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Minutes of Executive Board Meeting 84/170

10:00 a.m., November 28, 1984

J. de Larosière, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
A. Alfidja	
C. H. Dallara	M. K. Bush
	D. C. Templeman, Temporary
J. de Groote	H. G. Schneider
B. de Maulde	X. Blandin
M. Finaish	
	T. Yamashita
G. Grosche	B. Goos
J. E. Ismael	Jaafar A.
R. K. Joyce	L. Leonard
	C. Robalino
R. N. Malhotra	A. S. Jayawardena
	A. Abdallah
F. L. Nebbia	
Y. A. Nimatallah	J. E. Suraisry
	E. M. Ainley, Temporary
P. Pérez	
J. J. Polak	
	A. V. Romuáldez
G. Salehkhou	O. Kabbaj
J. Tvedt	A. Lindø
N. Wicks	T. A. Clark
S. Zecchini	N. Coumbis
Zhang Z.	Wang E.

L. Van Houtven, Secretary
J. C. Corr, Assistant

Also Present

IBRD: S. S. Husain, Vice President, Operations Policy Staff; C. Michalopoulos, Director, Economic Policy Analysis and Coordination, Economics and Research Staff. Administration Department: J. G. Keyes. African Department: A. D. Ouattara, Director; D. E. Syvrud, A. C. Woodward. European Department: L. A. Whittome, Counsellor and Director; O. J. Evans, P. L. Hedfors, R. P. Hicks, M. Ishihara, A. Knöbl, M. Mentini, S. Mitra. Exchange and Trade Relations Department: C. D. Finch, Director; W. A. Beveridge, Deputy Director; M. Guitián, Deputy Director; S. Mookerjee, Deputy Director; M. Allen, E. H. Brau, S. Kanesa-Thasan, M. H. Rodlauer. Fiscal Affairs Department: V. Tanzi, Director; G. Blöndal. IMF Institute: O. B. Makalou. Legal Department: G. P. Nicoletopoulos, Director; Ph. Lachman, S. A. Silard, A. O. Liuksila, J. M. Ogoola. Middle Eastern Department: P. Chabrier, Deputy Director, B. A. Karamali, G. Tomasson. Research Department: W. C. Hood, Economic Counsellor and Director; R. R. Rhomberg, Deputy Director; D. Gros. Treasurer's Department: M. N. Bhuiyan. Western Hemisphere Department: E. Wiesner, Director. Bureau of Statistics: W. Dannemann, Director; P. L. Joyce. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: D. Hammann, G. E. L. Nguyen, M. Z. M. Qureshi, T. Sirivedhin, A. Steinberg, A. Vasudevan, M. A. Weitz. Assistants to Executive Directors: J. R. N. Almeida, I. Angeloni, J. Bulloch, M. Camara, M. B. Chatah, Chen J., L. E. J. M. Coene, J. de la Herrán, G. Ercel, C. Flamant, V. Govindarajan, N. Haque, G. D. Hodgson, Z. Ismail, A. K. Juusela, H. Kobayashi, S. Kolb, A. Koné, M. Lundsager, K. Murakami, E. Olsen, M. Rasyid, J. Reddy, D. J. Robinson, C. A. Salinas, A. A. Scholten, Shao Z., S. Sornyanyontr, A. J. Tregilgas, Wang C. Y., B. D. White.

1. ICELAND - 1984 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1984 Article IV consultation with Iceland (SM/84/251, 11/7/84; and Sup. 1, 11/23/84). They also had before them a report on recent economic developments in Iceland (SM/84/252, 11/9/84), together with a communication relating to a recent devaluation of the krōna (EBD/84/297, 11/21/84).

Mr. Tvedt made the following statement:

At the time of the 1983 Article IV consultation (EBM/83/171, 12/9/83) it might have seemed premature to provide an overall assessment of the effectiveness and durability of the anti-inflationary policy of the Government. Although it had only been introduced six months earlier, the policy had, nevertheless, brought about remarkable results. Now one can say, with good justification, that the policy conducted over the last 18 months has--in important respects--been quite successful. Although the staff has well described developments in that period, a few points deserve emphasis.

The aim of the Government's economic policy for 1984 was to bring the rate of inflation down to an annual rate of about 10 percent by the end of the year. In recent months the inflation rate has been about 15 percent, and, prior to the wage settlements reached in late October and early November, which caused much higher wage increases in the last quarter of the year than previously agreed, inflation was moving toward the 10-12 percent range by the turn of the year.

The employment situation has been satisfactory, with the average rate of unemployment in 1984 only slightly above 1 percent. The external balance improved considerably in 1983, but deteriorated again in 1984. Production has kept up better than expected in spite of the weak cod catch, with the drop in real GDP expected to be about 1 percent in 1984. Real GDP has fallen in 1982, 1983, and 1984, making the current recession the most protracted in Iceland in the postwar period.

My authorities agree with the staff that financial policies may have been too lax in 1984, and efforts are being made to tighten both fiscal and monetary policies.

Recent economic trends and developments have shown some worrisome features. Imports have risen considerably more than expected on the basis of expenditure and relative price projections, and the outlook is for a current account deficit of about 5 percent of GDP in 1984. The difficulties facing the fisheries, both in their current operations and in their financial structure, constitute another cause for concern. The twin problems stem, on the one hand, from growing domestic demand pressures, presumably rooted in monetary and fiscal imbalances, and on the other hand, from the decline in the catch of cod and adverse trends in export markets, mainly due to increased competition from subsidized fisheries of other nations.

While inflation has remained moderate and has decelerated thus far in 1984, domestic demand pressures may have contributed to an emerging wage push, as, in fact, is evidenced by the reopening of wage negotiations early in the autumn of 1984. With the new wage settlements implying much larger wage increases in the next few months than previously envisaged, it is clear that the low point of inflation has been reached for the time being. Responding to the wage settlements, the Government gradually depreciated the currency by about 4.5 percent, and devalued it on November 20, 1984 by 12 percent in nominal effective terms, bringing the total depreciation since late October to about 16 percent. The size of the devaluation is sufficient to restore the level of competitiveness prevailing before the wage settlements, and it should prevent a further deterioration of the external accounts. The Government also announced that the previous policy of maintaining a relatively stable exchange rate would be restored. That policy implies that through 1985, changes in the nominal effective exchange rate will be kept within a relatively narrow range. The wage settlements and the inevitable consequent devaluation have without question been serious set backs for the anti-inflationary effort of the Government, as the achievement of the goal of bringing inflation down to 10 percent has been delayed by at least one year. Supplementary measures are at present being prepared. The Central Bank is engaged in discussions with the commercial banks on their proper response under the new circumstances, and the budget bill for 1984--which was presented to Parliament in early October--is being revised in order to take account of those latest developments. The intention is to tighten further both fiscal and monetary policies.

According to the latest projections, GDP should rise moderately--by 1.5-2 percent--in 1985. Exports are, however, only expected to increase slightly, owing to the continuing depressed state of the demersal fish stocks and capacity limitations in the energy-intensive industries. Based on projections for final domestic demand and movements in the terms of trade, the external current account deficit is expected to remain largely unchanged from the 1984 level of about 5 percent of GDP. On the basis of the most recent projections for foreign borrowing, the deficit would be roughly offset by long-term loans from abroad, implying no change in the net foreign reserves. The Government has reaffirmed its intention to halt the growth of foreign indebtedness relative to GDP.

The wage settlements--involving an increase in wages of 23-24 percent over the period from November 1984 to the end of 1985--coupled with devaluation will result in a substantial rise in inflation. The annual rate of quarterly price changes is expected to rise from 10-13 percent, as registered in the past three months, to over 40 percent in the next three months, but to subside thereafter. The rise in prices for 1984 as a whole is forecast at 20 percent.

These projections for 1985 are tentative at best, since all forecasts are currently under revision, both on the basis of the changed outlook following the wage agreements and the measures that have been enacted and are being formulated, and on the basis of pending decisions on fisheries policy for 1985. Nevertheless, they can be viewed as rought indications of what may be expected.

Broadly speaking, the thrust of the Government's policy remains intact. The fact that inflation has been brought down from annual rates in excess of 100 percent in the first half of 1983 to 20 percent is by any standard a signal achievement.

Medium-term prospects for the Icelandic economy are improving. The fish stocks are in the process of being restored, and the Government is actively seeking the cooperation of foreign enterprises in exploiting the rich energy resources of the country and thereby diversifyng the export base. The Government has taken important steps in liberalizing the domestic price and foreign exchange system, and, in the monetary field, individual banks have been given the right to set their own interest rates. The Government intends to further liberalize the economy, thereby enhancing efficiency and productivity in the long term. Moreover, efforts are being made to gain better control of monetary and fiscal policies, which is essential if the long-sought goal of bringing the rate of inflation down to the level prevailing among Iceland's main trading partners is to be attained.

Finally, my authorities have no objection to the next Article IV consultation being held on the standard 12-month cycle.

Mr. Schneider remarked that the major achievements of the Icelandic economy included the maintenance of external competitiveness, a high level of employment, and the beginning of a recovery in total output from the steep plunge in 1983. The important cutback in the inflation rate from more than 100 percent in 1983 to less than 20 percent in 1984 was also noteworthy. It had been achieved primarily through wage restraint, an approach that events had shown to be correct. However, the most recent wage settlements, together with the subsequent necessary devaluation of the krōna by 12 percent, had considerably reversed the prospects for a moderation of inflation, and price increases in 1985 were likely to be twice as high as those in 1984. Iceland seemed in danger of again being caught in a vicious circle of inflation and devaluation. To break that circle, the authorities would have to tighten their monetary and fiscal policies appropriately so as to safeguard the improvements achieved in 1984.

The current account position was among the economy's persistent problems, Mr. Schneider continued. It had deteriorated sharply and was likely to rise to more than 5 percent of GDP for 1984; the forecast for 1985 was similarly dismal. Imports had risen more strongly than expected, and exports, which consisted primarily of fish and fish products, had increased at a much slower pace. The situation constituted a major threat to the authorities' policy objectives, which required a stable current account balance as the underpinning of a stable exchange rate, on which moderate wage settlements were believed to depend. He agreed with the staff and the authorities that such elements were closely interlinked, especially because that proposition was borne out to a large extent by the events of 1983. However, if a policy stance centered on the current account was to bring about all the desired results, a whole set of accompanying measures would have to be taken and various conditions would have to be met on the domestic front. Thus far, monetary and fiscal policies had been too lax and too accommodating to support the overall policy objectives.

The targets for domestic credit expansion and for the growth rate of M-3 had been exceeded by a large margin in 1984, Mr. Schneider observed; those were surprising developments in view of the authorities' strong awareness of the gravity of the situation. Mr. Tvedt had indicated that the authorities intended to tighten financial policies in order to respond more effectively to recent developments; it would be helpful if Mr. Tvedt could say whether further information on the new monetary targets was available. Perhaps the staff could comment on how the shift to positive real interest rates could affect domestic savings. Indeed, the need for foreign borrowing had increased due to the deterioration of the current account and the continuing deficit of the public sector.

Fiscal policy was also insufficiently restrictive, Mr. Schneider said. A strengthening of the fiscal budget was necessary in the context of recent wage developments. Because it had proved impossible to bring expenditures down to the expected level, and because rising demand pressures were certain to rekindle inflation and worsen the external position, revenues should be increased. Such action was feasible because of the leeway provided by the structure of the tax system and by Iceland's tax ratio, which was low by international standards. He welcomed, therefore, the intention of the authorities to increase indirect taxes and, later, to introduce a value-added tax, thereby further widening the tax base.

Although the present difficulties of Iceland's economy might appear to be short term, Mr. Schneider commented, they were part of a much broader and longer-term problem rooted in the productive structure. Diversification was needed and he welcomed the authorities' intention to foster the development of new industries to utilize the great potential of Iceland's energy resources. Recently adopted policies were well suited to that purpose, particularly the liberalization of domestic prices and of the foreign exchange system.

Mr. Goos considered that a number of general lessons could be drawn from Iceland's economic experience. Developments in Iceland since 1981 provided a classic example of the limited scope of countries--particularly those with small, open economies--to counterbalance the impact of adverse external shocks on the domestic economy through recourse to expansionary policies. Iceland's experience also demonstrated that exchange rate changes alone were not a panacea and needed to be supplemented by an appropriate degree of financial restrictiveness. Furthermore, the authorities' success in reducing the inflation rate was intriguing. The staff indicated that the main measures contributing to that success had been the limitation of wage increases in combination with an abrupt suspension of indexation and the maintenance of a relatively stable nominal exchange rate. The resolution of similar problems in different countries often required quite different policy prescriptions. However, given the limited success of gradualism in fighting inflation in a number of countries, especially when gradualism was applied to the phasing out of indexation, Iceland's experience should at least provide grounds for second thoughts.

