

INTERNATIONAL MONETARY FUND

**Review of the Fund’s Mandate—Follow-Up on Modernizing Surveillance**

Prepared by the Strategy, Policy, and Review and Legal Departments

In consultation with Other Departments

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July 30, 2010

**Objective.** The Executive Board has been considering reforms to strengthen the Fund’s mandate to better equip the institution to safeguard global stability. Executive Directors have supported a range of reforms to modernize the Fund’s surveillance mandate and modalities (Box 1). This paper focuses on selected aspects of these reforms where further work was called for, including on a possible multilateral surveillance decision and proposals to enhance the traction and flexibility of bilateral surveillance. Plans for specific papers on other aspects of the Fund’s surveillance mandate are summarized in Table 1.

To buttress multilateral surveillance, this paper discusses:

- experimentation with “spillover reports” over the next year or so;
- options to enhance the effectiveness of the WEO and GFSR and the synergy between them and other multilateral surveillance activities; and
- what a Multilateral Surveillance Decision might entail (in light of concerns that it may be an unduly drawn out and complicated endeavor).

To enhance bilateral surveillance, this paper discusses:

- increasing the traction of surveillance, with more engagement with policymakers; and
- enhancing the flexibility of the process through greater use of lapse-of-time procedures and modernized rules for consultation cycles.

## I. BUTTRESSING MULTILATERAL SURVEILLANCE<sup>1</sup>

### A. Spillover Reports

1. **Filling gaps.** As was explained in [Modernizing the Surveillance Mandate and Modalities](#), the goal of “spillover reports” is to examine outward spillovers from countries whose policies or circumstances may significantly affect the stability of the system. They would complement and inform the analysis in the WEO and GFSR, by casting a spotlight on the direct implications of a specific member’s or group of members’ policies on others. These reports would also complement and provide an additional context for Article IV reports, filling two important gaps in the coverage of bilateral surveillance:

- *The policy gap.* Bilateral surveillance discusses a broad range of spillovers but is incomplete in its coverage.<sup>2</sup> As discussed in [Modernizing the Surveillance Mandate and Modalities](#), the legal and organizational frameworks for bilateral surveillance have contributed to limitations on coverage of spillovers. On the former, bilateral surveillance is guided by the scope of members’ obligations under Article IV, Section 1. Under Article IV, members are not required to change their domestic policies in circumstances where, despite the fact that these policies may have negative externalities, they do not undermine the member’s own domestic stability. Accordingly, spillovers from members’ domestic policies in these circumstances cannot be the primary subject of bilateral surveillance.
- *The counterpart gap.* Bilateral surveillance only involves policy discussions with the member whose policies are the subject of surveillance. Even where spillovers fall within the scope of bilateral surveillance, the Fund’s consultation with each member does not include discussions with members affected by that member’s policies despite the benefits of such discussions for the Fund’s analysis of spillovers. Whether the spillovers fall within or outside of bilateral surveillance, a spillover report would provide a broad perspective on the effects of the relevant policies.

2. **Experimenting with spillover reports.** To move past generalities, the current work plan envisages that staff will prepare on a trial basis over the next year or so five spillover reports (China, Euro Area, Japan, United Kingdom and United States), based on discussions with the relevant authorities—i.e., with the member country(ies) where spillovers originate, as well as those in affected countries—and to be discussed by the Executive Board. Discussing outward spillovers at the same time as the relevant bilateral Article IV consultation would allow for synergy between the two exercises while minimizing the burden on the authorities. However, for logistical reasons, and in order not to delay useful analysis in

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<sup>2</sup> See [The Fund’s Mandate—The Legal Framework](#) (pages 7–8) and [Modernizing the Surveillance Mandate and Modalities](#), Box 4.

the current crisis, some spillover reports will be initiated in 2010, ahead of the relevant Article IV consultations; others will follow in 2011.

### Box 1. Areas of Support to Modernize Surveillance

Two recent staff papers, *Modernizing the Surveillance Mandate and Modalities* and *Financial Sector Surveillance and the Mandate of the Fund*, laid out a vision to modernize the framework and modalities of Fund surveillance. This included more multilateral surveillance (including improving spillover and multilateral analysis), greater value and traction from bilateral surveillance, enhanced financial sector analysis and better integration among all dimensions of surveillance. Executive Directors supported many of the ideas put forward by staff, including:

