

INTERNATIONAL MONETARY FUND

Signaling Assessments of Members' Policies

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(In consultation with the other departments)

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EXECUTIVE SUMMARY

In the discussion on the experience with staff-monitored programs (SMPs) at the time of the 2002 biennial surveillance review, a number of Directors expressed concerns about certain aspects of signaling SMPs and requested a follow-up discussion on these SMPs. Several Directors felt that this discussion should also cover signaling through “comfort letters.” In response to this request, the paper lays out the main concerns about current policies on signaling SMPs and ad hoc signaling through “comfort letters” and proposes modifications to these policies that could address these concerns.

SMPs emerged as a vehicle for two very different purposes: general signaling to private and/or public creditors and donors, and building a policy track record toward a Fund-supported program. The experience with SMPs suggests that the present framework does not suit both purposes equally well.

The close formal resemblance to Fund-supported programs carries the risk that signaling SMPs may be misconstrued as entailing Fund endorsement and well-defined quality standards for the policies pursued; in addition, relatively lax standards for reporting on performance under these SMPs often allow policy slippages to go unnoticed. These risks are less serious in the case of track-record SMPs, where the purpose—building a track record toward a Fund arrangement—establishes a clear distinction from Fund supported programs as well as a simple yardstick for judging success or failure.

To remedy these weaknesses in current policies, it is proposed to limit the existing SMP framework to track-record SMPs and to introduce a modified framework for cases where monitoring is requested to provide the staff’s assessment of members’ policies to private and/or official creditors or donors. This framework—the enhanced monitoring procedure (EMP)—would essentially be an off-shoot of Article IV surveillance with periodic interim assessments, and would shift the focus of attention from the mere existence of a monitoring arrangement to the provision on an assessment of members’ policies. The EMP would eschew formal features of Fund-supported programs and would not be used to signal an endorsement of members’ policies similar to that conveyed by a Fund arrangement. The EMP would have clear standards for the staff’s assessments of the adequacy of the authorities’ policies relative to the identified macroeconomic and related structural problems, as well as well-defined rules for the communication of these assessments, including their circulation to the Board for information.

Concerns about signaling through “comfort letters” relate primarily to the lack of clear standards for content, interdepartmental review, and circulation to the Board of such statements. The resulting variations in practices raise questions about uniformity of treatment. To ensure a reasonable degree of uniformity, it is proposed to establish guidelines that would require “comfort letters” and similar staff statements (i) to contain a clear overall assessment of the adequacy of macroeconomic and related structural policies while avoiding endorsements of the lending operation for which the letter or statement is being sought; (ii) to be subjected to defined interdepartmental review procedures and management approval; and (iii) to be circulated to the Board for information.

I. INTRODUCTION

1. In the discussion on the experience with staff-monitored programs (SMPs) at the time of the 2002 biennial surveillance review, a number of Directors expressed concerns about certain aspects of signaling SMPs—i.e., SMPs with the primary purpose of providing signals about a member’s economic situation and policies to official and/or private creditors. Of particular concern was the possibility of signals being misconstrued in light of the uneven experience of reporting on performance under such monitoring arrangements. In order to clarify and remedy these problems, Directors requested a follow-up discussion on signaling SMPs. Some Directors felt that this discussion should also cover so-called “comfort letters”—statements on a member’s economic conditions, policies and its relations with the Fund—which are produced in a variety of circumstances, typically in response to an ad hoc request by other IFIs, donors, or creditors.

2. This paper lays out the main concerns about current policies on signaling SMPs and ad hoc signaling through so-called “comfort letters,” and proposes modifications to these policies that could address these concerns.¹ Section II deals with monitoring arrangements that convey the staff’s assessments of a member’s policies to private and/or official creditors or donors. Section III discusses ad hoc signaling through staff statements and “comfort letters.” The concluding section contains issues for discussion.

II. MONITORING FOR SIGNALING PURPOSES

A. Signaling SMPs: Key Concerns

3. In response to members’ requests for monitoring of their economic conditions and policies beyond Article IV surveillance and outside Fund arrangements, Fund staff have developed special monitoring arrangements. These arrangements have taken various forms—enhanced surveillance, Fund-monitored programs, and staff-monitored programs—and have served three distinct purposes: (i) to provide signals to official and/or private creditors or donors on a member’s economic policies; (ii) to help members clear their arrears to the Fund; and (iii) to help members establish a track record prior to approval of a Fund arrangement.

- ***Enhanced surveillance*** was developed in 1985 as a signaling device to assist members with a good record of adjustment in addressing their debt problems with commercial creditors in the context of multi-year rescheduling arrangements (MYRAs). Initiation of enhanced surveillance required Board approval based on a

¹ The current policy on signaling SMPs is based on draft guidelines that were discussed by the Board in 1998 (see, *Staff-Monitored Programs—Follow-Up and Guidance to Staff* (EBS/98/201, 11/25/98)). There are no guidelines for the preparation of ad hoc statements and “comfort letters” signaling the staff’s assessment of members economic conditions and policies.

positive assessment of the member's program by the staff, but the program did not have to meet the standards of upper credit tranche conditionality and did not carry Board endorsement. Application of the enhanced surveillance procedure was subsequently extended beyond the MYRA context, but it was rarely used and has become effectively defunct.²

- **Fund-monitored programs** were introduced in 1989 to help resolve cases of arrears to the Fund. They were initially applied to a few countries with relatively good prospects for clearance of their arrears within a relatively limited time period, and were subsequently developed into rights accumulation programs (RAPs) for members with more protracted arrears. Fund-monitored programs (and RAPs) are endorsed and reviewed by the Board and are expected to contain policies that meet the standards of upper credit tranche conditionality.³
- **Staff-monitored programs**—presently the predominant form of monitoring beyond surveillance and outside Fund arrangements—emerged as an informal monitoring procedure to satisfy requests for monitoring to build a track record toward a Fund-supported program or to provide signals to creditors or donors. Unlike enhanced surveillance, SMPs can be initiated without Board approval. Like enhanced surveillance (and unlike Fund-monitored programs), SMPs do not entail Board endorsement of the member's policy program, and do not require this program to meet the standards of upper credit tranche conditionality.⁴

4. While both enhanced surveillance and Fund-monitored programs/RAPs were designed and used for a specific, well-defined purpose, SMPs emerged as a vehicle for two very different purposes: general signaling to private and/or public creditors and donors, and building a track record toward a Fund-supported program. This raises the question of whether the existing SMP framework suits both purposes equally well. The experience with SMPs suggests it does not.

