is proposed to clarify, and, in the case of Statistical Appendices, expand, the flexibility offered by the current policy.** Specifically, it is proposed:

- To retain the current policy on **LOT conclusions of Article IV consultations.**
- To encourage flexibility on **mission size and the scope of the staff report** for Article IV consultations, with the understanding that all Article IV consultations need to ensure adequate coverage of the issues that are critical for the assessment of a country's macroeconomic conditions, prospects, and policies, external viability and crisis vulnerabilities; if there are no pressing issues, coverage would be appropriately brief.
- To encourage flexibility on **Selected Issues papers.** In principle, the extent and content of these papers should be guided by the need to provide support for the assessment in the staff report; in some instances, no background studies may be needed. Selected Issues papers should include the information previously provided in the RED to the extent that this is needed; in cases where this information is needed, it would be produced every other year.
- To allow flexibility in deciding on the production of **Statistical Appendices**, with the judgment on whether or not to produce a Statistical Appendix for a given Article IV consultation to be made by the area department in close consultation with the member's Executive Director. In arriving at this judgment, staff would be guided by Executive Directors' need for adequate information for effective surveillance and the extent to which statistical information for the country concerned is readily available to the public. Staff should be able to justify its decision at the time of the Board discussion.

This approach would jointly accommodate the elements of the proposed streamlined procedure, as well as the proposal to modify the requirements for the production of Statistical Appendices, allowing staff to use these elements flexibly according to country-specific circumstances. It would thus obviate the need for a special streamlined consultation procedure. In addition, it is proposed to retain the current policy on consultation cycles, except for program countries.

IV. SURVEILLANCE IN PROGRAM COUNTRIES

39. **Surveillance in countries with Fund-supported programs has received little special attention in past reviews of Fund surveillance.** Board discussions that touched on the issue have focused on procedural questions, notably consultation cycles and the practice of combining UFR and Article IV discussions and reports. In these discussions, the Executive Board has consistently affirmed the principle of annual Article IV consultations in program countries, notwithstanding the existence of frequent (in some cases monthly) program reviews.¹⁸ At the same time, the Board has generally welcomed the practice of combining Article IV and UFR discussions, provided the combined papers retained the distinct features of the two different papers. Thus, the Executive Board has implicitly taken the view that surveillance has an important and distinct role to play in program countries, and that linking consultations and program discussions does not interfere with this role.

40. **The notion that surveillance has a distinct role to play in program countries is not immediately obvious.** Since surveillance and Fund-supported programs share the same broad objectives—promotion (or restoration) of macroeconomic stability, external viability and sustainable growth—it could be argued that conditionality takes over the role of surveillance for the time of the program. However, the policies pursued in countries with Fund-supported programs need to be subjected to a broader scrutiny to ensure that the overall strategy is (or remains) consistent with the broader objectives of the program. The appropriate framework for such a “stepping-back” exercise is an Article IV consultation. Program reviews focus—by definition—on the specifics of a program framework that is founded on an agreed strategy; as such reviews tend to assess developments at the margin rather than reopening the larger strategic questions.

41. **While surveillance essentially serves the same purpose in program and non-program countries, it has been conducted quite differently in the two groups.**¹⁹ Even though Article IV consultation reports for program countries—which are nearly always combined with reports on program-related discussions—are not necessarily narrower in coverage than stand-alone consultation reports for non-program countries, they typically address the issues covered in a different way. Rather than stepping back from the program framework, they frequently use the program framework as the basis for the analysis of

¹⁸ This view, which has been maintained even when concerns about resource constraints prompted a move to longer consultation cycles for many other countries, appears to have been shared by the external evaluators of the Fund’s surveillance. While they recommended a reduction in the resources devoted to the surveillance of small and medium-sized industrial countries, through, inter alia, longer intervals between Article IV consultations, they did not question the practice of annual consultations for countries with Fund-supported programs. See *External Evaluation of Fund Surveillance*, IMF Website, 9/14/1999.

¹⁹ These conclusions are based on a comparison of 50 stand-alone Article IV consultation reports for non-program countries and 41 combined Article IV/UFR reports for program countries for 2000-01. See *Biennial Review of the Fund’s Surveillance and the 1977 Surveillance Decision: Surveillance in a Program Environment*.

economic developments, prospects and policy issues. Moreover, they often lack a critical assessment of the risks to the short- and medium-term outlook, and, in the majority of cases, provide no account of a policy dialogue between the staff and the authorities on key policy issues. In short, reports on combined Article IV/UFR discussions for program countries frequently suggest a lack of independence of the exercise from the agreed program framework.

