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Minutes of Executive Board Meeting 86/115

3:00 p.m., July 14, 1986

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

Executive Directors	Alternate Executive Directors
A. Alfidja	
C. H. Dallara	
J. de Groote	H. G. Schneider
M. Finaish	
H. Fujino	M. Sugita
G. Grosche	
	Song G., Temporary
J. E. Ismael	Jaafar A.
	J. Hospedales, Temporary
T. P. Lankester	
H. Lundstrom	
M. Massé	
	A. Abdallah
F. L. Nebbia	
Y. A. Nimatallah	J. E. Suraisry
P. Pérez	
H. Ploix	S. de Forges
J. J. Polak	J. de Beaufort Wijnholds
C. R. Rye	
G. Salehkhou	O. Kabbaj
A. K. Sengupta	A. S. Jayawardena
S. Zecchini	

L. Van Houtven, Secretary
K. S. Friedman, Assistant

Also Present

Asian Department: A. Ariyoshi, W. G. L. Evers. European Department: L. A. Whittome, Counsellor and Director; B. Rose, Deputy Director; L. J. Lipschitz, H. Vittas. Exchange and Trade Relations Department: C. D. Finch, Counsellor and Director; M. Guitián, Deputy Director; G. Belanger. External Relations Department: C. S. Gardner, Deputy Director; M. Goldstein. Fiscal Affairs Department: A. A. Tait, Deputy Director. Research Department: W. C. Hood, Economic Counsellor and Director; A. D. Crockett, Deputy Director; R. R. Rhomberg, Deputy Director; J. M. Boughton, M. C. Deppler, P. Isard, F. Larsen, P. R. Masson. Western Hemisphere Department: S. T. Beza, Associate Director. Bureau of Language Services: A. J. Beith, Director. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: W.-R. Bengs, L. K. Doe, L. P. Ebrill, S. Ganjarerndee, S. M. Hassan, G. D. Hodgson, K. Murakami, J.-C. Obame, A. Ouanes, I. Puro, M. Z. M. Qureshi, R. Valladares, A. Vasudevan. Assistants to Executive Directors: J. R. N. Almeida, O. S.-M. Bethel, B. Bogdanovic, K. Celebican, J. de la Herrán, F. Di Mauro, G. K. Hodges, Z. b. Ismail, S. King, M. Lundsager, T. Morita, M. Rasyid, S. Rebecchini, J. Reddy, J. E. Rodríguez, H. van der Burg, E. L. Walker, Yang W.

1. SURVEILLANCE - INDICATORS RELATING TO POLICY ACTIONS AND ECONOMIC PERFORMANCE

The Executive Directors continued from the previous meeting (EBM/86/114, 7/14/86) their consideration of a staff paper on indicators relating to policy actions and economic performance (EBS/86/127, 6/12/86; and Cor. 1, 6/18/86).

Mr. Sengupta said that the present discussion was merely exploratory in nature. The Executive Board's perception of multilateral surveillance was not yet as clearly defined as it should be, despite its experience with the world economic outlook exercises. Multilateral surveillance should encourage policy coordination among the major countries, whose individual policies had substantial repercussions on the international economy. However, such coordination should not be aimed at achieving consistency of policies irrespective of the performance of growth and employment in different countries. Coordination should be aimed at maximizing the level of output and employment of industrial countries and at maintaining price stability; in addition, it should contribute to the redistribution of real resources, thereby accelerating the rate of growth of the developing countries. Indicators should help that process by providing a framework of desired objectives in which to judge members' policies and performance in the context of desired objectives.

The staff's classification of indicators was a refinement of the Tinbergen-Thiel approach of targets and instruments, Mr. Sengupta considered. The introduction of intermediate variables was analytically convenient in the context of multilateral surveillance, as movements in those variables beyond certain benchmarks could trigger consultations more conveniently than could target variables. However, he agreed with Mr. Polak that the staff's classification had important policy implications. Even more important, the chosen policy indicators should reflect definite relationships between policy measures and agreed objectives. Without an analysis of such relationships it would be difficult to judge whether policies were adequate and whether the chosen indicators reflected the adequacy of policies. Research on those relationships would have to be continued in the national and international context.

He agreed with the staff's description of the purposes of indicators on pages 2-5, Mr. Sengupta said. The indicators should be timely, quantifiable, relatively easy to interpret, and adequately comparable, both across countries and in relation to objective standards. He agreed with Mr. Kafka that in assessing developments in the world economy--for example, during the world economic outlook exercises--one needed to review the behavior of a large number of indicators and to undertake considerable analysis. However, he would feel uncomfortable using all the indicators of performance for which members might be held accountable. It might be more practicable to monitor the movements of a few selected variables after reaching an agreement on their desirable path; that was one of the advantages of the target zone proposals. The whole system of surveillance could be built around the movements only of exchange rates within an agreed band. If that single variable was considered to be inadequate, one or two other variables could be added, such as interest rates, the ratio of fiscal deficits to GDP, or current account balances. Looking at both the exchange rate and the current account balance might show more clearly the role of capital flows to which Mr. Fujino in particular had referred. The staff could usefully identify the minimum number of variables that would capture effectively the developments in an economy and on which surveillance procedures could be based.

In the area of the analytical framework for the use of indicators in surveillance, the main issue that was discussed in the staff paper was the sustainability of underlying external current account balances, Mr. Sengupta observed. The staff had proposed that the underlying current account position based on existing policies and exchange rates should be compared with so-called sustainable positions on the basis of an assessment of the medium-term determinants of savings and investment. Any divergence between the underlying and sustainable positions would be a signal of the need for further discussions. While that proposal had considerable merit, it raised a number of issues that would have to be resolved. Determining sustainability on the basis of projected rates of savings and investment that were extrapolated from the past behavior of those variables might not be appropriate means of implementing surveillance that was designed to contribute to optimal growth and employment. The rate of savings in several countries could be raised above the historical trend if appropriate policies were adopted to modify the parameters of the savings function. Similarly, excess savings or a current account surplus could be sustained in some countries if appropriate methods of channeling investment funds to yield higher rates of return could be devised. A sustainable current account position should also be a desirable current account position. In addition, the surveillance exercise was proposed to be framed in a medium-term context. Mr. Lankester defined the medium term as three years. He could go along with that definition, but it should not be interpreted as implying that short-run or current considerations or situations should be disregarded or de-emphasized. The indicators exercise presumably would be undertaken frequently--perhaps on a quarterly basis--so that the needed corrective actions could be taken in time to help countries move along the desired path.

Neither Mr. Lankester nor Mr. Polak was comfortable with the staff's discussion of the so-called sustainable payments position, Mr. Sengupta remarked. They questioned the presentation on the grounds that it was difficult to estimate trends in savings and investment, the statistical discrepancy in world payments was substantial, and the causal process might not necessarily run from an ex ante desired domestic balance to a particular foreign balance. He agreed that those issues were difficult, but they did not place in question the logical basis of the staff's analytical framework.

While Mr. Polak had questioned the idea of taking into account the preferences of other countries in assessing the sustainable domestic savings/investment relationship in a particular country, Mr. Lankester apparently felt that a large imbalance in that relationship might well be a reflection of efficient intertemporal resource allocation and might meet the needs of other countries, Mr. Sengupta noted. In his view, even if a major industrial country was in a position to service its foreign debt over a long time, its absorption of resources from other major industrial countries to finance its deficit could be questionable in the context of optimal worldwide adjustment.

Commenting on individual indicators, Mr. Sengupta said that the number of indicators should be kept to a minimum, and that the current account balance would be a useful indicator. In addition, as the participants in the Tokyo Summit had suggested, trade balances might also need to be considered. In that event, exports and imports would be taken into account, thereby giving an idea of the evolving competitiveness among the major industrial countries. GNP growth supplemented by developments in final domestic demand would provide the best picture of the real side of an economy. The inclusion of an unemployment indicator would be useful only if it was supplemented by an indicator of capacity utilization. It would be unrealistic to have indicators that were not easily quantifiable, such as the so-called natural rate of unemployment or nonaccelerating inflation rate of unemployment, at least at the present stage. To measure international competitiveness it would be necessary to have more than mere consumer price changes or movements in GNP deflators. Unit labor costs would serve a useful purpose in that context, although Mr. Lankester's objections to that indicator were understandable.

He accepted many of the staff's arguments concerning policy indicators, Mr. Sengupta commented. Nominal money stock and, in its absence, nominal interest rate differentials, would be useful indicators. The norm for the money supply that could be considered for surveillance purposes could be based on the medium- or long-run real growth rate, so that there would be no accommodation of inflationary developments. The actual deficit, with no adjustments for inflation or cyclical factors, would also be a useful indicator. He agreed with Mr. Lankester that the ratio of public debt to GNP would help in assessing the sustainability of fiscal policy and in interpreting flows in a medium-term context. Exchange market intervention might not be easily captured by movements in reserves, the measurement of which could be a serious problem, as the Committee of Twenty had concluded in a report circulated in 1974. Given those factors, and since gross reserves had been rising in relation to imports in recent years, it would be useful to examine whether a ratio of reserves to imports could be a useful indicator. There would inevitably be difficulties in using quantitative measurements of structural policies as indicators. However, as Mr. Polak had suggested, the provision of short descriptions of structural policies was worth serious consideration. In addition, the possibility of quantifying protection and trade restrictions should be examined.

The direction of movement in interest and exchange rates could reveal an underlying disequilibrium in foreign exchange and capital markets, Mr. Sengupta remarked. Those variables would have to be provided in nominal rather than in real terms, so that there would be no accommodation of inflation.

Commenting on procedures for using indicators, Mr. Sengupta said that the staff's work with indicators should highlight the international consistency of objectives or forecasts as well as weaknesses in domestic economic policy and performance, and optional ways in which the inconsistencies could be reconciled. The staff could use Article IV consultations and miniconsultations to collect and analyze national data in a global framework. He fully agreed with Mr. Polak that a separate chapter on policy interrelations among the major industrial countries in the world economic outlook paper would be particularly useful. Material gathered by the staff in the course of multilateral policy discussions should be considered by the Executive Board. There should be follow-up reports, comparing actual developments with targets and projections. If a member departed significantly from agreed policy targets in a given short period, consultations should be held with the member. The staff apparently had argued that a short-run deviation from expected economic performance--say, with respect to GNP growth--would not be a cause for serious concern as long as economic policies remain on the intended track. While emphasis on the stability of policies and on indicators of policies would help to avoid the risk of fine tuning it should be clearly understood that short-run deviations in performance should not become precursors of long-run deviations. The follow-up staff reports should be brought to the Executive Board so that it could examine the policies that were needed to achieve the desired performance in line with the agreed indicators.

