

INTERNATIONAL MONETARY FUND

Implementation Plan in Response to Board-Endorsed Recommendations Arising from the IEO Report on The Evaluation of IMF Exchange Rate Policy Advice, 1999-2005

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In consultation with other Departments

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I. INTRODUCTION

1. **This paper presents an implementation plan that responds to the Board-endorsed recommendations in the IEO Report on the Evaluation of the IMF's Exchange Rate Policy Advice, 1999-2005** ("the IEO Report").¹ The IEO recommendations and the views of the Executive Board are summarized in Section II, followed by descriptions of implementation plans (Section III) and the projected resource cost associated with the implementation plan (Section IV).

2. **Enhancing the effectiveness of the Fund's exchange rate surveillance is a key priority under the Fund's Medium-Term Strategy (MTS), and the IEO report will help further strengthen efforts in this area.** The MTS initiatives include the recent adoption of a new Decision on Bilateral Surveillance, sharpening the toolkit for exchange rate analysis, better integration of financial sector analysis in surveillance, and the use of multilateral consultations as a new vehicle for surveillance. In drawing up the implementation plan, staff has built on the existing MTS initiatives and on other initiatives already in train that are broadly aligned with the IEO Report's recommendations.

II. IEO RECOMMENDATIONS AND BOARD REACTIONS

3. **The IEO report made wide-ranging recommendations on the Fund's exchange rate work.** The recommendations covered five categories: the rules of the game and guidance to staff, implementation of existing policy guidance, management of work on

¹ *Evaluation of IMF Exchange Rate Policy Advice, 1999-2005*, Independent Evaluation Office, 2007, and *The Chairman's Summing Up—the IEO Report on The Evaluation of IMF Exchange Rate Policy Advice, 1999-2005*. (both documents are available from the IEO's website)..

exchange rates, confidentiality and Executive Board oversight, and facilitating multilateral policy coordination (Table). The key recommendations included:

- Clarify the rules of the game for the IMF and member countries
- Develop practical policy guidance on key analytical issues
- Management to give more attention to ensuring effective dialogue with authorities
- Resolve inconsistencies and ambiguities in exchange regime classification
- Back up advice on exchange rate regimes with more analytical work
- Stay at the forefront of developing analytical framework for assessing exchange rate levels, and translating existing methodologies into relevant advice in policy discussions
- Identify and address weaknesses in data provision
- Develop and implement guidance for the integration of spillovers into bilateral and regional surveillance
- Better focus to the analytical work on exchange rates
- Better understanding on the use and sharing confidential information with the Board in Article IV consultations
- Strategic focus on opportunities for potential multilateral concerted action.

4. **The Board broadly endorsed most of the IEO report’s recommendations** (see Table), although Directors had diverse views on some of the IEO’s specific proposals. Directors stressed “the shared responsibility of the Board, management, and staff—as well as national authorities” in enhancing the effectiveness of IMF’s exchange rate policy advice, and in “responding constructively and openly to the challenges laid out in the [IEO] report.”

Table. Summary of IEO Recommendation, Directors' Response, and Follow-up Plan

IEO recommendation/finding	Board Discussion	Follow up plan
<i>I. Rules of the Game and Guidance to Staff</i>		
I.1 Clarify the rules of the game for the IMF and its member countries	“Most Directors agreed ... 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.”	Adoption of the 2007 Decision on Bilateral Surveillance.
I.2 Practical policy guidance should be developed on key analytical issues. Two priorities would be on the stability of the system and on the use and limits of intervention.	<p>Directors “had diverse views regarding the need for such guidance and on the feasibility of developing it.”</p> <p>“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.”</p> <p>“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.”</p> <p>Many Directors noted that “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.”</p>	<p>a. Revised Surveillance Guidance Note (by end 2007, note that guidance related to the 2007 Decision may be issued by October 2007).</p> <p>b. Tentatively, review of the stability of the system of exchange rates in 2009.</p> <p>c. Expand and improve CGER work (including refine methodologies and expand it to key low income countries and producers of exhaustible resources).</p> <p>d. Knowledge dissemination. A coordinated training plan will be developed by INS and PDR in 2008, and a section of examples of best practice in exchange rate surveillance will be posted on the PDR website in late 2007.</p>
I.3 Management should give much greater attention to ensuring effective dialogue with authorities.	“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.”	