- The close formal resemblance to Fund-supported programs carries the risk that SMPs may be misconstrued as entailing Fund endorsement and well-defined quality standards for the policies pursued, similar to the standards of upper credit tranche conditionality. This is of particular concern in the case of signaling SMPs, which should provide unambiguous signals about the nature of the Fund's involvement and the quality of the policy program. By contrast, track-record SMPs are less prone to misinterpretation, because their very purpose—building a track record—distinguishes

² See Appendix I for a summary of the experience with the enhanced surveillance procedure.

³ The experience with Fund-monitored programs is discussed in Appendix II.

⁴ The evolution and modalities of, and the experience with, SMPs are summarized in Appendix III. For a detailed review of the experience with SMPs, see *Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision—Surveillance in a Program Environment* (SM/02/82, Supplement 2, 3/15/2002).

them clearly from Fund-supported programs. At the same time, mimicking key formal features of Fund-supported programs has proven to be useful in helping members establish a policy track-record.

- The relatively lax standards for disseminating assessments of performance under SMPs⁵ are particularly problematic in the case of signaling SMPs, because they give play to perverse incentives for reporting such assessments: once the initial positive signal on the SMP is given, the incentive for the member to disseminate progress reports on implementation is inversely related to problems of compliance with the policy program, and, hence, to creditors' and donors' need to know. By contrast, in the case of track-record SMPs, the adverse effects of lax standards for reporting on performance during the program are mitigated by a well-defined standard for measuring success or failure at the end of the program. Since track-record SMPs are intended to pave the way to a Fund-supported program, the member's ability to move to such a program provides a clear indication of whether the SMP has achieved the intended objective.

5. Beyond these concerns about the potential pitfalls of signaling SMPs, the question arises whether special monitoring arrangements for signaling purposes, which were introduced in the pre-transparency era, are still necessary in an environment where publication of Article IV and program-related documents is encouraged by the Fund and practiced by an increasing number of member countries.

6. With increased transparency, the potential signaling role of regular Article IV surveillance has increased. Moreover, for members desiring closer Fund involvement and a seal of approval, precautionary arrangements continue to provide a framework for monitoring that entails clear quality standards—upper credit tranche conditionality. Finally, for those members with policies that do not yet measure up to the standards of upper credit tranche conditionality, track-record SMPs offer a well-defined, time-bound route toward such an arrangement. Neither Article IV surveillance nor precautionary arrangements or track-record SMPs are primarily designed for signaling purposes; but the signals they provide as a by-product are less susceptible to misinterpretation than the signals provided by signaling SMPs.

7. Nevertheless, the Fund may wish to continue offering special monitoring arrangements to members who (i) require more continuous monitoring than that provided by regular Article IV surveillance, and (ii) do not wish to engage in a precautionary arrangement, possibly because they want to avoid any suggestion of a potential need for

⁵ While the 1998 draft guidelines for SMPs establish clear expectations as to the form and frequency of monitoring, they are less specific on the reporting of the results. They stipulate that performance under an SMP should be reported in Article IV staff reports, but they do not indicate the extent of such reporting. As a result, the quality of performance assessments in Article IV staff reports has varied considerably. For a more detailed discussion of the experience, see *Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision—Surveillance in a Program Environment* (SM/02/82, Supplement 2, 3/15/2002)

Fund resources, or because their policies do not meet the standards of upper credit tranche conditionality. However, to avoid the pitfalls of signaling SMPs, such monitoring arrangements should be designed

- to minimize the risk of misinterpretation as regards the nature of the Fund's involvement and the quality of the policies pursued, and
- to minimize the risk that negative information about compliance with the policy program is withheld from creditors and donors.

8. There are essentially two ways of dealing with these risks. One way would be to introduce well-defined quality standards for the policies pursued under such monitoring arrangements and to seek Board endorsement of the program and of subsequent performance assessments. However, defining and operationalizing such quality standards outside the framework of upper credit tranche conditionality would be difficult, while using upper credit tranche conditionality as a quality standard would significantly limit the flexibility of the monitoring arrangements and would make them virtually indistinguishable from precautionary Fund arrangements.

9. An alternative way would be to separate the framework for signaling from track-record SMPs, eschew the notion that policies have to meet certain standards to qualify for monitoring, avoid formal resemblance to Fund-supported programs, and strengthen requirements for reporting on performance. Under such a framework, the focus of the information provided to private and/or official creditors or donors would shift away from the agreement on a monitoring arrangement to the content of the staff's assessments of the monitored policy program. Key elements of a monitoring framework based on this approach are outlined in the next section.

B. Monitoring to Signal Assessments of a Member's Economic Policies: A Modified Approach

10. Rather than relying on a program-type SMP with benchmarks and reviews, an Enhanced Monitoring Procedure (EMP) could be used to convey assessments of a member's economic conditions and policies. EMP would in essence be an off-shoot of Article IV surveillance, providing for regular assessments between Article IV consultations. Monitoring would be initiated at the request of the member. Board approval of the request would not be required, and policies would not have to meet certain standards to qualify for monitoring. As under Article IV surveillance, the staff would assess the member's economic conditions and prospects and would determine whether the authorities' program and policy implementation was adequate to address the identified problems.