Monitoring indicators was possible through the world economic outlook exercises and Article IV consultation discussions, Mr. Sengupta remarked. The procedures that the staff had suggested were broadly in line with those that had been proposed by the Group of Twenty-Four. In its report the Group of Twenty-Four had suggested a two-stage procedures: a chapter in the world economic outlook paper on the international repercussions of policies of the key currency countries, discussion of the chapter by the Executive Board, and communication of the Board's views to members; and preparation of follow-up reports on the implementation of policies. The staff had further suggested that economic performance would be monitored by comparing actual developments with targeted or projected developments; that monitoring could take place during world economic outlook exercises and Article IV consultations, or in other ways. That suggestion seemed to be a deviation from the procedure that had been suggested by the Group of Twenty-Four; follow-up action need not await the consideration of the world economic outlook papers or Article IV consultation reports. The "other ways" mentioned by the staff could include more frequent minidiscussions of the world economic situation.

Mr. Ismael, commenting on the analytical framework for the use of indicators, said that he agreed with the staff that special consideration should be given to the roles of indicators in highlighting interactions of economic policies and performance of major industrial countries within the short- and medium-term context. The external current account should play a central role in the indicators exercise. While focusing on that account would cover a substantial portion of economic interactions between members, the external current account could conceivably be used to check the consistency of projections by individual countries.

Different approaches had been advocated by Mr. Lankester and the staff with respect to the projection of the so-called underlying external current account balance, Mr. Ismael noted. While Mr. Lankester preferred a projection based on an assumption of a constant nominal exchange rate, the staff's usual practice was to assume a constant real exchange rate. He had no particular preference, but Mr. Lankester's proposal implied a changing pattern of real exchange rates that would have to be quantified, and that proposal would require an assessment of the impact of the changing pattern of real exchange rates on external current account projections.

As to the estimate of the so-called sustainable external current account balance, he recognized the limited ability of forecasting techniques to cope with the short-run volatility of investment behavior, Mr. Ismael said. Available forecasting tools were thought to be more accurate in assessing the investment profile in the medium-term context, since a secular trend in investment could be conveniently identified. Hence, he had no difficulty in supporting the staff's view on the appropriateness of basing an evaluation of the sustainable current account balance on an assessment of the medium-term prospects for the savings/investment balance.

It was useful to classify possible indicators into three types, namely, performance indicators, policy indicators, and intermediate variables, Mr. Ismael considered. However, he agreed with Mr. Polak that the traditional classifications of instruments and objectives were somewhat clearer. He had an open mind on whether indicators were expressed in nominal or real terms, but in theory demand and output indicators were more analytically meaningful when expressed in real terms. The external current account balance, final demand, GNP, the unemployment rate, unit labor costs, and the GNP deflator seemed to be the obvious choices as indicators of economic performance. If definitions of unit labor costs were not comparable among major industrial countries, the rate of change in the GNP deflator would probably be sufficient.

As for policy indicators, it seemed most logical to include the rate of change in nominal monetary aggregates, the fiscal deficit--with sufficiently broad coverage--on an actual and a cyclically adjusted basis, the ratio of public debt to income, as proposed by Mr. Lankester, and changes in the level of gross reserves, Mr. Ismael commented. He had some reservations about the use of monetary aggregates as policy indicators, especially in a relatively open economy whose monetary policy was managed in the light of exchange rate and interest rate developments, or in a country that did not have a monetary growth rate as a policy target. In those cases, it might be more meaningful to include real interest and real exchange rates along with monetary aggregates as policy indicators.

Structural adjustment and trade liberalization were conspicuously absent from the proposed list of policy indicators, Mr. Ismael remarked. Mr. Polak's comments on that matter deserved special attention. The difficulty in developing suitable indices of structural adjustment and trade liberalization were well recognized, but for practical purposes it might be desirable to encourage the staff to make a greater effort to construct some form of measurements--quantitative and qualitative--against which progress could be evaluated. Although considerable interest in that area had often been expressed by Executive Directors, little work--especially to develop a practical monitoring device--had been done. The economic repercussions of inadequate structural adjustment policies and intensified trade restrictions were in the short run likely to be more acute and damaging to the international community than other inconsistencies in macroeconomic policies. He agreed with Mrs. Ploix that further research on that matter would be helpful. As to intermediate variables, he agreed with the staff's selection.

He fully supported the staff's proposal for a three-step monitoring procedure, Mr. Ismael said. The procedures that the staff had proposed were particularly helpful because they would ensure international consistency of medium-term projections by individual members and would identify issues that were of international concern. In addition, he welcomed the suggestion that, if a member deviated substantially from agreed policy targets even though its economic performance was on track, discussion with the member would be called for. However, a persistent deviation of economic performance from targets should call for a special consultation, particularly if the deviation was believed to be a reflection of inappropriate policies. In addition to the usual Article IV consultations and the discussions on the world economic outlook, the Fund might have an active role to play by using the supplemental surveillance procedure if developments as shown by indicators so warranted.

Mr. Finaish considered that the use of objective indicators of economic policy and performance could be helpful in enhancing the effectiveness of the multilateral aspect of Fund surveillance over the major industrial countries. The use of such indicators would strengthen the basis for the examination of the interactions of economic policies and performance of those countries, would facilitate the assessment of their international compatibility, and would provide a systematic mechanism for identifying and discussing needed policy adjustments in a multilateral context. The use of indicators through an appropriate set of procedures could be a means of establishing a systematic and continuing framework for improved economic policy coordination among the major countries, in contrast to the essentially ad hoc moves in that direction that had been evident thus far. He had supported such an adaptation of Fund surveillance with respect to the larger countries whose policies and performance had a major impact on world economic conditions in successive annual reviews of surveillance, and he continued to hold that position.

The specification and monitoring of objective indicators to improve the international compatibility of major country policies should be conducted within the framework of the Fund as a way in which to strengthen the implementation of its surveillance responsibilities toward those countries and given its mandate to oversee the operation of the international monetary system and the international adjustment process, Mr. Finaish said. Efforts at better coordination of major country policies undertaken in other forums--for example, the Group of Five, the Group of Seven, and the Group of Ten--could supplement the Fund's surveillance role but should not substitute for it or detract from it.

Interest in the use of objective indicators had stemmed from the realization that better coordination of policies among the major countries was needed to avoid disorderly exchange rate movements and the emergence of large external financial imbalances and to improve the functioning of the international adjustment process in general, Mr. Finaish commented. In that context, a major focus of the analysis employing indicators of economic policies and performance would clearly be the attainment of a sustainable balance of payments pattern, as the staff had suggested. However, the objective of attaining balance in international payments should not be conceived narrowly or in isolation of other objectives of the Fund as a part of its task of ensuring the proper functioning of the international monetary system. Those other objectives, which were stated in the Articles, were inter alia the promotion of sustained and orderly expansion of trade and output of all members. Accordingly, the focal point of the exercise to achieve greater compatibility of major country policies through the use of indicators should be the attainment of sustainable balance of payments positions that were consistent with the attainment of sustained, noninflationary growth. The compatibility of major country policies should be assessed against that objective.

Moreover, that objective should be conceived of in terms of the global economy, Mr. Finaish continued. Therefore, the test of compatibility of major country policies should not only be that the policies were consistent in terms of their interactions among the countries concerned but also that they were consistent with the medium-term objectives of sound balance of payments adjustment together with sustained, noninflationary growth for the world economy at large, thereby taking into account the large impact on the developing countries of the policy choices and performance of the major countries. He agreed with Mr. Polak that even for the narrower task of judging the arithmetical consistency of the payments positions of the major industrial countries, account had to be taken of developments in the payments positions of other countries. In the assessment of the compatibility of policies an appropiate medium-term framework of analysis would need to be maintained, emphasizing the formulation of policies that were geared to the attainment of sound medium-term objectives, thereby avoiding the risk of a tendency toward short-term fine tuning of policies that some Executive Directors suspected could arise from attempts to coordinate policies.

Commenting on the nature of indicators to be used, Mr. Finaish said that the choice of indicators depended on the orientation of the analytical framework in which they were to be used. If the main focus of the analysis was to be the attainment of a sustainable pattern of payments balances and exchange rates consistent with satisfactory growth, then the indicators suggested by the staff seemed to be broadly appropriate. The suggested list of indicators was fairly comprehensive and yet was not unmanageably long. Some questions would of course arise in actually defining and quantifying some of the indicators and especially in determining the criteria against which objectives and performance with respect to certain indicators could be appraised. In that connection, several speakers had made specific observations relating to some of the suggested indicators. Comments had also been made about the complications involved in estimating the so-called underlying and sustainable balance of payments positions. He would not comment on the individual technical issues. While those issues clearly should not be lost sight of and indeed should be examined in greater depth where necessary, their importance should not be exaggerated. It should be possible to find agreed and workable approaches to them and to refine concepts and methods further as more experience was gained.

While, as the staff noted, it was difficult to devise satisfactory quantitative indicators for structural policies, developments in those policies--especially in trade restrictions--should be adequately examined qualitatively together with the periodic reviews of developments in the selected objective indicators, Mr. Finaish remarked. To the extent possible, quantitative assessments of changes in trade restrictions also should be made. Review and assessment of changes in trade restrictions were especially relevant not only for the indications that they provided of the sustainability of the prevailing pattern of payments balances and exchange rates, but also for their important implications for the functioning of the international adjustment process in general.

The world economic outlook exercise--the main channel through which the Fund's multilateral surveillance was carried out--could be adapted to incorporate the proposed framework of surveillance over major countries using objective indicators, Mr. Finaish commented. The world economic outlook papers should systematically include a set of projections, prepared in consultation with the countries in question, for the major variables covered by the selected indicators. In presenting those projections the staff should provide an assessment of their international compatibility. International compatibility of the projected policies and performance should be evaluated with reference not only to what could be termed their arithmetical compatibility but also to their compatibility with the medium-term objectives of international monetary stability and the smooth functioning of the international adjustment process. Aspects of national economic policies and performance that appeared to be incompatible with the medium-term balance of payments and growth objectives of the international economy should be clearly spelled out. The staff's presentation should include policy suggestions for addressing the incompatibilities that were identified.

The projections and accompanying staff analysis should be discussed in the Executive Board and by the Interim Committee as an extension of their current regular reviews of the world economic outlook, Mr. Finaish continued. Those discussions should aim at developing a common view on the course of economic policies and performance in the countries in question that would be compatible with the desired medium-term outcomes.

The monitoring of actual developments in the indicators in comparison with the targeted outcomes could be carried out through subsequent world economic outlook exercises and Article IV consultation reports, Mr. Finaish went on. The periodic world economic outlook papers could both evaluate actual developments in the indicators and roll forward the set of projections. More detailed specification and monitoring of individual country policies and performance could take place in Article IV consultation reports. Bilateral consultations with the major countries should be held against the background of the internationally compatible set of policy and performance indicators developed within the multilateral framework of the world economic outlook exercise.