<p>a. Management should develop a strategic approach to identify opportunities to improve the effectiveness of the dialogue.</p>	<p>“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.”</p> <p>“Ensuring that missions have the right mix of skills and expertise...was seen by many as requiring further efforts”.</p>	<p>a. Surveillance agendas.</p> <p>b. Ongoing initiatives to increase MCM participation in Art. IV missions.</p>
<p>b. Management and the Board need to adjust the incentives to raise controversial issues.</p>	<p>“Staff should be encouraged to raise controversial issues with the authorities, to better understand the viewpoint of national authorities, and to ensure evenhandedness.”</p>	<p>Clearer expectations and support from management.</p>
<p><i>II. Implementing Existing Policy Guidance</i></p>		
<p>II.1 Management and the Executive Board should resolve inconsistencies and ambiguity over the issue of regime classification.</p>	<p>“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.”</p>	<p>a. Revised Surveillance Guidance Note.</p> <p>b. Review of Exchange Arrangements, Restrictions, and Markets in September 2007.</p> <p>c. Focus on issue in internal review process.</p>
<p>II.2 IMF advice on exchange rate regimes should be backed up more explicitly by analytic work.</p>	<p>“Regarding the assessment of members’ choices of exchange rate regimes, Directors saw scope for more candid staff assessments while avoiding a mechanistic approach.”</p> <p>“In general, Directors agreed that staff’s views 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.”</p>	<p>a. Revised Surveillance Guidance Note.</p> <p>b. Knowledge dissemination (see above).</p> <p>c. Focus on issue in internal review process.</p> <p>d. Tentatively, review of the stability of the system of exchange rates in 2009.</p>
<p>II.3 To improve assessments of the exchange rate level, the IMF</p>	<p>“Directors welcomed the finding that analysis of exchange rate</p>	<p>a. Expand and improve CGER work (including refine</p>

<p>should be at the forefront of developing the needed analytical framework, while more successfully translating existing methodologies into advice that is relevant to discussion of individual country cases.</p>	<p>levels had improved, although in several cases there remained scope for improvement in the quality of the analysis.”</p> <p>“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 over-reliance on model-based estimates of equilibrium exchange rates.”</p>	<p>methodologies and expand it to key low income countries and producers of exhaustible resources).</p> <p>b. Knowledge dissemination (see above).</p> <p>c. Additional research in area departments, including cross-country work on oil producers in MCD.</p> <p>d. Focus on issue in internal review process.</p>
<p>II.4 Management and the Executive Board should consider further what lies behind the apparently serious problems of data provision for surveillance, and how incentive structures can be improved.</p>	<p>“Directors... welcomed the recommendation to consider further the scope of the problem [of data availability] and possible remedies. Thus, they looked forward to the upcoming review of data provision to the Fund.”</p>	<p>Review of data provision to the Fund in late 2007.</p>
<p>II.5 Incentives should be given to develop and implement guidance for the integration of spillovers into bilateral and regional surveillance.</p>	<p>“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.”</p>	<p>No new initiatives. Continued implementation of existing initiatives under the MTS.</p>
<p><i>III. Management of Work on Exchange Rates</i></p>		
<p>III.1 Management should address how to bring better focus to the analytical work on exchange rates.</p>	<p>“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.”</p>	<p>No changes in departmental organization and responsibilities.</p>
<p>a. Management should clarify responsibility and accountability for exchange rate policy issues and actively use a forum like the</p>	<p>“Directors encouraged further strengthening of the existing coordinating mechanisms (including the Surveillance</p>	<p>Strengthened role of the Surveillance Committee and CGER.</p>

