

THE CHAIRMAN'S SUMMING UP

IEO REPORT ON THE EVALUATION OF THE IMF EXCHANGE RATE POLICY ADVICE, 1999–2005

**Executive Board Meeting
May 9, 2007**

Executive Directors welcomed the report by the Independent Evaluation Office (IEO) assessing the Fund's exchange rate policy advice during the evaluation period 1999–2005. The evaluation provides a wealth of information on the strengths and weaknesses of the Fund's exchange rate policy advice. Directors strongly concurred with the statement by the Managing Director that exchange rate policy advice lies at the core of the Fund's mandate, and that the IEO evaluation will be an important input into ensuring that the Fund remains responsive to the rapidly evolving world economy.

Directors broadly endorsed the IEO's conclusion that during 1999–2005 the Fund was not as effective as it needs to be in some important aspects of the Fund's exchange rate policy advice, and that the Fund should aim at enhancing the effectiveness of its analysis, advice, and dialogue with member countries, as well as address any perception of asymmetry in its exchange rate surveillance. Directors stressed the shared responsibility of the Board, management, and staff—as well as national authorities—in carrying forward these objectives and in responding constructively and openly to the challenges laid out in the report.

Directors recognized that the practice of exchange rate surveillance is constrained by the intrinsic complexity of exchange rate analysis. This includes the conceptual and practical difficulties in estimation, the lack of empirical models that are applicable or appropriate in all cases, and the constant evolution of exchange rate regimes and financial markets. In this respect, some Directors felt that these constraints had not been adequately taken into account by the IEO evaluation.

Directors noted that, for many countries, progress has been made in recent years in strengthening the Fund's coverage of exchange rate policy issues, including in particular in its focus and analytical content. Directors noted that, since the end of the evaluation period, a further strengthening of exchange rate surveillance has been identified as a priority in the implementation of

the Fund's Medium-Term Strategy, and pointed to the initiatives under way to enhance the effectiveness of the Fund's work in this area. Against this background, Directors had an extensive and frank discussion of the report's assessments, findings, and recommendations, and several were of the view that further measures would need to be considered in response to the report.

Rules of the Game and Guidance to Staff

Most Directors concurred with the IEO's finding that the rules of the game for exchange rate surveillance remain unclear in some important areas, and that this lack of clarity can impair the effectiveness of the Fund's engagement with members, as well as management's and staff's ability to fulfill their responsibilities. Accordingly, most Directors agreed with the IEO's recommendation that a revalidation of the fundamental purpose of surveillance is an important goal, although views differed on the best vehicle through which this revalidation could occur. In this connection, most Directors noted that the update of the 1977 Decision currently under way should help toward achieving the goal of revalidating the objectives of surveillance. Some Directors stressed that such a revalidation would also enable members to clarify their commitments in the realm of exchange rate policy, as called for by the report. Some Directors suggested that a periodic statement of priorities and responsibilities would usefully complement a revised Decision. A number of Directors were not convinced that an updated Decision is needed, and considered that the rules of the game would best be clarified through a compendium of best practices or similar tools. Several Directors stressed the importance of strengthening the implementation of Fund surveillance over exchange rate policies.

Directors took note of the IEO's call to develop clear practical policy guidance on certain key analytical issues. They had diverse views regarding the need for such guidance and on the feasibility of developing it. To provide an updated framework for guidance to staff and given the Board's responsibility for oversight over the international monetary system, a number of Directors saw merit in a Board discussion on the stability of the system of exchange rates, similar to the one undertaken in 1999. A number of other Directors, however, noted that the *WEO* already provides a useful platform for such an assessment. Many Directors saw the need for practical policy guidance on specific aspects of exchange rate policy advice, while some Directors underscored the practical difficulties in formulating such guidance. Although many Directors noted that Fund staff is at the forefront of research in this difficult area, more effort needs to be put into integrating cutting-edge techniques into the Fund's country work, and in disseminating such knowledge within the Fund. Some Directors also underscored the practical difficulties in formulating guidance and the limitations in prescribing optimal reserve levels. Other Directors saw scope for guidance, particularly on intervention. On balance, Directors encouraged staff to discuss the uses and limits of intervention whenever relevant from the macroeconomic perspective in Article IV consultations, bearing in mind the importance of flexibility and of tailoring advice to country circumstances and of avoiding an overly prescriptive approach. Efforts will also be needed to ensure greater consistency across the membership in this area.

Policy Dialogue

Directors discussed extensively the IEO's recommendation that management should give much greater attention to ensuring effective dialogue with country authorities. It was noted that the IEO survey showed that national authorities across all country groups were generally satisfied with the policy dialogue with the Fund, and that a majority felt that the Fund had played the roles of confidential advisor and intellectual partner adequately. Nevertheless, the evidence provided by the IEO evaluation supports the conclusion that many countries seek still greater value added from their dialogue with the Fund. It was noted in this context that both Fund staff and management and country authorities have a responsibility to engage constructively in surveillance discussions. In particular, country authorities should be sufficiently forthcoming in the provision of information to allow surveillance to be effective. Directors agreed that there remains scope to explore further ways to improve the dialogue with member countries, and to address any perception of lack of evenhandedness. They underscored in this context the considerable

importance of ensuring that the relationship between the Fund and member countries—as well as the Fund's policy advice—is, and is perceived to be, evenhanded, and called for further efforts in this area.