If during any given period actual developments were found to deviate significantly from the projected or desired policy courses, the staff could prepare an information notice for the Executive Board, Mr. Finaish commented. On the basis of the information provided by the staff, and in the light of the nature and seriousness of the deviation, the Executive Board could call for a special consultation with the country concerned. Emphasis in that process of monitoring should be placed on keeping policies on the intended track, rather than on shifting policies in response to short-term deviations in performance. Under such an arrangement deviations from the projected or desired policy courses would not be treated as automatic triggers for further consultations or a policy response. Instead, adequate room would be allowed for the exercise of discretion in determining whether the deviations in question called for further investigation through special consultations and in determining what, if any, policy response might be needed. Moreover, the approach to be followed in that respect would need to be sufficiently selective in order to avoid a proliferation of information notices and to keep special consultations to a minimum. In certain cases, in which high-level attention was felt to be urgently needed, the Executive Board could request the Managing Director to raise the points of concern directly with the finance minister concerned.

Procedures for the application of a system of multilateral surveillance of major countries based on the use of indicators could to some extent be expected to evolve with practice, and greater precision in the mechanics and procedures of the system could be achieved as the implementation of the system proceeded, Mr. Finaish remarked. What was needed at present was an agreement on the main elements of such a system. If there was sufficient commitment on the part of the relevant section of the membership to move toward such a system, practical solutions to the technical and procedural difficulties that might be encountered in its implementation could be found, and improvements could be made with experience.

Mr. Rye said that he approached the subject of indicators with some skepticism, particularly because he doubted whether a system of indicators would impose more effective discipline on members than at present and whether the system would enhance peer pressure on recalcitrant governments. He agreed with Mrs. Ploix that the staff proposals were ambitious. They clearly had the potential to tie up a large proportion of the Fund's resources--which were already under strain--in which event a radical shift in the Fund's priorities might be required.

The validity of his concerns would depend upon the extensiveness and intensiveness of the indicator scheme, Mr. Rye continued. By extensiveness of the system he meant how widely it would be applied--to the reserve currency countries alone, or the participants in the Tokyo Summit, or, at the other extreme, all members, through Article IV consultations. There was a similar spectrum of possibilities with respect to the intensity of the scheme, particularly the extent to which indicators would be seen as targets, the range and number of indicators, and the extent to which the Fund would attempt to look into the future. The staff paper was not clear on those matters, although it seemed to be based on the assumption of the adoption of a fairly moderate approach to indicators, at least at the start. That assumption was fully appropriate. He favored a less extensive approach that would limit indicator analysis to the major industrial economies and that would extend the analysis, if at all, only very gradually as experience was accumulated.

He was pleased that the staff paper reflected an appreciation of the practical problems to which the indicators approach would undoubtedly give rise and of the limitations of that approach, Mr. Rye remarked. In that connection, the staff's comments in the paragraph on the bottom of page 4 and the top of page 5 should be underscored: few indicators would be satisfactory in all relevant respects, and single-valued indicators were generally unable to capture the complexity of the economic situation they were being used to portray. Still, it was clear that in practice reliance would have to be placed mainly on single-valued indicators. That likelihood underscored the importance of the staff's conclusion that additional analysis would be needed to provide an adequately rounded picture of economic developments, policies, and prospects. It would certainly be inappropriate to use indicators in any mechanistic way, such as an automatic trigger for policy responses.

Commenting on the analytical focus of the indicator approach, Mr. Rye said that indicators should emphasize the international interactions of economic policies and performance, that they should have regard to the medium-term framework in which policies were set, and that a major focus of analysis would be prospective balance of payments developments, which were after all the traditional focus of the Fund's attention. However, he had some difficulty in applying a quantified approach to the concept of a sustainable balance of payments, and he shared some of Mr. Fujino's concerns about that matter. The staff had understandably made no attempt to define "sustainability." While it seemed to be a straightforward concept, sustainability became increasingly illusive as one attempted to define it. He agreed with the staff that sustainability was a particularly difficult analytical subject on which it would undoubtedly be necessary to proceed gradually. In his view, not much importance should be attached to any quantification of a sustainable balance of payments. His authorities had suggested that trade intervention should not be neglected; substantial protection and export subsidies should be taken into account in the determination of external sustainability.

As to the nature of the indicators to be used, Mr. Rye said that the classification of the policy indicators, performance indicators, and intermediate variables were useful. He agreed with the staff that to be helpful in the surveillance process indicators must be limited in number, quantifiable, and relatively easy to interpret. Of course, meeting all those criteria would be difficult. For example, in many countries there were substantial problems in interpreting the monetary aggregates owing partly to the widespread trend toward financial deregulation and partly to some subtle broad economic, institutional, and social trends that were not fully understood. In any event, the authorities in many countries seemed less concerned about apparently rapid growth in monetary aggregates than they might have been several years previously and more inclined to look at a range of indicators of monetary conditions through a kind of checklist approach.

Nonetheless, the indicator system should be kept as simple as possible, Mr. Rye went on. If the indicator approach were to prove to be worthwhile, it would be because it had influenced decision-makers and not merely technicians. Politicians would feel more comfortable dealing with familiar indicators. That was one reason for doubting whether it would be wise to adjust budget deficits for cyclical positions, although that idea also gave rise to conceptual problems. Similarly, differences from country to country in, say, monetary definitions, might have to be accepted to ensure that the monetary indicators would be familiar to each group of national authorities.

He shared Mr. Lankester's concern about the use of real GDP as an indicator, Mr. Rye commented. Experience in Australia clearly suggested that governments that framed their policies around a notion of a sustainable rate of real growth sooner or later found themselves in difficulty. He sympathized with Mr. Polak, who had expressed concern about excessive concentration on real measures in general, and on the real exchange rate in particular. It might be desirable to add to the list of suggested indicators the capital account, as the current account was undoubtedly driven by the capital account. Moreover, the absence of any labor market indicator from the staff's suggested list was striking. His authorities had questioned the appropriateness of excluding unemployment from the indicators of performance.

The procedural arrangements that the staff had proposed seemed to be appropriate, Mr. Rye said. The three conditions for promoting dialogue among the major countries mentioned in the second paragraph on page 22 were appropriate. He agreed with Mr. Lankester that the indicator procedures should be built on the world economic outlook framework. Accordingly, the procedures would be used on a six-monthly basis. At present, Article IV consultations with major economies were generally timed to be concluded in the period prior to the September Interim Committee meeting; thenceforth, that timing could be regarded as the norm, with supplementary discussions as necessary in the period prior to the April Interim Committee meeting.

Mr. Dallara made the following statement:

Introduction

"Among the laws that rule human societies," Alexis de Tocqueville stated, "there is one which seems to be more precise and clear than all others. If men are to remain civilized or to become so, the art of associating together must grow and improve in the same ratio in which the equality of conditions is increased." This quote from Democracy in America perhaps has some relevance for today's discussion, since like de Tocqueville, we are concerned with the art, as well as the science, of associating together--specifically, how our member countries interact economically. Also, like de Tocqueville, many of you seem to have America uppermost in mind.

As more and more countries become competitive in international markets for various goods and services, as interdependency becomes increasingly evident for more and more sectors of our economies, as the larger, more industrialized developing countries diversify and broaden their product lines, as capital markets move closer to global integration, as the role of the dollar and the U.S economy are gradually reduced secularly, one might say that we are moving slowly toward a "greater equality of conditions," to use de Tocqueville's words. Perhaps, in fact, we have moved further in that regard than we have moved in perfecting our ability to practice the art of economic association. If that is so, and I tend to believe that it is, there is a pressing need for a more effective set of rules and mechanisms to guide our economic relationships. We are here today to consider one possible approach to doing this. It will not be easy to make this approach work; if it is to have a chance, it will require, at a minimum, the commitment of all of the major countries. If it does not work, then we will need to consider other approaches, for economic interdependence marches on as we talk.

These introductory remarks should have already made clear that we view today's discussion as part of an important effort to strengthen the functioning of the international monetary system and to enhance the mechanisms for international economic policy coordination. Multilateral surveillance has considerable potential in this regard. Some might say, however, that multilateral surveillance has had considerable potential for many years. But the difference is that now we have renewed momentum and political commitment, as reflected in the latest Interim Committee commumiqué and the Tokyo Economic Decelaration. There is a clear willingness to use economic indicators in an effort to strengthen surveillance, and we have been asked to further that effort in the Executive Board by exploring a set of objective indicators in the context of our regular reviews of the world economic outlook. It should also be recalled, as Mr. Zecchini did, that the Interim Committee also asked us to "consider further whether there are any modifications in the exchange rate system which could contribute to enhancing exchange rate stability." Today's discussion must, therefore, be seen in the context of both of those requests, since we must follow up on both.

In our efforts in the Board, I believe that we should take a pragmatic approach, recognizing that we are still at an early stage in what will need to be an evolutionary process, and recognizing that developing a consensus on all aspects will not be easy. But, as Mrs. Polix suggested, we should not let the absence of further consensus block progress.

I found the staff paper to be helpful in framing our discussion today and in suggesting possible approaches. An issue that arises in the introductory section of the paper concerns the scope and context for application of indicator-based surveillance. Like the staff, I see application occurring initially in the world economic outlook exercise. Over time, I would expect to see some application in single country Article IV consultations, although I beieve that the multilateral application of indicators should be our priority, particularly at this stage.

Regarding the scope for application, I would see it initially focusing on the G-10 countries, consistent with the recommendations of the G-10 Deputies Report that we should prepare a separate chapter of the world economic outlook paper analyzing the international repercussions of policies in those countries. Such a chapter could be the framework for our initial efforts in applying objective indicators and might be the basis for the first day of a two-day discussion of the world economic outlook. As Mr. Fujino noted this morning, I have suggested in the past that a second day could center on an interactions chapter covering the developing countries. That chapter could build on the first day's discussion by analyzing the major linkages between industrial and developing countries, along the lines suggested by Mr. Kafka. In addition, I would suggest including a discussion of interactions among the major developing countries themselves, perhaps initially emphasizing policies strengthening the potential for trade flows between those countries. With preparatory work this fall, such an approach could perhaps involve some application of indicators to the 25 largest members of the Fund during the course of the world economic outlook exercise in 1987.