The validity of the staff's analysis and conclusions had been impressively confirmed by the most recent developments, Mr. Goos continued, which had added renewed emphasis to the urgent need to adopt more resrictive financial policies. He agreed fully with the staff's comments on fiscal and monetary policies. It would be disappointing if the restoration of the country's external competitiveness resulting from the latest exchange rate devaluation was again placed in jeopardy through an accommodating fiscal and monetary stance. The potential drawbacks of such a policy stance on the country's external position, on its inflation rate, and even on the perception of its creditworthiness had been clearly spelled out by the staff. He supported the staff's assessment that restrictive demand management policies were indispensable also because of the introduction of reopening clauses in wage contracts. Under certain circumstances such clauses could be as harmful to the country's stabilization efforts as indexation; their abolition was, therefore, advisable. As for the medium-term outlook, the more stable macroeconomic framework arising out of appropriate fiscal and monetary policies should also facilitate the necessary structural adjustment of the Icelandic economy. In that respect, the medium-term approach pursued by the authorities, as described by Mr. Tvedt, was reassuring.

Mr. Polak commented that Iceland presented an interesting example of an attempt to break out of an inflationary spiral that had assumed dangerous proportions, the rate of inflation having been more than 100 percent during at least one quarter. Although a year earlier Iceland had appeared to be conquering inflation, the position was much less certain at present. While inflation had been brought down to about an annual rate of 15 percent, it clearly could not be maintained at that level, and the authorities expected a surge to about 40 percent early in 1985 and hoped that the surge would prove temporary. The success thus far against inflation had been brought about in part through a deterioration in the balance of payments, a problem that had been almost eliminated in the middle of 1983. Of course, there was frequently a conflict between efforts to fight inflation and attempts to safeguard the balance of payments; moreover, it was highly unlikely that both those objectives could be achieved while employment and real wage rates were safeguarded.

Iceland had performed remarkably well with respect to employment, but it had not done as well as hoped with respect to inflation and the balance of payments, Mr. Polak, continued. The major question was whether the partial lack of success on the latter two fronts was attributable to excessively lax fiscal and monetary policies, which could simply be tightened as the authorities had promised, or whether those policies were a continuation of the generally lax policies of the past 30 years and were, therefore, an accurate reflection of the priorities of the authorities. In 1983 it had appeared that a fundamental rearrangement of priorities had occurred, but the situation was less clear at present. Nevertheless, while the results were less good than might have been hoped for, the authorities should be congratulated for having reduced inflation drastically.

The staff attributed the authorities' success in reducing inflation to the stabilization of the nominal effective exchange rate, supported by appropriate wage policies, such as deindexation and the limitation of wage increases to less than the rate of inflation, Mr. Polak noted. However, the staff appeared to disregard the important contribution made by the decrease in domestic credit in nominal terms in the first half of 1983. Domestic credit had also fallen sharply in real terms during most of 1983, as had the broadly defined money supply. Even if the authorities had not taken deliberate action to that end, the significant contribution of those developments to the reduction of inflation in late 1983 and 1984 should not be underestimated. The reverse also held true: monetary policy and incomes policy, which should have been tight in 1984, had been allowed to become too lax. The table on monetary developments on page 8 of SM/84/251 indicated the compensating movements of net foreign assets and domestic credit, which was succinctly and ably described by the staff in two sentences: "In the 12 months to August 1984 the increase in net domestic assets of the Central Bank contributed 61 1/2 percentage points to the growth of base money, but over the same period the growth of base money itself came to only 35 percent. The rest drained out."

Recent wage settlements were so far above the official guidelines that it was doubtful whether a policy of deindexation could be said to continue in place, Mr. Polak remarked. In the face of the existing incomes, monetary, and fiscal policies, the commitment to a relatively stable nominal exchange rate appeared questionable. The commitment had first been made with regard to 1984 and had been repeated, following the midsized devaluation in November 1984, with respect to 1985. It affected inflation only on the cost side and could easily be negated by excessively expansionary demand policies. Moreover, there was always a risk that such a preannounced exchange rate policy could generate in 1985 the kind of capital flight and excess of imports that it had produced in 1984. In that context, the staff appeared to have overestimated the contribution of a change in the exchange rate regime, a point of view that was also evident in a Departmental Memorandum entitled "Demand for Money in a Period of Rapid Disinflation--The Case of Iceland" (DM/84/71, 11/20/84). The author of that paper had concluded that there had been a change from a flexible exchange rate regime to stability in nominal effective terms, a proposition that appeared to overstate the case in view of the periodic minidevaluations that had been a feature of the Icelandic regime.

The Icelandic authorities had justifiably decided against the deindexation of monetary aggregates, Mr. Polak considered, and he regretted that the subject had not been discussed in the report for the 1984 Article IV consultation. However, in general, he fully agreed with the staff's analysis and its appraisal. Finally, the adverse developments in the real economy, especially the decline in the fish catch, which was expected to continue, should not be forgotten. The authorities faced the difficult task of diversifying economic activity in order to prevent a slowdown of growth, a worsening of the balance of payments, and a decline in per capita income. It was clear that they were not being helped by the subsidy practices of some of Iceland's competitors, nor by the protectionist measures in some of its markets.

Mr. Templeman said that the Icelandic authorities should be commended for their courageous action in launching economic adjustment in 1983 and for the initial progress in reducing inflation and the external deficit. In particular, the cancellation of wage indexation and the temporary suspension of free collective bargaining had paid off by interrupting the previous pattern of rapid inflation. High employment and a lower rate of unemployment had been maintained despite negative growth of GNP between 1982 and 1984. However, the chronic failure to tighten fiscal and monetary policies now threatened to erode past gains.

The accommodation of high wage demands in late October 1984, the continued relative laxity of monetary and fiscal policies, and uncertainties about the adequacy of future exchange rate policy cast doubt on the outlook for 1985 and beyond, Mr. Templeman continued. However, Mr. Tvedt's assurances that his Icelandic authorities were re-examining their policies were noteworthy. Over the longer term, the uncertain prospects for the fishing industry emphasized the need for structural change and economic diversification.

Following the two-year suspension of quarterly wage indexation and the imposition of temporary limits on wage rate increases, real earnings had fallen by 20 percent between the second quarter of 1982 and the second quarter of 1984, Mr. Templeman noted. It was not surprising, therefore, that there had been strong pressure for higher nominal wage rates during the round of negotiations that had led to the October 1984 settlement. Nevertheless, the estimated 22 percent increase in average wages in 1985--more than double the target figure of 9-10 percent--was a clear sign that the prospects for a continued decline in the inflation rate had significantly worsened. Evidently, the Icelandic authorities shared that view. In retrospect, the failure to tighten monetary and fiscal policies during the period of imposed stability in wages and the exchange rate had assumed increased importance. While the recent 12 percent devaluation of the krōna was welcome as a step to offset the immediate loss in competitiveness from the large wage increase, there was at present a serious threat of a resumption of the cycle of rising wage rates and declining exchange rates that had prevailed before May 1983.

The most disappointing element of the adjustment program remained the inadequacy of financial policies, Mr. Templeman commented, in particular, the continued rapid rise in domestic credit expansion and monetary growth despite the rapid deceleration of price inflation. The Central Bank had engaged in large overdrafts with banks, in rediscounting bills of exchange at privileged interest rates, and in financing part of the budget deficit. In addition, official resistance to higher real interest rates appeared evident, and the 1984 target rates for credit and M-3 would be substantially exceeded. The rationale for the behavior of monetary policy was neither clear nor persuasive. Some positive steps had been taken recently, including the introduction in August 1984 of new financial instruments for nonbank financing of the public sector, the planned elimination in the following six months of overdrafts of the banks, the expected discontinuation of central bank rediscounting of bills of exchange in the autumn of 1985, and the de facto rise in real interest rates as a result of the fall in inflation. However, those actions had been late in coming. On the other hand, it was encouraging that the authorities intended to tighten monetary policy further, as indicated by Mr. Tvedt.

On fiscal policy, Mr. Templeman observed that the absence of consolidated data on central government borrowing requirements and the almost total absence of data on the overall public sector made it difficult to assess the state of those accounts and their effects on monetary and other economic variables. He encouraged the authorities to accelerate the pace of improvement in such statistics. For example, it appeared that the Treasury's net borrowing requirement, including lending activities in 1983, amounted to about 2.8 percent of GNP. Although the figure was low by international standards, the addition of the financing requirements of local governments and of treasury capital expenditures would, apparently, raise the ratio to about 6.5 percent, a level that, if correct, had very different implications for fiscal and monetary management. It provided a good reason to support the staff's suggestion that the achievement of a surplus in the central treasury accounts would make an important contribution to limiting the overall public sector borrowing requirement. Whatever that requirement might be, its size was apparently inconsistent with monetary restraint and with the need to reverse the recent worsening of the external accounts. He welcomed the authorities' planned revision of the 1985 budget and their intention to tighten fiscal policy.

The return of the current account deficit to the equivalent of 10 percent of GNP in the second quarter of 1984 and the worsening prospects for 1984 and 1985 were particularly disappointing, Mr. Templeman considered. No doubt the situation partly reflected the effects of the real effective appreciation of the exchange rate that had occurred since early 1983 and that would not be offset by the latest devaluation. The estimated 11 percent rise in the volume of imports in 1984, compared with a rise of only 3.5 percent for exports, suggested the continuation of an exchange rate problem. Thus far, the authorities had, with some success, employed a policy of nominal exchange rate stabilization as a tool against inflation. Initial progress in achieving a rapid drop in the inflation rate suggested that that policy might have been a better way of ensuring international competitiveness than the earlier pattern of depreciation of the exchange rate in response to the rate of inflation. However, the resumption of rapid nominal wage increases at present, in the absence of sufficiently supportive financial policies, made a policy of continued nominal exchange rate stability risky. In particular, such an exchange rate policy could only work if credit expansion was brought under better control.

The exchange rate could also be a powerful tool in the medium term to diversify the economy from its heavy dependence on the fishing industry, Mr. Templeman suggested. The relative openness of Iceland's trade regime was commendable and should help that process. Furthermore, the authorities appreciated the opportunities offered by foreign direct investment. Indeed, the overall investment climate--both domestic and foreign--would be the key to future growth. The worrisome rise in the foreign debt burden added urgency to the issue. At the end of 1984, the net debt ratio was likely to reach about 59 percent of GNP and the debt service ratio would be more than 23 percent, compared with 34 percent and 14 percent, respectively, as recently as 1980. The staff's medium-term scenario, based on moderate economic growth, showed that the debt and debt service ratios would rise to 68 percent of GNP and 33 percent, respectively, by 1990; even under the slow-growth scenario, the ratios would rise to 43 percent and 26 percent. All of those figures were high. In fact, Iceland's ability to continue to tap foreign credit markets with relative ease might have lulled the authorities into assigning too low a priority to the need to address the balance of payments and debt issues.

Mr. Leonard said that the Icelandic authorities had set themselves ambitious targets in the policy package of May 27, 1983. As he had noted on the occasion of the 1983 Article IV consultation with Iceland, the pursuit of greater stability in the exchange rate, the elimination of the external current account deficit, and the winding down of inflation would not be easy even in ideal circumstances. It was not surprising, therefore, that in present world trading conditions the aims of the package had been only partially achieved. The main gains had included the reduction in the rate of inflation from about 130 percent on an annual basis in mid-1983 to about 15 percent in recent months; the containment of unemployment--not counting unemployed fishermen--to a remarkably low level; and a degree of success in the use of the exchange rate as a policy instrument. Unfortunately, progress in two of those areas had to be qualified: inflation had already reached its low point and it appeared set to rise sharply in 1985, and effective use of the exchange rate and pursuit of exchange rate stability as an objective in itself had been undermined by a lack of support from monetary and credit policies and, more lately, incomes policy.

The failure to bring down the external current account deficit was a negative aspect of the picture, Mr. Leonard continued. It appeared that the adjusted figure of minus 5 percent of GDP envisaged at the time of the discussions with the staff would be exceeded, so that the gap--at about the same average level since 1981--remained as wide as ever. The Government's continued reliance on heavy external borrowing was another negative feature, as a result of which mounting debt service could soon restrict the room for fiscal maneuver. Finally, pay restraint had been seriously impaired through wage drift and recent pay settlements.

Despite those negative developments, Mr. Leonard remarked, the recovery of lost ground and a return to balanced economic management were still possible. It appeared that a large measure of agreement had been reached between the authorities and the staff on the weakness of present policies and on what needed to be done to strengthen them. The failure to keep domestic demand reasonably in line with domestic resources, the oversupply of credit, the relaxation of the fiscal stance, the consequent emergence of the deficit, and the pressure of wage demands had been discussed in full by the staff. He agreed with the staff's analysis of those issues and supported the thrust of its recommendations.

In particular, the authorities should recognize the need for financial and wage restraint in support of nominal exchange rate stability as a counterinflationary instrument, Mr. Leonard said. Otherwise, their intention to keep the rate relatively fixed through 1985 would be difficult to realize. It was not easy to comment on the finances of the public sector because no consolidated measure of the borrowing requirement of the Government was available. He hoped that that deficiency would soon be made good and that the provision of a consolidated account for the whole public sector would not be long delayed. The case for strengthening the fiscal budget was clear; however, in view of the inflationary dangers, the use of indirect taxes to raise revenues might not be warranted.