11. The proposed EMP would have the following features:

- *Initiation, duration, and frequency.* Monitoring would typically be initiated in the context of an Article IV consultation; however, initiation between Article IV consultations would be possible. The duration of the EMP would typically be until the conclusion of the next Article IV consultation, but continuation could be requested during the Article IV consultation discussions. Staff would assess the member's

economic conditions and policies between two annual consultations; one such interim assessment would be the norm, but more frequent assessments could be considered in some cases.

- *Presentation of the policy program.* At the outset, the authorities would be expected to lay out their program and the key elements of their macroeconomic framework. In essence, this would cover—albeit possibly in greater detail—the information on the authorities’ objectives, macroeconomic targets, and planned policies that is typically provided during Article IV consultation discussions. In addition, staff would need to agree with the authorities on data and other information to be provided for subsequent assessments. The staff would describe the macroeconomic framework, the policy program, and the information required for monitoring in the relevant staff report. The authorities would have the option to present, for attachment to the staff report, a written statement on their policy program, which would, however, avoid close resemblance to the LOIs/MEFPs of Fund-supported programs or staff-monitored track-record programs.
- *Assessment and discussion of the policy program.* Based on an examination of economic developments and prospects, staff would identify the key policy challenges and assess the adequacy of the authorities’ program vis-à-vis these challenges. The staff would discuss in some detail the program and its assessment with the authorities. In the process, the authorities could solicit the staff’s advice in modifying their macroeconomic framework and policy program, but “negotiation” of the policy program would be avoided. Of course, it is unlikely that the authorities would want to proceed with the EMP if the staff were to find their program wholly inadequate.
- *Performance assessments.* The assessment of policy implementation would be made against the background of the initial appraisal of the policy program, taking into account economic developments, including external shocks. Failure to provide the information for monitoring agreed upon at the outset, possible reasons, and the implications for the evaluation of policies would be noted; information gaps that render an assessment of policy implementation impossible would be flagged.
- *Documentation.* If monitoring is initiated during Article IV consultation discussions, the staff’s description and assessment of the policy program would be subsumed in the Article IV staff report, and covered in the staff appraisal. This staff report would attach the summary statement on the policy program, if the authorities chose to provide such a statement. If monitoring is initiated after an Article IV consultation, staff would circulate a short paper to the Board for information, containing a description of the macroeconomic framework and policy program as well as the staff’s assessment of the program, which would build on the findings of the preceding consultation. A short paper on the interim assessment of policy implementation would also be circulated to the Board for information; this paper would essentially contain the assessment provided to the authorities at the conclusion of the mission.
- *Role of the Board.* While the proposed monitoring arrangement would not entail Board endorsement of the monitored policy program, Directors would have an

opportunity to comment on these policies during the discussion of the Article IV consultation. Directors could, of course, request a discussion of papers sent to the Board for information, but this would likely occur only in exceptional cases.

- *Dissemination of assessments.* For official creditors or donors, the proposed circulation to the Board of papers on the initiation of, and progress under, the staff monitoring arrangement would ensure regular access to all staff assessments. If the staff's assessments are intended, at least in part, for private investors (i.e., in countries that rely on access to international capital markets) there would be a presumption of publication of a press release on the staff's assessment at the end of the discussions during which the EMP was initiated and at the time of each scheduled interim assessment; a brief press release would also be published when a scheduled interim assessment had not taken place within a reasonable timeframe because policies were off track. In all cases, publication of Article IV staff reports and PINs, and of the papers on interim staff assessments would be voluntary, consistent with the publications policy for Article IV surveillance, but would be encouraged.⁶

12. The proposed EMP would permit considerable flexibility as regards both the frequency of monitoring and the quality of the monitored policies—although a program seen by the staff as entirely inadequate to its objectives would make the exercise pointless. EMP could thus respond to a variety of demands for monitoring, ranging from members with relatively limited adjustment efforts to members with policies that would qualify for upper credit tranche conditionality. There would also be considerable flexibility in the presentation of the authorities' program and the staff's involvement in the formulation of this program. While formal features of Fund-supported programs would be avoided, the proposed framework would not preclude monitoring arrangements that are in substance quite similar to staff-monitored track-record programs. The EMP could thus be used in member countries—and, with certain qualifications, in non-member countries or entities⁷—where considerable staff assistance in the formulation and implementation of a policy program is required and where this is perhaps a key motive for requesting such monitoring.

13. This flexibility would be balanced by more clearly defined standards for form and content of the staff's assessments of the monitored policies, as well as stricter rules on reporting to the Board and transparency vis-à-vis the outside world. Under such a framework, the staff's assessments of the monitored policies, rather than the mere existence of a monitoring arrangement, would form the basis of the information provided to private and/or

⁶ A decision to publish the Article IV staff report (or other paper) containing the initial assessments of the policy program would be presumed to imply a commitment to publishing the papers containing subsequent assessments of implementation.

⁷ In non-member countries or entities, the extent of the staff's involvement under the EMP would depend on the Board's views on the appropriate role for the Fund in each individual case, within the limits of the Fund's legal framework. Also, since the Fund does not conduct Article IV consultations with non-members, in these cases, EMP would not be linked to the Article IV process.

official creditors or donors. There would thus be no simple binary—“red light/green light”—signal, but rather a more textured and elaborate assessment of the adequacy of the member’s economic policies in addressing the identified macroeconomic and related structural problems.

14. The proposed modification of the policy on monitoring for signaling purposes is expected to be resource-neutral compared with current procedures for signaling SMPs.