42. **The view that surveillance lacks independence from program activities has been at the center of recent criticism of Fund surveillance.** Specifically, it has been argued that the predominance of program considerations has compromised surveillance and that greater independence is needed to ensure its effectiveness.²⁰

43. **While the review of surveillance in program countries suggests that the present relationship between Article IV consultations and the program framework can be a problem, there are no simple solutions to the problem.** Surveillance in a program context is an important but difficult task. In particular, any independent surveillance exercise in a program context needs to address the question: what are the implications of its conclusions for the program? This question should not stymie the independence of the surveillance exercise, but neither can it be ignored. Efforts to increase the independence of surveillance need to take this into account.

44. **A radical approach to increasing the independence of surveillance in program countries would be to establish an “institutional firewall” between program and surveillance activities.** For instance, combined Article IV/UFR discussions could be ruled out and consultation missions could be headed by a different mission chief (possibly from another department than the area department concerned). This would clearly facilitate taking a “fresh look,” and could be particularly appealing when there are serious concerns about the viability of the program strategy. However, the resource cost of a radical separation of surveillance and program activities would be substantial. More importantly, it may complicate the process of reconciling the conclusions from the surveillance exercise and practical program considerations. Indeed, there could be significant efficiency losses as the potential for a three-way negotiation process could exacerbate the difficulties of making progress on the program.

45. **Rather than relying on a radical separation of surveillance and program activities, clear guidance from the Board on the role of surveillance in program countries could help increase its independence.** This guidance might highlight the need for a “fresh and independent look,” and would emphasize the need for:

- A comprehensive assessment of economic developments beyond the narrow focus on program targets;

²⁰ U.K. Chancellor Gordon Brown expressed this view in an interview with the Financial Times (11/15/01), and in a speech to the Federal Reserve Bank of New York on November 16, 2001.

- A critical review of short- and medium-term prospects, including a discussion of the risks and vulnerabilities, even if this calls into question the original program framework;
- A stock-taking of measures to date and their effectiveness;
- A candid account of the dialogue between the staff and the authorities on key policy issues and the program strategy more generally, even if this would reveal major differences, as one or the other party has revised its assessment of the program or the economic environment.

46. **Guidance on the role of Article IV consultations in program countries may need to be complemented by guidance on their timing.** A comprehensive assessment of economic developments, prospects and the policy strategy in the context of an Article IV consultation is clearly not equally useful at every point in the life of a program, but it is important:

- Before a program is negotiated, or soon after program approval, if a crisis situation does not permit a pre-program consultation.
- Some time down the road in multi-year arrangements, typically before or during the negotiations of a new annual arrangement, or during an annual PRSP progress report in the case of a PRGF arrangement.
- When a program has moved off track as evidenced by a significant delay in completing a review, or when a major change (such as an augmentation) is envisaged.
- Between two programs.

47. **Aligning the timing of Article IV consultations in program countries to program timetables may require greater flexibility on formal consultation cycles for these countries.** Given the long delays of Article IV consultations in many program countries, the rule that these countries should be on annual cycles has become largely ineffective. Moreover, given frequent program reviews, ensuring continuity of contact with the authorities is typically not a concern in program cases.

48. **A possible approach would be to move members under Fund arrangements to a 24-month cycle for the time of the arrangement—as suggested in the Proposals for Reducing Work Pressures—subject to two qualifications:**

- If the last Article IV consultation was concluded more than 6 months before the approval of the arrangement, the next consultation should be completed no later than 12 months (plus the usual 3-month grace period) after the last consultation or 6 months after the approval of the program, whichever is later. After the conclusion of this consultation, the country would move to a 24-month cycle.

- If completion of a program review gets delayed, an Article IV consultation should be concluded no later than 12 months (plus the usual 3 month grace period) after the previous consultation or 6 months after the original date of the delayed review, whichever is later, unless a review is completed within that period.

The first qualification, which would apply to all new programs (including those replacing another program), would ensure that in cases where an Article IV consultation did not take place within a reasonable timeframe before program approval, it is not unduly delayed afterwards. The second qualification would provide for an Article IV consultation within a reasonable timeframe when a program moves off track, while avoiding an unduly rigid approach in cases where a program review gets delayed briefly for technical reasons. Countries would automatically revert to a 12-month cycle when the program expires, with the next consultation to be completed no later than 12 months (plus the usual 3-month grace period) after the last consultation or 6 months after the end of the program, whichever is later.