The Icelandic authorities differed with the staff on the urgency of achieving external balance, Mr. Leonard commented. Although there was no compelling short-term need to do so, attention to the medium-term well-being of the economy pointed to the necessity of early action. There were indications that present imbalances were less subject to self-correction than in the past, and there was a growing need for policies specifically directed at strengthening exports through further diversification of production and enhanced competitiveness. Failure to close the present balance of payments gap and the consequent need for foreign borrowing militated against both goals. In addition, it was possible that the authorities' room for fiscal action could become restricted as a result of rising debt service costs. He hoped that Iceland would avoid such a situation. While at present such an outcome could be considered a possibility, it could turn into a reality very quickly and take a long time to overcome.

Canada's fishing interests were mentioned briefly by the staff, Mr. Leonard noted. In its recent economic statement, "A New Direction for Canada," the new Canadian Government acknowledged that problems existed in the fishing industry and stated that government financial rescues were not the solution. His Canadian authorities would be reviewing the fishing sector to see how it could be strengthened; their policies would be designed to facilitate industry improvements, not to hinder market adjustments.

Mr. Clark observed that the positive developments in Iceland included steps toward deindexation and the sharp decline in inflation. However, as Directors had commented during a recent discussion in the Executive Board, important preconditions for successful deindexation were appropriate fiscal and monetary policies. Developments in Iceland in the past year had demonstrated the truth of that proposition. Unfortunately, the authorities' determined and initially successful efforts to reduce inflation had not been sustained by equally determined monetary policies. As a result, a substantial external deficit persisted, and the re-emergence of wage pressures after three years of restraint would mean at least a temporary resurgence of inflation in 1985. The first priority should be to bring monetary policy, particularly domestic credit expansion, back under control. Tighter control was essential for a lasting reduction in inflation and for a reduction in the current account deficit to a more manageable level. In view of Iceland's high debt burden, the authorities' apparent reconciliation to another large current account deficit in 1985 was somewhat disturbing, and did not accord with their intention, which was perhaps not sufficiently ambitious, to hold the growth of foreign indebtedness stable relative to GNP. It would take serious efforts simply to maintain that ratio at the level of about 60 percent of GNP even if international real interest rates moderated.

Although the credit budget for 1984 had set targets for domestic credit expansion and for M-3, Mr. Clark continued, the staff made it clear that both targets would be missed by substantial margins and that the loss of net foreign assets was likely to continue. Therefore, the measures by the authorities in August 1984 were welcome, but it was not clear that they would be sufficient. The authorities would have to accept a further rise in interest rates, not just to reduce credit expansion to households and enterprises, but also to stem short-term capital outflows--which had been substantial in 1982 and 1983 and were likely to continue in 1984--and to reverse the decline in private savings. Monetary control had been made more difficult as a result of the financial problems of the fishing industry; domestic credit expansion to that sector had expanded again in 1984. The proposals announced by the authorities in July 1984 to alleviate the fishing industry's problems were welcome; it would be useful if the staff or Mr. Tvedt could provide further information on their likely effects on monetary expansion in the short and medium term.

A tight fiscal policy would be needed to support a tight monetary policy, Mr. Clark added. The overall fiscal stance in Iceland was difficult to assess because of the lack of consolidated accounts; he welcomed the authorities' intention to improve statistical reporting. He agreed with Mr. Leonard that the effects of the reduction in the treasury deficit in 1984 were not clear, given that some expenditures had been shifted from the treasury accounts and that revenues had been much larger than expected as a result of a continuing increase in imports. The staff's projection of a further large borrowing requirement for the public sector as a whole in 1985 was a matter of concern; he agreed with the staff's analysis of its potential effects. It was, therefore, encouraging that the budget bill was in the process of being revised. He urged the authorities to take measures to tighten the fiscal stance significantly.

Mr. Ainley remarked that one year earlier the authorities had been making impressive progress toward adjustment, but at present their hard-won achievements seemed to be at risk. The authorities faced a difficult task in preventing a further deterioration in inflation and in the current account deficit in 1985. They had traditionally attached great importance to employment and to supporting the fishing sector; if, however, the authorities wished to give priority to bringing inflation back under control and restoring external balance, there was a clear need for what the staff referred to as a rapid and pronounced shift toward financial restraint. He agreed with other speakers that that advice applied with particular force on the monetary side; however, it was not clear whether the monetary control measures outlined by the staff would be sufficient, and it was encouraging that, as indicated by Mr. Tvedt, the authorities were preparing supplementary measures in that area. He invited Mr. Tvedt to provide, if possible, further information on those measures.

Restraint was also needed on the fiscal side, Mr. Ainley continued. Therefore, he supported the authorities' intention to tighten fiscal policy in 1985 and to restrain expenditures. New tax measures would probably be necessary, but, given the commitment to reduce income taxes, it appeared that indirect taxes would have to increase. Had the authorities formulated specific plans to broaden the indirect tax base or to raise indirect tax rates? Although there was an inflationary risk in increasing indirect taxation, as Mr. Leonard had noted, if a political decision to reduce income taxes had been made, there did not appear to be much alternative in order to raise the necessary revenues.

Firm financial policies were vital with respect to future wage settlements, Mr. Ainley said. The experience of the past few months had shown how difficult it was for Iceland--or for any other country--to hold the line on wages if financial policies were inadequate. As the staff pointed out, the prospects for the next round of wage negotiations in mid-1985 would be considerably improved if the authorities moved decisively toward demand restraint. On the external side, the recent devaluation had been necessary to maintain Iceland's competitive position; however, the beneficial effects of that devaluation could be eroded quickly if firm financial policies were not in place. Financial policies had been the Achilles' heel of the adjustment strategy. It would be crucial to take action in that area. For the longer term, the authorities should be encouraged to continue their efforts to diversify the economy; those efforts were particularly important in view of the relatively poor outlook for the fishing industry. Diversification would take time, but he welcomed the plans to develop energy-intensive industries in which Iceland had a comparative advantage. He commended the authorities for their continued adherence to free trade principles, particularly at a time of growing protectionist pressures in Iceland's trading partners.

Mr. Tvedt, speaking on behalf of his Norwegian authorities, stated that, in connection with the reference by the staff to the detrimental effects on Iceland's fishing exports of the Norwegian and Canadian subsidies to their fishing industries, his Norwegian authorities did not fully accept the view of the Icelandic authorities but stood ready to discuss the matter bilaterally with them.

The staff representative from the European Department remarked that Iceland's credit budget, which usually contained indicative targets for domestic credit expansion and broad money, had not yet been presented for 1985; thus, the staff did not have quantitative information on the objectives of monetary policy in 1985. Mr. Tvedt had indicated that the authorities intended to tighten monetary policy, which was, in the staff's view, vital if the authorities' objectives, particularly with respect to inflation, were to be realized. At the least, a halving of the rate of increase in broad money experienced thus far in 1984 was required, together with a much greater slowdown in domestic credit expansion in order to protect the balance of payments. Such an approach would undoubtedly require higher interest rates, especially on nonindexed financial instruments, because inflation was projected to accelerate in the coming few months. Higher real interest rates should also boost domestic savings and thereby have a positive effect on the external current account.

Since the beginning of 1982, in order to establish a comfortable competitive position, the Icelandic authorities had depreciated the exchange rate of the krōna rapidly, the staff representative continued. The policy had clearly been aimed at external adjustment, although at the cost of rapidly accelerating inflation. Indeed, inflation had accelerated so rapidly that broad money had fallen in real terms in early 1983. The May 1983 measures, which had included stabilization of the real effective exchange rate and a statutory incomes policy, had quickly brought the rate of inflation down from more than 100 percent, on an annual basis, in the spring of 1983 to about 15 percent thus far in 1984. However, as the staff had stressed at the time of the 1983 Article IV consultation, that achievement was unlikely to be sustained if the exchange rate and incomes policy were not supported by adequate financial restraint.

The staff had dealt with the issue of wage indexation in their report for the 1983 Article IV consultation (SM/83/236, 11/14/83), the staff representative recalled. The suspension of indexation had certainly contributed to the cut in real wages that had been experienced in 1983 but, in the longer run, financial policy remained important, even if wage policy was deemed adequate. The effects of indexation of financial assets had been dealt with in the appendix to the report on recent economic developments in Iceland (SM/84/252) and in the recently issued Departmental Memorandum on monetary policy in Iceland (DM/84/71, 11/20/84). In those papers, it was pointed out that the financial reform that had begun in 1979 had, through the introduction of indexed financial instruments, aimed at preventing a flight from money within the banking system in periods of high inflation through the introduction of indexed financial instruments. As indicated in Chart 9 of Appendix I to SM/84/252, the policy had been successful. Conversely, in a period of decelerating inflation, such as the present, there had been no corresponding flight into money, and the rapid increase in the monetary aggregates thus far in 1984 indicated, therefore, a very easy monetary policy stance.

The reforms aimed at tackling some of the structural difficulties in the fishing sector through reductions in capacity should not have an impact on monetary control in the short run, the staff representative from the European Department said. In the medium term, the resulting improvement in the financial position of the fishing sector should help to dampen its demand for bank credit. Finally, the staff agreed with the observation that the treasury budget, which was referred to as the "A budget" in Iceland, provided an incomplete account of the fiscal position. As the staff had pointed out, although the treasury budget was in balance, the public sector borrowing requirement had remained large and had tended to undermine monetary policy. The figure of 6.5 percent of GNP referred to by Mr. Templeman appeared to include the 1983 treasury budget, plus the gross borrowing requirement for investment purposes of the Central Government, plus the net borrowing requirement of the local authorities. Unfortunately, however, it was not possible to provide an accurate estimate of the size of the public sector because no consolidated accounts of the sector were available.

Mr. Polak stated that he agreed with the staff that, in a situation in which a large part of the money supply was indexed, inflation did not necessarily produce a reduction in the supply of money in real terms nor did disinflation necessarily produce an increase in the money supply in real terms. However, it would have been interesting if the staff had discussed with the Icelandic authorities why they had not deindexed financial assets.

Mr. Tvedt commented that the courageous measures introduced by the Icelandic authorities in May 1983 had produced a sharp deceleration in the rate of inflation and a marked reduction in the external current account deficit from its 1982 level. The cost in terms of higher unemployment had been limited. However, as Directors had pointed out, important elements in the longer-term success of the anti-inflationary program had been missing. Monetary policy had been accommodating, particularly from the second half of 1983, although it was difficult to interpret the developments of the monetary aggregates when inflation was slowing dramatically and positive real interest rates were emerging. Furthermore, fiscal policy had not lent sufficient support to the adjustment effort; again, it was difficult to assess the position because of a lack of consolidated public sector accounts.

As a result of lax policies, Mr. Tvedt continued, pressures had started to build that had in turn led to increased imports and a deterioration in the external accounts. Wage pressures had also developed, culminating in the wage settlements of October and November 1984, which were by any standards excessive and which could seriously jeopardize the stabilization program. The Icelandic authorities had acted promptly by devaluing the currency in order to restore the level of competitiveness prevailing before the wage settlements and to prevent a further deterioration of the external accounts. The latest available statistics on trade indicated that the current account deficit in 1984 would be less than 5 percent of GDP.

As he had indicated earlier, Mr. Tvedt recalled, the authorities had announced that their previous policy of maintaining a relatively stable exchange rate would be restored. He hoped that they would succeed in convincing the public of their commitment in that regard. If not, and despite the continued ban on wage indexation, a "catch-up" system might develop, based on excessive demands by unions and expectations among employers that, if they met those demands, they would eventually be bailed out through an accommodating exchange rate policy.

The credibility of exchange rate policy would depend crucially on a more appropriate stance of demand management than had been seen thus far, Mr. Tvedt added. The authorities recognized that point and had, therefore, indicated their intention to tighten both fiscal and monetary policies. In his budget speech of November 27, 1984, the Minister of Finance had presented revisions to the budget bill for 1985 based on the changed price and exchange rate forecasts. While he had announced no substantive changes in the bill, he had indicated that the current deficit of the Treasury would be about 1.5 percent of total revenue, slightly smaller than the amount anticipated in the initial budget bill. He had reaffirmed the Government's intention to lower income taxes and had indicated that a value-added tax proposal would be presented to Parliament soon. Furthermore, he had mentioned that strong efforts would be made in the period ahead to strengthen the public finances, both administrative and structural. With respect to prospective price developments, the Minister had indicated that by the middle of 1985 inflation might have come down to the level that it had been immediately prior to the wage settlements of November 1984.