III. AD HOC SIGNALING THROUGH “COMFORT LETTERS”: EXPERIENCE AND PROPOSED POLICY

15. Fund staff provide signals directly to other IFIs, donors, and creditors through so-called “comfort letters” and statements to donor/creditor groups.⁸ These statements are typically produced in response to an ad hoc request from creditors/donors and may cover countries under Fund-supported programs, countries with SMPs, or surveillance-only cases.

16. Content, form and inter-departmental review of “comfort letters” and other ad hoc staff statements have tended to vary widely.⁹ While a systematic record of such statements does not exist, a review of selected examples produced in recent years suggests that these statements

- typically cover economic developments, policies, and Fund relations; including, in program or near program countries, a factual update of performance under the program or progress in program discussions;
- often include an indirect or direct endorsement of the lending operation for which the statement has been sought;
- are frequently reviewed by PDR and in many, but not all, instances sent to management; and
- are generally not circulated to the Board.

17. The variation in current practices of ad hoc signaling raises questions about uniformity of treatment and suggests that it may be helpful to establish guidelines to ensure a

⁸ The basis for requests from the World Bank for such statements is the Bank’s Operational Directive OD8.60 of 1992, which defines the Bank’s internal operational policy on World Bank adjustment lending. This directive states that “Bank adjustment lending is undertaken only when an adequate macroeconomic framework is in place. The presence of an appropriate IMF program is usually an important input in this determination. If there is no Fund arrangement, Bank staff ascertain, before making their own assessment, whether the Fund has any major outstanding concerns about the country’s policies.” Other major multilateral development banks have similar internal requirements.

⁹ See Appendix IV for an overview of the practice on “comfort letters.”

reasonably uniform approach to requests for such signaling. The following principles could form a basis for such guidelines:¹⁰

- *Content.* Letters or statements produced by the staff in response to a request from another IFI, multilateral or bilateral official creditors or donors, or as a contribution to a creditors/donors meeting, would provide an assessment of macroeconomic conditions and prospects and of macroeconomic and related structural policies. They should build, to the extent possible, on recent, more comprehensive assessments produced in the context of Article IV surveillance, Fund-supported programs, staff-monitored track record programs or the proposed enhanced monitoring procedures; if necessary, they would contain an update of these assessments. In addition, they should contain a factual account of the status of the Fund's relations with the member country, including, in program or near program countries, a description of the status of the program or the state of play of program discussions.
- *Summary judgments.* While Fund staff clearly have the competence to provide an assessment of macroeconomic and related structural policies, it is questionable whether they are competent to comment on specific lending operations of other IFIs or bilateral creditors, except, perhaps, to indicate that the envisaged operation is included in the financing assumptions of an ongoing Fund-supported program. Letters and statements prepared by the staff for ad hoc signaling should, therefore, avoid endorsements of the lending operations in question. They should also avoid simple on/off—"red light/green light"—signals on the adequacy of policies. Instead, they should contain a clear and nuanced assessment of the quality of macroeconomic and related structural policies. This assessment should focus on the extent of macroeconomic imbalances and related structural distortions, and on the extent to which current and planned policies are dealing with (or perhaps are contributing to) these problems; it should indicate whether Fund staff have major outstanding concerns about these policies. In cases of extreme macroeconomic imbalances or pervasive distortions that would likely nullify the benefits of any particular loan or grant, the staff would draw attention to these distortions.
- *Review and management approval.* Letters and statements for ad hoc signaling would be subject to the review procedures for country documents and would require management approval.
- *Circulation to the Board.* Given the possibility that the letters and statement provided by the staff to other IFIs may be circulated to the Boards of these IFIs, letters and statements for ad hoc signaling should be issued to the Board for information at the time of their dissemination to outside recipients.

¹⁰ The proposed guidelines would cover letters requested by other IFIs, creditors or donors, and formal statements at creditor/donor meetings that are being prepared in advance; they would not extend to oral comments by Fund staff at World Bank Board meetings or at local creditor/donor meetings in member countries.

18. Guidelines based on these principles would, in essence, regularize current best practices. The selective review of “comfort letters” in Appendix IV indicates that most of the suggested principles are being fairly commonly applied, suggesting that observing such guidelines would entail relatively small resource costs. While the proposed circulation to the Board would add to the resources required for the preparation of “comfort letters” and similar staff statements, clearer guidance on content and procedures would likely facilitate the process and could yield some savings.

IV. SUMMARY AND ISSUES FOR DISCUSSION

19. This paper identifies key concerns about current policies and practices on signaling SMPs and ad hoc signaling through “comfort letters” and similar staff statements. Specifically, it is argued

- that the signals provided by signaling SMPs are prone to being misconstrued, given the close formal resemblance of these arrangements to Fund-supported programs and the lax requirements for reporting on performance;
- that the absence of guidelines for “comfort letters” and similar staff statements, and the resulting differences in practice, raise questions about uniformity of treatment.

Do Directors share these concerns?

20. To address the concerns about signaling SMPs, the paper suggests that the existing framework for SMPs should be limited to track-record SMPs, and proposes a new approach—the Enhanced Monitoring Procedure (EMP)—for cases where monitoring is required to provide assessments of a member’s economic policies to private and/or official creditors or donors. This approach would shift the focus of signaling from the agreement on a monitoring arrangement to the staff’s assessments of the policies pursued under the arrangement, and, hence, from “red light/green light” signals to more textured assessments. This would be achieved by

- ensuring that EMPs eschew formal features of Fund-supported programs and the notion of well defined quality standards for policies as a precondition for monitoring, thereby maintaining a clear distinction between EMPs and Fund-supported programs;
- strengthening requirements for the staff’s assessments of the monitored policies, for reporting on performance during the monitoring arrangement, and for the transparency of these assessments.

Do Directors agree that this approach could address present concerns about signaling SMPs? Directors comments on the key features of the proposed enhanced monitoring procedures would be appreciated.