49. **The proposed guidance on the timing of Article IV consultations, combined with appropriate guidance on the role and content of Article IV consultations, could enhance the effectiveness of surveillance in program countries.** It could help ensure that surveillance becomes more independent from the program framework and that the necessary “stepping back” is done at the right time.

V. STAFF-MONITORED PROGRAMS

50. **Staff-monitored programs (SMPs) have emerged as the main vehicle for closer monitoring of members' policies outside a Fund arrangement.**²¹ Most SMPs are used to establish (or re-establish) a track record toward a Fund-supported program, but in some cases (about one quarter of all SMPs in the past 3 years) they serve to convey a signal to official creditors, donors and/or financial markets. Unlike Fund-supported programs, SMPs do not carry Fund endorsement, nor do they have to meet the standards of upper credit tranche conditionality.

51. **Faced with a significant expansion of SMPs, the Executive Board considered the role of SMPs in the context of the 1997 biennial surveillance review and subsequently discussed a set of draft guidelines.** These draft guidelines were intended to retain the flexibility of the established practice, while ensuring consistency of treatment among members, promoting greater transparency, and providing for adequate information of the Executive Board (Box 5).

52. **The draft guidelines discussed in 1998 have led to striking changes in the form, documentation, and communication of SMPs.**

²¹ Another vehicle, enhanced surveillance, has not been used recently.

- Monitorable macroeconomic frameworks have become universal.
- Policy programs have been commonly described in LOIs/MEFPs and communicated to the Board.
- All SMPs have been communicated to the public by means of press releases, news briefs, or PINs.

Changes in the policy content have been more difficult to measure because there are no well-defined standards, but the requirement that SMPs be guided by the policy recommendations of the last Article IV consultation has generally been met.²²

53. **One area where progress has been less evident is the monitoring of performance under an SMP.** While the 1998 draft guidelines established clear expectations as to the form and frequency of monitoring, they were less specific on the reporting of the results. As a general rule, they stipulated that performance under an SMP should be reported in Article IV staff reports; for signaling SMPs, they suggested that the authorities should be *encouraged* to release the staff's regular assessments to the public. In the absence of clear guidance on the extent of reporting on performance, the quality of such reporting has varied widely: in a number of cases, it has been limited to a few sentences in the Article IV staff report. In addition, publication of information on performance under SMPs has been relatively scant—in contrast with the public announcement of their initiation, which was done in all cases. Staff reports and PINs containing references to the performance under the SMP have been published in only four cases, and the staff's performance assessments provided at the end of the mission have been made available to the public in only three cases since 1999.

²² See *Biennial Review of the Fund's Surveillance and the 1977 Surveillance Decision: Surveillance in a Program Environment* for a detailed discussion of the results.

Box 5. Staff-Monitored Programs: The 1998 Draft Guidelines

The 1998 draft guidelines outlined the circumstances under which informal staff monitoring would be appropriate, and defined a set of rules for such monitoring. The purposes of staff-monitored programs (SMPs) were identified as: "(i) serving as a kind of extended prior action for members seeking to establish or re-establish a policy track record with the Fund; (ii) serving as a vehicle for maintenance of a particularly close policy dialogue with the Fund, including after the completion of a Fund financial arrangement; and (iii) serving to convey a signal to official creditors, donors, and/or financial markets of a member's commitment to credible and sound macroeconomic policies."

In light of the views expressed by the Board in preceding discussions on SMPs, the draft guidance note set forth a proposed set of rules focusing on policy content, monitoring framework, documentation and communication of SMPs:

- **Program content.** The draft guidelines stipulated that the program content should be guided by the most recent Article IV consultation and supported by a quantitative macroeconomic framework, including medium-term projections. While it was recognized that members' policies under an SMP "may not be sufficiently strong to elicit Fund financial support," program content and monitoring of a track-record SMP were to resemble closely, or build toward, the target arrangement; in the case of signaling SMPs, they were expected to be sufficiently strong to "maintain or improve the member's medium-term economic outlook and external viability, providing a framework conducive to the effective use of external resources." Staff was advised to refrain from reaching understandings on an SMP if "a credible and consistent policy package is not in place," and prior actions could be required "in cases where a member's policies are significantly misaligned at the outset."
- **Program length and frequency of monitoring.** While it was understood that the duration of SMPs would likely vary, depending on a member's past track record, the objectives of the program and the policy measures included, the draft guidelines established an expectation that SMPs would cover a minimum of six months and two test dates, and would generally not extend beyond 12-18 months, although longer periods were not precluded.
- **Documentation and communication to the Board.** The draft guidelines stipulated that SMPs should generally be supported by a memorandum of economic and financial policies (MEFP) specifying the authorities' objectives and policies, including quantitative and structural benchmarks. Timing and form of communication to the Board could vary, depending on the timing of the request for an SMP. If the request was received during an Article IV consultation, the program should be described in the Article IV staff report, which would attach the MEFP. If the request was received between Article IV consultations, staff should inform the Board during the next country matters session and describe the SMP, as well as performance up to that point, in the next Article IV report, with the MEFP attached. Alternatively, a stand-alone paper on the SMP could be circulated to the Board for information. In any case, staff should explain the purpose of the SMP, the quantitative framework, and the risks associated with the authorities' program. Assessments of performance under an SMP should be included in Article IV staff reports and subsequent requests for Fund resources.
- **Communication to the public.** To guard against possible misinterpretation of the status of staff monitoring and impart discipline to the use of an SMP, the authorities should be encouraged to publish their MEFP, and to request a PIN following the conclusion of an Article IV consultation held during or after an SMP. Recognizing that transparency is particularly important when the primary objective of an SMP is to provide a signal to financial markets, the draft guidelines suggested that, in such cases, the authorities should be encouraged to release the staff's regular assessments of the program, and that staff may refrain from reaching an agreement on an SMP if adequate understandings on transparency cannot be obtained. Finally, staff should insist that any public statements by the authorities on the SMP convey its informal nature.

54. **The weaknesses in reporting on performance under SMPs raise concerns, particularly in the case of signaling SMPs.** Unlike track-record SMPs, where the ability to move to a Fund-supported program will eventually indicate whether the SMP has achieved its objective, signaling SMPs are not subject to a specific test of “success.” Adequate and transparent reporting on performance is thus critical for the assessment of the authorities’ policy effort under a signaling SMP. Weaknesses in performance reporting add an additional element to the risk that official and/or private creditors may misjudge the authorities’ policy program, which is typically presented in a form similar to that of a Fund-supported program but does not have to meet the same quality standards as the latter, i.e., the standards of upper credit tranche conditionality.

55. **Clearer guidance on performance reporting and greater transparency could help reduce the risk that signaling SMPs may be misjudged.** Specifically, frequency, form, and scope of reporting on performance could be further clarified and a presumption could be created that not only MEFPs/LOIs but also all staff assessments under an SMP will be published. These publications would include a statement indicating that SMPs do not involve Board endorsement of the member’s policy program and that the latter does not have to meet the standards of upper credit tranche conditionality. This approach would clarify the nature of SMPs, reduce the risk of blurring the line between SMPs and Fund-supported programs, and ensure transparency of reporting on performance under an SMP. However, it may not entirely rule out potential misinterpretation of the strength of an SMP, because making such an assessment is difficult in the absence of more clearly defined quality standards.

56. **To rule out the risk of misinterpretation in signaling cases completely, more rigorous quality standards could be required, for instance in the context of a precautionary stand-by arrangement.** This may not satisfy members wishing to avoid any suggestion of a possible need for Fund financing. In these cases, a monitoring arrangement similar to the Fund-monitored programs used in the arrears strategy—which require upper credit tranche conditionality and carry Fund endorsement—may be worth considering. In either case, there would be no ambiguity about the standards for the policy program and the nature of the Fund’s involvement. Members opting for these arrangements for signaling purposes would thus send a clear signal about the strength of their policies. Of course, members who are unable to meet the more rigorous standards could temporarily request monitoring under a track-record SMP building toward such an arrangement.

VI. ISSUES FOR DISCUSSION AND NEXT STEPS

57. This review has taken stock of the evolution of the framework for surveillance. It has argued that this evolution has reflected a series of steps to adapt surveillance to a changing global environment to maintain or enhance its effectiveness. In particular, the coverage of surveillance has expanded from an original focus on exchange rate, fiscal and monetary policy and the exchange regime to structural policies, financial sector issues, institutional issues, and more comprehensive and detailed assessments of countries' crisis vulnerabilities, with greater attention to capital account and external debt issues.