Surveillance Committee to ensure proper focus on key issues, and to discuss a variety of different views and perspectives.	Committee and the CGER), as envisaged by the Medium-Term Strategy.”	
b. The structure of staff teams could be reconsidered.		No new initiatives. Ongoing initiatives to increase MCM participation in Article IV missions.
<i>IV. Confidentiality and Executive Board Oversight</i>		
<p>An understanding is needed on what are the expectations for inclusion in the Article IV staff report, what may be mentioned orally at Board meetings, and what may be understood to have been discussed between staff and the authorities on the clear understanding that it would not be revealed to the Executive Board.</p> <p>a. Confidential policy discussions about possible policy actions in the case of contingencies should be a regular feature of the dialogue with member countries.</p> <p>b. Options for the Board to exercise its accountability and oversight functions.</p>	<p>“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.”</p> <p>“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.”</p>	No new initiatives planned at this time, at least pending the discussion of the Board’s Ad Hoc Committee on Confidential Information on a report on related issues in use of Fund resources.
<i>V. Facilitating Multilateral Policy Coordination</i>		
<p>Opportunities for potential multilateral concerted action deserve to be a key strategic management focus.</p>	<p>“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.”</p>	Continued use of the multilateral consultation vehicle.

III. IMPLEMENTATION PLAN

5. **The implementation plan integrates current or planned initiatives with several new actions.** Its key components include updating the principles and framework of exchange rate surveillance, more focus on developing and disseminating knowledge and analytical tools, improving operational quality through better quality control, clearer guidance, and a keener awareness of the need for a strategic approach for effective engagement with country authorities. The plan includes actions directly in response to the recommendations, but as

explained below, some of the recommendations (e.g., on data provision) will require more work before concrete actions can be taken. The recommendations as quoted below are taken from the IEO Report, but the actions respond to the Board's views on these (see Table above).

6. **The 2008 Triennial Surveillance Review (TSR) will review progress on implementation.** The TSR will take stock of the tangible deliverables in the implementation plan and will gauge—albeit at an early stage—the results of less measurable efforts, such as better quality control through the internal review process. It will also provide an opportunity to update the plan where warranted. In addition, the status of the implementation plan will be reported on in the IEO's Annual Report.

Rules of the game and guidance to staff

IEO recommendation: Clarify the rules of the game for the IMF and its member countries.

7. **The 2007 Decision on Bilateral Surveillance Over Members' Policies has revalidated the fundamental purpose of surveillance.** The new Decision has made clearer what is expected of surveillance and provided guidance in various areas covered by the IEO report, such as assessment of exchange rate levels and policies, candor, and evenhandedness.

8. **To support implementation of the new Decision, the Surveillance Guidance Note (SGN) will be fully revised by end 2007.** The revised SGN will fully reflect the expectations set out in the new Decision with regard to Fund surveillance, including in the area of exchange rate surveillance. Guidance on the operational aspects related to the 2007 Surveillance Decision is expected to be made available by October 2007. In the meantime, an Interim Guidance Note was issued and substantial outreach material has been produced to familiarize staff and others with the new Decision.

IEO recommendation: Practical policy guidance should be developed on key analytical issues. Two priorities would be on the stability of the system and on the use and limits of intervention.

9. **The following initiatives are planned to implement this recommendation.**

- The revised SGN will include guidance on assessing exchange rate levels and on the uses and limits of intervention, emphasizing the need to tailor advice to country circumstances and avoiding an overly prescriptive approach.
- Depending on resource constraints, a review of the stability of the system of exchange rates is tentatively planned for 2009, similar to the one conducted in 1999. This review—to be prepared by the Research Department (RES) and Policy Development and Review Department (PDR), in consultation with the Monetary and Capital Markets Department (MCM)—would focus on

implications for international financial stability of trends in exchange regimes and policies, as well as other relevant developments, during the current decade. Results of the review could be useful input for potential further guidance in the area of exchange rate policy advice and regime assessment.²

10. Other initiatives that will help to integrate cutting edge techniques into the Fund's country work include a further improvement and expansion of CGER methodology and better knowledge dissemination efforts. These efforts are aimed at helping staff to apply appropriately relevant techniques in exchange rate analysis without relying on a rigid and mechanistic approach.