21. To ensure greater uniformity in practices on “comfort letters” and similar statements, it is proposed to introduce guidelines that would clarify content, review, and circulation to

the Board of such letters and statements. *Directors' views on the usefulness of such guidelines and on the proposed principles for guidelines would be welcome.*

Enhanced Surveillance: Modalities and Experience

Modalities

1. Enhanced surveillance was established in 1985 in response to the request of some members for intensified monitoring without a Fund arrangement. The procedure was intended to facilitate commercial bank multiyear rescheduling agreements (MYRA) by providing private creditors with information about the member's policy program and progress in its implementation.¹¹ The applicability of enhanced surveillance was broadened at the time of the 1993 biennial review of Fund surveillance to include any situation where a member would find such monitoring helpful to boost domestic and external confidence in general, not necessarily in connection with efforts to mobilize external financing.¹²
2. The operational modalities of enhanced surveillance centered on three elements: (i) a quantified macroeconomic program prepared by the authorities in consultation with Fund staff describing major objectives and the supporting policies; (ii) semi-annual consultations to assess progress in implementation, with Board discussion of the related staff reports;¹³ and (iii) the release of staff reports by the member to creditors that were parties to the MYRA.
3. While initiation of enhanced surveillance required Board approval, the procedure did not entail Fund endorsement of the economic program submitted by the member. The reports issued to the creditors were to reflect only the staff's views and were not to contain any reference to the discussions and views of the Executive Board. On/off signals were to be avoided; creditors would need to weigh the information provided to them in order to arrive at a judgment about the economic performance of the country to make their financing decisions. To avoid the need for a clear "off" signal in cases of non-cooperation and unilateral termination by the Fund, Board approval of the procedure was limited to a 12-month period or the time until the next Article IV consultation.

Experience

4. Enhanced surveillance was approved and activated in only six cases: Venezuela (1985), Yugoslavia (1986), and Uruguay (1987) in the context of MYRAs; and Ghana (1992), Bangladesh (1993), and the Gambia (1993) in the context of post-ESAF monitoring. In the latter cases, enhanced surveillance was sought as a means to continue close

¹¹ *The Role of the Fund in Assisting Members with Commercial Banks and Official Creditors* (EBS/85/173, 7/23/85).

¹² *Summing Up by the Chairman, Biennial Review of the Fund's Surveillance Policy, Executive Board Meeting 93/15, January 29, 1993* (SUR/93/15, 2/3/93).

¹³ Interim reports—i.e., between Article IV consultations—were to be issued to the Board for information only.

involvement with the Fund, to boost external and domestic confidence, and to catalyze official financing, following the expiration of an ESAF arrangement.¹⁴

5. In five of the six cases, Directors commenting on the reports prepared under enhanced surveillance expressed concerns about policy slippages and the resulting divergence of views between the authorities and the staff on the needed policy adjustments.¹⁵ In the case of Yugoslavia, commercial bank creditors eventually made further rescheduling contingent on an upper credit tranche arrangement.¹⁶ Similarly, in Bangladesh, Directors considered that only a Fund-supported program with a sufficiently ambitious structural reform agenda could win the confidence of foreign investors.¹⁷ Only in the Gambia was performance under enhanced surveillance as strong as expected, but monitoring was cut short by political developments.

6. In reviewing the experience with enhanced surveillance, Directors expressed concern about the Fund's limited leverage over members' policy implementation, noting policy

¹⁴ In a number of other cases (Mexico, Ecuador), the use of enhanced surveillance was approved by the Board but not activated because subsequent developments led the authorities to request a Fund arrangement.

¹⁵ *The Chairman's Summing Up at the Conclusion of the 1987 Article IV Consultation with Venezuela, Executive Board Meeting 88/2, January 6, 1988 (SUR/88/9, 1/28/88); The Acting Chairman's Summing Up at the Conclusion of the Midyear Consultation with Yugoslavia under Enhanced Surveillance, Executive Board Meeting 86/134, August 8, 1986 (SUR/86/83, 8/14/86) and The Chairman's Summing Up at the Conclusion of the 1987 Mid-year Consultation with Yugoslavia under Enhanced Surveillance, Executive Board Meeting 87/126, August 31, 1987 (SUR/87/92, 9/2/87); The Acting Chairman's Summing Up at the Conclusion of the 1989 Article IV Consultation with Uruguay under the Procedures for Enhanced Surveillance, Executive Board Meeting 89/123, September 12, 1989 (SUR/89/72, 10/3/89); The Chairman's Summing Up at the Conclusion of the 1993 Article IV Consultation with Ghana, Executive Board Meeting 93/99, July 14, 1993 (SUR/93/72, 7/16/93); The Acting Chairman's Summing Up at the Conclusion of the 1994 Article IV Consultation with Bangladesh, Executive Board Meeting 95/11, February 1, 1995 (SUR/95/14, 2/6/95).*

¹⁶ *The Acting Chairman's Summing Up at the Conclusion of the 1987 Article IV Consultation with Yugoslavia, Executive Board Meeting 88/88, June 1, 1988 (SUR/88/49, 6/3/88) and Yugoslavia—Stand-By Arrangement, Decision No. 8884-(88/88), adopted June 1, 1988 (DEC/8884, 6/1/88).*

¹⁷ *The Chairman's Summing Up at the Conclusion of the Midterm Review of the Bangladesh Authorities' Program Monitored under the Enhanced Surveillance Procedures, Executive Board Meeting 94/35, April 15, 1994 (SUR/94/44, 5/3/94).*

slippages and the persistent divergence of views between Fund staff and the authorities on the appropriateness, or the desirable speed, of adjustment measures.¹⁸ Reflecting these concerns, Directors stressed that a strong adjustment record was critical for the approval of enhanced surveillance. However, Directors subsequently felt that selective approval of the procedure may have contributed to creating the appearance of Fund endorsement of the programs monitored. Given this dilemma, Directors concluded that in the absence of balance of payments need, most members would be well served by either endorsement associated with a precautionary arrangement or by more informal staff monitoring.¹⁹