- *Do Directors agree with this assessment of the broadened framework for surveillance?*

58. At the last biennial surveillance review, Directors agreed that the twin objectives of breadth and focus could only be achieved by selectivity. While missions should be aware of a broad range of aspects of a country's performance, these aspects should be filtered into the staff report using the criterion of macroeconomic relevance. Directors thought, however, that there existed a hierarchy of concerns for the Fund and that issues related to external sustainability and vulnerability to balance of payments or currency crises should always be covered.

- *Do Directors endorse these views on selectivity, macroeconomic relevance, and a hierarchy of concerns?*
- *Are there other issues—such as growth and the global impact of policies in individual countries (particularly in the large advanced economies)—that ought to be placed high on the hierarchy of concerns?*

59. The review of the Fund's surveillance activities in 2000-01 suggests that in spite of the broadened framework, surveillance has been quite successful in maintaining a focus on the key policy issues. In particular, while exchange rate, monetary and fiscal policy issues have remained at the center and financial sector surveillance has become a standard part of surveillance, structural and institutional issues have been covered more selectively. Nevertheless, there is room for greater selectivity in some areas, including in the coverage of trade policies.

- *Do Directors share this broad assessment of the focus of surveillance? Is there room for greater selectivity in areas other than trade? Should certain areas be covered more consistently?*

60. Exchange rate, monetary and fiscal policy issues are typically covered well in Fund surveillance, but ensuring adequate coverage in other areas has often been challenged by serious constraints on information and expertise. FSAPs have made a great difference for the coverage of the financial sector, but have been available only for a limited number of countries. ROSCs have also provided valuable background information, but limited

availability is a constraint—particularly in areas where consultation missions are least experienced, such as the corporate sector. Vulnerability assessments and sustainability analyses have frequently been constrained by inadequate data, especially on corporate sector debt and balance sheet exposure.

- *Do Directors share the view that the quality of financial sector surveillance, which is seen as one of the core areas of Fund surveillance, should measure up to the analysis of other core areas? How can this be achieved?*
- *How do Directors see the role of ROSCs in supporting Fund surveillance?*
- *Directors' comments on the factors constraining the quality of vulnerability assessments and sustainability analysis would be welcome. Is quality of coverage a concern in other areas?*

61. The modalities of surveillance have been adapted to a changing environment. Recent innovations have focused in particular on multilateral surveillance of capital markets and on the integration of bilateral and multilateral surveillance.

- *Do Directors view these changes in multilateral surveillance positively? What, if any, are the shortcomings?*

62. Article IV consultations have remained the cornerstone of the Fund's bilateral surveillance. The review has examined the proposal to introduce a streamlined consultation procedure and allow for greater flexibility in the production of Statistical Appendices. It concludes that current policies on consultation procedures, combined with the proposal on Statistical Appendices, offer a degree of flexibility that accommodates the elements of the proposed streamlined procedure. Endorsement of these policies and of the proposal on Statistical Appendices would obviate the need for a special streamlined consultation procedure.

- *Directors' views on this assessment and on the clarifications of current policy included in the paper would be welcome.*

63. The review of the implementation of surveillance in program countries suggests that surveillance in these countries has frequently failed to step back from the program framework. This has impaired its effectiveness.

- *How do Directors see the role of surveillance in program countries? Do Directors agree that surveillance in these countries should become more independent?*
- *If greater independence is needed, how can it be achieved? Would clearer guidance on the purposes and principles be sufficient or are "institutional firewalls" between surveillance and program work necessary?*

- *Directors' comments on the proposed rules on the timing of Article IV consultations in program countries and on consultation cycles would be welcome.*

64. Finally, the review has examined the experience with staff-monitored programs (SMPs) following the 1998 draft guidelines. While these guidelines have helped improve the format, documentation and communication of the policy program, reporting on performance has been very uneven.

- *How do Directors see the recent experience with SMPs?*
- *Do Directors agree that signaling SMPs risk being misinterpreted by official and/or private creditors and that both the lack of clarity on the degree of rigor of such programs and inadequate reporting on performance are matters of concern?*
- *Directors' comments on the proposal to strengthen requirements for the reporting on performance as well as transparency would be appreciated.*

65. Board guidance from this biennial review—in particular on the issues outlined above—will be incorporated in a short follow-up paper, to be discussed before the Annual Meetings. This paper will lay the groundwork for revised guidance to the staff on the conduct of surveillance and on staff-monitored programs. It will include draft guidelines for further comment by Executive Directors as well as draft decisions that may become necessary to implement the proposed changes to consultation procedures. The follow-up paper will also contain a draft decision concluding the 2002 biennial surveillance review.