Directors agreed with the recommendation that management has a key role to play in ensuring effective dialogue with the authorities, and that this is no less important than developing the right advice. Directors encouraged management to give consideration to the IEO recommendations in this area, particularly to a strategic approach to identifying opportunities to improve the effectiveness of the dialogue. Ensuring that missions have the right mix of skills and expertise, in particular, was seen by many as requiring further efforts. Staff should be encouraged to raise controversial issues with the authorities, to better understand the viewpoint of national authorities, and to ensure evenhandedness.

Implementing Existing Policy Guidance

Directors concurred with the IEO that, over the review period, there had been problems in implementing various aspects of existing policy guidance. Most Directors agreed that there remains scope for improvement in several areas.

Directors reaffirmed the importance of a clear description of the *de facto* exchange rate regime. Many Directors also underscored the need to better understand the factors underlying differences between the *de facto* and *de jure* classifications. Regarding the assessment of members' choices of exchange rate regimes, Directors saw scope for more candid staff assessments while avoiding a mechanistic approach. Directors noted the report's finding that staff advice in recent years has leaned toward increased exchange rate flexibility. In general, Directors agreed that staff's views on a member's choice of exchange rate regime should, whenever warranted, be explicitly underpinned by more comprehensive analytical discussion of the pros and cons, taking into account country circumstances, the authorities' views, and implementation issues when macroeconomically relevant. Staff advice should be informed by the Fund's considerable cross-country experience.

Directors welcomed the finding that analysis of exchange rate levels had improved, although in several cases there remained scope for improvement in the quality of the analysis. Many noted positively that staff's work in this area had been strengthened in recent years, with more sophisticated analytical tools being applied—including with respect to the emerging markets. At the same time, Directors recognized that methodological uncertainties remain daunting in this area, and should not be discounted in Fund assessments of exchange rate levels. Directors generally agreed with

the IEO that the Fund should stay at the forefront of developing the analytical framework in this area, including with respect to developing countries. Several Directors advocated caution in the Fund's public communications on its findings on equilibrium exchange rates and misalignments, including those based on CGER assessments. In this context, a few Directors cautioned against overreliance on model-based estimates of equilibrium exchange rates.

Directors underscored the importance of better incorporating the analysis of policy spillovers into regional and bilateral surveillance and welcomed the initiatives recently taken in this area under the aegis of the Medium-Term Strategy.

Directors expressed concern at the IEO report's finding that data availability remained a challenge in many cases, and welcomed the recommendation to consider further the scope of the problem and possible remedies. Thus, they looked forward to the upcoming review of data provision to the Fund.

Management of Work on Exchange Rates

Directors agreed with the recommendation that management should ensure that exchange rate work across the Fund is organized and managed effectively, in tandem with ongoing work to integrate financial sector issues into Fund surveillance. They encouraged further strengthening of the existing coordinating mechanisms (including the Surveillance Committee and the CGER), as envisaged by the Medium-Term Strategy.

Confidentiality and Role of the Executive Board

Directors considered the concerns received by the IEO regarding the potentially difficult trade-offs between staff's and management's role as confidential and trusted advisor—and the critical importance of ensuring that the Executive Board has all the information that it needs to enable it to carry out its surveillance responsibilities. Indeed, because it is the Executive Board that is ulti-

mately responsible for the conduct of surveillance, many Directors had concerns with the IEO suggestion to have an independent party periodically review Fund staff activities that are not reported to the Board. Most Directors emphasized that management is responsible for providing the Executive Board with all the information that it needs to conduct surveillance, and is accountable to the Executive Board for how it combines this duty with the need for the staff and management to serve as a confidential advisor to members.

Facilitating Multilateral Policy Coordination

Directors noted the IEO's finding that the Fund had not explored sufficiently, over the evaluation period, the scope for countries to act in concert to deal with global payments imbalances. Most Directors considered multilateral consultations to be a useful addition to the surveillance toolkit because they helped to improve policymakers' understanding of each other's objectives. In this context, they took note of the recent multilateral consultation on global imbalances, under which policy plans set out by the participants represent further progress with the shared responsibility for the implementation of the International Monetary and Financial Committee strategy.

Follow-Up

Directors looked forward to considering soon a follow-up implementation plan to be prepared by staff in line with the guidance from today's discussion. Given the initiatives directly relevant to the IEO findings launched under the Medium-Term Strategy, as well as the resource constraints, Directors felt that the implementation plan should be comprehensive, while leveraging existing and planned initiatives to the greatest possible extent to address the IEO recommendations endorsed by the Board. In this respect, some Directors suggested that follow-up actions may require the reallocation of resources from areas less central to the Fund's mandate.