The Icelandic authorities had to pay due regard to short-term as well as to longer-term considerations in formulating their policies, Mr. Tvedt observed. In that connection, he stressed that the planned reform in the fishing sector would improve the outlook for more stable monetary management. Although the prospects for the fishing industry were somewhat brighter than a year earlier because of an increase in fish stocks, which, however, were difficult to assess with any degree of accuracy, the contribution to overall growth by the fishing industry in the future was likely to be limited. Thus, further diversification of the economy was needed. The authorities intended to continue to pursue hydroelectric and geothermal development, and they were actively seeking joint ventures in viable energy-related industrial projects. However, it was important to realize that the savings potential of a small economy, such as Iceland's, represented a constraint on the speed with which the energy sector could be developed. That constraint could be eased somewhat by running a moderate import surplus which, it was to be hoped, could be financed to a large extent by direct investment from abroad. Iceland's international credit rating was high and the debt service ratio had remained manageable, suggesting that the overall debt burden was not particularly worrisome at present.

The Icelandic authorities were in the process of reviewing their policies, and they would benefit from the comments of Directors and the staff, Mr. Tvedt concluded. With large energy resources, a well-developed institutional framework, a highly educated labor force, and a high degree of social cohesion, Iceland should be in a position to create a sound economic base from which further progress could be made. However, policies and the attitudes of the major interest groups would have to be such that those assets could be fully exploited.

The Chairman made the following summing up:

Executive Directors supported the views expressed in the staff appraisal in the report for the 1984 Article IV consultation. They commended the Icelandic authorities on the sharp deceleration in inflation from an annual rate of 130 percent in mid-1983 to about 15 percent thus far in 1984 and on the maintenance of full employment. They noted, however, that in the early months of 1985 inflation was projected to accelerate to more than 40 percent, largely because of the recently concluded generous wage settlements and the overly lax stance of financial policies, which had forced the devaluation of the krōna. Directors regretted that firm exchange rate and incomes policies had not been supported by financial restraint and that, as a result, the initial impressive progress toward external and domestic adjustment was being reversed.

Directors considered that the authorities' intention to seek a sharp reduction in inflation in the latter months of 1985 would require a decisive change in the financial policy stance and greater wage restraint. The official forecast of an external current account deficit equivalent to 5 percent of GDP in 1985 was viewed as a reflection of inadequate and unduly easy policies. A major, sustained improvement in the external current account was regarded as vital in view of Iceland's onerous external debt and debt servicing burdens. To that end, a pronounced strengthening of financial policies and firm management of domestic demand would be required.

Directors observed that continued rapid rates of expansion in the monetary and credit aggregates had led to a resurgence of demand in the economy, with attendant wage pressures, and had ultimately eroded credibility in the exchange rate policy. The authorities had taken steps in recent months to raise real interest rates, had attempted to reduce accommodation by the Central Bank, and had developed a wider range of debt instruments. While those measures were welcomed, the authorities were encouraged to tighten monetary policy further. In particular, experience suggested that the establishment of monetary control would require that interest rates be raised further, especially on nonindexed debt instruments, if the planned sales of debt instruments were to be achieved.

Directors noted the slippage on the expenditure side in the budget for 1984 and the much greater recourse to foreign borrowing than initially budgeted. They observed with concern the large borrowing requirement associated with the 1985 budget. Such a borrowing requirement would pose a challenge to monetary policy, especially if the foreign borrowing was not effectively constrained. At any rate it would be important to strengthen the treasury accounts and to attempt to raise the nonbank financing of the public sector. If it continued to be difficult to curb expenditures it would be necessary to raise the tax burden, and there appeared to be room to do so. The need to improve the statistical base of the operations of the consolidated public sector was stressed.

Directors considered the recent devaluation to have been appropriate, but added that an appropriate financial policy stance together with adequate wage restraint and a stronger external current account position were prerequisites for a return to a policy of relative exchange rate stability. They believed it would be important to maintain the present competitive position, not only in order to initiate external adjustment but also, over the medium term, to promote export diversification. Indeed, the subdued outlook for the fishing sector made the need to strengthen the supply position of the economy all the more urgent, and Directors noted with interest the Government's medium-term policies in that respect. It was also noted, with regret, that the trade, payments, and subsidy practices of some of Iceland's competitors had had detrimental consequences for Iceland's exports and export receipts.

It is expected that the next Article IV consultation with Iceland will be held on the standard 12-month cycle.

2. FUND-BANK COLLABORATION AND ADJUSTMENT PROCESS - ISSUES FOR CONSIDERATION

The Executive Directors considered a paper on issues relating to Fund-Bank collaboration and the adjustment process (SM/84/242, 10/30/84). They also had before them a progress report on Fund-Bank collaboration (SM/84/210, 8/27/84; and Cor. 1, 11/15/84).

Mr. Wicks made the following statement:

The world economic environment of the 1950s and 1960s, which was characterized by relatively stable growth rates and relatively limited fluctuations in external balances, facilitated a neat division of functions between the Fund and the Bank. The Fund concentrated on promoting balance of payments equilibrium--mainly through adjustment of demand and, on occasion, exchange rates--and on the provision of short-term finance to cover external deficits while adjustment took place. The Bank concentrated on the development of a country's economic infrastructure--through public utility, industrial, and agricultural projects--supported by technical advice and long-term finance.

In recent years, the economic environment has changed sharply and the severe structural problems in many economies have become painfully apparent. This has been reflected in the emergence of large and persistent financial imbalances, especially on external account.

Many Fund members have responded to these developments by taking appropriate macroeconomic policy measures and by initiating, in parallel, major reforms in economic structure, including changes in institutional and administrative arrangement, and major reappraisals of, for example, social programs, the balance between the public and private sector, public investment, trade policy, and parastatal pricing.

Both the Fund and the Bank have responsibilities under all these headings. This is recognized in principle in the recent staff paper on collaboration (SM/84/242), for example, in the quotation from the 1966 memorandum of the then Managing Director:

> In the final analysis, there is no aspect of that structure or progress of which either institution can afford to be ignorant or which is irrelevant to its efforts to assist the member....

and in the statements:

> The activities of the two organizations thus complement and reinforce one another in the attainment of their common aims.

> By furthering domestic investment, the adaptation of productive facilities, and foreign investment in general, as well as by helping countries in making efficient choices on investment and development priorities, the Bank contributes to the same purposes in the areas of trade, and balance of payments, employment, and real income as those that are pursued in the Fund.

If my colleagues agree with those propositions, the crucial question facing the Executive Board of the Fund--and equally the Executive Board of the Bank--is whether procedures are in place that are effective in turning the need for deep collaboration between the world's two most important international financial institutions into a practical, operational reality. As the latest Annual Review of Project Performance Audit Results by the World Bank's Operations Evaluation Department noted:

> In order to be meaningful and effective, Bank-Fund collaboration in countries where both are active must extend beyond formal staff cooperation to planned complementarity between the programs of the two organizations.

Despite past progress, my authorities believe that there remains scope for further action to deepen the collaboration between the two institutions, while respecting the distinct character of the Fund as a monetary institution and its primary responsibility for restoring balance of payments equilibrium, and recognizing the Bank's primary function of promoting development.

Perhaps the most important step is for there to be greater progress in "the objective of harmonizing diagnoses" referred to on page 13 of SM/84/242. At that first stage, the two institutions need to develop a shared understanding of a member's economic problems. From dialogue, there should emerge a mutual recognition of the contribution that each institution can make in helping its member address its problems and improve its growth potential and development. Finally, the two institutions should collaborate in the mobilization of financial resources in support of the member's economic reform program, both from their own and from outside sources--the "catalytic function."

If this process--harmonized diagnosis, mutual recognition of each institution's contribution, and mobilization of financial support--is to be meaningful and effective, it needs to emerge from systematic and frequent discussion between the staff directly concerned in the two institutions. Above all, the process needs to reflect the particular expertise and approach of each institution, with each institution retaining sole responsibility of decision and implementation for action within its own competence.

The approach sketched out in the conclusions of SM/84/242 goes some way toward these objectives, but it will not, in my authorities' view, bring about the quality of collaboration necessary if the Bretton Woods institutions are to realize their full potential in helping their members. My authorities hope, therefore, that Fund management, in consultation with the management of the Bank, will reflect further on this issue and put forward additional proposals designed to strengthen collaboration. Such proposals should focus on carrying into practical effect the process that I have just outlined. They should also address the more particular matters that I will mention later.

There are two particular proposals in the staff's paper with which I disagree. First, the staff deals awkwardly with the suggestion that Bank staff should participate actively in discussions at the Fund Executive Board. It is argued that there will be problems involving the accountability of staff members; that Fund staff might be asked to attend Bank Board meetings; and that there could be embarrassment if a staff member were asked about the policies of a member. There undoubtedly could be embarrassment and confusion if the proposal were implemented in a tactless manner. But it need not be implemented in that way. In any event, the staff overlooks the fact that similar difficulties are satisfactorily overcome when Fund staff attend meetings of GATT, the Paris Club--which the Bank staff is anxious to attend on a more regular basis--and consultative groups. As for embarrassing questions, our Chairman would ensure fair play in that respect. I continue to believe that participation by Bank staff in Fund Board meetings is both practical and desirable.

Second, as a means of securing collaboration at working levels, the staff places emphasis on the designation of an individual staff member in Fund area departments and Bank regional offices to act as formal liaison with the counterpart departments. Welcome though it may be on its own account, I do not believe that that suggestion reflects the right approach to collaboration. Such an arrangement can be no substitute for procedures that place responsibility for effective collaboration on the staff in each institution responsible for a particular country. It is their responsibility to secure effective collaboration, not that of a departmental liaison officer; and procedures need to be designed to that end.

The following are specific procedures that might be instituted or strengthened in furtherance of the process of deeper collaboration:

- where appropriate, shared preparation of and participation in missions as normal practice;

- better coordination in the programming of missions where that sharing is not possible or appropriate;

- the preparation of a consistent country economic analysis, as a basis for

  Article IV reports (for the Fund Board) giving more extensive discussion of the objectives, time frame, and progress of Bank programs,

  country assessments (for the Bank Board) examining the overall impact of Bank involvement in a country, and program proposals by both institutions;

- participation by senior staff of one institution at reviews prior to Board discussions in the other;

- regular reviews in the Bank Board of the overall performance and objectives of Bank programs in a particular country;

- close contacts between each constituency's Bank and Fund Executive Directors;

- appointment of Executive Directors of one institution as Temporary Alternate Executive Directors of the other, to allow observation of and participation in discussions;

- attendance at Board discussions in each institution of appropriate staff members from the other; and

- informal joint meetings or seminars of the two Boards.

In addition to these steps, which relate to the analytical and lending functions of the Fund and the Bank, it may be helpful to implement a number of other changes in "domestic" arrangements. For example:

- closer coordination of training activities of Fund and Bank educational institutes, through, for example, exchanges of teaching staff;

- closer coordination of research programs and more joint research projects;

- amalgamation of activities on debt statistics and associated advisory services;

- expansion and closer coordination of technical assistance programs to avoid overlaps and to secure more effective implementation of Fund-Bank programs;

- "cross-training" of each institution's staff in the other;

- longer-term personnel exchanges between the two institutions; and

- a joint report, perhaps annually, to the Interim and/or Development Committee, reviewing issues and progress on Fund-Bank cooperation.

Extending his remarks, Mr. Wicks said that it was generally recognized that a sound economy and a sustainable external payments position required more than the right exchange rate and the right fiscal balance. Almost equally important were measures to promote the supply side of an economy, to allow price signals to operate effectively, to create efficient public sector institutions, and the like. That lesson emerged clearly from the many discussions in the Executive Board of members' economies. In drawing a distinction between "macro" policy measures and "micro" or supply-side measures, he did not wish to suggest that the Fund had the sole interest in macroeconomic policies and the Bank in microeconomic policies. On the contrary, both institutions had responsibilities in each area.

For example, Mr. Wicks continued, inappropriate prices lay at the heart of the difficulties experienced in many economies and their effects were pervasive. Prices affected the financial situation of the parastatal enterprises, and they could have an impact on the overall fiscal position; for those reasons, they were very much a concern of the Fund. At the same time, the success of a country's development policies was likely to depend heavily on adequate incentives, which, in practice, often meant price incentives; in that context, even the exchange rate became a matter of clear interest to the Bank.

A second area where there was particular scope for collaboration between the two institutions was investment policy, Mr. Wicks suggested. Investment expenditures directly affected such aspects as financing requirements and debt servicing profiles, which had been traditionally major features of Fund analysis. In the medium to long term, they had implications for supply capacity, an important aspect of the Fund's medium-term scenarios. On the other hand, investment strategy lay firmly within the traditional area of the Bank's concern. Trade matters constituted a third example: tariff structures, subsidies, product diversification, and the like, were issues that needed to be examined by the Fund and the Bank together.

In those areas and others, the competence and expertise of the Bank and the Fund overlapped, Mr. Wicks observed. However, he did not wish to argue for a blurring of the distinct responsibilities of the two institutions. What was needed was planned complementarity in their operations, based as far as possible on a common understanding of a country's problems and a shared view of the contribution that each institution could make to solving those problems. Furthermore, he was not in favor of cross-conditionality in relation to the use of the resources of the two institutions. Nor was he suggesting that one institution should take the lead in a particular country while the other withdrew. His proposals were aimed at the development between the two institutions of a shared understanding of a member's economic potential. Such understanding did not necessarily involve joint forecasting exercises, but the staffs of the two organizations should consider together in a planned, systematic way the problems faced by individual members. Each institution should recognize what it might do to help the member unlock its potential, and that recognition should be developed in a mutual fashion between the two institutions. The Fund and the Bank should also make a common effort--if necessary, in parallel--to mobilize financial resources on behalf of a member.