- RES will continue to refine the CGER methodology against a gradually increasing stock of experience in applying CGER in exchange rate surveillance. Work planned in this area includes an examination of whether CGER estimates are broadly in line with subsequent real exchange rate movements at different horizons and work on the link between capital flows and real exchange rates.
- In addition, RES will seek to expand, with the help of area departments, the CGER methodology to key low income countries and producers of exhaustible resources. Given the significant data limitations and analytical challenges in this project, the results would be expected to be shared with the Board on a trial basis in FY2009 in the context of the semi-annual CGER note.
- Dissemination efforts (training, workshops, and seminars) will be further strengthened. Such efforts will ensure that relevant existing knowledge and techniques are translated into operational use by staff teams. While the IMF Institute (INS) already has a strong training program in exchange rate issues, INS and PDR will work together, in consultation with RES and MCM, to develop a coordinated and targeted dissemination plan in early 2008 to ensure that staff teams are familiar with existing techniques for assessing exchange rate levels and regimes and aware of best practices in this area. In addition, a section containing examples of best practice in exchange rate surveillance will be created on PDR's website in late 2007.

² This review would also help inform, among other things, advice on the role of exchange regime and exchange rate management for the use of aid in low income countries. This is an area that was identified as requiring more work in the *Implementation Plan in Response to Board-Endorsed Recommendations Arising from the Independent Evaluation Office Report on the IMF and Aid to Sub-Saharan Africa*.

IEO recommendation: Management should give much greater attention to ensuring effective dialogue with authorities.

a. Management should develop a strategic approach to identify opportunities to improve the effectiveness of the dialogue.

11. **The new tool of surveillance agendas is encouraging an early focus on the engagement strategy with the authorities.** Staff will be encouraged, whenever feasible, to seek inputs from the authorities on critical policy issues that should be the focus for surveillance, as well as areas where the authorities see potential value-added through technical assistance. In addition, as suggested in the 2004 Biennial Surveillance Review, member countries could be encouraged to prepare policy statements, which would be an input into policy discussions.

12. **Ongoing initiatives to strengthen financial sector expertise in Article IV missions will improve the skill mix of staff teams over time.** Participation by MCM staff in Article IV missions is being increased, and staff teams are also being encouraged to seek more actively technical inputs from MCM at an earlier stage of surveillance. Moreover, INS and MCM are setting up a financial sector surveillance training program featuring two new one-week courses expected to be attended by about 60 mission chiefs and desk economists a year, with the first deliveries expected in late 2007 and early 2008 respectively; and INS will also provide a one-week course targeted at economists with little or no training in finance, starting in October 2007. The improvement in skill mix will help strengthen understanding of the market underpinnings of exchange rate issues and integrate financial sector analysis in exchange rate surveillance.

b. Management and the Board need to adjust the incentives to raise controversial issues.

13. **Management will help promote candor in surveillance, and the Board too will need to play its part.** Management will make clear to staff, e.g. through its participation in the Surveillance Committee, its expectations that critical issues—including controversial ones—should be adequately raised and covered in surveillance. Management's clearance of staff reports already signals its support for the positions taken by staff on potentially controversial issues, and management will provide support when needed in discussions with authorities or at the Board. With the adoption of the new Surveillance Decision, the Board's role in supporting candor in surveillance is expected to be further strengthened.

Implementing Existing Policy Guidance

IEO recommendation: Management and the Executive Board should resolve inconsistencies and ambiguity over the issue of regime classification.

14. **Actions in this area consist of the following:**

- The revised Surveillance Guidance Note will provide clear guidelines on description and analysis of *de facto* and *de jure* regimes. It will clarify that the existing requirement of identifying in staff reports the *de facto* exchange rate regime requires primarily a careful description of backward-looking *de facto* exchange rate policies, with inputs from the classification maintained by MCM. It will also underscore the importance of discussing clearly the authorities' forward-looking policy intentions. The SGN will also clarify that staff reports should indicate, at least in the Appendix on Fund Relations, what the *de jure* exchange regime is. MCM will collect and publish information on *de jure* exchange regimes beginning with the 2008 Annual Report on Exchange Arrangements and Exchange Restrictions (AREAER).
- The upcoming Review of Exchange Arrangements, Restrictions, and Markets (REARM), planned for September 2007, will be an opportunity to address existing deficiencies in the classification of *de facto* regimes used for the AREAER. The staff paper will review recent trends in foreign exchange regimes, and propose measures to improve the existing classification of *de facto* regimes.
- In addition, coordination between MCM and PDR on issues of classification and description of *de facto* regimes has been strengthened, with PDR now routinely commenting, along with area departments, on proposed AREAER re-classifications by MCM.