- **Multilateral surveillance.** Directors saw merit in the idea of a decision to clarify the remit, but some remained skeptical given the possible complication in the process of agreeing on a formal decision. There was broad support for producing, at least on a trial basis, reports on outward spillovers for countries whose policies or circumstances may significantly affect the stability of the system. Directors were also receptive to the idea of conducting multilateral consultations as needed to foster collaboration on specific topics that have systemic implications. *The illustrative multilateral surveillance decision in Annex I aims to shed some light on how complicated—or straightforward—such a decision might be;*
- **Bilateral surveillance.** Thematic multi-country reports were seen to be a useful vehicle for promoting a better understanding of cross-country linkages. These reports are intended to complement the WEO analytical chapters through an in-depth and policy-focused examination of the lessons to be drawn from the experience of a limited number of countries facing similar issues. There was also support for increased use of lapse-of-time procedures for completing Article IV consultations and greater flexibility in consultation cycles. The Board also underscored the importance of ensuring surveillance takes place within a reasonable timeframe. There was interest in pursuing more ambitious approaches to improving the traction of surveillance, possibly through greater ministerial engagement at the IMFC. *Section II of this report discusses modalities for implementation;* and
- **Financial sector surveillance.** In order to improve risk assessment, there was support for staff's plans to obtain the data necessary to assess spillovers through global financial networks and their implications for macro-financial stability. There was also broad agreement that the Fund should (i) seek more regular access to data on individual financial institutions, building on existing modalities for FSAP assessments and the ongoing work in the context of the G-20 data gaps initiative, and (ii) deepen its engagement with key global financial institutions. *Table 1 sets out associated work plans.*

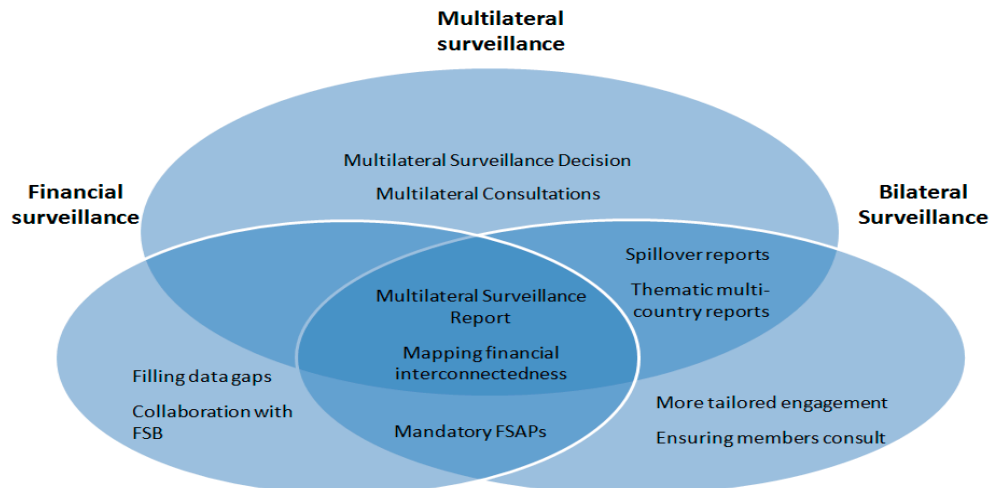


Table 1. Strengthening Surveillance: Forthcoming Papers

<b>Strengthening Bilateral Surveillance</b>	
<b>Promoting cross-country understanding</b> (October 2010)	The next thematic report will be on <i>Cross-Cutting Themes from Selected Countries: Employment Experiences</i> . It will review, based on case studies, the crisis experience of select advanced and emerging market economies with different institutional, policy and labor market settings, with the objective of identifying broader lessons and policy options to reduce unemployment and strengthen productivity.
<b>Ensuring that surveillance takes place</b> (October 2010)	<i>Bilateral Surveillance—the Obligation of Members to Consult with the Fund under Article IV</i> will examine the legal framework governing members' obligations to consult with the Fund under Article IV.
<b>Strengthening Financial Sector Surveillance</b>	
<b>Relationship with FSB</b> (September 2010)	<i>Fund Membership in the Financial Stability Board</i> will explore the implications of membership in light of the legal frameworks of the two bodies, and will discuss the delineation of responsibilities between the Fund and FSB.
<b>FSAPs and Article IV</b> (September 2010)	<i>Integrating Stability Assessments under the Financial Sector Assessment Program into Article IV Surveillance</i> will examine legal considerations and operational aspects, such as definition of countries with systemically important financial sectors; the coverage, frequency, and integration with Article IV consultations; coordination with the World Bank; and resource implications.
<b>Interconnectedness</b> (October 2010)	<i>Financial Interconnectedness: Building a Global Risk Map</i> : The crisis has led to calls for constructing global financial risk maps that track the build-up of systemic risk and enhance surveillance. The paper will put forth a framework for mapping cross-border financial interconnections to identify critical fault lines along which risk concentrations might develop and financial shocks propagate. The framework will be used to interpret developments in the past decade and assess data needs.
<b>Capital &amp; Financial Flows</b> (October/November 2010)	<i>Cross-border Capital and Financial Flows—the Fund's Role</i> : Size and volatility of cross-border capital and financial flows are a major concern of policymakers around the world. This paper examines the case for greater multilateral coordination of data and policies related to cross-border flows, the extent to which the Fund is well-positioned to play such a role, and the scope for principles to guide its advice to members in this area.

