

Web Document 4.B: Operational Guidance to the Staff

Beginning in 1991, the Executive Board approved a series of notes to guide the staff in the conduct of surveillance activities. Much of the 1991 note dealt with procedural matters, but paragraphs 3 and 7 specified priorities for the coverage of issues in Article IV and other surveillance reports.

Staff Operational Guidance Note, February 1991*

1. The Executive Board confirmed the principle of annual consultations with all members, including under the bicyclic procedure.¹ In all cases, consultation discussions between the staff and the authorities will result in a staff report to be submitted for consideration by the Executive Board. In the case of staff reports for interim Article IV consultations under the bicyclic procedure, the Board may discuss the staff report or complete the consultation without discussion and without reaching conclusions. In all other cases, the Executive Board will reach conclusions which would be reflected in a summing up of the discussions.

2. Staff reports on interim Article IV consultations will be circulated to the Executive Directors and a tentative date for possible Executive Board discussion will be indicated in the covering note. However, unless there is a request from an Executive Director for a discussion of the report or the Managing Director places the report on the agenda of the Executive Board within two weeks of its circulation, the interim consultation with the member will have been completed without discussion. In such a case, the Executive Board decision completing the consultation will take note of the staff report, but will not endorse or approve the conclusions contained in the appraisal section of the staff report. The decision will become effective on the expiration of the two-week period following the circulation of the staff report to the Executive Directors.

3. Staff reports will focus in each case on the core areas of surveillance over exchange rate policies, within the framework of macroeconomic and related structural policies, and will examine whether these policies are conducive to the achievement of reasonable price stability, sustainable external positions, and orderly economic growth.

*Minutes of EBM/91/15 (February 8, 1991), pp. 13–15.

¹Except those countries under an 18- or 24-month cycle. Under the previous bicyclic procedure, consultations were held every two years and a report on interim discussions between the staff and the authorities was circulated to the Executive Board for information. Under this modified bicyclic procedure, the Executive Board will conclude consultations with the member on the basis of the interim discussion reports.

Beyond this coverage of the core policy areas, the staff should exercise judgment regarding the scope of consultation reports, and selectivity rather than uniformity of coverage of subjects will be encouraged.

4. The staff should attempt to streamline a consultation report, especially if the circumstances of the country have not changed significantly from the previous year. More in-depth reporting should be provided where significant changes have occurred in policy or external circumstances since the last staff paper or in cases where it is judged that policy issues need to be covered in greater depth or wider scope. In any event, a comprehensive staff report would be expected for each member at least once every two years. For countries using Fund resources, consultation reports will be folded into the other reports prepared in connection with the use of Fund resources to the fullest extent possible. Special efforts will be made to shorten and focus as much as possible the interim reports under the bicyclic procedure. All reports will be kept concise.

5. Generally, the paper on recent economic developments (RED) would be issued every other year, unless the staff and the authorities deem it appropriate to issue more frequent REDS. This may be the case especially where such reports would be helpful to the member in formulating its own policies or in obtaining external support. Analytic papers or reports on special topics could be presented at any time.

6. The *World Economic Outlook* will continue to evolve as the multilateral framework for bilateral surveillance, as well as the basis for integrating the analysis of individual countries, including in particular the seven major industrial countries, into a larger multilateral contest.

7. The staff will endeavor to strengthen the coverage of regional and cross-country issues, particularly in the context of the WEO, but also, where appropriate, in consultation or special reports.

*In April 1995, the Executive Board adopted a new guidance note, incorporating much of the language of the original. Some technical changes were required, because the bicyclic procedure had been abandoned in the interim. On substance, the three major changes were to require a more explicit treatment of exchange rate issues, an examination of the linkages between financial sector problems and macroeconomic performance, and a report on any crucial data deficiencies. Paragraphs 2 and 7 of the 1991 note were replaced with these two:**

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2. Staff reports will focus in each case on the core areas of surveillance over exchange rate policies, within the framework of macroeconomic and related structural policies, and will examine whether these policies are conducive to the achievement of reasonable price stability, sustainable external positions, and orderly economic growth.

*"Reviews of Surveillance," SM/95/22, Suppl. 3 (April 17, 1995), Attachment II.

Reports will include a candid assessment of the behavior of members' exchange rates and their exchange rate policies based on an evaluation of balance of payments developments, including the size and sustainability of capital flows, against the background of reserves and indebtedness. Where appropriate, reports will include assessments of financial market developments and their implications for macroeconomic policies and performance. The staff will endeavor to strengthen the coverage of international and regional issues in staff reports and include cross-country comparisons where appropriate. Beyond the coverage of the core policy areas, the staff should exercise judgment regarding the scope of consultation reports, and selectivity rather than uniformity of coverage of subjects will be encouraged.