IEO recommendation: *IMF advice on exchange rate regimes should be backed up more explicitly by analytic work.*

15. **Efforts will be made in several areas to strengthen analysis of exchange regimes:** better guidance in the revised Surveillance Guidance Note, better dissemination of techniques and best practices, and more emphasis in the internal review process. The Guidance Note will point to the key dimensions for analysis and will stress that analysis of regime choice should be candid, balanced, and comprehensive, should take into account country circumstances, pay attention to implementation issues when relevant, and be informed by cross-country experience. Best practice examples of analysis of exchange regimes will be placed on PDR's website. And the tentatively planned review of the stability of the system of exchange rates (paragraph 9) could help distill practical guidance and collect cross-country experience in this area.

IEO recommendation: *To improve assessments of the exchange rate level, the IMF should be at the forefront of developing the needed analytical framework, while more successfully translating existing methodologies into advice that is relevant to discussion of individual country cases.*

16. **The response to this recommendation consists of several components:**

- Include guidance on assessing exchange rate levels in the revised Surveillance Guidance Note (paragraph 9, first bullet).
- Continue to develop and refine new analytical tools for assessing exchange rates. Initiatives in this area are described in detail in the work program for CGER (paragraph 10, first and second bullets).
- Better knowledge dissemination to staff teams of cutting-edge techniques and best practices (paragraph 10, third bullet).
- Area departments are planning additional work on exchange rate assessments in the context of bilateral surveillance, using inputs from the CGER methodology, other quantitative methodologies tailored to individual countries, and qualitative analyses. Analytical work on the issue of exchange rate assessment for oil producers has been initiated in the Middle East and Central Asia Department (MCD).
- Increase the emphasis on assessments of exchange rate levels in the internal review process. This additional emphasis is already coming about as a result of the 2007 Surveillance Decision.

***IEO recommendation:** Management and the Executive Board should consider further what lies behind the apparently serious problems of data provision for surveillance, and how incentive structures can be improved.*

17. **Improving data provision to the Fund remains a challenge.** The planned review of data provision to the Fund in late 2007 will constitute an opportunity to consider further the scope of the problem and possible remedies in this area.

***IEO recommendation:** Incentives should be given to develop and implement guidance for the integration of spillovers into bilateral and regional surveillance.*

18. **The current initiatives under the aegis of the Medium-Term Strategy will continue.** The initiatives include a focus on overall regional trends through regional outlooks, better assessment of external economic and financial market spillovers affecting individual countries by drawing on the analysis in multilateral and regional surveillance, and spillovers emanating from systemic countries.³ The analysis of spillovers has benefited from

³ As an implementation step of the MTS, management has recently instructed that “Staff reports for systemically important countries ... should include a substantive analysis and discussion of spillover issues, drawing the implications of the country’s developments, policies, and vulnerabilities both generally for the international community and specifically for neighboring countries and other affected groups.”

increased use of the Fund's Global Economic Model and Global Fiscal Model. These initiatives were welcomed by Directors, and no new initiatives are planned.

Management of Work on Exchange Rates

IEO recommendation: *Management should address how to bring better focus to the analytical work on exchange rates.*

a. Management should clarify responsibility and accountability for exchange rate policy issues and actively use a forum like the Surveillance Committee to ensure proper focus on key issues, and to discuss a variety of different views and perspectives.

b. The structure of staff teams could be reconsidered.