## B. Synergy between the WEO, GFSR and Other Surveillance

3. ***Enhancing the effectiveness of WEO and GFSR.*** The WEO and GFSR are well-respected and individually branded products that provide analysis of global economic and financial stability developments, trends and risks, as well as broad policy ideas, with different core external audiences. During recent Board discussions, Directors put forward suggestions to enhance the effectiveness of these products and the synergy between them and with other multilateral surveillance activities. Building on these suggestions, staff plans to:
- a. Enhance integration of the Fund’s macro-financial analysis through (i) incorporation of more explicit references between the WEO and GFSR, and (ii) updates to the format and content of Chapter 1 of the WEO to better incorporate the findings of the GFSR; and
  - b. Prepare a short stand-alone document with the main policy messages from the WEO, GFSR and other relevant surveillance products, including the Fiscal Monitor. This new document would help ensure the consistency of messages between the WEO, which focuses on the baseline scenario, and the GFSR, which focuses more on downside risks; it could also ensure integration of the findings of the Fiscal Monitor. This report would be used to communicate key messages to top policymakers, and would be published in the same timeframe as the WEO and GFSR under publication policies applying to those documents. It could be expanded over time (or a complementary report prepared) to incorporate the findings of cross-cutting thematic reports and analysis on spillovers once further experience has been gained.

## C. Multilateral Surveillance Decision

4. ***Multilateral surveillance.*** The Fund engages in multilateral surveillance to discharge its obligation under Article IV, Section 3(a) to “oversee the international monetary system in order to ensure its effective operation.” However, in contrast to bilateral surveillance, there is no comprehensive Executive Board decision providing guidance on the scope and modalities for this half sentence reference to multilateral surveillance in the Articles. This, per se, is not a problem, and indeed flexibility in conducting multilateral surveillance is arguably a strength—unless, as argued in [Modernizing the Surveillance Mandate and Modalities](#), the lack of clarity itself contributes to gaps in the coverage and traction of surveillance, gaps that heightened staff efforts, successive Board reviews, and ministerial urgings have not eliminated.<sup>3</sup> As such, the role of a Multilateral Surveillance Decision (MSD) would be to

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<sup>3</sup> For example, the 1999 [Evaluation of IMF Surveillance](#) noted, “...the international implications of exchange rate policy and directly associated macroeconomic policies (including financial sector and capital account issues) should be given significantly greater attention.” The 2006 [IEO Report on Multilateral Surveillance](#) noted, “The IMF needs to strengthen the multilateral dimension of surveillance, particularly for systemically important countries.” The 2008 [Triennial Surveillance Review](#) noted, “...surveillance needs to better place countries in the global context by discussing cross-border economic linkages more explicitly.” The 2010 [IEO Report on IMF Interactions in Member Countries](#) noted the need to, “Improve the quality and relevance of the international dimensions of the Fund’s work.”

create clear expectations for both the Fund and each member regarding the conduct of multilateral surveillance, provision of data, analysis of spillovers, and direct engagement with policymakers. In recent discussions, Executive Directors have asked for further thinking about the features of an MSD, while also expressing concern about a potentially controversial process to reach agreement on it. To help demystify the decision and gauge the force of these issues, Annex I sets out an illustrative example, building on the framework laid out in [Modernizing the Surveillance Mandate and Modalities](#). *It should be stressed that this illustrative MSD is not proposed for adoption at this stage, and is intended only to help guide further discussion.*

5. **Scope of multilateral surveillance.** The MSD would specify the scope of multilateral surveillance. For this purpose, it would clarify the meaning of the “international monetary system” (as described in [The Fund's Mandate—The Legal Framework](#)) and provide guidance on the range of issues the Fund may examine in order to ensure its effective operation.<sup>4</sup> As the purpose of multilateral surveillance is to assess whether the IMS is operating effectively, the conduct of multilateral surveillance requires the Fund to examine not only the four elements of the IMS itself, but also those issues that may have an impact on the IMS’s effective operation. These include issues relevant for global economic and financial stability, which from an economic point of view is necessary for the effective operation of the IMS. The scope of multilateral surveillance will therefore encompass a broad set of economic and financial issues. These include global economic and financial market conditions (currently done in the WEO and GFSR, with the support of tools such as early warning and vulnerability exercises), cross-country financial interconnectedness, and the spillovers from policies (including domestic policies) of individual members or groups of members that may have important implications for the operation of the IMS as a whole. Multilateral surveillance needs to examine risks generated both through and outside members’ balance of payments as, in a financially integrated global economy, shocks can be transmitted without necessarily affecting the balance of payments, for example, de-leveraging by global banks (Illustrative MSD ¶¶3, 4).