The Fund and the Bank each had its own administrative structure, management style, and policymaking process, Mr. Wicks went on, and, in the past, there had been a certain guardedness in their relationship. While that situation made the task of collaboration harder, it was not an excuse to avoid the challenge of developing the correct degree of collaboration. In that respect, SM/84/242 and SM/84/210 had been somewhat disappointing. The present discussion by the Executive Board was only a first step. He hoped that there would be further opportunities to continue the discussion in light of proposals by the managements of the two institutions, the comments of both groups of Executive Directors, and the reviews of the issue that were taking place in other forums. Fund-Bank collaboration would be a significant aspect of the discussion in the spring 1985 meeting of the Interim and Development Committees. Ensuring that members derived maximum benefit from the combined operations of the two institutions could make a helpful contribution to addressing the interlocking problems of development and financial stability with which both were concerned.

Mr. de Maulde remarked that he agreed with almost all the proposals made by Mr. Wicks. They were similar to suggestions made by the representative of France at the spring 1984 meeting of the Development Committee. Indeed, on the initiative of France the question had been taken up during the London Summit of June 1984. As Mr. Wicks had pointed out, the Fund and the Bank were in the same business; he had made reference to various staff documents in support of that view. It was possible to go further and to compare the text of Article I of the Articles of Agreement of each institution, which clearly established that the basic purpose of the Bank and of the Fund was to promote the expansion of international trade and the development of productivity, employment and income in all member countries.

Although they pursued the same goals and served the same members, Mr. de Maulde continued, there were two reasons why the Fund and the Bank remained separate institutions. First, the nature of their resources differed. The Fund's resources were made available by central banks that--legitimately--wished to consider them part of their liquid external reserves. The Bank's resources came mostly from borrowing in the private financial markets around the world, where investors wished to be assured that their capital had been invested in safe and productive uses. Second, the professional staffs of the two institutions had different specialities. Traditionally, the Bank concentrated on project financing, which demanded the expertise of engineers. The skills of the Fund staff lay more in financial and macroeconomic analysis. However, too much emphasis should not be placed on the second difference because it had been diminished by developments in recent years.

The conclusion that could be drawn from the foregoing analysis was that the basic rule of conduct for the Fund and the Bank should be common action, Mr. de Maulde suggested, because they had the same purpose and served the same "customers." The only restrictions to the application of that rule should be those that were unavoidably imposed by the differences in resources and in skills. Such restrictions need not be many. In sum, they amounted to the propositions that the Bank should remain able to extend longer-term financing than the Fund and that it would be uneconomical for the Fund staff to perform the intellectual work for which the Bank staff was better qualified and vice versa. All other restrictions should be eliminated because they constituted additional costs or losses of effectiveness that were borne by the "customers" of the two institutions.

Commenting on Mr. Wicks's specific proposals, Mr. de Maulde said that he agreed with all of the suggested "domestic" arrangements mentioned by Mr. Wicks at the end of his statement. Indeed, he would go further and urge that they be rapidly implemented as a first step and that both managements should launch further major studies aimed at limiting duplication, regrouping activities, and sharing facilities. Similarly, both Executive Boards should explore further means of improving the sharing of information and cross-fertilization of policies.

The most important issue was the common action that the Fund and the Bank could undertake vis-à-vis members, Mr. de Maulde considered. He agreed with the general thrust of Mr. Wicks's ideas for deepening collaboration between the two institutions; unfortunately, Mr. Wicks had been too diplomatic in addressing the problem. It was clear that the Executive Board of the Fund had become thoroughly convinced on the basis of all past experience that the Fund's so-called adjustment programs were built on foundations of sand and condemned to collapse if not properly complemented by sound longer-term structural and development policies. As he had noted earlier, one reason for common action by the Fund and the Bank was that they had the same purposes and served the same customers. A second, more important reason, was that those customers needed such common action if their problems were to be solved. As to the precise modalities of common action, his authorities had already put forward certain proposals and intended to go further in that regard. The cross-conditionality issue was meaningless. The problem was not to find ways for each institution to take a negative attitude, but for both to combine their skills and their financing in a positive fashion so as to make possible the implementation by the country concerned of a realistic economic recovery program. In reality, the Fund and the Bank were called upon to finance the same program.

Mr. Yamashita stated that in considering the issue of Fund-Bank collaboration it was important to bear in mind that each institution had to retain the original character mandated by their respective Articles of Agreement. At the same time, however, there should be deep collaboration between, in Mr. Wicks's words, "the world's two most important international financial institutions," so that their activities complemented and reinforced each other. How best to achieve such deep collaboration had been the subject of several discussions in the Fund Executive Board since the 1960s. The procedures agreed to in past discussions and that had been implemented should be reviewed from time to time in order to take account of the changing needs that arose from the evolution of the world financial environment. In that regard, the present discussion was timely, especially in view of the increasing pressure for greater efficiency and streamlining in public organizations, including international institutions. His authorities believed it was important to approach the issue of Fund-Bank collaboration in that broader context and to try to eliminate overlap of Fund and Bank business so as to achieve greater efficiency. They also believed that efforts directed to that end would be vitally important in securing continued assistance from the members of the two institutions.

Collaboration between the Fund and the Bank had assumed increasing importance in recent years, Mr. Yamashita continued, especially in the context of debt problems. A fundamental solution to the debt problem required that the member concerned should take structural measures to increase the productive capacity of its economy over the long run, while adopting and maintaining adjustment policies to improve current account balances, thereby regaining the confidence of the financial community. To assist such members fully, the two institutions should try to achieve even closer collaboration wherever feasible, and to resist sectionalism.

To implement adjustment policies effectively, the conditionality attached to lending by the Fund and the Bank--particularly, the Bank's structural adjustment loans--should be consistent, Mr. Yamashita said. In some cases, similar or identical conditionality might be attached independently by the respective institutions if deemed necessary to achieve their respective policy objectives. Furthermore, reviews of the implementation of such conditionality should be carried out in a consistent manner in both institutions. In those cases where similar or identical conditionality was adopted, each institution should be encouraged to pay due regard to the judgment of the other in the areas where the other had more expertise.

Such an approach would increase the efficiency with which programs could be implemented. Of course, it was important to retain independent and responsible management in each institution, but collaboration between the Fund and the Bank in the manner that he had described--with the two institutions adopting, where appropriate, similar or identical conditionality based on a judgment by each of how to achieve their respective goals--could and should be encouraged within the overall framework of separate identities.

Because it was important to avoid conflicting advice from the two institutions to members, Mr. Yamashita went on, it was appropriate to promote even closer contact between the staffs through regular meetings or joint committees on specific regions so as to ensure mutual understanding and familiarity with each other's viewpoints, activities, and constraints. With regard to the suggestion that an individual staff member should be designated to act as formal liaison with counterpart departments, the exact nature of that device was not made clear by the staff in SM/84/242. If the designated staff member was to be occupied only on liaison work, considerable additional manhours might be involved, which could be too costly. It could also be an inefficient way of communication compared with direct contact between the staff in each institution responsible for a particular country. However, the device might serve its purpose well if it was understood by everyone concerned that it could only be a subsidiary instrument involving few extra manhours and that the relevant staff must have its own input if there was to be meaningful cooperation.

The suggestion that the staffs of both institutions should be encouraged to attend or participate in the Executive Board meetings of the other could be helpful in certain cases, Mr. Yamashita considered. If the staff was requested to answer delicate questions at a meeting of the Executive Board of the other institution, it should be able to bring the question back to its own institution and to seek the view of its management or Board. Another suggestion in SM/84/242, namely, that the Fund staff could prepare and transmit to the Bank staff a note listing all the questions on Bank issues raised in a Fund Executive Board meeting, could also be helpful. In that regard, he wondered why the Bank staff had indicated that it would be difficult to make such an arrangement reciprocal.

The statement by Mr. Wicks and his list of proposals could provide a useful basis for further reflection on the important issue of Fund-Bank collaboration, Mr. Yamashita stated. In particular, his authorities would place strong emphasis on harmonized diagnoses, particularly on the importance of arriving at consistent balance of payments and financing gap estimates, which should be the basis for any external financing exercise. Finally, his authorities believed that the issues should be considered again by the Executive Board, in the light of discussions to be held by the Bank and by the Deputies of the Group of Ten. Nevertheless, those steps that were mutually acceptable should be implemented as soon as possible.

Mr. de Groote commented that the issue of Fund-Bank collaboration had long been a recurrent theme in the deliberations of the Executive Board. It had assumed even greater importance in recent years because of the payments difficulties of many heavily indebted countries and the resulting need for them to improve their domestic policy environment. It should be emphasized that in the great majority of cases collaboration between the Fund and the Bank had worked satisfactorily. There had not been many cases of conflict between the Fund's recommendations and what the World Bank considered to be necessary conditions for the successful implementation of the projects that it was financing. Conversely, the Fund had generally tried to integrate development strategies supported by the Bank into the design of the adjustment programs of members. The experience with the countries in his constituency fully corroborated the conclusion that there had generally been uniformity of views on the blend of balance of payments policies advocated by the two institutions for the developing countries in his constituency. Turkey, for example, had been the first case in the Fund where developmental factors had become an integral part of the medium-term balance of payments scenarios devised by the Fund staff.

Divergences of view had occasionally arisen in the past and would continue to do so in the future, Mr. de Groote continued. They were normal between institutions that had the responsibility of addressing the economic situations of their common members from different viewpoints. Therefore, Executive Directors should not conclude when divergent views existed that the country concerned should not be entitled to use the resources of one or both institutions. The issue of Fund-Bank collaboration was in no way a matter of establishing cross-conditionality. There could be no question of making decisions adopted by either institution dependent on the satisfactory adherence to conditions imposed by the other. It was possible to contemplate cases where the Bank lent to a country that was unwilling to engage in a Fund program, provided that the Bank was satisfied that policies were being pursued that permitted the full realization of the benefits of the project or program that it was financing. In such a case the issues should be brought out clearly before the Executive Board of the relevant institution, and the Board should accept its responsibility to come to a judgment with full knowledge of all the relevant facts. As the staff had convincingly pointed out, there was no case for subordinating either institution to the other in their respective areas of responsibility. Because the Fund and the Bank often found themselves intervening simultaneously in the same country, and because each was striving to achieve the same objectives, it was normal to seek to streamline the actions of both institutions; that was what collaboration was about. The interdependence and complementarity of their actions should be stressed, but without creating new dependencies between them.

It was inappropriate to continue to present the issue of Fund-Bank collaboration in terms of Fund responsibility for short-term problems and Bank responsibility for the medium and long term, Mr. de Groote suggested. Nor was it appropriate to continue to present the collaboration in terms of the Fund being responsible for demand management and the Bank being concerned with supply responses. The Second Amendment to the Articles of Agreement and the Fund's continued practice since then in dealing with structural payments imbalances had clearly made the Fund responsible for all issues relating to balance of payments adjustment, while the Bank oversaw the development policies of its members. That division of labor implied that the Fund should pronounce itself on all elements that bore on the balance of payments, including the evolution of costs, exchange rates, monetary and fiscal policy, and structural factors, because it was impossible in some cases to influence the balance of payments in a positive direction without structural reform. Many of those issues also happened to be development issues over which the World Bank had to exercise its responsibility. Where the responsibilities of the two institutions overlapped, their actions should as far as possible be mutually supportive and complementary, and active discussions between the staffs and joint evaluations of policy should be established.

The occasional problem in Fund-Bank collaboration arose from the need to link financing more closely to adjustment, Mr. de Groote remarked, an approach that was familiar to the Fund but to which the Bank had only recently been led to give attention. Indeed, in the past, the Bank's lending program had been based to a limited extent on the idea of the distribution of resources among countries in accordance with their changing payments needs and to a much greater extent on criteria designed to identify their development needs. Even at present, that point was largely true. Since the distribution issue was highly sensitive and political, there had been a tendency to avoid changes in the ways financing flows were distributed to the recipient countries. Financing had traditionally been geared to the time path of specific projects, and adjustment issues had been largely excluded in the determination of those flows. Substantial progress had been made by the Bank in recent years in establishing a link between financing and adjustment through the introduction of structural adjustment lending, program or sectoral lending, and the Special Action Program. Despite that recent and welcome change in the Bank's approach to economic policy in member countries, its approach remained far from consistent with the Fund's way of looking at those issues. No set of procedures would ever succeed in automatically reconciling the two different approaches. The only way to prevent their collision was for the Fund and the Bank to provide each other with better information about their respective actions and intentions in individual countries.

On further steps that could be taken to improve the collaboration between the two institutions, Mr. de Groote observed, clear procedures had been established since 1966 that amply covered the sharing of information. They did not need to be improved or further elaborated; instead, they needed to be implemented more effectively. The real issues were the style and practice of cooperation, not new rules. Every staff member of either institution with responsibility for a given country should feel responsible for maintaining rapport and effective collaboration with his opposite number in the other institution.