Purposes of indicators

I believe the basic purpose of indicators is to help promote policies that are internally consistent and internationally compatible, so that they can foster internationally agreed goals, such as high growth consistent with price stability and viable payments positions, and maintenance of an open, growing trade and payments regime. This is fine, but it is on such a general plane that the specific question remains--what can indicators really do in our efforts to strengthen multilateral surveillance? Of course, different indicators perform different functions. I found the categorizations used by the staff generally useful. Viewing indicators collectively for the moment, however, I basically see indicators serving at least four related functions:

1. As a tool to help clarify to a government and to others the objectives and priorities of individual country policies. (The extent to which indicators can perform this function will depend in part on the willingness of governments to develop their own forecasts.);

2. as a guide or benchmark to policymakers, against which and through which performance can be assessed and monitored;

3. as an instrument of analysis to facilitate the early identification of imbalances, inconsistencies, and incompatibilities; and

4. to help prompt discussions that can lead to corrective actions, and thereby to help catalyze and crystallize peer pressure.

In connection with most, if not all, of these functions, the ex ante and ex post reference of the staff could be relevant.

Analytical framework

Having these purposes and functions in mind, let me now turn to the question of an analytical framework. I would make the following points.

First, I welcome the focus on current account balances, with reference to the medium term. As Mr. Polak noted, the Fund could play a valuable role in attempting to forecast how the policies of some countries could affect the payments positions of many other countries.

Second, although the balance of payments represents a principal point of interaction among our economies, I would join other Directors who have said, in effect, so does the exchange rate. Although it is certainly true that the exchange rate is a determinant of relative competitiveness, and thereby a principal factor in influencing current account developments, it is a key variable in its own right and deserves perhaps more attention in any analytical framework than it is accorded by the staff. In this connection, I would note that the exchange rate appears to be increasingly viewed by some major industrial countries more as an indicator of economic policy than as an intermediate variable. That may particularly be the case if one modifies the staff's definition of indicators of economic policy as those variables over which authorities have, or seek to have, fairly close control--witness recent public statements by policy officials of major industrial countries toward that end.

Third, with regard to analyzing developments in the balance of payments, I have some comments and reservations concerning the use of the concepts of "underlying" and "sustainable" balance of payments positions as put forward by the staff. On the former, I believe that the objective of arriving at an "underlying" payments position can be accomplished without actually using the concept of underlying payments position, a concept that factors in so-called "cyclical" adjustments, whith I believe may not be particularly relevant in current circumstances for this exercise. By forecasting trade and current account positions over a two- to three-year period, one woudl capture the lagged effect of earlier exchange rate changes while avoiding the problems that might be inherent in a "cyclically adjusted" approach.

On the question of sustainability, I could agree with the staff that we must proceed gradually in establishing criteria for what should be considered sustainable. But then the staff went some further distance in saying that a sustainable position could be defined primarily on the basis of domestic savings and investment positions. While I would agree that savings and investment ratios are important in determining sustainability, we must take care not to use economic identities to explain causal relationships, and not to use an approach that could deflect attention away from consideration of policies that could change the private sector components of these ratios. Moreover, I believe that defining sustainability largely on the basis of these ratios is too narrow, possibly excluding other factors that can effect and help determine sustainability. A number of other Directors have already pointed out many of the limitations of an approach that focuses too heavily on savings/investment ratios, and I will therefore limit my additional comments on this while associating myself with many of those earlier comments, although I would not go as far as Mr. Fujino did.

Even if the external positions of the major countries were in some sort of "balance," in theory there could be many savings/ investment flow configurations consistent with that external "balance." In addition, the paper seems to presume implicitly that savings and investment flows are to a large extent determined by government fiscal positions. These are important, in some cases critical. But the private sector's role in the savings/ investment ratio is also obviously important in determining world capital flows as well. And it needs to be kept in mind that a wide range of government policies can affect the private sector components. Furthermore, the treatment of the preferences of other countries related to asset accumulation/decumulation as "given" might be seen as deflecting attention from policies that can change these ratios. As Mr. Sengupta suggested, this might not be the most productive approach.

As I mentioned earlier, sustainability can be affected by a range of policies that might not be directly, or easily, captured in the savings/investment ratio. Is the "safe haven" factor, for example, adequately captured by the reference to "corresponding preferences" of other countries? I think not. Another example might be that credibility in a particular monetary authority's policies can have a direct impact on the sustainability of a current account position. In addition, exchange rate changes can affect sustainability, as Mr. Fujino pointed out, not only through effects on the current account, but also through their effects on capital flows. For example, an apparent move to a longer-run sustainability payments position via an exchange rate depreciation could actually reduce the size of a deficit that could be viewed as sustainable by reducing the relative attractiveness of investing in a particular currency, thereby reducing capital inflows. One only has to look at current circumstances to see such a possibility. This example also points to the need to give adequate attention to market attitudes and expectations in judging sustainability.

Before concluding my comments on the analytical framework for judging sustainability, I would add that sustainability must also be viewed in a political as well as economic context. Imbalances that apparently might be financially sustainable, at least for a time, might not be politically sustainable in the context of maintaining open markets.

Finally, I would stress that no matter how much emphasis is given to the current account, or for that matter the exchange rate, the analytical framework used must ultimately help policy-makers focus on the broad range of underlying policies that can affect external positions and exchange rates and help reduce incompatibilities. If not, then the framework, no matter how well structured, will likely have failed in its task.

Types of indicators

First, I believe that priority should be placed on evaluating and monitoring performance, as well as policies, even in the short run. Short-run deviations in performance might not signal a long-run trend, as noted in the staff paper, but should nonetheless be considered. This is particularly true since adjustment in performance is generally feasible only with a considerable lag an requires early attention if problems are to be corrected before they assume major proportions. Second, I have already noted my concerns relating to the framework for use of balance of payments indicators.

With regard to output indicators, we should also look at final domestic demand, as mentioned in the staff paper. Furthermore, we need to be cognizant of the fact that structural rigidities can have a significant impact on potential output. While I recognize the difficulty in developing indicators for structural problems, I am not sure that it is beyond the capacity of the Fund. Regarding an employment measure, I would prefer that the unemployment rate be included as an indicator. On pricing, I would suggest the use of other pricing indicators in addition to unit labor costs, such as GNP deflators or consumer price indices.

Regarding the fiscal policy indicator, like Mr. Lankester, I suggest using the actual fiscal deficit, both central and general government budget. As I mentioned earlier, I have doubts about cyclically adjusted indicators.

Exchange rate indicators are a more complicated issue, given the difficulty in forcasting rates. It may be that actual forecasts of exchange rates are not made by many authorities, but many clearly do express their views and preferences from time to time, at least concerning the appropriate level and/or direction of movement in rates. This needs to be factored into our exercise. In any event, one must make assumptions about exchange rates in order to conduct our analysis of sustainability. As the staff points out, one approach could be to assume that current nominal exchange rates are maintained. Another would be to assume constant real effective exchange rates. A third possibility would be to develop various scenarios of likely or possible exchange rate changes that could reduce imbalances, depending on other possible policy changes. In fact, such scenarios could be based in part on the publicly expressed views of authorities, particularly if they suggest the desired direction of movement, or lack of it. I agree that Mr. Lankester that we must be careful with regard to market-sensitive variables. But as was done in last year's Article IV consultation, alternative exchange rate scenarios can be developed without creating the policy difficulties.

Regarding the exchange rate methodology used, I have reservations concerning the use of the MERM in deriving real effective exchange rates. I would prefer to use a real effective exchange rate calculation based on bilateral trade weights.

Procedures for using indicators in surveillance

Regarding procedures for using indicators in surveillance, starting with each country's own forecasts appears appropriate, since those projections would be grounded in the staff's continuing contacts with member country authorities and would be framed against the background of those authorities' own medium-term objectives. Where current data, or forecasts, are not available, the staff would need to make their own estimates or projections, so that we would have as comprehensive a database as possible.

In terms of the monitoring of economic developments, I generally endorse the procedures suggested, including the attempt to highlight international inconsistencies and weaknesses in domestic performance and policies.

It might not be realistic to expect that the monitoring process at this stage could do more than identify problems and suggest possible directions for solutions to these problems. I would endorse the staff suggestion at the top of page 22 that the staff could review the various alternative ways in which inconsistencies can be reconciled. The staff can also play a useful role by identifying the possible economic costs and policy implications of not acting to reduce or eliminate incompatibilities or inconsistencies. Regarding the question of judging the need for follow-on consultations, I agree with others that we should proceed very cautiously at this stage and concentrate our efforts on developing an appropriate set of indicators and a methodology for using those indicators that can help identify problems, point toward their solutions, and foster a process that encourages policymakers to make needed policy changes. Ultimately, the policymakers must make the decisions; we should try to provide the soundest analytical basis for those decisions.

In conclusion, I recognize that, like other Directors, we have not made the tasks of the staff any easier by our comments today. But the complications and complexities notwithstanding, I look forward to moving ahead in the process of strengthening multilateral surveillance through the use of indicators. I believe that the Fund must play an important role in that process.

Mr. Nebbia considered that the staff paper was a welcome first step in the process of improving the multilateral setting of surveillance through the use of specific indicators that might be helpful in assessing the international repercussions of the policies and objectives of the major industrial countries as well as the consistency and sustainability of those policies over the medium run. The methodology that the staff had used seemed to be broadly appropriate; it was in line with the ultimate objectives of surveillance. However, the search for a set of objective indicators should be aimed mainly at ensuring a mutually consistent set of objectives and a set of policies that would achieve the objectives of the major industrial countries. The emphasis of the surveillance exercise must clearly be shifted from national policies and objectives to the consistency and repercussions of economic developments in industrial countries on other industrial countries as well as the rest of the world. An appropriate set of indicators to ensure the consistency of objectives and policies among industrial countries would not impede the achievement of those objectives; indeed, it would help to promote an orderly adjustment of the sizable imbalances that still remained in the world economy. Indeed, achieving that goal was the aim of the effort to improve surveillance in a multilateral setting; at the same time, the indicators approach would discourage members from making unilateral adjustments at the expense of an increase in the imbalances of other members.

In addition, indicators would help to measure and to correct deviations between actual outcomes and recommended targets, Mr. Nebbia commented. He agreed with the staff that when used for that purpose indicators should be complemented by a frame of reference against which to judge whether policies had been appropriate and performance had been successful. That frame of reference could be provided by a set of indicators and objectives that were agreed at the beginning of a policy period. The effectiveness of surveillance could be improved by including in consultation reports for the major industrial countries references to the policy recommendations that had been made by the Fund and accepted by the member during the previous consultation and the measures that the country had adopted since that consultation. That information would be helpful in assessing the extent to which any departure from expected developments had been due to a lack of policy action by the authorities or to unforeseen developments in performance variables.