6. **Role of the Fund and its members.** An MSD would provide guidance on the role of the Fund in the conduct of multilateral surveillance and clarify what is required of members (Illustrative MSD ¶¶4–6). In particular:

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<sup>4</sup> [The Fund's Mandate—The Legal Framework](#) described the four elements of the IMS as comprising: (a) the rules governing exchange arrangements between countries and the rates at which foreign exchange is purchased and sold; (b) the rules governing the making of payments and transfers for current international transactions between countries; (c) the rules governing the regulation of international capital movements; and (d) the arrangements under which international reserves are held, including official arrangements through which countries have access to liquidity through purchases from the Fund or under official currency swap arrangements.

- *Role of the Fund.* Multilateral surveillance is mandatory for the Fund. However, in fulfilling its responsibility under Article IV, Section 3(a), the Fund is not required to rely upon any particular modality. Rather it may choose between different modalities, and, in practice, has done so—for example, making use of analytical exercises such as the WEO or GFSR and, in 2006–07, conducting a multilateral consultation. Multilateral surveillance outputs individually do not have to examine all issues relevant to the effective operation of the IMS, but each of them should be designed to contribute to the Fund’s overall oversight of the IMS; and
- *Role of Members.* Article IV, Section 3(a) imposes a *procedural* obligation to consult with the Fund for the purposes of multilateral surveillance but (in contrast to bilateral surveillance) does not impose *substantive* obligations on members respecting the conduct of their policies. The obligation to consult arises whenever the Fund (i.e., the Executive Board) concludes that such consultations are necessary in order for the Fund to effectively discharge its oversight responsibilities.

7. ***Modalities.*** The MSD would provide guidance on the modalities through which the Fund would engage in multilateral surveillance. These might include the production of reports for discussion by the Board—for example, the *WEO*, *GFSR*, spillover reports, and reports on multilateral consultations. However, the MSD would not mandate the production of specific reports, so as to retain the flexibility to adapt them as needed (Illustrative MSD ¶¶7, 8).

8. ***Analysis of outward spillovers.*** The MSD would specify the modalities for in-depth analysis of outward spillovers that would be consistent with the approach outlined in paragraphs 1–2 above. It would clarify that the Fund would conduct analysis on the outward spillover effects of the policies of the most systemically important members (or groups of members) and the options to address such spillovers. It would be expected that such analyses would be conducted every one to two years, depending on circumstances. Reports would be prepared less frequently (either on a rotating basis or as dictated by circumstances) for other countries with policies or circumstances that could have a systemic effect. The selection of members would be informed by the findings of the WEO, GFSR, and other relevant surveillance activities. The scope of the analysis would vary with the circumstances of members. In preparing such analysis, the Fund would consult with the member whose policies are being examined and selected members affected by such policies (which may include advanced and developing countries). The Managing Director would seek to reach understandings with the relevant members on the modalities through which such consultations would take place. Given the cooperative nature of the Fund, it is expected that such consultations would normally take place on a voluntary basis. In those cases where it was not possible to reach agreement, the Managing Director would report to the Executive Board and the Board could require the member to consult for this purpose. Reports on spillover analysis would be discussed by the Executive Board and be subject to a summing



up. The presumption would be that the report would be published with the consent of the member(s) whose policies are being examined (Illustrative MSD ¶¶9–12).

9. ***Multilateral consultations on special topics.*** The recent global crisis has shown that developments in the global economy may present risks to the stability of the system that would best be addressed through collaboration and collective action by members. These risks could be immediate or longer-term in nature. The MSD would provide that, whenever an issue has arisen in a policy area or country that may affect the operation of the international monetary system and requires collaboration among members that is not already taking place in another forum, the Managing Director would informally and confidentially discuss the issue with the relevant members. When the Managing Director forms the view that there is a need for a multilateral consultation, the Managing Director would seek to reach understandings with the relevant members on the recommended scope and modalities of the possible multilateral consultation and would report to the Executive Board. The Board could then decide to initiate the multilateral consultation taking into account the Managing Director’s recommendation. While the relevant members would be required to consult with the Fund in accordance with the decision, it would generally be expected that, given the cooperative nature of the Fund, the Board’s decision would reflect understandings that the Managing Director has reached with the relevant members. The Fund’s role would be to facilitate discussion among members by providing analytical input and identifying policy options, while the discussion on how to share the policy adjustments would be led by participating members. During the period of the multilateral consultation, members would provide the information required for the Fund to undertake its analysis and participate in meetings convened by the Fund with relevant officials from participating member countries. The consultation discussions (including any resulting agreement between participants on policy adjustments) would be reflected in a staff report that would be discussed by the Board and published following the conclusion of the consultation. The Board—or possibly a ministerial body (as is proposed in [IMF Governance Reform](#))—would conclude the consultation with a summing up (Illustrative MSD ¶¶13–16).