Another major area where there was scope for progress in improving dialogue between the Fund and the Bank was participation in each other's missions, Mr. de Groote went on. The downward trend of recent years in the number of missions with joint staffing was not encouraging. Bank staff had taken part in only 8 out of more than 300 Fund missions in 1983. Even if Article IV consultations and reviews under stand-by arrangements were excluded, the figure was low, given that 44 countries had been using Fund resources in that year. Experience had shown that consultations between Fund and Bank staff prior to missions and debriefings afterward were not sufficient to promote better understanding and harmonization of points of view, and that participation in missions improved the awareness of each institution about the other's specific concerns and about any difficulties between the institution and the member.

In addition to improving understanding of each other's actions, Mr. de Groote said, the Fund and the Bank should also strive to achieve better complementarity between their actions. First, harmonization of the diagnoses made by the two institutions would be required, as pointed out by Mr. Wicks, which was another area in which participation in each other's missions would prove useful. The common understanding of a member's economic problems should then lead to an assessment of the mutual contribution of each institution in helping the member address those problems. The harmonization of diagnoses would not imply the introduction of cross-conditionality, but only an agreement on economic policy and advice and, where needed, on an appropriate time profile for Fund and Bank financial assistance. Indeed, the Bank should actively work with the Fund to assess medium-term financing needs of member countries. When the Bank had identified for a member suitable development policies, it should, together with the Fund, see how the ensuing financing requirements fitted into the financial constraints imposed by the market.

In the course of such an evaluation, the Bank and the Fund would each have to determine its financial contribution, independently and on the basis of its own policies, but within the framework of a common diagnosis, Mr. de Groote stated. The Executive Board would then be in a position, when considering a request for the use of Fund resources or during an Article IV consultation, to take account of the longer-term development objectives of the country and to see how a stabilization program or the policies advocated in the course of an Article IV consultation could contribute to those objectives. Such an approach might require providing space in Fund staff appraisals or in annexes to Fund documents for an assessment by the Bank of the country's longer-term development objectives and for an indication of how the Bank intended to address those issues. In that way, the Bank staff would be given an opportunity to see how its investment programs fitted into the macroeconomic policy setting of the member. Similarly, the Bank might find it useful, when discussing proposals for structural adjustment loans, or for project lending, to integrate into Bank documents the Fund's assessment of the more immediate adjustment requirements or of the appropriate policy setting of the borrowing country. If clearly identifiable differences of views persisted, they should not be solved at all costs at the staff level but instead should be submitted to the appropriate Board, which could then discuss them with full knowledge of all factors affecting that particular country. That Board would then make an independent judgment.

The kind of approach that he had suggested would, of course, entail the participation of staff members of each institution in the Executive Board meetings of the other institution, Mr. de Groote observed. He agreed with Mr. Wicks that the staff's concern about possible problems in that regard were exaggerated and considered that such participation was desirable and capable of being implemented without delay. However, it might take some time to establish the various practices for improving collaboration. The Fund staff was more open and flexible in that respect, since it was accustomed to assessing immediately and in depth general economic policies and to expressing its viewpoint when questioned by the Board. The Bank staff was less accustomed to that way of proceeding; a transitional period would be required during which both staffs could become familiar with the different procedures of the two Boards.

Collaboration should not be envisaged as a measure to be implemented only in times of crisis, Mr. de Groote commented. In emergencies, there was generally no problem in establishing collaboration. However, to prevent the emergence of conflicts, collaboration should be the general practice. The Fund staff should routinely consult the Bank with regard to the impact of Fund-supported adjustment programs on the development programs of members. The Bank should consult the Fund in considering the macroeconomic settings of the projects that it financed in order to evaluate the balance of payments implications of a country's development strategy. A permanent working relationship should be established so as to offer the real possibility of continuing "cross-fertilization," as Mr. de Maulde had put it. Finally, he fully agreed with various suggestions made by Mr. Wicks.

Mr. Finaish noted that, given the increase in nonproject lending by the Bank that was related in some form to the balance of payments as well as the move in the Fund toward longer periods of adjustment and greater attention to structural and supply-side aspects of payments problems, the area over which the functions or responsibilities of the two institutions overlapped had grown appreciably. That development reflected an adaptation to the experience of the past decade demonstrating that a durable resolution of payments problems in many cases required a medium-term adjustment strategy that should encompass measures to deal with structural problems. The increase in the common ground between the two institutions had necessitated greater collaboration between them in order to ensure that their policies and activities were mutually consistent and complementary. Measures that could make collaboration more effective should, thus, be supported. At the same time, it was important that policymaking in the two institutions continue to recognize fully their separate identities and roles and their fairly distinct areas of primary responsibility. The preservation of separate identities and roles was compatible with the promotion of collaboration, because collaboration involved making better use by one institution of the expertise and information available to the other in its recognized field of primary responsibility.

The approach to collaboration should, therefore, be balanced, Mr. Finaish continued. It should avoid overzealousness or excess, for excess of anything could be bad, even of good intentions for collaboration, as the hoped-for gains could be marred by a lack of focus, diffusion of tasks, too many procedures, and delays in the flow of work. An overzealous approach to Fund-Bank collaboration could, thus, be counterproductive. Effective collaboration should be sought in carefully identified areas where functions overlapped. In other areas, a clear separation of roles should be preserved and cooperation should be sought indirectly through concentrating on the effective discharge of separate functions, which should in general be mutually reinforcing in the final analysis.

The purpose of collaboration should, of course, be to improve the quality of services provided by the two institutions to their membership, Mr. Finaish remarked. In the case of Fund-supported adjustment programs, collaboration with the Bank should permit improved program design, with the policy composition of programs better matched to the requirements of individual cases and with adjustment better harmonized with growth. Such a result should be possible because the tapping of Bank expertise and information on supply-oriented adjustment should lead to a wider set of adjustment policies that could be effectively considered for inclusion in a program, thereby permitting greater flexibility in the choice of measures. Bank involvement in the formulation of Fund programs should, thus, lead to the design of more appropriate conditionality, and not to additive conditionality, namely, the simple addition of one set of conditionality to another. Furthermore, the conduct of collaboration should avoid creating apprehensions that it could become, in the words of the communiqué of the Ministers of the Group of Twenty-Four at the time of the 1984 Annual Meeting, "a means of exerting concerted pressure on borrowing countries." Collaboration should also avoid the apprehension that it could lead to reducing the lending operations of the two institutions to some kind of lowest common denominator.

Cross-conditionality was a related issue, Mr. Finaish went on. In previous discussions of Fund-Bank collaboration, the view had been clearly stated that collaboration between the two institutions should avoid giving rise to cross-conditionality. In his summing up of the previous Executive Board discussion of the subject (EBM/81/62, 4/20/81), the Chairman had stated that "the management does not support at all any notion of cross-conditionality." While policy on the matter should indeed be stated clearly, care needed to be exercised to avoid subjecting programs to cross-conditionality in practice. The objective of collaboration with the Bank should be to make use of Bank expertise and information on matters that were relevant to the Fund in the exercise of its functions.

The way that the Fund used the advice furnished by the Bank and how it bore on its lending operations should be up to the Fund to determine in line with its own policies and criteria.

While it was useful to have a clearly spelled out set of policies and guidelines for Fund-Bank collaboration, Mr. Finaish commented, the Executive Board should avoid establishing procedures that were too rigid and that might not allow sufficient flexibility in the day-to-day conduct of collaboration. The case for flexibility could be illustrated with respect to the practice of seeking the Bank's assessment of a member's public investment program in considering requests for use of Fund resources. For example, the need to seek such an assessment, and the weight attached to it, would depend on the nature of the Fund arrangement and the relative importance of public sector investment in the country in question. Moreover, in cases where a detailed Bank assessment was not available or would cause delay, it might be sufficient to proceed with a Fund arrangement on the basis of a broad indication by the Bank of the thrust of the public investment program.

An important factor behind the renewed interest in the subject of Fund-Bank collaboration was the debt problem, Mr. Finaish observed. The subject had been raised recently in several forums in the context of discussions of policies to deal with the debt problem. In the continuing debate in the Bank on its future role, a key question being discussed was the appropriate role for the Bank vis-à-vis debtor countries and in relation to the Fund's role. In those and other discussions, several relevant questions had been raised. They included the assignment of responsibilities to the Fund and the Bank, in keeping with their respective characters, to deal with a problem that had both short-term and long-term aspects, and that was both financial and structural in nature; how well a supportive role by the Bank in the debtor countries could mesh with Fund adjustment programs while they were in effect; and how the Bank's longer-term involvement with its members could be useful in complementing the Fund's work in debtor countries in the period following the completion of Fund programs. While the debate on those questions had been interesting, they would need to be considered further if practical suggestions were to be derived on ways in which Fund-Bank collaboration could be strengthened in a constructive manner with respect to the debt problem.

The existing procedures for collaboration as described by the staff in SM/84/210 and SM/84/242 appeared to be generally adequate, Mr. Finaish considered. The problems that had been encountered in practice seemed to be related more to difficulties of implementation, the solution to which lay mainly in improving implementation in the light of actual experience. Differences in policy assessments between the staffs of the Fund and the Bank were only to be expected, given the different nature of the functions of the two institutions and their different vantage points. To a certain extent, initial differences in points of view could indeed be useful for a more in-depth discussion of the issues involved. It was, however, a matter of concern when differences of viewpoints were translated into conflicting or inconsistent policy advice to members, or when delays occurred in the resolution of the initial differences in assessment. Both possibilities carried adverse implications for the countries concerned. The incidence of such cases could be minimized through closer cooperation between the respective operational staffs; better mutual understanding at the conceptual level of the structural aspects of adjustment--especially those on which differences of view had arisen more frequently--through joint staff seminars and improved coordination between the functional departments; and effective implementation of procedures for the expeditious reconciliation of differences that persisted at the operational staff level.

In addition to cases of inconsistent policy advice, there had been cases reported where conflicts had emerged between Fund program ceilings and the implementation of the Bank's planned financial operations, Mr. Finaish said. Such cases had not been specifically addressed by the staff; it would be helpful, therefore, if the staff could comment briefly on how they arose, their incidence, and how they were resolved. With regard to the problem of delays that sometimes occurred in the availability of Bank assessments, and the impact that such delays could have on the timing of Fund programs, the relevant Bank staff should be approached with the request for the specific input at as early a stage as possible.

To improve cooperation in the field, staff participation in the missions of the other institution could be useful in some cases, Mr. Finaish went on. The need for such participation, particularly for parallel or joint missions, should be carefully determined in each case. Parallel missions could place a heavy burden on the relevant government staff in some countries, especially when the missions were large and frequent, as in many cases of use of resources. Joint missions could lead to diffusiveness or a lack of focus in the discussions, unless they were sent to study a specific well-defined issue.

Staff attendance at Executive Board meetings of the other institution on relevant country and policy items could be a useful means of expanding the exchange of information between the two institutions with respect to Board discussions, Mr. Finaish added. Although a general invitation had been sent by the Fund to the Bank as early as 1970 to send a staff member to attend Fund Board discussions on country matters, it appeared that no such attendance took place even at present from either side. He invited the staff to explain the present procedure with respect to such attendance. The suggestion that attending Bank staff members might also answer questions at Fund Board meetings could also be useful, in that it would make available to the Executive Board fuller information on relevant Bank-related matters at the time of the discussion. However, to the extent that the Fund staff itself could be adequately briefed to answer questions on those matters, which was currently not the case in many instances, such a procedure would not be necessary. The suggestion that at the conclusion of a Board meeting the staff should prepare a note for transmittal to Bank staff listing all Bank-related questions raised in the discussion could also be helpful. It should, however, be noted that if the Fund staff was to be able to answer Bank-related questions during the same Board discussion it would require adequate information on such questions from Bank staff prior to the discussion.

Procedures existed at present for the exchange of country papers and documents among the relevant staff of the two institutions, Mr. Finaish noted. It would also be useful if procedures could be instituted for making available to the Board and relevant staff of one institution papers on policy matters of common interest prepared by the other institution. As suggested by Mr. Wicks, the amalgamation of activities on debt statistics of the two institutions could be explored further. Finally, while it was useful to review from time to time the procedures for Fund-Bank collaboration, as had occurred in the past, the suggestion that there should be regular, perhaps annual, reports on the subject to the Interim Committee and/or Development Committee appeared to be excessive.