19. **Improvements to the existing structure are the primary focus.** Exchange rate analysis permeates many Fund activities, which makes it virtually inevitable that the relevant responsibilities are spread across several departments. Management does not propose to significantly reorganize departmental responsibilities in exchange rate work. However, improvements to the existing structure will include:

- Better coordinating mechanisms on exchange rate work. The Surveillance Committee has been tasked to review periodically topics in exchange rate work that are of Fund-wide relevance, and make relevant recommendations to management. CGER will continue to be a key forum to improve analytics on exchange rate levels in the Fund.
- Closer integration of financial sector work in Fund surveillance through MCM. MCM is increasing its participation in Article IV missions and existing initiatives to better integrate financial sector analysis in surveillance are expected to contribute to an improvement in exchange rate work.

Confidentiality and Executive Board Oversight

IEO recommendation: *An understanding is needed on what are the expectations for inclusion in the Article IV staff report, what may be mentioned orally at Board meetings, and what may be understood to have been discussed between staff and the authorities on the clear understanding that it would not be revealed to the Executive Board.*

20. **At present no new initiatives are proposed.** Further actions could be considered following the planned discussion of Board's Ad Hoc Committee on Confidential Information of a report on related issues in cases of use of Fund resources.

Facilitating Multilateral Policy Coordination

IEO recommendation: Opportunities for potential multilateral concerted action deserve to be a key strategic management focus.

21. **Multilateral consultations will continue to be a key vehicle to promote debate on issues of systemic or regional importance.** Created as envisioned under the MTS, the multilateral consultation vehicle has shown that, flexibly applied, it is a valuable instrument to enhance and deepen Fund multilateral surveillance, and to promote an improved understanding among participants of the issues and of each other's positions.⁴ It will continue to be used.

IV. ESTIMATED COSTS

22. **While many of the initiatives described above are already part of the MTS, the additional resource costs related to the above initiatives are still considerable.** The additional cost is estimated at some US\$5 million (19.6 full time equivalent (FTE) staff years) in FY2008 (see Appendix).⁵ The costs would be lower in subsequent years, though the review of the stability of the system of exchange rates, tentatively planned for FY2009, would add an estimated US\$0.7 million (almost three FTE staff years) in that year.

23. **The further development of CGER (and the update of the Surveillance Guidance Note) is expected to cost about US\$1.1 million in FY2008, a similar amount in FY2009 (reflecting a continuation of CGER development costs), and US\$0.8 million in subsequent years** (reflecting the recurrent cost for CGER of monitoring a larger set of countries). The resources are expected to come mainly from reallocation within RES (reflecting in part the tailing off of a previous phase of development of CGER), and from a small reallocation within PDR's regular surveillance policy development work (expected to involve in particular a slightly reduced scope of the Triennial Surveillance Review), with any possible residual being financed from central resources. The magnitude of the additional costs, for RES in particular, means that other departmental activities will need to be reduced namely research on trade, low-income countries, and emerging markets (the dollar equivalent of three FTEs) and that approximately US\$0.25 million (the dollar equivalent of one FTE) will need to be financed from central resources. Any potential additional resources for RES beyond FY2008 will be discussed in the course of preparing the FY2009 budget. This is also the reason why the review of the stability of the system of exchange rates can only be tentatively planned for 2009.

⁴ Executive Board Assessment—Multilateral Consultation on Global Imbalances (PIN/07/97).

⁵ The cost estimates do not include costs arising potentially from further follow-up actions after the data provision review.

24. **The cost of devoting greater resources to exchange rate surveillance is estimated at about US\$3.9 million in FY2008, and probably somewhat less in subsequent years.**

The amount estimated for FY2008 represents some 3.2 percent of the current surveillance budgets of area departments, and the pace of improvement in exchange rate work may be limited by the scope for reallocating resources from other tasks.

25. Finally, the new procedures adopted as follow up to the external evaluation of the IEO envisage seeking the Board's feedback on the implementation plan. Accordingly, Directors' views on the plan set out above would be welcome.