10. ***Data provision.*** The Fund is empowered under Article VIII, Section 5 to require members, subject to certain limitations, to report any information the Fund deems necessary for its activities, including multilateral surveillance. While members are under no obligation to furnish information in such detail as to disclose the affairs of individuals or corporations, the Fund may obtain such information through voluntary agreements with members. These principles are reflected in the illustrative MSD ¶6.

11. ***Review.*** In order to allow for the adaptation of the framework as experience is gained with its implementation, the MSD would initially be expected to be reviewed within three years after its adoption (Illustrative MSD ¶17).



## II. BILATERAL SURVEILLANCE

### A. Enhancing Traction

12. ***Defining and measuring traction.*** Traction, or rather its absence in many cases, has attracted significant attention in the discussion of surveillance.<sup>5</sup> However, the concept is only loosely defined and is difficult to measure. Traction can be understood to have two dimensions: the extent to which the authorities engage with the Fund on its analysis and recommendations (or, more broadly, the value Fund surveillance adds to the policy debate); and the extent to which Fund advice is reflected in policy action. While a prerequisite in any discussion on traction is that Fund surveillance provide top-quality analysis and advice and to communicate this advice effectively, ultimately policy debate and changes are shaped by many factors, of which Fund surveillance is only one.

13. ***No one/simple solution.*** Because there are many complex and intertwined factors behind low traction, no one reform will address the problem. That said, the Fund is making a sustained effort to address, on all fronts, those factors within its control, spanning from surveillance policies to governance, communication, outreach, and human resource policies (Box 2), in addition to the core issue of the quality of analysis itself. The review of the Fund's mandate is part of this effort. Following up on Directors' recent suggestions to improve traction, the following further actions could be considered:

- *Use the IMFC—or some variant of this higher-level forum—to discuss and conduct peer review of cross-country spillovers.* This could be based on an expanded version of the report on multilateral surveillance discussed in paragraph 3, following discussions by the Executive Board. This model would provide an opportunity for engagement with policymakers when systemic issues arise and foster engagement on the Fund's most important policy messages by actors responsible for economic policy decisions in their own countries. It would also provide an opportunity for the IMFC to endorse the Fund's analysis and recommendations on some issues;
- *Engage more with regional/country groups of policymakers.* Greater engagement with regional groupings (e.g., ASEAN+3 or the European Union) or other country groupings would be a way to enhance traction. The idea would be to better serve the needs of such groupings, where discussion often takes place at senior policy-making levels. Staff could do so, for example, by offering tailored repackaging of existing surveillance work to ensure maximum usefulness for the particular group (as currently with the G-20 Surveillance Notes). Regional Economic Outlook reports are already an established vehicle for engagement with regions. In addition, engagement similar to the experience

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<sup>5</sup> Analysis from as far back as the 1999 [Evaluation of IMF Surveillance](#) notes that “surveillance is hardly ever going to be a primary influence on a country's policy actions.” More recently, the 2010 [IEO Report on IMF Interactions in Member Countries](#) identified advanced economies and large emerging markets as the members where the Fund's traction is the lowest.

with the G20 Mutual Assessment Process, while not formally surveillance but technical assistance, could help achieve greater traction of Fund surveillance;

### Box 2. Complexities in improving traction

This Box identifies broad reasons for lack of traction and summarizes recent efforts to address some of them.

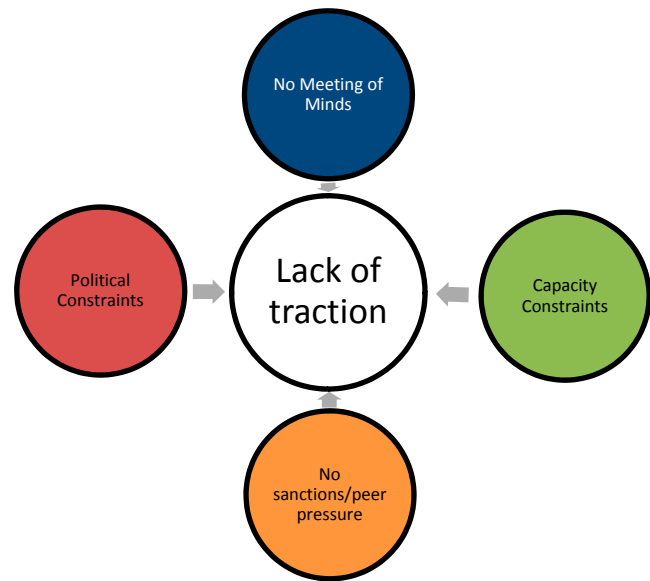
**No meeting of minds.** Disagreement of members with the Fund’s analysis or recommendations can arise for several reasons, including when the authorities have a different model in mind, have different priorities, or do not view the Fund as legitimate. In addition, members may suffering from message fatigue, especially in good times when negative outcomes do not materialize. Fund advice is also sometimes seen as too prescriptive (lacking options), or too generic (one size fits all). And Fund surveillance is arguably too “Board-centric,” reflected in a communication tailored to internal audiences rather than to the policymakers themselves or to the wider public. To address some of these issues, and in addition to continuous

efforts on the analytical front, the Fund has been sharpening its communication of key messages and increasing its outreach to think tanks, parliamentarians, and labor unions (among others) to reach stakeholders beyond policymakers; enhancing its engagement with regional groups; advancing governance reforms; adjusting its human resource policies (for a more tailored mix of staff experience and profile), and modernizing and focusing surveillance.