Mr. Joyce observed that the issue of Fund-Bank collaboration was one of the most important facing the two institutions at present. The staff correctly noted that under their respective Articles of Agreement the Fund and the Bank were to cooperate closely in the shared objectives of promoting balanced growth of world trade, balance of payments stability, and high levels of growth and employment. Of course, while each institution had different areas of specialization, the basic need for cooperation and collaboration had always been recognized. Indeed, if anything, the requirement for cooperation had grown as the problems facing the organizations had become more complex and the difficulties of many countries had been compounded. Balance of payments problems in many countries could no longer be readily solved in the short term. The problems were more deep-rooted and reflected underlying structural difficulties. Resolving them would take time and would require in many instances help and advice from both institutions. The key issue was the respective role of each institution and how to avoid duplication, particularly when there were areas of overlapping interest and responsibility. Thus, the division of labor between the organizations and the ways in which they worked together were worth considering again, especially in light of the debt situation and the difficult choices imposed at present on many countries by the need to pursue stabilization and adjustment policies that at times were thought to run counter to, or at least to delay, the attainment of longer-term development objectives. It was also time to look more closely at the impact of the organizations' combined activities on particular countries and on the workings of the system as a whole.

The issue of Fund-Bank cooperation had been addressed on numerous occasions, Mr. Joyce recalled. The guidelines set out in the joint memorandum of February 19, 1970, and other directives of the respective institutions, had provided a good basis for closer cooperation. Moreover, the system of formal and informal contacts and consultation at staff and management levels has worked reasonably well, far better than many people outside the institutions were led to believe. Nevertheless, steps could be taken to improve procedures and he supported most of the staff's conclusions in SM/84/242 and most, although not all, of Mr. Wicks's proposals.

Fund-Bank collaboration should not mean a blurring of the functions of each institution, Mr. Joyce continued. Each had its own mandate and its own expertise that had been developed over time. Each was responsible to its own Executive Board and Board of Governors for the execution of its duties and the use of its resources. While there was no doubt that each organization ought to take into account the nature of the problems and the policies in the areas of expertise of the other in deciding on the use of its own financial resources, such an approach did not mean that in particular circumstances the Bank ought to have a veto power over the use of Fund resources or vice versa. Collaboration meant that the management and staff of both institutions and the Executive Boards should be kept fully informed of what the other institution was trying to achieve and what it planned to do. It also meant that they should take each other's views into account in deciding on issues of mutual interest.

In that respect, concerns had been expressed on various occasions, and at the present meeting, about cross-conditionality, Mr. Joyce noted. Cross-conditionality was to be avoided precisely because it could limit the capacity of each institution to act independently. As the staff correctly pointed out, it was vital for each institution to maintain its independence in setting lending standards. However, the Fund or the Bank could not turn a blind eye to the economic situation in the country or ignore those circumstances that could inhibit the effectiveness of the programs that they were supporting. The Bank had to ask itself if the economic and political situation was propitious to the achievement of the objectives that the Bank sought, whether or not the Fund was supporting a program in the country concerned. The Bank might judge that in the absence of certain basic policy changes the overall development strategy for that country was not going to work. It might, therefore, take the position that it was unwilling to proceed in the absence of certain changes, for example, in the price structure, in the management of parastatals, or even in the exchange rate. Whether such changes were to be achieved under the aegis of a Fund program was irrelevant. Of course, if a Fund program existed and if the Fund had expressed concern about such matters and was setting out certain requirements with respect to some of the features of its program, the Bank would be interested in the extent to which success was being achieved. However, such a situation did not represent cross-conditionality; it was, rather, a matter of parallel concern and, indeed, of ordinary good sense.

Similar considerations applied with respect to Fund programs, Mr. Joyce added. In extended arrangements, the timing and degree of structural adjustment were key factors, and the Fund often turned to the Bank, appropriately, for advice on such matters that lay outside its competence and yet were essential to the achievement of the medium-term objectives agreed with the country. Again, cross-conditionality was not involved; rather, it was a matter of cooperation in light of the relevant concerns and functions of each organization.

The determination of the appropriate mix of balance of payments financing and adjustment had to remain the responsibility of the Fund, Mr. Joyce stated. As the staff noted, the Fund neither could nor should provide all the balance of payments support needed by members. It was essential, however, that all such assistance should be properly coordinated so as to ensure that the appropriate degree of adjustment and conditional financing was applied. An example where such considerations might involve both institutions was when a country was engaged in an extended arrangement with the Fund and was a recipient of a Bank structural adjustment loan. In that respect, the Managing Director's memorandum of June 9, 1980 (EBD/80/161) was particularly relevant.

Commenting on specific procedures, Mr. Joyce said that his authorities believed that the various measures outlined by the staff, including participation in joint missions and regular meetings of the two staffs, were wholly appropriate. He stressed that no matter what institutional arrangements were created, continuing efforts on the part of staff and management would be necessary to ensure that effective collaboration took place at all levels. The Executive Board could play a useful role by encouraging the staff to include, to the extent possible, information on recent World Bank activity in a country, the Bank's objectives, and its views on recent developments within the Bank's area of expertise. He hoped that the Bank would do the same with respect to Fund activities. He had no objection to selected Bank staff members attending the meetings of the Fund Executive Board, provided that the arrangement was mutual. He shared Mr. Yamashita's view that it was strange that the Bank staff might have difficulty in providing a note for Fund staff on any Fund-related questions that might arise during discussions in the Bank's Executive Board. Such an attitude was contrary to the spirit of enhanced cooperation; it would be interesting to hear the reasons behind it.

Although he agreed with most of Mr. Wicks's suggestions, Mr. Joyce remarked, he could not accept that it was necessary for the Bank and Fund to prepare consistent country economic analyses. Of course, agreement of views was welcome. Nevertheless, there would be instances when the forecasts by the Bank and the Fund might differ. While such a situation could be embarrassing to the institutions and perhaps confusing to outside observers, it should not be regarded as surprising. Differences of view among economists were to be expected, even within the Fund. Therefore, it should not be a matter for concern that the Bank's economists might sometimes be more optimistic than Fund economists; indeed, their emphasis on development and longer-term issues could lead them in that direction. However, differences in forecasts need not create problems so long as the reasons for them were clear and the differences themselves were not so fundamental that they resulted in Bank and Fund scenarios that were incompatible. The emphasis should be on compatibility, not identity, of strategies and scenarios. If serious differences persisted, the resolution of the conflicting views might have to be made at a higher level than the staff. If such resolution was not possible, the Executive Boards should be appraised of the extent of the differences and of the implications for their respective programs. As a minimum, there should be an understanding that, whatever the outcome of the forecasts, each institution would be prepared to adjust its strategy, if necessary. Finally, once the question of cooperation had been discussed by the Executive Board of the Bank, the managements of the two institutions should prepare for Executive Board consideration a program of action, including provision for periodic review of the adequacy and functioning of that program.

Mr. Grosche stated that the Managing Director's memorandum of June 9, 1980 (EBD/80/161) continued to provide the appropriate principles for Fund-Bank collaboration and a good base for its practical implementation. However, in the four years since the memorandum had been circulated, there had been only minor improvements in day-to-day implementation. It was, therefore, somewhat disappointing that the staff had not provided the Executive Directors with many new ideas on practical ways to enhance cooperation between the two institutions. The most important proposal made by the staff was to strengthen the contacts between the two staffs; while such a step was appropriate, there was clearly scope for further action and, in that regard, he could support a number of the proposals put forward by Mr. Wicks.

The Bank and the Fund each had its particular objective that it had to pursue in the framework of its own responsibilities, Mr. Grosche continued. The areas in which they operated were closely interrelated and, as a first step, both institutions should collaborate closely in order to harmonize diagnoses along the lines suggested by Mr. Wicks. From such dialogue, a coordinated effort to help members to adjust financial policies and to improve their growth prospects should emerge. While pursuing complementarity, each institution would have to pay due respect to the particular role of the other in cases of conflicting views. For example, the Bank would accept that the Fund had to play the leading role in overseeing exchange arrangements and exchange rates. In that context, he fully supported the staff's view that "the Fund has responsibilities to exercise surveillance over the compliance by members with the obligations regarding their exchange arrangements. These are responsibilities that the Fund has to discharge at all times and vis-à-vis all members; they can neither be shared with nor delegated to other international institutions."

It could be argued that the Bank, when providing assistance to members, should take into account the macroeconomic view developed by the Fund in the course of Article IV consultations even if no financial arrangement with the Fund was in place in the country concerned, Mr. Grosche considered. The Bank's effort to enhance development and growth would only be fully effective if the right macroeconomic policies at the national and global level were pursued. As Mr. Joyce had pointed out, such a view did not involve cross-conditionality. As a minimum, cooperation between the Bank and the Fund should ensure that advice offered by one institution was not at variance with the view of the other. Many countries would be better off if Bank assistance at the microeconomic level had been supported by macroeconomic policies along the lines of Fund advice. Better results could be expected in future if the Bank looked to the Fund for its views and vice versa, particularly in countries where adjustments took a relatively long time and where the Fund's catalytic role was more important. In those countries, the Bank had to assume a crucial role in assisting structural adjustment efforts.

Collaboration between the two institutions was easier said than done, Mr. Grosche remarked, especially given the administrative structure of the Bank and the pace of its activities. It would be helpful to explore whether and when the suggestions put forward by Mr. Wicks could be implemented. Perhaps the staff could produce a further paper on the practical implementation of those proposals. With regard to the suggestion that the Bank staff should participate actively in discussions of the Fund Executive Board, the idea could be explored further, but at present he was more inclined to support the staff's arguments than those of Mr. Wicks. An observer role for both staffs would appear to be sufficient, provided that each staff had been fully informed by the other so that, for example, the Fund staff could respond to Directors' questions on Bank issues in a satisfactory manner. To that end, a communication system had to be put in place along the lines proposed by the staff on page 15 of SM/84/242. He shared the interest of other speakers in knowing the reasons why the Bank staff would find it difficult to make such an arrangement reciprocal. The staff could also explore further the idea of adding to the cover note of relevant Fund documents the name and telephone number of the Bank staff member who was in a position to answer questions relating to the Bank's involvement in that particular country.

In his statement, Mr. Wicks had quoted the following passage from the latest World Bank Annual Review of Project Performance Audit Results, Mr. Grosche recalled:

> In order to be meaningful and effective, Bank-Fund collaboration in countries where both are active must extend beyond formal staff cooperation to planned complementarity between the programs of the two organizations.

He too agreed with that proposition and would go one step further. In light of the considerations that he had mentioned, each institution should look to the other for views even if only one was actively involved in a country with a financial program.

Mr. Robalino said that he supported the main thrust of the staff's comments in SM/84/242 and in SM/84/210. He particularly welcomed the staff's adherence in SM/84/242 to the view that had been stressed by Executive Directors in previous Board meetings concerning the need to avoid cross-conditionality. The Fund and the Bank were, and should remain, independent, and each should be responsible for ensuring that its own lending standards were met, thereby avoiding cross-conditionality. All financial arrangements with either institution should remain clearly separate from each other and differences of views between the two institutions should not interfere with each other's decisions on lending.

The penetrating remarks by Mr. Wicks were also welcome, Mr. Robalino continued. He strongly supported the proposal for informal joint meetings or seminars of the two Executive Boards and for more extensive documentation of the objectives, time frame, and progress of Bank programs in Fund Article IV consultation reports. On the other hand, he shared the staff's cautiousness concerning the problems that could arise with regard to the accountability of Fund staff; the Fund should proceed more cautiously than suggested by Mr. Wicks with respect to joint preparation of and participation in missions as a normal practice. A case-by-case approach should be the rule in determining the convenience of joint missions, not only because of the constraints arising from the heavy work pressure felt by the Fund staff, who sometimes would not have time to read critically all Bank papers, but also because in many cases the Bank was associated with projects that did not have a clear relationship to the macroeconomic perspective of Article IV consultations.

Although he agreed with most of the staff's conclusions, Mr. Robalino commented, he was not convinced by the suggestion that the Fund staff should prepare and transmit to the Bank a note listing all the questions raised on development and Bank-related issues in Fund Executive Board meetings and that it should add a summary of the associated discussion. The staff indicated that the Bank staff would find it difficult to make such an arrangement reciprocal. It would be unfortunate to create a double standard; moreover, it was doubtful whether all pertinent questions and the subsequent discussion, which was often complex, could be set down without the benefit of the final minutes. The best approach would be to limit the staff's comments to the main points on Bank-related issues addressed in the Chairman's summing up.

The staff did not make clear what mechanisms and procedures might be used in the absence of full agreement on policies by the two institutions, Mr. Robalino remarked. For example, in certain cases, the Bank had negotiated loans to members, the proceeds of which were to be re-lent at a fixed rate of interest while the exchange risk was to be covered by the treasury or central bank of the country. As Directors were aware, the Fund did not usually support such a policy because it could give rise to subsidies; consequently, the member could be faced with the choice of canceling the Bank loan or increasing the fixed interest rate to such a level that the loan would be uncompetitive with other, domestic options.

To take a second example, Mr. Robalino went on, some Bank operations required a counterpart amount of domestic currency as a necessary condition for the disbursement of Bank loans. Those counterpart funds might be of such amounts that they would exceed the ceilings of the performance criteria of a Fund program, perhaps the net domestic asset ceiling of the central bank or the ceiling on the public sector borrowing requirement. Improved collaboration between the Bank and the Fund required that the Fund's performance criteria should be designed to take into account the counterpart funds required by the World Bank. While he did not have specific suggestions on how to solve such problems, arrangements could be made to work more effectively if there was full understanding of the working procedures of both institutions and if there was a full exchange of information between the staffs and managements of both.