Further examination of procedures for modifying targets of policies was required, Mr. Nebbia considered. It would be appropriate to treat as targets indicators related to policy variables over which the authorities had a reasonable degree of control in the short run and departures from which could be presumed to be deliberate. If such departures significantly endangered the consistency and sustainability of the objectives of other members, the staff should inform the Executive Board of the problem either by means of an information notice or in reports on Article IV consultations so that the Executive Board could fully discuss the reasons why the country concerned had not implemented the agreed policies. The Executive Board could examine such problems during consultation discussions and in reviewing the performance of and prospects for the world economy in the context of the world economic outlook exercise. He had consistently stressed that the authorities of any industrial or developing country--whether or not it used the Fund's resources--should always have a fair degree of flexibility in making needed economic adjustments, but because of the repercussions of the policy actions of major industrial countries on the rest of the world economy, those countries should respond relatively promptly to the need to correct emerging imbalances that might threaten world economic stability.

Just as members using the Fund's resources had to comply with agreed targets in order to maintain their access to the resources of the Fund and of other creditors, the major industrial countries should comply with the targets that were agreed with the Fund in the context of Article IV consultations, Mr. Nebbia continued. To that end, he was prepared to examine the issue of automatic triggers for policy response in the event of significant deviations by one member that increased the imbalances of other members. He maintained an open mind on possible workable mechanisms to ensure effective collaboration between individual members and the Fund and the international community.

Commenting on the analytical framework, Mr. Nebbia said that he agreed with the staff's emphasis on international policy interactions and economic performance. In addition, there was a need to develop an appropriate medium-term framework in which policies would be set. Accordingly, surveillance should focus on prospective balance of payments developments, including trade and capital flows, as well as on the factors that determined the level and direction of those flows.

He had no difficulty with the distinction that the staff had made between policy indicators, performance indicators, and intermediate variables, Mr. Nebbia remarked. Those classifications provided a readily identifiable set of dividing lines according to the degree of control that the authorities had over the actual outcomes and overall performance of the economy. The staff recognized that, in certain circumstances, the distinction between the classifications could be somewhat blurred. The choice of variables proposed by the staff was appropriate, although the list could include the trade balance as a proxy for the degree of market access and trade liberalization that a member offered to the rest of the world.

Mr. Alfidja said that he welcomed the examination of indicators as a way to improve the existing framework of surveillance of the policies and performance of some members. A major step toward strengthening the international cooperation among members would be taken if the present and subsequent discussions were to lead to an agreement on a set of indicators and on a mechanism to monitor their evolution so that corrective measures could eventually be introduced.

The focus of the indicators exercise on the international effects of economic and financial policies and goals of the main industrial countries and on ways in which to improve policy coordination, as recommended by the Interim Committee, was appropriate, Mr. Alfidja continued.

He agreed with the staff that trade and capital flows provided the main channel through which the repercussions of national policies of industrial countries could be evaluated. Substantial and persistent imbalances in those flows could create undue uncertainty in financial markets, particularly with respect to interest and exchange rates. Such imbalances also could intensify protectionist pressures.

Commenting on the nature of the indicators, Mr. Alfidja said that he fully agreed with the staff that the indicators should be limited in number, quantifiable, available on a timely basis, and easy to understand and interpret. Having those characteristics would ensure that the indicators would be practicable. He also agreed with the staff's categories of policy and performance indicators. The definition of intermediate indicators was less clear to him. The staff itself seemed to recognize that the distinction between intermediate and other indicators could be blurred; therefore, flexibility and pragmatism should guide the Fund in its classification of the agreed indicators.

In the discussion on specific macroeconomic variables that could be used as indicators, the staff had mentioned the possibility of focusing on the external current account balance, real GNP, and a measure of unemployment and inflation as performance indicators, Mr. Alfidja remarked. The staff had also mentioned the growth of domestic demand and changes in unit labor costs as possible performance indicators. Persuasive arguments probably could be made in favor of or in opposition to all those variables. The number of indicators should be kept small, and the list that the staff had mentioned could be reduced.

He agreed with the staff that it would be useful to include in the category of policy indicators a monetary or credit variable as well as a fiscal indicator, Mr. Alfidja said. The staff had concluded that consideration should be given to using changes in the level of gross reserves as a policy indicator. Such an indicator would be appropriate. As to intermediate variables, a case could be made for including that category, although there was some uncertainty about its appropriateness.

Commenting on procedural matters, Mr. Alfidja said that he fully agreed with the staff that the indicators system would evolve gradually as the relevant body of theoretical and empirical knowledge grew. Given the relatively limited experience in the use of indicators as monitoring and policy instruments at the international level, and given the existing national constraints, pragmatism and flexibility should be the guiding principles in the area of procedures. Accordingly, he agreed with the thrust of the staff's proposal on pages 20-24, and especially that the central source of data and projections on the various indicators should be national authorities, not only because those authorities were likely to have the largest amount of quantitative and qualitative information that was needed to work with the indicators, but also because the staff approach would reduce the risk of conflict and enhance cooperation between the Fund and members at the technical and policy levels. As the staff had clearly indicated, reliance on the national authorities as the primary source of information did not preclude the use of judgment by the staff on various aspects of the actual and perspective evolution of the indicators. He endorsed the staff's intention to highlight the international consistency--or lack of consistency--of macroeconomic targets and the shortcomings in policies and performance. As the staff had mentioned on page 22, increased contacts would be useful in the effort to remove inconsistencies in forecasts. He hoped that such contacts would be characterized by a spirit of close cooperation.

Short-lived deviations of policies and performance from their respective expected paths should not be a cause for alarm, Mr. Alfidja commented. Instead, the Fund should focus on persistent movements away from the intended track. A principal difficulty in that connection was the timely detection of such persistent deviations. An even more thorny matter was the ability of policymakers to take steps to correct or reverse the deviations. Major efforts at persuasion would be needed to overcome domestic resistence to needed changes.

The staff had suggested that the analysis of the indicators should be part of the world economic outlook papers and Article IV consultation reports, Mr. Alfidja remarked. He favored instead the preparation of a separate report on indicators that would be examined by the Executive Board in a separate discussion. He had an open mind on the frequency with which such reports should be distributed. A biannual report that could be examined by the Executive Board just before the regular Interim Committee meetings might well be realistic.

Economic indicators should be used in the effort to give a practical meaning to the responsibility for surveillance that was set out in the Articles, Mr. Alfidja said. A consensus on a mechanism to monitor more closely the behavior of basic economic variables of countries that had a large weight in the world economy could be a step in the direction of reducing uncertainties, especially those in the financial markets. While the present paper constituted a good starting point, some issues remained to be elucidated. For example, how should the Fund deal with persistent differences of view between the Fund and some members resulting from the analysis of indicators? One point of disagreement could relate to the policy mix that should be introduced to achieve the agreed performance targets. For example, a disproportionate reliance on monetary policy at a time when the main source of imbalances was the fiscal sector probably would not yield satisfactory overall results. Which country or group of countries would act as the leader in taking corrective steps? Those and other questions might need to be considered in detail before the proposal to use indicators as an effective instrument for enhancing surveillance could become operational.

Mr. Nimatallah remarked that the issues at hand were complex, and the present discussion was clearly a preliminary one. The performance of the major industrial countries had been inadequate, and he was pleased that they recognized that steps to improve their performance were needed, and that increased policy coordination was in their own interest. An increase in coordination was the main objective of the indicators exercise. On page 2 the staff had mentioned that the basic purpose of economic indicators was to give quantitative content to a government's economic goals and achievements. As Mr. Lankester had stressed, the objective of the indicators exercise was broader than the staff had mentioned. Mr. Lankester had remarked that the purpose of strengthening multilateral surveillance was to facilitate more substantive international discussion of policies with a view to reducing the scope for damaging or unsustainable external imbalances between the major economies. Keeping that broader objective in mind would probably make it easier for some countries to accept the intrusion into their national sovereignty that the indicators exercise represented.

He was pleased that the major countries recognized the need for improved policy coordination, Mr. Nimatallah continued. Surveillance over the policies and performance of major countries was clearly required, and indicators were obviously needed to improve surveillance. Executive Directors from major countries had indicated the minimum amount of intrusion on their national sovereignty that they would accept to improve surveillance and international coordination. The number of indicators at the start should be moderate; the list of indicators that Mr. Lankester had mentioned seemed to be realistic.

There seemed to be some confusion about the nature of the indicators, which had been referred to as instruments, objectives, and variables, Mr. Nimatallah remarked. In that connection, a difficulty with indicators was that they had two distinct aspects. First, indicators were variables that influenced other variables. For example, the exchange rate could influence other factors in an economy. At the same time, those factors could be influenced by other developments, thereby making it difficult for authorities to accept the Fund's recommendations to correct certain policies. Because of the dual nature of indicators, it seemed best to limit the set of indicators to a few core indicators that could be supported by supplementary indicators. He agreed with Mr. Fujino that nominal magnitudes were important; they could be supplemented by the real values of variables. When the United Kingdom had maintained a medium-term financial policy, the authorities had become apprehensive about setting targets for growth and unemployment, partly because of the possible inflationary effects of introducing policies to achieve growth and employment goals. The industrial countries could fall into the same trap in the 1980s that they had fallen into in the 1970s. If an economy was pushed beyond its short-term means of reaching growth or employment targets, it became difficult for the member to control other variables in an inflationary environment. The indicators exercise should emphasize nominal values and should involve a medium-term approach. The dual nature of indicators should be borne in mind, and indicators should be treated carefully.

The scope of individual indicators could differ from one country to the next and within the same country over time, Mr. Nimatallah said. As with any other complex aspect of international coordination, there was an immediate need to deal with those differences and to agree on the comparative scope for each indicator to ensure that each government would have a precise idea of each indicator that was used.

There was also a need for a larger number of discussions on policy objectives and performance in an international context, Mr. Nimatallah considered. Such discussions need not always take place in the Executive Board. In addition to the semiannual world economic outlook exercise and Article IV consultation discussions, meetings outside the Executive Board to assess developments in the major indicators as well as in supplementary indicators would be helpful. Such extra meetings should be held on a regular basis; they should not be restricted to crisis situations. The discussions would improve communications among members. As the number of countries that played an important role in the world economy increased, the discussions on international policy coordination should involve a growing number of members. Such discussions would be in the best interest of all members.

The present discussion had given some indication of the extent to which individual countries were willing to give up some of their national sovereignty in order to increase and improve international policy coordination, Mr. Nimatallah remarked. He hoped that the next discussion on indicators could be more detailed, and that the major countries would be willing to reach an agreement on a helpful set of indicators.