3. Given the importance of high quality, methodologically and inter-sectorally consistent and timely data for the exercise of effective surveillance, the staff will draw to the attention of the Board those cases where deficiencies in data quality and/or lack of timely reporting are hampering effective ongoing surveillance and provide recommendations for improvement.

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In July 1997, a new guidance note was issued, with more detail on both procedures and substance. That note remained in effect for the next five years. The main emphasis was to encourage a more frank presentation of major policy issues, especially exchange rate policies. The following two paragraphs effectively replaced those in the 1995 note reproduced above.

3. Staff reports should focus on the core areas of surveillance over exchange rate, macroeconomic, and related structural policies, and examine whether, in the light of the country's situation, these policies are conducive to the achievement of reasonable price stability, sustainable external positions, and economic growth. Reports should include a candid assessment of a member's exchange rate and exchange rate policy, based on an evaluation of balance of payments developments, including the size and sustainability of capital flows, against the background of reserves and external indebtedness. The assessment should be made within the framework of a comprehensive analysis of the general economic situation, recognizing that domestic macroeconomic as well as exchange rate policies have an impact on the balance of payments. Reports should include assessments of financial market developments and prospects as well as problems and policy issues in the banking and financial sector where they are of macroeconomic significance. Where relevant, the staff should also examine current and capital account measures. Beyond the coverage of the core policy areas, the staff should take into account management guidance on the coverage of other issues. Overall, the staff is expected to exercise judgment regarding the scope of consultation reports, applying selectivity rather than uniformity of coverage. For members of regional or systemic importance, staff reports should focus on the international as well as the domestic implications of members' policies; reports would be expected to include cross-country comparisons where appropriate. For members of regional economic or monetary unions

whose union-level policies have significant economic implications, the staff would conduct periodic discussions, generally once a year, assessing the policies at the level of the union. The staff is expected to report periodically on these discussions to the Board.

4. Staff reports should give a candid assessment of the impact of deficiencies in the timeliness and/or quality of data provided to the Fund on the staff's ability to conduct effective surveillance. Staff reports should also provide the staff's recommendations for improvement, where necessary, including recommendations for technical assistance. Where relevant, staff reports should discuss progress in the implementation of recent technical assistance recommendations in statistics.

Also in July 1997, the Executive Board approved a separate guidance note on the Fund's role in addressing governance problems in member countries (EBS/97/125, July 2, 1997). The following excerpts pertained, at least in part, to the introduction of such issues in bilateral surveillance.

Responsibility for Good Governance

4. The responsibility for governance issues lies first and foremost with the national authorities. The staff should, wherever possible, build on the national authorities' own willingness and commitment to address governance issues, recognizing that staff involvement is more likely to be successful when it strengthens the hands of those in the government seeking to improve governance. However, there may be instances in which the authorities are not actively addressing governance issues of relevance to the IMF. In such circumstances, the staff should raise their specific concerns in this regard with the authorities and point out the economic consequences of not addressing these issues.

Aspects of Governance of Relevance to the IMF

5. Many governance issues are integral to the IMF's normal activities. The IMF is primarily concerned with macroeconomic stability, external viability, and orderly economic growth in member countries. Therefore, the IMF's involvement in governance should be limited to economic aspects of governance. The contribution that the IMF can make to good governance (including the avoidance of corrupt practices) through its policy advice and, where relevant, technical assistance, arises principally in two spheres:

- improving the management of public resources through reforms covering public sector institutions (e.g., the treasury, central bank, public enterprises, civil service, and the official statistics function), including administrative

procedures (e.g., expenditure control, budget management, and revenue collection); and

- supporting the development and maintenance of a transparent and stable economic and regulatory environment conducive to efficient private sector activities (e.g., price systems, exchange and trade regimes, and banking systems and their related regulations).

6. Within these areas of concentration, the IMF should focus its policy advice and technical assistance on areas of the IMF's traditional purview and expertise. Thus, the IMF should be concerned with issues such as institutional reforms of the treasury, budget preparation and approval procedures, tax administration, accounting, and audit mechanisms, central bank operations, and the official statistics function. Similarly, reforms of market mechanisms would focus primarily on the exchange, trade, and price systems, and aspects of the financial system. In the regulatory and legal areas, IMF advice would focus on taxation, banking sector laws and regulations, and the establishment of free and fair market entry (e.g., tax codes and commercial and central bank laws). In other areas, however, where the IMF does not have a comparative advantage (e.g., public enterprise reform, civil service reform, property rights, contract enforcement, and procurement practices), the IMF would continue to rely on the expertise of other institutions, especially the World Bank. But, consistent with past practice, policies and reforms in these areas could, as appropriate, be part of the IMF staff's policy discussions and conditionality for the IMF's financial support where those measures were necessary for the achievement of program objectives.