**Political constraints.** Policymakers seek to balance what is desirable against what is deemed feasible. To help inform the public debate on policy alternatives, staff has been enhancing its outreach strategies to broader policy-making groups, the media, and specific stakeholders. On outreach more generally, the Interdepartmental Communications Group, which meets regularly to provide guidance to staff on strategic communications and outreach priorities, is chaired by the FDMD. Increased support is also offered to organize outreach activities, including with non-official stakeholders.

**Capacity constraints.** They limit the ability of some countries to implement the Fund’s policy advice. The Fund offers technical assistance to help members in this regard, and will continue to sharpen its TA to improve impact on policy implementation.

**Insufficient peer pressure.** The essence of surveillance is peer review in the global interest. However, in practice, many members—and arguably the largest ones—have not felt much pressure from Fund surveillance as it is currently practiced. Enhancing peer pressure is a possible, though not easy, avenue, which has been explored as part of the proposed governance reforms in addition to the specific proposals in paragraph 13.



- *Promote multilateral dialogue among countries facing similar issues.* In addition to better serving existing fora, the Fund could consider promoting the grouping of countries that face similar issues as a means to foster international dialogue based on the Fund’s surveillance output. This could be done for instance by establishing multi-country wrap-up meetings for reports on cross-cutting themes, as a first step towards more continuous engagement with and among the relevant group of countries. At present, staff visits (or consults with) all the countries covered in the multi-country cross-cutting themes paper for discussions to inform the report, but does not hold a concluding meeting gathering the authorities from all such countries. Such a meeting could take place on the margins of other meetings (e.g., IMFC meetings) to minimize the burden on the authorities;
- *Continue to strengthen the clarity, focus and timeliness of Article IV staff reports.* Such efforts would draw on the recent pilot on innovative formats for staff reports, which aims to improve the focus and timeliness of reports bearing in mind the multiple audiences for these reports (the Board, policymakers, economic analysts, and the wider public). Staff intends to build on the encouraging results of this pilot and produce best practices for the format of Article IV reports. The goal is to enhance the clarity, focus, and relevance of Fund messages, minimizing the potential for “drowning” the main recommendations and fostering wider readership. Clearer key messages in staff reports would complement the initiative underway within the Board to support more focused peer review; and
- *Increase the involvement of Directors in promoting traction.* One suggestion for how best to achieve this could be to encourage the Director for the member for which an Article IV report is being discussed to include routinely in his or her BUFF a section on follow-up to past policy advice (in addition to having this in staff reports as per current requirements). This would provide the authorities with an opportunity to put forward their own perceptions of the contribution of staff’s advice to policy debate and action.

## **B. Enhancing Flexibility of Engagement**

14. ***Lapse-of-time procedures.*** The use of LOT procedures for Article IV consultations has increased significantly in 2010 with nine such cases so far this year—compared to just eight cases in the preceding decade. Clearer guidance on when they should be used is under discussion by an Executive Board Working Group as part of a broader effort to improve the efficiency of Board work practices. The Group’s report is pending.

15. ***More variable consultation cycles.*** Given the support for greater use of longer consultation cycles, some modification of the existing criteria is warranted. Currently, countries can be considered for extended consultation cycles (i.e., beyond the standard 12-months) if they do not meet any of the following criteria: (i) systemic or regional importance; (ii) outstanding Fund credit above 25 percent of quota; (iii) completion of a Fund arrangement in the past year; and (iv) perception of some risk because of policy imbalances or exogenous developments, or identification of pressing policy issues of broad interest to the Fund membership. Staff proposes to modify criterion (ii) and (iii) above and simplify the

separate, complex criteria for members under a Fund arrangement or policy support instrument, “PSI” (see below). A draft Decision that follows the approach outlined below, lays out transitional arrangements, and consolidates in one single document all the rules applicable to consultation cycles could be issued for consideration, possibly on a LOT basis, following the Board discussion.

