FOR
AGENDA

EBS/86/127
Correction 1

CONFIDENTIAL

June 18, 1986

To: Members of the Executive Board

From: The Secretary

Subject: Indicators Relating to Policy Actions and Economic Performance

           The following correction has been made in EBS/86/127 (6/12/86):

Page 10, para. 2, line 3:   for "current account account"
                            read "current account balance"

           A corrected page is attached.

Att: (1)

Alternatively, it might lead to the conclusion that there was indeed a potential problem, and that remedial action was needed.

The various possibilities for remedial action are suggested by the factors that determine current and capital account flows. These flows may be altered through factors that bring about shifts in competitiveness, changes in relative growth rates, or structural changes that influence trading patterns, as well as by measures that affect domestic saving and investment positions. The choice of the particular means for restoring sustainability will depend on the extent to which, in given circumstances, particular indicators of domestic policies and performance in individual countries diverge from agreed or projected paths.

This last point implies that the setting and monitoring of objectives with respect to domestic variables is a matter of international concern, at least to some extent. The choice of whether a balance of payments disequilibrium should be corrected by exchange rate movement or a shift in relative rates of economic growth requires, for example, a view on the rate of growth in an individual country that should be considered attainable.

IV. Types of Economic Indicator: Uses, Scope, and Limitations

Against the background of the foregoing discussion, this section provides an analysis of various indicators that are useful in assessing the policies and developments that lie behind balance of payments and exchange rate trends. It also considers ways in which such indicators can be adapted to make them more useful for the kind of comparative analysis that is required to improve the effectiveness of multilateral policy discussions among countries. Section V will then offer some more concrete suggestions concerning how surveillance procedures can be adapted to make more effective use of indicators.

Indicators can be classified into three types: indicators of economic performance, which broadly speaking cover the more fundamental objectives of economic policy, i.e., economic growth, employment, and balance of payments and price stability; indicators of economic policy, which cover variables over which the authorities have fairly close control, but which are not themselves components of economic welfare, i.e., monetary growth, exchange market intervention, the fiscal deficit, etc; and indicators of intermediate variables, which are variables through which policies influence performance-- savings and investment levels, interest rates, and exchange rates. Although the distinctions between these three different types of variable can sometimes be blurred, it is convenient to discuss them separately.

1. Indicators of economic performance

   (a) The balance of payments

   The balance of payments can be considered either an objective of policy or an intermediate variable. For the major currencies with floating exchange rates, it is not an objective in the sense that these countries have quantified aims for the structure of their balance of payments. However, most countries would probably subscribe to the objective of restoring or maintaining a "sustainable" external payments structure, so as to limit the dangers of protectionist pressures and to minimise the costs and uncertainties that are involved when an unsustainable position emerges and has to be corrected. Moreover, from the point of view of surveillance, the restoration and maintenance of a balance of payments pattern that is adequately consistent with the domestic policies and priorities of all members must be considered a key objective.

   A widely used indicator related to the balance of payments is the current account surplus or deficit, and it seems appropriate that the current account balance remain the primary indicator of developments in the external sector. 1/ As noted in the previous section, however, a satisfactory analytical framework for judging the sustainability of a given exchange rate pattern would involve an assessment of the "underlying," as well as the actual, current account position. It may be useful, therefore, to include in staff analyses estimates of how the underlying current account balance differs from the recorded or projected position. This would involve making adjustments for the effects of recent exchange rate changes that had not yet been fully reflected in trade flows, for the impact on imports and exports of cyclical divergences from "normal" employment levels, and for any other special factors affecting payments flows in a given period.

   Presentation of underlying balance of payments estimates would facilitate multilateral discussions of the sustainability of the external positions implied by current policies and prospects. A sustainable balance of payments position can be defined as one in which the underlying current account surplus or deficit is matched

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1/ The trade balance is another indicator of external developments that often attracts attention, particularly in the context of the need for trade liberalization and market access. The trade balance is also useful as a leading indicator of developments in the overall current account, since data related to trade are usually available on a more timely basis. In general, however, there seems little economic reason for drawing a distinction between trade in goods and trade in services.