7. Although it is difficult to separate economic aspects of governance from political aspects, confining the IMF's involvement in governance issues to the areas outlined above should help establish the boundaries of this involvement. In addition, general principles that are more broadly applicable to the IMF's activities should also guide the IMF's involvement in governance issues. Specifically, the IMF's judgments should not be influenced by the nature of a political regime of a country, nor should it interfere in domestic or foreign politics of any member. The IMF should not act on behalf of a member country in influencing another country's political orientation or behavior. Nevertheless, the IMF needs to take a view on whether the member is able to formulate and implement appropriate policies. This is especially clear in the case of countries implementing economic programs supported by the IMF from the guidelines on conditionality that call on IMF management to judge that "the program is consistent with the IMF's provisions and policies and that it will be carried out." As such, it is legitimate for management to seek information about the political situation in member countries as an essential element in judging the prospects for policy implementation.

Criteria for IMF Involvement

8. The IMF's mandate and resources do not allow the institution to adopt the role of an investigative agency or guardian of financial integrity in member countries, and

there is no intention to move in this direction. The staff should, however, address governance issues, including instances of corruption, on the basis of economic considerations within its mandate.

9. In considering whether IMF involvement in a governance issue is appropriate, the staff should be guided by an assessment of whether poor governance would have significant current or potential impact on macroeconomic performance in the short and medium term and on the ability of the government credibly to pursue policies aimed at external viability and sustainable growth. The staff could draw upon comparisons with broadly agreed best international practices of economic management to assess the need for reforms.

10. As regards possible individual instances of corruption, IMF staff should continue raising these with the authorities in cases where there is a reason to believe they could have significant macroeconomic implications, even if these effects are not precisely measurable. Such implications could arise either because the amounts involved are potentially large, or because the corruption may be symptomatic of a wider governance problem that would require changes in the policy or regulatory framework to correct. Instances could include, for example, the diversion of public funds through misappropriation, tax (including customs) fraud with the connivance of public officials, the misuse of official foreign exchange reserves, or abuse of powers by bank supervisors that could entail substantial future costs for the budget and public financial institutions. Corrupt practices could also occur in other government activities, including the regulation of private sector activities that do not have a direct impact on the budget or public finances, such as ad hoc decisions made in relation to the regulation of foreign direct investment. Such practices would be counter to the IMF's general policy advice aimed at providing a level playing field to foster private sector activity.

11. Instances of corruption that do not meet the threshold of having significant macroeconomic implications are best addressed through the IMF's efforts to promote transparency and remove unnecessary regulations and opportunities for rent seeking consistent with the broad principles that apply to other issues of economic governance. Staff recommendations could include improvements in government management processes and systems that would have the beneficial side effect of preventing a recurrence of corrupt practices or advice to the authorities to seek the assistance of competent institutions for advice in these areas.

Modalities of IMF Involvement in Governance Issues

12. Governance issues are relevant to all member countries, although the problems differ depending on economic systems, institutions, and the economic situation. The mode of IMF involvement will have implications for the manner in which governance concerns are addressed by staff in different member countries. Nonetheless, whatever the mode of involvement, the IMF's main contribution to improving governance in all countries—both countries receiving financial support from the IMF and other countries—will

continue to be through support for policy reforms that remove opportunities for rent-seeking activities and through sustained efforts to help strengthen institutions and the administration capacity in member countries.

Article IV Consultation Discussions

13. In Article IV consultation discussions, the staff should be alert to the potential benefits of reforms that can contribute to the promotion of good governance (e.g., reduced scope for generalized rent seeking, enhanced transparency in decision-making and budgetary processes, reductions in tax exemptions and subsidies, improved accounting and control systems, improvements in statistical dissemination practices, improvements in the composition of public expenditure, and accelerated civil service reform). The potential risk that poor governance could adversely affect private market confidence and, in turn, reduce private capital inflows and investment—even in countries enjoying relatively strong growth and private capital inflows—should also be brought to the attention of the authorities. IMF policy advice should also make use of the broad experience of countries with different economic systems and institutional practices and be based on the broadly agreed best international practices of economic management and on the principles of transparency, simplicity, accountability, and fairness. In the case of international transactions that involve corruption, the staff should pay equal attention to both sides of corrupt transactions and recommend that such practices be stopped if they have the potential to significantly distort economic outcomes (e.g., the tax deductibility of bribes in member countries or certain operations of official agencies). Where poor governance with a significant economic impact is evident and brought to the staff's attention in its surveillance activities, the staff should discuss the issue with the authorities.

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