Mr. Zecchini observed that Fund-Bank collaboration had been a recurrent theme in Executive Board meetings over the years and was a crucial issue in every discussion of adjustment in developing economies. The fact that the subject was being brought forward for discussion again raised the question of which shortcomings in the current approach needed to be overcome. Recent observations made on behalf of some members suggested that, first, the roles of the two institutions had evolved in the past decade in such a manner as to broaden the area where their activities overlapped. As a result, the probability of contradictory approaches to economic problems of member countries that could lead, inter alia, to inconsistent recommendations for action had risen. Second, the financial needs of debtor countries had assumed characteristics that made it increasingly difficult, if not impossible, for each institution to solve them without coordinating its intervention with the other as well as with other financial intermediaries. Third, the actual implementation of the current collaboration procedures had fallen short of expectations as far as the effectiveness of the results was concerned.

It was impossible not to agree with the contention that both institutions, insofar as they assisted members to attain balanced economic expansion, shared to a large extent the same ultimate goals, Mr. Zecchini continued. However, within that framework, there were strong reasons why the two institutions had to perform distinct functions. The attainment of the same goal involved the attainment of intermediate targets that were different in nature and in their time dimensions: such differences had made it necessary in 1944 to establish two separate organizations empowered with different instruments for intervention. Although the world economic conditions had evolved substantially over the years, the separation of roles continued to be justifiable for the reasons that he had mentioned, particularly after the Second Amendment of the Fund's Articles of Agreement. In that respect, there was at least one fundamental function that was a specific, direct concern of the Fund, namely, the exercise of surveillance over members' exchange rates and macroeconomic policies in general. Indeed, that responsibility was more than a function, it was an obligation, and it could not be shared with other institutions.

While there was a need to avoid duplication in the organizations' roles, Mr. Zecchini observed, the distinction of functions should not be overemphasized. Because each institution's function complemented the other's--as each aimed at helping to solve the same country's problems--large areas of overlapping competencies of the two institutions could emerge. Such areas had been increasing in recent years, especially after the breakdown of the system of fixed parities and the two rounds of oil price increases. Thus, better collaboration between the two organizations was needed, although they should maintain well-defined and differentiated functions.

With regard to the provision of financial assistance to members, Mr. Zecchini said, it was clear that the circumstances that triggered such assistance, the time frame, and the sources of financing differed between the two institutions. It was not by chance that 80 percent of the Bank's financial assistance continued to be project related, that the average maturity of the Fund's total outstanding credit was less than 4.5 years compared with about 12.3 years for the Bank (excluding IDA), and that the Fund had not yet drawn on the financial market for its resources. At the same time, assistance from both institutions benefited a country's balance of payments position in the short term through the inflow of currency and in the longer term by strengthening the efficiency of domestic resource use and competitiveness of the entire economy. Therefore, there continued to be room to improve the coordination of the two approaches to financing.

Commenting on the operational aspects of collaboration, Mr. Zecchini noted that the scope of Fund-Bank cooperation was a function of evolving world economic conditions. Consequently, procedures should be relatively flexible, and the Executive Board should limit itself to setting the conditions under which fruitful collaboration could arise and develop in practice.

The question of coordination of the two institutions' intervention in specific countries was most delicate, Mr. Zecchini went on, partly because the areas of responsibility did not fully coincide and partly because there was no adequate experience of close collaboration in that field. As far as the preparation and implementation of programs of financial assistance in relevant countries were concerned, there should be an intensive exchange of views on program design and, during the subsequent phase of program development, an approach that ought to ensure consistency of action and the success of the program on more than one front, with the ultimate aim of achieving the twin objectives of adjustment and growth.

It was crucial in countries experiencing protracted, sizable balance of payments difficulties to ensure a coordinated approach by the two institutions to country financing, Mr. Zecchini considered. Such an approach would involve a coherent understanding of the country's financial needs, careful design--through informal contacts--of the amount and timing of the assistance to be provided by each institution in conformity with their respective financial characters, a common effort to attract the critical financial resources, and, subsequently, periodic exchanges of views to monitor and adjust the financial program. The realization of effective collaboration in Washington would reduce the need for cross-participation in missions, which probably created more practical problems than tangible benefits. However, such participation, as well as joint missions, should not be ruled out in principle, but it should remain the exception rather than the rule. With regard to the delicate and frequently mentioned issue of cross-conditionality, he agreed with the staff's comments; however, cases might arise in which financial assistance from one institution hampered the effectiveness of the conditionality required by the other, thereby ultimately reducing the effectiveness of the action of either institution. That problem deserved further consideration as it was integrally connected with the overall issue of Fund-Bank cooperation. He agreed with Mr. Wicks that closer coordination of technical assistance might also be needed, particularly in areas of common interest, such as taxation and the management of state enterprises.

The exchange of information was fundamental, and improvements should be sought in that area, Mr. Zecchini stated. A number of the suggestions by Mr. Wicks related to the activities of the Executive Boards: for example, reports for Article IV consultations should include--and already did include to a certain extent--analysis of Bank involvement in a country, with particular emphasis on the macroeconomic implications. Moreover, the Executive Boards should constantly be in close contact to ensure the best possible coordination of policies. There should be personal contacts, cross-participation of Executive Directors' staffs in Board meetings as Temporary Alternate Executive Directors, and informal meetings among Directors whenever deemed useful. On all those points, Mr. Wicks's proposals were useful and properly went beyond the simple exchange of minutes proposed by the staff. Furthermore, cross-participation of staff members in Board discussions could occasionally be helpful. For the reasons mentioned by the staff, such a step should only be taken in selected circumstances, and the Fund Board should be consulted beforehand.

There should also be a close exchange of information between the staffs of the two institutions in relation to analysis of specific countries--for example, for Article IV consultations or country analyses by the Bank--broader research issues, and the collection and organization of statistics, Mr. Zecchini remarked. Outgoing and incoming missions should organize meetings whenever necessary to keep colleagues in the other institution informed of relevant developments in countries of common interest. An important point mentioned by the staff was the coordination of scenarios for the World Economic Outlook. While the scenarios were necessarily conditional on a set of assumptions about the economic environment and should not be seen strictly as forecasts, the choice of values in those assumptions and the development of the different scenarios undoubtedly constituted a view of what was likely to happen, and could not but reflect opinions on current economic trends. Therefore, the environmental assumptions for the annual projection exercise should be carefully coordinated between the two institutions, and diverging opinions should be debated and, whenever possible, reconciled.

Within the general framework of increased contacts between the staffs of the Fund and the Bank, importance should be attached to the development of training and personnel exchange programs that could help to improve each institution's understanding on matters of common interest, Mr. Zecchini suggested. He welcomed the indication by the staff in SM/84/210 that in the future more frequent contact between the IMF

Institute and the Bank's Economic Development Institute seemed likely. Part of the courses offered by the IMF Institute to officials of member countries should focus on matters of joint Fund-Bank concern. He personally found appealing the idea that staff members might be allowed, on a strictly voluntary basis, to take temporary appointments in the other institution, an experience that could not fail to broaden the analytical perspective of the host departments and the staff members involved. However, he did not have specific suggestions in that regard and looked forward to the comments of other Directors and of the staff.

In sum, Mr. Zecchini concluded, the Fund and the Bank were separate entities, whose areas of interest were essentially distinct and whose respective roles, although complementary, were valid in their own right. However, the areas in which those roles and responsibilities overlapped had expanded in recent years in connection with the global trends of the international economic system. The sensible answer to that development was a greater effort at coordination, while avoiding a confusion of functions that should, in any case, remain separate. He had indicated a number of possible ways to strengthen such cooperation where it might be more urgently needed. Within that general framework, he remained open to further suggestions by colleagues or others.

Mr. Nimatallah remarked that, although they had separate characteristics and responsibilities, the Fund and the Bank shared a common objective: to help members find the best way of dealing with their economic and financial problems. Achieving that objective was particularly important at present, when many members faced serious payment imbalances and deep-rooted structural problems. It was, therefore, in the interest of members to encourage Fund-Bank collaboration whenever possible.

Closer cooperation would especially benefit two categories of members, Mr. Nimatallah continued. The first group consisted of the heavily indebted countries. Those countries had to adjust, and the Fund had rightly taken the lead in helping them to adopt and to implement appropriate programs. However, they also had to be put on a path of sustained economic growth if they were to repay their debts in an orderly fashion. The World Bank could help in that respect, by identifying viable investment projects and by advising on appropriate investment strategies over the longer term. The countries of sub-Saharan Africa represented the second group of countries that could benefit from closer Fund-Bank coordination. They faced serious problems that would take many years to resolve. The Fund could help, and had helped, most of those countries to start the process of adjustment. However, given the longer-term nature of their problems, there were limits to what the Fund could do. The Bank was well placed to build on the framework established by the Fund and to provide much-needed advice on longer-term structural reforms. Equally important, the Bank could take the lead in helping those countries to attract longer-term concessional assistance, which was urgently needed.

If it was agreed that closer coordination could benefit members, Mr. Nimatallah commented, the important question was how to make it more effective in the period ahead. There was scope for strengthening cooperation in three main areas. First, each institution should keep the other fully informed of its activities. Each should be aware of what the other did with regard not only to general policies but also to specific countries. Among the means to achieve that objective, some of which already existed, were the exchange of documents on a systematic basis, regular contacts between the two staffs, and closer contacts between the two Executive Boards. In that context, some of the suggestions made by Mr. Wicks had been useful. In particular, it would be helpful to appoint Executive Directors of one institution as Temporary Alternate Executive Directors in the other. Directors would then be in direct touch with the work of both institutions. He had taken such a step himself and had found it beneficial. He also agreed in principle with Mr. Wicks that participation by Bank staff in Fund Board meetings and vice-versa could be advantageous. In practice, such participation could be permitted whenever appropriate, at the discretion of both managements.

With regard to the second main area for cooperation, Mr. Nimatallah said, the Fund and the Bank should make every effort to develop coordinated diagnoses of the economic problems of members seeking assistance from both institutions. Such an approach could make it easier for the Fund and the Bank to offer complementary policy advice to members. Of course, cross-conditionality should not be involved. He agreed with the staff's comment in that respect. A coordinated approach would mean that an adjustment program recommended by the Fund was consistent with the member's institutional framework and longer-term structural objectives. It should also mean that a member's development strategy was in harmony with the macroeconomic policies and the financial targets of a program supported by the Fund. There were several ways to achieve that goal. For example, it would be helpful, where possible, for Fund and Bank staff to work together when preparing missions to certain member countries that had borrowing relations with both institutions, and to participate in each other's missions, where appropriate. There might also be scope for closer coordination of technical assistance programs, joint research projects, and work on country data. Those were only a few examples of cooperation, some of which might already be under way. He hoped that the managements of the two institutions would work together to look for more ways to improve the quality and consistency of policy advice to members.

Third, the Fund and the Bank could also cooperate to mobilize more financial resources for members, Mr. Nimatallah considered. At present, the Fund and the Bank put together financial packages in a number of ways for members that were undertaking adjustment. The two institutions could provide finance from their own resources, and they both had well-established catalytic roles. Both often participated in meetings for official and commercial debt rescheduling, and both sometimes participated in consultative groups and donor meetings. In view of the need at present for multiyear rescheduling, perhaps the two managements could coordinate to examine the possibility of enhancing collaboration for tapping the various financing channels more effectively; members might thus obtain adequate financing, on perhaps better terms.

Closer collaboration between the Fund and the Bank could be helpful for individual countries and for the system as a whole, Mr. Nimatallah stated. Of course, there could be continuing differences of view between the two institutions, and practical problems might arise. Moreover, each should maintain its own character and mandate. However, the Fund and the Bank were working toward a common objective. If they could work together, the benefits for their members could be considerable. Such benefits would, of course, be realized only with the full support and cooperation of the members of both institutions.

The Executive Directors agreed to resume their discussion in the afternoon.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/84/169 (11/26/84) and EBM/84/170 (11/28/84).

3. PERU - 1984 ARTICLE IV CONSULTATION - POSTPONEMENT

The Executive Board notes the request contained in EBD/84/303 (11/21/84). Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, the Executive Board agrees to extend the period for completing the 1984 Article IV consultation with Peru to not later than December 21, 1984.

Decision No. 7850-(84/170), adopted
November 26, 1984

4. STAFF COMPENSATION - JOINT BANK-FUND COMMITTEE - COMPOSITION

The Executive Board approves the proposal of the Managing Director on the composition of the Joint Bank-Fund Committee of Executive Directors on Staff Compensation, as set forth in EBAP/84/195, Supplement 3 (11/21/84).

Adopted November 27, 1984

5. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director as set forth in EBAP/84/253 (11/26/84) and by Advisors to Executive Directors as set forth in EBAP/84/251 (11/23/84) and EBAP/84/253 (11/26/84) is approved.

APPROVED: August 27, 1985

JOSEPH W. LANG, JR.
Acting Secretary