APPENDIX. Estimated Costs ⁶

1. It is estimated that the cost of addressing the IEO's recommendations is some US\$5 million in FY2008 (19.6 (FTE) staff years).⁷ These costs can be divided in two broad categories:
 - Costs associated with developing knowledge and guidance, estimated at US\$1.1 million (4.3 FTE staff years):
 - ◇ The bulk of these costs consist of the enhancement of CGER which is expected to cost US\$1 million. This far-reaching work is expected to include the expansion of CGER methodologies to low-income countries and exporters of natural resources (US\$0.38 million); a self-assessment of whether CGER estimates are broadly in line with subsequent real exchange rate movements (US\$0.15 million); and work on the link between capital flows and the real exchange rate (US\$0.5 million).⁸
 - ◇ Other costs are expected to be much lower and mainly consist of incorporating better guidance on exchange rate issues into the Surveillance Guidance Note, which is expected to cost approximately US\$0.06 million.
 - Costs generally associated with improving the coverage of exchange rate issues, estimated at US\$3.9 million (15.3 FTE staff years):
 - ◇ One key proposal in this area—improving the assessment of exchange rate levels—is linked to the recently approved 2007 Surveillance Decision. To obtain a rough estimate of the cost of raising the quality of analysis in this area, it is estimated that significant additional work would be needed in 64 cases, costing approximately US\$2.2 million.⁹

⁶ These costs do not include the already incurred cost of reviewing the IEO report and preparing this plan, those related to outreach on the IEO report, nor those related to actions already envisaged by the MTS.

⁷ In this and subsequent calculations, the standard staff cost includes a 45 percent mark-up to account for leave and overhead costs.

⁸ The development of the methodology for low-income countries is not included in the costs since that initiative was already envisaged as part of the MTS.

⁹ The estimated number of cases corresponds to approximately one-third of the 191 countries/areas covered in the IEO report. This rough estimate is consistent with: (i) staff's own assessment in the *Treatment of Exchange Rate Issues in Bilateral Surveillance*, which found that one-third of the 30 cases covered had deficiencies in the analysis of the exchange rate level; and (ii) the survey findings in the IEO report (e.g., Figure 7), which suggest that the staff paid less attention to exchange rate level issues than country authorities in approximately one-third of the cases.

- ◇ Other proposals in this area include: (i) further analysis of regime suitability, the work on which could cover approximately 53 cases and cost US\$1.1 million¹⁰; (ii) improving missions' skill mix in order to incorporate knowledge on financial sector issues, which is mostly already under way and has already been incorporated into MCM's medium-term budget. Incorporation of experts on foreign exchange markets to Article IV missions may still need to be considered for perhaps 10 cases, which would cost approximately US\$0.4 million¹¹; and (iii) dissemination initiatives (third bullet of paragraph 10). A precise estimate of the cost of this initiative cannot be given at this stage as its format is still being discussed, but it is estimated that it could cost approximately US\$0.08 million (reflecting a cost of approximately 0.1 FTE staff years for preparation and an additional 0.2 FTE staff years of attendance per year).

2. Beyond FY2008, the costs associated with the above activities will decline, as the development of methodologies for the expansion of CGER is expected to be concluded in FY2009, and the analytical work on exchange rate surveillance, although recurrent, is expected to cost less in subsequent years (updates are likely to cost less than initial assessments). Nonetheless, substantial recurrent costs will remain, including recurrent costs of the CGER expansion to follow up and monitor the larger set of countries, estimated at US\$0.8 million (three FTE staff years). In FY2009, the review of the stability of the system of exchange rates, tentatively planned for that period, would add approximately US\$0.73 million (2.9 FTE staff years) to the costs.

¹⁰ The IEO identified that regime suitability was analyzed in only 10 out of 63 countries, hence our assumption that 53 countries will require further work in this area. While this calculation may underestimate the number of cases since it only includes the cases in which advice was given (i.e., it does not include those cases for which advice should have been given but was not), this bias is probably small.

¹¹ The number of cases builds on the IEO's report finding that five out of the 30 cases covered in the in-depth review exhibited an incomplete coverage of intervention issues. If we were to extend that ratio to the approximately 60 advanced and emerging market countries that are Fund members (the issue is not likely to be relevant for other country groups) then the number of cases would increase to ten.