- The criterion that prevents countries with 25 percent of quota or more in outstanding Fund credit to be on an extended cycle substantially limits the number of countries that may be placed on such cycles. As of end-June 2010, this means that 73 members would not qualify for extended cycles based on this criterion alone. Staff proposes to raise this limit to 200 percent of quota, in line with the threshold for post-program monitoring. As of end-June, this would mean that only 16 countries would be precluded by this criterion alone from consideration for extended cycles.
- To simplify the criteria for members under a Fund arrangement or PSI and build in more flexibility, staff proposes to:
  - Eliminate the criterion that automatically places a country that has completed a Fund arrangement or PSI (or where these expire or are otherwise terminated) on the standard 12-month cycle. Adopting this approach would allow these countries to remain on the 24-month cycle unless they meet other criteria that would require annual consultations. The appropriate cycle would be discussed at the time of the last program or PSI review; and
  - Apply the 24-month cycle to all members with an “on-track” arrangement or PSI, dropping the stricter rule that requires such members to complete their next consultation sooner than 24 months if their most recent Article IV consultation was completed 6 months or more before the approval of the arrangement or PSI. In cases where a program review is not completed by the date specified in the arrangement, the current requirements (implying a shortening of the cycle in most cases) will continue to apply.

### **III. RESOURCE IMPLICATIONS**

16. It is difficult to assess the resource implications of the proposals discussed in this paper without first gaining some experience. While these resource costs should not be downplayed, equally they should not be exaggerated. A rough estimate of the potential cost of each spillover report would be approximately 1 to 2 staff years—so that three reports annually would imply 3 to 6 staff years. The resource implications of a multilateral consultation would depend upon the specific issues and number of participating countries—but could be in the range of 2 to 3 staff years. Early experience with multi-country thematic reports suggests that they require one staff year to produce; preparation of three such reports annually implies a cost of three staff years. The proposals to increase traction are intended to better leverage existing initiatives and may not have a net impact on resources. Greater use of LOT could imply substantial savings in Board time, assuming there is significant take-up;

this would also imply savings of up to 2 to 3 staff years for country teams. The proposals on consultation cycles would imply some savings, including in travel costs; the degree of these savings will depend on the extent to which longer consultation cycles are taken up. Resource implications for new procedures discussed in Table 1, including related to financial sector coverage and data, will be assessed separately, but could be larger. The net resource implications from all of these proposals would need to be considered in the medium-term budget strategy.

#### **IV. ISSUES FOR DISCUSSION**

- Do Directors agree there is scope to reform current multilateral surveillance products in order to maximize their effectiveness and the synergy among them?
- In light of the illustrative example of a possible draft Multilateral Surveillance Decision presented in Annex I, do Directors see merit in pursuing work on further developing a formal Multilateral Surveillance Decision for adoption?
- Do Directors agree with the actions proposed in paragraph 13 to increase traction?
- Do Directors agree with the proposals in paragraph 15 on consultation cycles?

**Annex I. Illustrative Example for a Possible Multilateral Surveillance Decision  
(NOT FOR DECISION)**

Preamble

*The Fund engages in multilateral surveillance to meet its obligation under Article IV, Section 3(a) of the Articles to oversee the international monetary system in order to ensure its effective operation. The integration of the global economy underscores the importance of the Fund engaging in effective oversight of the international monetary system and, in this context, of monitoring global macroeconomic and financial developments, the linkages between members' economies, and potential spillovers associated with member countries' policies. To better enable the Fund to meet its obligations under Article IV, Section 3(a), it is necessary to set out a framework that specifies the scope and modalities of multilateral surveillance and provides guidance on what is required of the Fund and of its members for this purpose. It is emphasized that the obligations of members Article IV, Section 3(a) are procedural in nature: Article IV, Section 3(a) does not impose on members any obligations respecting the conduct of their substantive policies.*

1. This Decision specifies the scope and modalities of multilateral surveillance and provides guidance on the manner in which the Fund will oversee the international monetary system in order to ensure its effective operation under Article IV, Section 3(a). It also clarifies the obligations of the members for this purpose.
2. Part I provides guidance on, first, the scope of multilateral surveillance and the meaning of principal concepts set out in Article IV, Section 3(a) and, second, on the responsibilities of the Fund and the related obligations of the members in the context of multilateral surveillance. Part II describes the modalities under which multilateral surveillance will be undertaken and the procedures to be followed.

*Part I. Scope of Multilateral Surveillance and Related Obligations*

3. The international monetary system consists of: (a) the rules governing exchange arrangements between countries and the rates at which foreign exchange is purchased and sold; (b) the rules governing the making of payments and transfers for current international transactions between countries; (c) the rules governing the regulation of international capital movements; and (d) the arrangements under which international reserves are held, including official arrangements through which countries have access to liquidity through purchases from the Fund or under official currency swap arrangements.
4. In conducting multilateral surveillance, the Fund will examine issues and developments that are relevant for the effective operation of the international monetary system and make, as necessary, policy recommendations to this effect. Such issues may encompass both the official sector and developments in the private markets and include:

- i. Global economic and financial stability, including global economic and financial market conditions, the outlook for the future and global risks and vulnerabilities, in particular, those stemming from capital flows and financial interconnectedness.
  - ii. The external and domestic economic and financial policies of systemically important members, including the interlinkages between these policies and their impact on other members (i.e., outward spillovers) whether or not they are transmitted through the relevant member's balance of payments.
5. The Fund may request that members consult with it whenever it considers such consultations necessary for the effective discharge of its responsibilities under Article IV, Section 3(a). Members shall consult with the Fund in accordance with any such request for consultations. The circumstances and conditions under which the Fund will request that members consult under Article IV, Section 3(a) are specified in paragraphs 12 and 14 below.
6. The Fund may, under Article VIII, Section 5, require members to provide the Fund with information it deems necessary for the conduct of multilateral surveillance. The Fund may also obtain such information by agreement with members, including firm-specific financial sector information, with due regard to the confidentiality of such data.