¹⁸ *The Chairman's Summing Up of the Discussion of the Review of Enhanced Surveillance, Executive Board Meeting 89/13, February 8, 1989 (SUR/89/8, 2/13/89).*

¹⁹ *Summing Up by the Chairman: Precautionary Arrangements, Enhanced Surveillance, and Program Monitoring; and Need as a Condition for the Use of Fund Resources, Executive Board Meeting 95/2, January 9, 1995 (SUR/95/2, 1/13/95).*

Fund Monitored Programs: Modalities and Experience

Modalities

1. Fund Monitored Programs (FMPs) were initiated in 1989 to help members resolve their arrears to the Fund in the context of the intensified collaborative approach to overdue obligations. Under FMPs, the Executive Board was expected to endorse the program as being consistent with conditionality in the upper credit tranches, and to agree to monitor progress in implementation based on observance of quarterly targets without committing Fund resources. Observance of program targets served to establish a track record of performance and cooperation prior to the clearance of arrears.²⁰ FMPs were initially used by members that appeared to have good prospects for clearance of their arrears within a relatively short period of time. Subsequently, the FMP approach was further developed into “rights accumulation programs” (RAPs) for members with larger and more protracted arrears to the Fund.²¹

Experience

2. Guyana (1989) and Panama (1990) agreed to FMPs to address their arrears to the Fund. In these cases, the text of the Board decisions following the program approval/reviews contained a standard paragraph indicating that “The Fund has reviewed the program of [country X] and finds that it meets the standards for programs supported by upper credit tranche arrangements from the Fund.” Notwithstanding some policy slippages in Guyana, both countries succeeded in clearing their arrears and had a regular Fund program approved soon thereafter. In addition, there were two near-FMP cases—Somalia (1989) and Zambia (1990)—that differed from regular FMPs in that they did not have adequate financing assurances. In Somalia further progress was subsequently thwarted by political developments; Zambia cleared its arrears under a three-year RAP that followed the FMP. Peru and Sierra Leone have also successfully completed RAPs.²² There have been no new FMPs since the mid-1990s, but the RAP approach continues to be available to members with protracted arrears to the Fund.

3. Reflecting on the experience with FMPs, Directors thought that it might be difficult to maintain the standards of endorsement in the absence of the commitment of Fund resources,

²⁰ *Overdue Financial Obligations to the Fund—Further Consideration of Modalities of the Cooperative Approach* (EBS/89/10, 1/27/89).

²¹ *Overdue Financial Obligations to the Fund—Operational Modalities of the “Rights” Approach* (EBS/90/102, 5/29/90).

²² *Review of the Fund’s Strategy on Overdue Financial Obligations* (EBS/01/122, 7/23/01).

echoing reservations expressed in the past about providing endorsements of programs without committing financial resources.²³

²³ *Concluding Remarks by the Chairman; Short-Term Financing Facility; Executive Board Meeting 94/104, November 30, 1994 (BUFF/94/112, 12/8/94).*

Staff Monitored Programs: Evolution, Modalities and Experience

Evolution and Modalities

1. Informal monitoring by staff evolved in the early 1990s as a means of signaling staff's assessments of members' economic policies outside the regular Article IV consultation cycle (thus effectively supplanting enhanced surveillance) and as a vehicle for helping members establish a track record toward a Fund arrangement.
2. Informal staff monitoring was first addressed by the Executive Board in January 1995 in the context of a discussion on the modalities of the Fund's involvement in member countries outside the framework of a financial arrangement.²⁴ At the time, Directors felt that informal staff monitoring represented a flexible vehicle for meeting members' requests for a more intensive policy dialogue with the Fund and for assistance in translating policy objectives into a quantified macroeconomic framework outside the context of the use of Fund resources. Directors underscored, however, that it was incumbent upon the staff to emphasize to the authorities that Fund endorsement of their policies could only be provided by the Board.
3. The Board revisited the issue of staff monitoring in March 1997 in the context of the biennial review of Fund surveillance.²⁵ Overall, Directors reiterated the views expressed during the 1995 discussion. However, some Directors expressed concern that the public might misinterpret programs monitored by Fund staff as carrying the Funds' "seal of approval." Consequently, they felt that when closer monitoring and policy advice were required in the absence of a balance of payments need, members should be encouraged to make use of precautionary Fund arrangements, which would provide Fund endorsement of the member's policies.
4. In recognition of the need to establish minimum criteria for the content and format of staff monitored programs (SMPs), and to ensure uniformity of treatment across the membership, the staff proposed a framework for the design and implementation of SMPs, which was discussed by the Board in August 1998.²⁶ At the time, Directors reiterated their broad support for SMPs and requested the preparation of a set of guidelines that reflected Directors' views expressed in the discussion. Draft guidelines were discussed by the Board in

²⁴ *Need as a Condition for the Use of Fund Resources* (SM/94/299, 12/16/94).

²⁵ *Biennial Review of the Implementation of the Fund's Surveillance over Members' Exchange Rate Policies and of the 1977 Surveillance Decision* (SM/97/53, 2/19/97).

²⁶ *Staff-Monitored Programs—A Proposed Framework* (EBS/98/137, 8/6/98).

December 1998.²⁷ These draft guidelines became the basis for the modalities of subsequent SMPs (Box A1).

Experience

5. A total of 47 SMPs were agreed prior to the 1998 draft guidelines, of which 15 were signaling SMPs, and 28 SMPs have been agreed since the beginning of 1999, of which 5 were for signaling purposes.²⁸ Currently, there are four active track record SMPs (the Republic of Congo, Sao Tome and Principe, Sudan, and Yemen) and one active signaling SMP with Jamaica.