Mr. Lundstrom made the following statement:

> The staff has produced an illuminating and constructive paper and should be commended for that. My authorities are in broad agreement with the general outline of the analysis and with the general thrust of the conclusions drawn from it, which does not mean that they do not have some important reservations.
>
> We agree that, at this stage, it is appropriate to concentrate on the way in which indicators might be used, with particular emphasis on existing indicators and their application to major industrial countries. Later on, the scope could be widened to include additional countries. Obviously, some questions have had to be left out of the staff paper. One of them is the relationship between indicator-based surveillance in the Fund and similar exercises in more limited groups of major countries. It is understandable that the staff has refrained from elaborating on this question at the present stage. I will as well. Let me just say that this relationship between coordination and surveillance exercises in different forums is of course essential, and that, in this context, my authorities attach great importance to the Managing Director's participation in ministerial meetings with multilateral surveillance as their main focus. Furthermore, they assume that the expertise and capacity of the Fund staff will be drawn on in the preparation of such meetings. But the form of this cooperation is less important than its objective, which should be to minimize the risk of inconsistency between activities designed to reduce inconsistencies.

My authorities see the role of indicators as an auxiliary one. Surveillance has to retain a largely judgmental character. Accordingly, I agree with those who maintain that indicators should not be used as automatic triggers for policy measures. Therefore, I see no reason for further study of suggestions for that purpose.

As for the analytical framework of the indicators, I endorse the emphasis on international interaction and international repercussions. I also agree that the focus should be on a medium-term perspective rather than on "fine tuning." Particular importance should be attached to the development of the external balance. I share the view that the staff paper does not seem to pay sufficient attention to the practical problems arising from the use of the "underlying payments balances." On an earlier occasion, this chair pointed to the problems in making such calculations, for instance, difficulties in correcting the cyclical position and in agreeing on the factors determining capital movements. This basic uncertainty remains, despite continuous research in this field. It is particularly difficult to establish criteria for what could be regarded as a sustainable position for individual countries. These problems reduce the immediate practical applicability of the analytical framework recommended by the staff. Therefore, it is important that work in this area be carried forward. In this connection, as suggested by the staff, the assessment of savings and investment balances should be given particular attention, although, there too, here are practical and analytical problems.

Indicators can be used in different ways, some of which might be a little more operational than the staff paper would seem to imply. As earlier suggested by this chair, one indicator could be given a triggering function. But it would not trigger policy measures, only discussions on the possible need for such measures, with a view to bringing about a consensus. There should be no presumption about the choice of measures, nor about the distribution of the adjustment burden. For this purpose, an exchange rate indicator would seem particularly appropriate. It would be easy to read and could give an early indication of inconsistencies in economic policies and economic trends. The present system of information notices on major changes in exchange rates could serve as a basis on which to build.

As for the number of indicators, I share the preference of Mr. Sengupta and others for a less ambitious start than suggested in the paper. As experience is gained, the system could gradually be enlarged and improved. Generally speaking, more attention should be paid to how a system of indicators can be expected to work in practice than to the ambition, laudable as it may be, to make the system theoretically completely coherent.

I will now make a few comments on the different indicators suggested. The obvious first step should be to try to determine which indicators should be further explored. In this connection, studies of the various indicators' performance in a historic perspective would be very useful.

An indicator should have the following general properties:

- it should measure the same phenomenon in different countries;

- it should be reported reasonably promptly and regularly and should preferably not be subject to significant revisions;

- it should concern variables with a considerable potential impact on other countries; and

- it should be measurable in such a way as to depict developments vis-à-vis other countries.

Against the background of these criteria, it appears reasonable--as suggested by the staff--to exclude indicators for employment and structural policy. The staff's list of some ten indicators seems already to be on the long side. This, of course, does not mean that I disagree with Mr. de Groote and others, who have pointed to unemployment figures as an important indicator of economic performance.

It is further essential that the three main types of indicators be given their appropriate relative importance. In this respect, I wish to emphasize the important role that should be accorded to indicators of intermediary variables, perhaps in particular the exchange rate. More generally, and in a longer-run perspective, priority should be given to performance indicators.

Therefore, the objective now should be to identify indicators that could provide rather simple and prompt information on developments. The next step would be a more thorough analysis. The following brief comments on some of the indicators recommended by the staff should be seen against this background.

The current account balance is evidently a primary indicator; but it should be assessed together with developments in the counter items on the capital account.

Gross national product, as actually computed, is also a natural indicator. But it would be useful mainly as complementary information in a more thorough analysis, as it is published quarterly and only with some lag. Since the composition of GNP is of crucial importance for an assessment of external repercussions, I support the suggestion to look at final domestic demand as well. For early signals, the latest official forecast might have to be used, perhaps supplemented by some additional, more frequently published indicators--for instance, industrial production.

As for inflation, the suggested GNP deflator cannot, for the same reasons, be used to provide the only signals, but might have to be complemented by, for instance, consumer prices. In international comparisons, unit labor costs is a valid indicator. However, it has the drawback of covering only manufacturing, thus omitting other important sectors of the economy subject to international competition. Also, computations of unit labor costs are very shaky and can be produced only relatively late.

I have certain reservations about the money supply as an indicator of monetary policy, because in many instances it has proven increasingly difficult to interpret money stock developments. As a result of these difficulties, even countries using monetary targeting seem to attach less importance to this technique than before. In any case, the use of money growth as an indicator must be seen in conjunction with the development of different interest rate variables and the exchange rate.

With regard to fiscal policy, I support the staff's judgment that a measure of the structural fiscal deficit should be complemented with the actual deficit, particularly when assessing external effects of deficit financing. Furthermore, the relative shares of domestic and external financing of the fiscal deficit are also of vital importance. In addition, there are problems in calculating the structural budget deficit, a concept that is far from unambiguous.

As for exchange market policy, I would be hesitant to include changes in gross reserves in a selection of only few, central indicators. At least for countries with floating exchange rates, a pure intervention indicator, combined with the exchange rate, might be an alternative. But in addition, such an indicator is impaired by technical problems that restrict its direct usability.

As for interest rates and exchange rates, I think that the staff's concentration on real magnitudes is going too far. Nominal rates would seem to provide better information, in particular with regard to short-term developments. Although nominal rates, in my opinion, should be given priority, real effective exchange rates constitute a very valuable indicator, while real interest rate differentials should be used only as a supplementary indicator. In this connection, we should not forget the complications involved in choosing a deflator that correctly reflects inflation expectations.

Mr. Hassan said that the staff paper, although preliminary in nature, represented an important step in developing an analytical framework in which to use quantitative indicators to strengthen multilateral surveillance and to improve international policy coordination. It was important to stress that the key objective of the use of indicators in surveillance was to make multilateral surveillance more effective and to reduce the disruptive effect of inconsistency among the policies of major industrial countries and the insensitivity of national authorities to the international repercussions of their domestic policies.

The ultimate goal of surveillance was to reduce both the asymmetry that had characterized the international monetary and financial system and the imbalances and irregularities in international adjustment that had created a disproportionately large burden for the weaker partner countries, Mr. Hassan continued. Future efforts to improve multilateral surveillance and policy coordination among major industrial countries should of course build on the positive achievements of recent years. However, the examination of economic indicators should be aimed at offsetting the negative effects of those policies by establishing a mechanism for assessing their international repercussions. Mr. Lankester had emphasized the need to maintain restrictive policies that provided firm control of nominal aggregates, but there was also a need to sustain noninflationary growth and to reduce the record high levels of unemployment in many industrial countries as well as to maintain expansion in world output and trade; to meet that need, changes in the policy mix of a number of industrial countries were called for. There was a clear need to adapt the present global economic environment in order to promote sustained growth of output and employment, to facilitate the expansion of world trade, and to ensure orderly adjustment.

He agreed with the thrust of the staff's analysis and supported most of the staff proposals, Mr. Hassan said. As the staff had stressed, the emphasis of the analytical framework should be on the international repercussions of the national policies of major industrial countries by focusing on the impact of developments in individual countries on the global economy. Assessing the sustainability and desirability of prospective balance of payments developments in major industrial countries, and supplementing that assessment by a consideration of the domestic savings/investment balance in those countries would be appropriate, provided that adequate attention would be given to the implications of those developments for the international adjustment process.

Multilateral surveillance should be aimed not only at eliminating imbalances in the pattern of the current account positions of the major industrial countries, but also at promoting sustained growth of output, employment, and trade of all countries and at ensuring adequate adjustment, Mr. Hassan continued. Therefore, if the analysis based on indicators was to be comprehensive, the assessment of the international repercussions of national policies of major countries should include how the functioning of the global system as a whole and the growth and adjustment in developing countries were influenced by such policies and by developments in the industrial countries. In that connection, the implications for growth and adjustment in developing countries should be an important element of the assessment of a sustainable balance of payments position in industrial countries. Excluding that element from the assessment would give a distorted picture that could lead to incorrect conclusions and policy recommendations. After all, the Fund's main goal, as stated in the Articles, was to facilitate the expansion and balanced growth of international trade and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as a primary objective of economic policy.

The indicators that the staff suggested to use in the analysis and assessment of policies and developments in major economies might not be comprehensive, Mr. Hassan remarked. None of the indicators could be used directly to detect the repercussions of national policies of major industrial countries on growth and adjustment in the developing countries and on the present asymmetry of the international adjustment process. Unless those national indicators were supplemented by global variables for the world economy, the assessment of policies and developments in industrial countries might fail to take into account major problems in the world economy and in the functioning of the global financial system.

Mr. Salehkhou recalled that on a number of previous occasions he had stated that the surveillance exercise was well developed. The Articles provided all the necessary legal tools for surveillance, and the Executive Board had concluded that no changes in the tools were required. The staff was well equipped to carry out its surveillance tasks. Moreover, members, including the seven largest industrial countries, made available ample statistical information, as official departments, public and private institutions, universities, commercial banks, industrial organizations, labor unions, and political parties contributed to the debate on economic policy formulation. Moreover, modern communication techniques made the information instantly available all over the world, and especially among the G-7 countries. Hence, he saw no reason to consider developing a mechanism for collecting and analyzing national forecasts or to assess what indicators should be used; after all, the Tokyo Economic Declaration already contained a comprehensive and explicit description of indicators. He wondered whether the suggestion was that the Executive Board was empowered to modify that list.

In addition to Article IV consultations, the Fund conducted multilateral surveillance in the framework of the world economic outlook exercise, Mr. Salehkhou continued. That commendable work by the staff, to which his countries attached great importance, had been developed over time and provided a suitable occasion twice a year on which the Executive Board and the Interim Committee could sort out the issues facing the world economy with a view to encouraging at least convergence among the national policies of the industrial countries. There was no need for any technical strengthening of the world economic outlook exercise, in which the staff had invested valuable resources and substantial expertise, time, and energy.