*Part 2. Modalities and Procedures for Multilateral Surveillance*

7. In conducting multilateral surveillance, the Fund will make use of various modalities and will adapt these to changing circumstances. These modalities include the production of reports on issues relevant to the operation of the international monetary system and the conduct of multilateral consultations as described below.

*A. Assessments of Issues Relevant to the International Monetary System*

8. The Fund will assess issues relevant for the effective operation of the international monetary system. These assessments may take the form of reports produced by staff for discussion by the Executive Board on such issues as the outlook for the world economy, and global financial stability. In order to inform the Fund's oversight of the operation of the international monetary system, the Managing Director may collaborate with other international bodies in conducting assessments of relevant issues, such as early warnings to the system, and may inform the Executive Board and the International Monetary and Financial Committee<sup>1</sup> of such assessments.

9. The Fund will conduct assessments of the outward spillover effects of the policies of selected members or groups of members that may significantly affect the operation of the international monetary system.

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<sup>1</sup> To the extent that a higher ministerial body is established as is proposed in [IMF Governance Reform](#), the reference to the IMFC would be replaced with a reference to this new body.



10. The Managing Director, in consultation with the Executive Board, will select the members for which an assessment of outward spillovers is to be conducted, and the frequency by which such assessments are to take place. It is expected that assessments of outward spillovers will, in principle, be conducted at least every two years for those members or group of members whose economies account for a significant portion of the world GDP or financial flows. They will also be prepared as appropriate for other countries whose policies may have systemic effects, in particular, because of their size, sectoral dominance, or the current state of their economy. The selection will be informed by the findings of other relevant multilateral and bilateral surveillance activities, as well as broader staff analysis.

11. The scope of such assessments will vary with the circumstances of members and, in particular, may include spillovers from the financial sector, monetary and fiscal policies, or structural policies. Staff will report to the Executive Board on such assessments and will provide, as necessary, options for policy adjustments. Such assessments will be discussed by the Executive Board whose conclusions will be set out in a summing up of the Chairman.

12. In conducting assessments of outward spillovers under this section, the Fund will consult with the member whose policies are the subject of such assessments, and may also consult with members affected by such policies. The Managing Director will seek to reach understandings with the relevant members on the modalities through which such consultations will take place. Whenever the Managing Director is unable to reach understandings on the modalities that he believes necessary for this purpose, the Managing Director shall inform the Executive Board. In these circumstances, the Executive Board may request that the member consult with the Fund and may specify the terms of such consultations, and the relevant member shall consult in accordance with this request.

*B. Multilateral Consultations*

13. Whenever the Managing Director considers that an issue has arisen in a policy area or a member country that may affect the operation of the international monetary system, and that requires collaboration among members that is not already taking place in another forum, the Managing Director shall informally and confidentially discuss the issue with the relevant members. Where the Managing Director forms the view that a multilateral consultation is necessary, the Managing Director will seek to reach understandings with the relevant members on the recommended scope and modalities of the consultation and will report to the Executive Board.

14. After consideration of the Managing Director's report, the Executive Board may decide that a multilateral consultation will be held. Taking into account any understandings reached by the Managing Director and the relevant members, the decision to initiate a multilateral consultation will set out (i) the scope of the consultation, (ii) the participating members, (iii) the specific modalities for the consultation, and (iv) the date by which the consultation is to be completed. The relevant members shall consult with the Fund in accordance with the decision.

15. A multilateral consultation will consist of discussions between Fund staff and management and officials of relevant member countries, which may take place on a bilateral

or multilateral basis. The Fund will facilitate discussion among participating members and encourage them to agree on policy adjustments that will promote the effective operation of the international monetary system. In these discussions, the Fund will provide analysis and propose policy options that participants may adopt, and may advise on the effect of different combinations of policy adjustments.

16. After the conclusion of these discussions, the Managing Director will report to the Executive Board on the discussions, any agreed policy adjustments and their impact on the participants and the operation of the international monetary system. The Executive Board will conclude the multilateral consultation with the consideration of this report and its conclusions will be set out in a summing up of the Chairman.

#### *Review*

17. The Fund's oversight over the international monetary system must evolve in light of developments in the international monetary system and experience. It is thus expected that the Fund will review this Decision, its general implementation, and the periodicity of further reviews, after three years.