6. The Board reviewed the experience with the post-1998 SMPs in the context of the 2002 biennial review of Fund surveillance.²⁹ During this discussion, Directors generally agreed that SMPs constitute a useful vehicle for closer monitoring of a member's policies outside a Fund arrangement.³⁰ While noting significant improvements in the design and documentation of SMPs since the discussion of the 1998 draft guidelines, Directors felt that reporting on performance under SMPs had been uneven, which was of particular concern in cases where the SMP was intended to provide signals to official and/or private creditors (Table A1).

²⁷ *Staff-Monitored Programs—Follow-Up and Guidance to the Staff* (EBS/98/201, 11/25/98).

²⁸ In addition, there were two SMPs with non-members: Faroe Islands in 1992-93 and Netherlands Antilles in 1997.

²⁹ *Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision—Overview* (SM/02/82, 3/14/02).

³⁰ *Minutes of Executive Board Meeting 02/37* (EBM/02/37, 6/12/02).

Table A1. Signaling SMPs: Reporting on Initiation and Performance 1/

	Reporting on initiation of SMP		Reporting on performance assessment		
	Publication of LOI/MEFP	Publication of Article IV staff report reporting on initiation of SMP	Coverage in Article IV staff report 2/	Publication of the Article IV staff report containing performance assessment	Publication of mission concluding statement on SMP performance
Jamaica (2000) original program	Stand alone	No Article IV that year	Limited, 2001 Article IV	Yes	No
Jamaica (2000) first revision 3/	Revised SMP targets	n.a.	No	No	No
Jamaica (2000) second revision 4/	Revised SMP targets	n.a.	Extended, 2002 Article IV 5/	Yes	No
Trinidad and Tobago (2000)	Stand alone	No Article IV that year	Limited, 2001 Article IV	Yes	No
Paraguay (2001)	Stand alone	Yes, LOI/MEFP attached	No	No	No
Slovak Republic (2001)	Stand alone/news brief	Yes	Limited, 2002 Article IV	Yes	Yes, after each review
Jamaica (2002)	Stand alone	Yes, LOI/MEFP attached	Mid-term review scheduled for November 2002 did not take place		

Source: Policy Development and Review Department

1/ Covering only signaling SMPs that were initiated after the 1998 draft guidelines.

2/ "Limited" indicates that the coverage is limited to brief factual statements throughout the report without elaborating on the factors underlying deviations from the program targets in the context of policy discussions or, in some cases, without referring to the targets or including them in the report. "Extended" indicates a more comprehensive assessment of performance relative to the targets along with a discussion of the reasons for under/over performance.

3/ May 2001

4/ December 2001

5/ In light of the discussion on SMPs during the 2002 biennial surveillance review, the Article IV staff report contained a more comprehensive discussion of performance under the SMP relative to the second revision, with the first revision to the original program targets relabeled as original program.

Box A1. Modalities of Staff-Monitored Programs

The framework for SMPs is outlined in the draft guidelines of 1998. While these guidelines recognize the dual purpose of SMPs, their provisions apply to all SMPs, irrespective of the specific purpose.

Program content. Members' policies under an SMP do not have to meet the standards of upper credit tranche conditionality, but the guidelines contain broadly defined quality standards. In the case of track-record SMPs, program content and monitoring are to resemble closely, or build toward, the target arrangement. Under signaling SMPs, policies are expected to be sufficiently strong to "maintain or improve the member's medium-term economic outlook and external viability."

Program length and frequency of monitoring. SMPs should cover a minimum of 6 months and two test dates, and should normally not extend beyond 12-18 months, although a longer duration is not explicitly ruled out.

Documentation. A memorandum on economic and financial policies (MEFP) specifying the authorities' objectives and policies, as well as quantitative and structural benchmarks, is expected.

Communication to the Board. If an SMP is initiated during an Article IV consultation, the content and purpose of the program are to be described in the Article IV staff report, which should attach the MEFP. If the request for an SMP is received between Article IV consultations, a stand-alone paper including the MEFP may be circulated to the Board for information; alternatively, staff may inform the Board during an informal country matters session and circulate the MEFP together with the next Article IV staff report.

Reporting on performance. Assessments of performance under an SMP should be included in Article IV staff reports and subsequent requests for Fund resources, but there are no standards for the breadth and depth of such assessments.

Communication to the public. The authorities are encouraged to publish their MEFP and to request a PIN following the conclusion of an Article IV consultation held during or after an SMP. In addition, release of the staff's regular assessments of performance under an SMP is encouraged. Article IV staff reports reporting on the initiation of, or performance under, an SMP are subject to the Fund's policy of voluntary publication.

“Comfort Letters”—Background and Practices

1. Under the World Bank’s internal operational policy governing Bank adjustment lending, such lending is undertaken only when an appropriate macroeconomic framework is in place. Presence of a Fund arrangement is considered an important input in this determination. In the absence of a Fund arrangement, Bank staff is required to ascertain, before making their own assessment, whether Fund staff has any major outstanding concerns about the adequacy of the country’s policy.³¹ Other major multilateral development banks (MDBs) and official creditors (such as the E.U. Commission) have similar internal requirements for the approval of loans and subsequent tranching disbursements.
2. When requested, such assessments have typically been provided by the Fund’s area departments by means of so-called “comfort letters.” However, there are no established standards or procedures to guide the preparation and provision of comfort letters; in the absence of guidelines, a variety of approaches have been followed, particularly with respect to content, as well as review and clearance procedures. An overview of examples of “comfort letters” produced in recent years suggests that in some cases neither management approval nor review by PDR was sought and letters were sent directly by the area department (Table A2). Many of the letters provided to MDBs included indirect—and some direct—endorsements of the lending operation under consideration. This has typically been done by reiterating the importance of the loan in question for the achievement of certain policy objectives, and by indicating that these objectives are part of a current or prospective Fund arrangement.