What was lacking was the political will to make the necessary changes in response to the prevalence of narrow, domestic motivations for policy choices, such as the proximity of elections or the lack of effective authority in the decision-making process, Mr. Salehkhou went on. For example, during the latest world economic outlook discussions and during the discussion of the latest Article IV consultation with the United States, the Executive Board had agreed that the United States should reduce its budget and trade deficits, and that Germany and Japan should stimulate their economies and reduce their trade surpluses. He wondered what indicators other than those already published daily in those countries were needed to establish the direction in which their economies were moving. For example, in Germany, growth and inflation were clearly negative. In Japan, all indicators pointed to the persistence and even to the enlargement of the country's trade surplus. In fact, political considerations prevailed in the choice of national policies. That reality would not be changed merely by changing the normal surveillance exercise by strengthening the multilateral surveillance element through the use of indicators. That fact was particularly clear in the light of the statements by the major countries to the effect that indicators should not trigger changes in national policies.

Although he did not believe that it would lead to any important changes, the staff should include in its examination of indicators a section on the effects of the Group of Seven countries' policies on developing countries, Mr. Salehkhou said. In that connection, the topics that should be covered should include trade, the persistent problem of protectionism, official aid flows, and private flows, including private investment. He was surprised that the staff had not discussed those factors in the present paper, as they partly explained the sluggish growth in the industrial countries. Finally, it would be useful to know the share of developing countries in the total trade of industrial countries.

Mr. Lankester commented that he shared the desire of other Executive Directors to have a system of indicators, but it was important to develop the system slowly. Any attempt to move too quickly threatened to undermine confidence in a new system. The indicators exercise should focus on external imbalances that were likely to have a disruptive effect through protectionist pressures, overshooting of exchange rates, or sharp increases in interest rates. The Fund should not be excessively ambitious in the range of indicators or in the way in which they were used. The need for caution underscored the importance of avoiding forecasts of market-sensitive information. No market-sensitive forecast should be published; indeed, forecasts and assumptions about exchange rates should be excluded from the indicators exercise, including documents made available only within the Fund, given the risk that the forecasts and assumptions might eventually become known outside the Fund. Projections of current account balances based on an unchanged nominal exchange rate would provide substantial information and guidance to participants in the indicators exercise on how policies might need to be changed, including the direction in which exchange rates might need to be moved. He was somewhat surprised that a number of Executive Directors had agreed that the Fund should not make any forecasts of changes in reserves or of intervention while they had no qualms about forecasting exchange rates.

The U.K. authorities would be willing to receive additional staff visits that would be useful in connection with the indicators exercise but they were reluctant to see any elaborate new procedures created. The kinds of imbalances that the indicators exercise was meant to prevent did not occur in a short period. Accordingly, annual Article IV consultations and two world economic outlook discussions per year would provide sufficient opportunities to review indicators.

The nominal values framework on which he would prefer to base the indicators exercise had been criticized by Mr. de Groote, Mr. Lankester remarked. The case for using such a framework had been clearly stated by Mr. Nimatallah: the indicators exercise should be based on the approach to economic management that virtually all members had adopted in recent years, when governments had decided to avoid policies that accommodated inflation. It would be a mistake and inconsistent to try to coordinate policies among nations within a framework that was basically different from the framework in which domestic policies were formulated.

Apparently Mr. de Groote also felt that, under the U.K. authorities' approach, the international implications of policies would be given insufficient attention in comparison with the need to achieve domestic policy objectives, especially financial stability, Mr. Lankester continued. It was unrealistic to expect any member to compromise its inflation objective for the sake of other countries' policies or external balances. He agreed, however, that to the extent possible members should try to achieve their domestic objectives in ways that would not prejudice the attainment of other countries' objectives. In that connection, multilateral surveillance could be helpful and its primary focus should be on the sustainability of external imbalances.

There seemed to be a broad consensus on most of the specific indicators that should be used, Mr. Lankester remarked. However, he would not wish to include market-sensitive indicators, especially the exchange rate. In addition, he doubted whether the unemployment rate would be a usable indicator. Including the unemployment rate among the indicators would suggest that governments could control the level of unemployment through their demand management policies, a conclusion that could potentially lead to the restoration of the fine tuning that seemed to have failed in the 1970s. Moreover, the unemployment rate probably was not the best measure of capacity utilization in an economy.

Mr. Polak said that he had noted two inconsistencies in the discussion on indicators. First, while most Executive Directors had agreed that the number of indicators must be limited, nearly all of them had suggested adding certain indicators to the staff's list. Moreover, there was an inconsistency between the indicators that Executive Directors wished to use for the industrial countries and the indicators that the Fund had used in the past for the membership in general. During the recent discussion on possible enhanced monitoring for Yugoslavia, the Executive Board had been informed that the Yugoslav authorities had asked to be given a limited list of indicators that would be used to monitor their policy implementation. The Executive Board had rejected the authorities' request, and the Managing Director had written a letter to the Prime Minister of Yugoslavia in which he had mentioned that an important feature of enhanced monitoring was that the discussions involved would not be limited to any particular set of variables or targets but would cover all the variables and targets that were relevant at any given time, as was the case with a regular Article IV consultation for all members. He hoped that that conclusion was still valid.

The Director of the Research Department remarked that the Fund was beginning a new stage in its collective efforts to analyze members' policies and to encourage the policy compromises that were the essence of multilateral surveillance. As Mr. Rye and Mr. Dallara in particular had emphasized, the Fund must develop analyses that were useful for policymakers as well as technicians. The goal of surveillance was to enable policymakers in individual countries to judge the consequences for other countries of their policy positions and to participate in the bargaining that was required to adjust those consequences. The Fund's role was to assist in that effort, and its assistance must be based on credible analysis that would be readily usable by ministers. That effort would have to evolve over time; the staff clearly did not have a definitive indicator system ready for implementation at the present stage.

Under the approach that the staff had used in its paper, the staff had started from the fact that the balance of payments recorded the points at which economies interacted with each other and was therefore a natural focal point of multilateral surveillance, the Director commented. In addition, the staff's approach recognized the fact that international transactions reflected not only exchange rate values but a variety of domestic conditions as well, and that accordingly in judging the compatibility of actual or prospective payments positions it was important to take domestic indicators into account.

A collective judgment would have to be made as to whether the payments positions were acceptable and whether market forces would make them acceptable without specific policy action, the Director went on; at the same time, if policy actions were needed, the specific actions and the countries that should take them should be identified. Payments positions at any time were subject to changing forces, and those forces would have to be studied and catalogued to determine whether policies to affect the payments positions were needed. The forces in question ranged from the effects of exchange rate changes and of variations in relative cyclical positions to policy adjustments that were required to avoid such unsustainable trends as a continuing rise in the ratio of interest payments to total payments to foreigners or in the ratio of public debt to national income. The mechanisms for analyzing and summarizing those forces that the staff had suggested in its paper would need to be further developed. The forces that changed a given constellation of payments balances did not take full effect simultaneously; their various effects were felt at different times over a period of some years. It would therefore be necessary to judge whether such effects should be accelerated or delayed.

Furthermore, in judging whether current or prospective payments positions were acceptable, the Fund would have to judge domestic economic conditions. If the domestic conditions in some or all of the countries concerned were unacceptable, policy action would be required to improve those conditions, and that action might well affect the payments positions.

It had been suggested by Mr. Polak that no payments deficit of any country other than the United States could conceivably make an important enough difference to the savings/investment balance of the rest of the industrial world for it to be felt as interfering with national preferences, the Director recalled. Presumably Mr. Polak would agree that the domestic situation in at least a few major industrial countries in addition to the United States should be taken into account in judging the acceptability of payments positions.

The staff would carefully examine Executive Directors' various comments on indicators, the Director remarked. The staff sympathized with Executive Directors who wished to pay attention to nominal interest rates and nominal exchange rates.

There was perhaps an inconsistency in the discussion thus far, the Director remarked: Executive Directors apparently wished to have the indicators exercise focus on the medium term, but some Executive Directors had stressed the usefulness of certain indicators because they were published relatively quickly. The speed of publication might not be essential in an exercise that emphasized medium-term developments.

The staff certainly would not favor publishing highly sensitive information, provided in the course of the indicators exercise, the Director commented. However, the staff did not wish to feel inhibited in presenting useful material to the Executive Board. The question of the information that was desirable to present to the Executive Board should be considered separately from the question of the information that should be published. There was also the question of whether it was desirable to include in staff papers the staff's thoughts on the implications of the present array of forces in the system that would affect future exchange rates, interest rates, and other factors that were thought to be market sensitive. In that connection, a cautious approach was required to avoid the danger of placing the staff in a position in which it would feel reluctant to comment on important matters.

He was somewhat surprised that some Executive Directors felt that the staff had neglected the capital account in its analysis in the present paper, the Director of the Research Department said. The emphasis in the paper on the savings/investment balance was a reflection of the staff's continuing concern about the capital account.

The Deputy Director of the Research Department, responding to Mr. Salehkhou's question, said that the developing countries' share in industrial countries' trade was about 26 percent. As to Mr. Lankester's concern about market-sensitive information, the staff was always aware of the sensitivity of certain variables and tried to present its analysis in a way that reflected that sensitivity while illuminating the issues that needed to be discussed.

The staff agreed that it was desirable to use nominal exchange rates as indicators, the Deputy Director of the Research Department remarked. A difficulty in so doing was that the staff had to guard against the possibility that in analyzing prospective exchange rate trends in a medium-term framework there could be substantial differences in underlying inflation rates. That might lead the staff to conclude that there was a problem with exchange rates that would appear in the longer term if exchange rates remained unchanged in nominal terms but did not exist at present, given the current combination of competitive positions of individual countries. The staff had to be careful to present its analysis in a way that did not suggest that problems existed when in fact there was no evidence of those problems. Several Executive Directors had asked why it was necessary to consider the savings/investment balance since, by definition, savings always equaled investment. In their view, it would be sufficient to examine the external current account. The staff felt that it was important to know whether trends in the current account reflected changes on the savings or investment side. Possible corrections in unsustainable positions would involve by definition factors affecting savings and investment, and it was desirable to be explicit about the particular channels through which the corrections could be made.

The Chairman made the following summing up:

General comments

In presenting their views today Directors generally organized their remarks around the three subject areas identified in the staff paper (EBS/86/127) namely, the analytical focus of the proposed approach to surveillance, the nature of the indicators to be used, and the proposed procedures.