³¹ The World Bank’s internal operational policy on adjustment lending is described in the Bank’s Operational Directive OD8.60 of 1992.

Table A2. Recent Experience with "Comfort Letters"

Country	From	To	For	Reviewed by PDR	Sent to Management	Content	Summary Judgment
Argentina, August 2002	WHD	IDB	To support the disbursement of IDB's social sector loan.	Yes	For approval	Described the status of discussions with the authorities of an economic program that could be supported by Fund resources, including the status of key outstanding policy issues.	Stated that the disbursement of the IDB loan would help the authorities manage their external situation and streamline social expenditures.
Bolivia, December 2002	WHD	IDB	To support the disbursement of IDB's social sector loan.	Yes	Yes	Described the status of discussions with the authorities towards a new PRGF, including the status of key outstanding policy issues.	Stated that the second disbursement of the IDB loan would provide the authorities with the needed budget financing.
Bolivia, May 2002	WHD	World Bank	To support continued disbursements of a number of structural adjustment credits.	Yes	For approval	Described the status of relations with the Fund. Indicated that the Fund PRGF program was off track and was replaced by informal monitoring based on quantitative and structural benchmarks. Indicated that the informally monitored program was "on track".	Stated that the Fund's BOP projections and official reserve targets were based on the assumption of continued disbursements of the World Bank adjustment credits. Stated that the continued disbursement of those credits would provide the authorities with the needed budget financing.
Bolivia, December 2001	WHD	IDB	To support the disbursement of IDB's social sector loan.	Yes	No	Described the objectives of the PRGF program supported by the Fund, recent developments, and the status of relations with the Fund. Indicated that program review did not take place.	Stated that the IDB loan would provide the authorities with the needed budget financing.
Honduras, August 2001	WHD	IDB	In connection with the IDB Executive Board consideration of interim relief and a number of loans for Honduras.	Yes	For approval	Described economic performance during the period covered by PRGF and the status of relations with the Fund. Indicated that the program was off track due to lack of progress on structural reforms.	None
Mauritius, April 2002	AFR	World Bank	In connection with the World Bank Executive Board meeting on a Public Expenditure Reform Loan for Mauritius.	Yes	For information, after the letter was sent to the World Bank.	Provided Fund assessment of the macroeconomic situation and the sustainability of fiscal policies along the lines of the most recent Article IV staff report. Stated that the staff was encouraged by the authorities resolve and heartened by the public pronouncements in the fiscal area.	Contained no reference to the World Bank loan in question.
Niger, August 2000	AFR	World Bank	To support Bank approval of Public Finance Recovery Credit	?	?	Described the status of negotiations on a new PRGF program and the main fiscal objectives.	Stated that the World Bank support under the proposed credit would help the authorities achieve poverty reduction strategy as a key requirement for a prospective Fund program.
Niger, December 2000	AFR	European Commission	To support disbursement of budgetary assistance from the European Union ahead of the Board meeting on Niger's request for PRGF and HIPC decision point.	Yes	For approval	Described recent developments and the status of relations with the Fund. Indicated that Management would recommend, and the Board was expected to approve the PRGF request and the decision on the HIPC decision point.	Stated that exceptional financing from the EU before the Board approval would allow the authorities to implement their poverty reduction strategy.

Table A2. Recent Experience with "Comfort Letters"

Country	From	To	For	Reviewed by PDR	Sent to Management	Content	Summary Judgment
Zambia, December 1998	AFR	World Bank	To provide the basis for World Bank to go forward with the preparation of a Public Sector Reform and Export Promotion Credit for Zambia.	Yes	For information, after the letter was sent to the World Bank.	Presented an assessment of the macroeconomic situation and summarized the understanding reached with the authorities ad referendum on a program that could be supported by the Fund. Provided the timing and detail of structural reform measures necessary for the presentation to the Fund's Board of the authorities' request for an ESAF arrangement.	Stated that the World Bank support through the proposed credit would assist the authorities in the privatization of the ZCCM which was a key requirement for a prospective Fund program.
Zambia, April 2000	AFR	World Bank	To indicate a non-objection to the disbursement by the World Bank of a second tranche of its Public Sector Reform and Export Promotion Credit.	Yes	No	Acknowledged that the Fund was not in a position to complete its review of Zambia's PRGF.	Stated in the opening sentence that the Fund staff would have no objections to the disbursement of the World Bank credit.
Moldova, April 2002	DMD	Bond holders 1/	At the authorities request, to enhance the prospects for and conditions of the bond restructuring.	Yes	n.a.	Summarized the current status of negotiations for completing a PRGF review.	Stated that financial support from the private creditors was essential for the sustainability of Moldova's external position.
Russia, June 2000	MD	Bond holders 1/	At the authorities request, to support the proposed bond restructuring on terms consistent with Russia's return to medium term external viability.	?	n.a.	Described recent developments, the economic program of the government, and the status of relations with the Fund.	Stated that the proposed bond exchange warranted the support of the international community.
Pakistan, November 1999	MD	Bond holders 1/	At the authorities request, to support the proposed bond restructuring to ensure sufficient program financing and burden sharing among various creditors.	Yes	n.a.	Described Pakistan's macroeconomic adjustment and structural reform program supported by the Fund.	Urged the international community to support the proposed bond exchange.
Ecuador, July 2000	MD	Bond holders 1/	At the authorities request, to support the proposed bond restructuring to bring Ecuador's payment obligations in line with its medium-term payment capacity.	Yes	n.a.	Described key policy elements of the program supported by the Fund as well as performance under the program.	Urged the international community to support the proposed bond exchange.

Source: Policy Development and Review Department.

1/ The letter was attached to the Bond Exchange Offer.