In these closing remarks I will follow the same order, although I will begin by noting several points of a more general character that deserve emphasis. First, in welcoming today's discussion on the staff paper--which was considered to be of high quality--many speakers underlined its preliminary character. They noted that the process of developing an appropriate role for indicators in Fund surveillance would have to evolve gradually, and that it would be a mistake to be too precise or to stress operational aspects at this early stage. Second, several Directors stressed, as they have on earlier occasions, the paramount need for political will if surveillance is to be effective. As a third general point, many Directors emphasized a point made in the staff paper, namely, that the use of indicators in surveillance should be a useful complement to broad-based judgmental analysis. A fourth general point is that the purpose of the indicators exercise is, as most Executive Directors said, to strengthen the process of multilateral surveillance in order eventually to influence governments so that they will not pursue policies that would be harmful to the international community at large. The indicators exercise is not to be an end in itself.

Analytical framework

Let me turn now to the first of the three subject areas I mentioned at the outset, the analytical framework. Most Directors agreed with the staff that the central focus of surveillance should be on developments affecting the balance of payments. A few, however, felt that a better focus of analysis would have been to look directly at exchange rates, while others favored primary concentration on domestic policy variables. In general, however, I think that it is fair to say that it was accepted that the monitoring of domestic economic variables would be undertaken in light of their domestic implications as well as in light of their implications for the world economy and for balance of payments flows, and that international consistency and compatibility of external payments positions in a medium-term framework was the right focus for the surveillance exercise. This notion, which has been confirmed today, is an important one.

Most Directors felt that the saving/investment framework was a helpful vehicle for interpreting international economic interactions. The need to examine the factors influencing saving and investment was also recognized. However, a few Directors, and Mr. Fujino in particular, said that they were not convinced that it was helpful to explain balance of payments developments by their relationship to domestic saving/investment balances. Directors acknowledged that it was difficult to make firm judgments on such complex matters, on which interpretations can vary, but they felt that it would be desirable to make the attempt. Some speakers, however, viewed the analytical structure proposed by the staff as being too constraining and implicitly favored a more eclectic approach to the interpretation of developments in key variables. For example, a number of Directors said that they doubted whether the concept of a sustainable balance of payments, as developed by the staff, could be given a satisfactory empirical content. Directors also noted that calculations of underlying or cyclically adjusted current account positions should be approached with caution.

Choice of indicators

Most Directors broadly agreed with the list of indicators suggested by the staff, with many speakers offering useful and sometimes critical comments and suggestions on specific indicators. Nearly all speakers expressed some reservations about particular points, although they could agree with the thrust of the staff recommendations. A few Directors questioned the usefulness of the classification system used by the staff. Nevertheless, for convenience I will follow it in this summary. Before I come to the individual variables, I would say that on the whole Directors agreed that indicators should be limited in number, quantifiable, timely, relatively easy to interpret, and comparable from country to country.

Performance variables

Most Directors agreed with the use of real GDP (or GNP) growth as the primary measure of output, although many speakers considered that it should be complemented by a measure of domestic demand growth. In addition, and with various degrees of emphasis, some Directors expressed the view that nominal variables, including nominal GDP, should be focused on and should at least be incorporated in the analysis.

Most Directors held the view that it would be helpful to use unemployment as an indicator, perhaps together with other measures of capacity utilization. They judged that it was important to know whether a given balance of payments outcome was being achieved consistently with an adequate rate of capacity utilization and that, although unemployment figures had to be interpreted with caution, they were nevertheless useful. It was also suggested that attention should be paid to employment and other labor market data.

On the subject of inflation, there was a division of views. There was a measure of support for the concept of normalized unit labor costs as a possible measure of underlying cost pressures. For the most part, however, Directors, especially those from larger industrial countries, expressed reservations about the concept of unit labor costs and would appear to prefer a more familiar indicator such as the GDP deflator or the wholesale price index.

In regard to the balance of payments, there was no dissent from the suggestion to use the current account, in a medium-term framework, as a primary indicator. Some speakers felt that this indicator should be complemented by information on the capital account, and by estimates and projections for the terms of trade and relative cyclical positions. The usefulness of movements in foreign reserves as a special indicator was doubted by some Directors.

Policy variables

On monetary policy, there was broad agreement that the indicator chosen should be the one employed by the authorities of the country concerned, should be expressed in nominal terms, and should be interpreted with great caution.

Regarding fiscal policy, most Directors agreed that the actual fiscal deficit should be the primary indicator. There were some differences of view on how much weight should be given to cyclically adjusted fiscal deficits, with several Directors noting the analytical difficulties that are encountered in making such adjustments. There was relatively little support, at least from the larger countries, for adjusting the fiscal deficit to inflation. Mr. Fujino noted that, while it would be difficult to develop indicators of appropriate medium-term fiscal policy objectives, it would be important to examine possible ways in which to assess fiscal policy in a medium-term perspective.

Directors generally acknowledged that structural policies were difficult to quantify, but it was noted that they were nonetheless important, and several Directors requested that the staff analysis should be as explicit as possible in describing structural policies, including trade policies.

Intermediate variables

Concerning interest rates and exchange rates, several Directors pointed out that these were market-determined variables and that staff projections of those variables would be extremely sensitive. They cautioned that the staff should not venture beyond making assumptions with respect to these variables and certainly should not publish any material that would give the impression that we were making forecasts. Other Directors, however, pointed out that an analysis of economic interactions would be incomplete if the implications of alternative exchange rate trends were not adequately explored. These two positions are not mutually inconsistent, because the second position entails assumptions and not forecasts. But discretion is clearly of great importance in this field.

As to measures of savings and investment, several Directors pointed out the statistical shortcomings of estimates of these variables. Some speakers felt that these shortcomings, together with the underlying reservations about the basis of the staff's analysis, made it unwise to attempt to collect estimates and projections for savings and investment. On the whole, however, most Directors supported the staff's proposed approach.

Procedures

Directors generally agreed with the procedures proposed on page 25 of the staff paper. It was noted that these procedures should be considered experimental and subject to change as experience with surveillance was gathered and as guidance was provided by the Board. The role of Article IV consultations as the means of collecting and analyzing national forecasts was stressed. It was assumed that the multilateral discussions of indicators should take place at the same time as the world economic outlook discussion, although--and this matter will be further studied--there could be a separate discussion for which separate documentation would be provided. In that context, the analysis in a special world economic outlook chapter or document of policy interrelations among the industrial countries--particularly the G-10 countries--and their international consequences would acquire particular importance. The analysis of other significant country groupings was also advocated by several Directors.

As far as follow-up procedures were concerned, some reservations were expressed about the use of additional information notices or special minidiscussions on the world economic outlook. Directors generally seem to favor the Managing Director using his discretion to judge when economic developments had reached a point at which a general discussion or special consultation would be helpful. It was also suggested that the Managing Director should participate in ministerial meetings on surveillance.

This discussion was very interesting and highlighted the complexities and the potential of the indicators exercise. The concept of indicators has indeed broad potential, and indicators could be used at different levels. Indicators can be seen as a means of checking the consistency within a country between performance objectives and the policy measures that are to be used to reach those objectives at a given point in time. They can also be seen as a means of checking the consistency of the national forecasts and objectives of a particular country with the national objectives and forecasts of other countries.

Indicators can further be seen as providing, in a more ambitious vein, a global model, or, in a less ambitious vein, a limited set of checks in order to provide signals. Indicators could be used to assess the medium-term sustainability of balance of payments developments, including sustainability in the context of an "optimal" pattern of worldwide growth and stability. That is the most ambitious concept. Indicators can be seen as a tool for intellectual analysis or they can be used to encourage policy action and to trigger more effective international cooperation.

The more the international community wants to move toward the ambitious concepts and goals to which I have referred, the more convincing we would have to be, and the more the notions of sustainability, capital movements, and the models that underlie the notions of optimal growth and stability worldwide would have to be understood and would have to be based on firm and valid analysis that is acceptable to the interested members. We are not yet at that point; further elaboration of the notions to which I have referred--particularly balance of payments sustainability in a medium-term framework--is called for. I thank Mr. Polak in particular for his views on this point. Clearly we will need pragmatism, discretion, gradualism, and judgment. No one today has advocated mechanistic or automatic application of a set of indicators. As Mr. Kafka said, a set of indicators cannot of itself make a coherent system. Nor can indicators be used to automatically trigger policy actions. But indicators can and should signal the existence of potential problems for countries and for the system at large. Thus, if indicators cannot trigger direct action, they can at least trigger questions, discussions and, I would hope, eventually consideration of possible policy action.

We will take stock of the important and interesting suggestions made during this discussion. I am particularly grateful to Mr. Lankester, Mr. Polak, and Mrs. Ploix for having circulated their views in advance, and I share Mr. Nimatallah's hope that others--especially Directors from countries that are directly involved in multilateral surveillance--will circulate the statements they have made.

In taking stock of Directors' suggestions I believe that we will gradually, in an evolving process, be able to enrich the world economic outlook exercise. We are in my view at a turning point in that exercise: an excessive focus on indicators could introduce rigidities and weaken the world economic outlook exercise; but, on the other hand, indicators could give new perspectives and perhaps give signals that our classical approach does not--for example, of inconsistencies between national concepts, forecasts, or assumptions. In a sense, the world economic outlook exercise is a sanitized exercise: these inconsistencies do not appear--they are eliminated because national projections are made consistent. I think that it would be interesting to present, perhaps in a parallel set of figures, all the national projections, even if they are inconsistent, and to show how they are inconsistent and how they could be reconciled. Such an exercise should lead to a better understanding of problems and further on to more effective international cooperation.

As Directors and I myself stressed, our discussion today has been a preliminary one. We will move gradually and cautiously in coming months to respond to the Interim Committee's request to study possible indicators. The staff will carefully review Directors' comments and suggestions in the course of preparing the next world economic outlook paper. Any changes in the world economic outlook exercise resulting from those comments and suggestions will be explained in the introduction to that paper. The Executive Board will thus have an opportunity to review and comment on the next world economic outlook paper--including any innovations in the use of indicators--before the September 1986 meeting of the Interim Committee; those comments by Directors will of course be instrumental in guiding the staff's further work on indicators and the world economic outlook exercise. At the September Interim Committee meeting, I will summarize our work on indicators. In so doing I will draw on my concluding remarks in this discussion and I will supplement those remarks as necessary.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/86/114 (7/14/86) and EBM/86/115 (7/14/86).

2. GHANA - TECHNICAL ASSISTANCE

In response to a request from the Ghanaian authorities for further technical assistance in the tax field, the Executive Board approves the proposal set forth in EBD/86/189 (7/8/86).

Adopted July 14, 1986

3. LIBERIA - TECHNICAL ASSISTANCE

In response to a request from the Liberian Minister of Finance for technical assistance to study the Liberian currency system with a view to identifying policy options for the future, the Executive Board approves the proposal set forth in EBD/86/190 (7/8/86).

Adopted July 14, 1986

APPROVED: April 3, 1987

LEO VAN HOUTVEN
Secretary