



MONETARY THEORY AND POLICY

WEEK 4-COORDINATION OF FISCAL AND MONETARY POLICY

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COORDINATION OF FISCAL AND MONETARY POLICY

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In this topic we will discuss the following-

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I. INTRODUCTION

The efficient pursuit of the objectives of the authorities' overall macroeconomic policy framework requires a close degree of coordination of financial policies. In this topic, the interaction between monetary and fiscal policies is analyzed, stressing the need for policy coordination at two different levels: fulfillment of the overall policy objectives (including financial sector development), and institutional and operational procedures.

In many countries, monetary policy has been subservient to fiscal policy; central banks have often been required to finance public sector deficits, including those arising from quasi-fiscal activities. Such subordination of monetary policy to fiscal needs introduced an inflationary bias. In recent years, however, there has been a worldwide trend-in the context of the modernization of financial markets-to set up institutional and operational mechanisms that would ensure more efficient overall policy design and implementation. These include the adoption of market-based monetary and debt management instruments, as well as moves to increase central bank independence and in some cases the design of strict rule-based monetary arrangements, such as currency boards.

Two fundamental issues need to be stressed regarding the nature of monetary and fiscal policy coordination. First, the overall policy mix as well as each individual policy must be set on a sustainable course. Second, monetary and fiscal policies operate in different time frames, with monetary policy adjusting almost on a continuous basis and economic agents reacting with much shorter lags to it than in the case of changes to fiscal policy, while fiscal policy takes time to adjust and economic agents react with a lag to such adjustments.

A. The Need to Coordinate Monetary and Fiscal Policies

The foremost objective of macroeconomic policy is to achieve sustainable economic growth in a context of price stability and viable external accounts.

For this, it is essential to achieve a close degree of coordination among decision makers in the areas of monetary and fiscal policy. The ultimate effect of measures taken in either of these areas will inevitably depend on how the policies in each area affect those of the other. Without efficient policy coordination, financial instability could ensue, leading to high interest rates, exchange rate pressures, rapid inflation, and an adverse impact on economic growth. At the same time, however, monetary and fiscal policies are designed and implemented by different official bodies, each with its own objectives, resources, constraints, and incentives.

The effective implementation of monetary and fiscal policies thus requires extensive coordination between the respective authorities. Effective coordination makes it easier for policy makers to achieve their stated policy objectives in an efficient manner. It also ensures the commitment of decision makers responsible for these two policy areas to mutually agreed objectives, thus helping to eliminate the problem of time inconsistency in the design of monetary policy. Within this general framework, coordination can take the form of ongoing contacts between the fiscal and monetary authorities to decide jointly on aspects relating to policy design and implementation, or alternatively, coordination could be based on a set of rules and procedures which minimizes the need for frequent interaction; the particular

characteristics of any given country and its degree of institutional development will determine the most efficient choice.

Lack of coordination between the monetary and fiscal authorities will result in inferior overall economic performance. A weak policy stance in one policy area burdens the other area and is unsustainable in the long term. For example, lax fiscal policy will put pressure to tighten monetary policy, even if the latter cannot fully compensate for fiscal imbalances. Moreover, the lack of credibility of the overall policy framework caused by the long-term inconsistency of such a policy mix will diminish the effectiveness of monetary policy.

Efficient coordination of monetary and fiscal policies needs to take into account at the outset the need for policy sustainability. A necessary condition for the efficient coordination of monetary and fiscal policies is that each policy be on a sustainable course. Even if decision makers closely coordinate their policies, coordination cannot succeed if the intended medium-term course of one or both policies is unsustainable.

Equally important for the overall policy framework is achieving credibility for each of the two policies. The stabilization of expectations through monetary policy can only be successful if public finances do not give rise to destabilizing expectations; the pursuit of price stability could lead to very high interest rates or a large loss of international reserves if the markets called policy credibility into question owing to an unfavorable perception of the fiscal stance. At the same time, the less credible monetary policy is, the larger the burden on fiscal policy, since interest rates would tend to be higher than otherwise.

The coordination process also needs to take into account that monetary and fiscal policy adjustments operate in different time frames. Normally, it takes a long time to alter the fiscal stance through policy action. By contrast, monetary policy can be adjusted to alter monetary conditions on a daily basis. This inevitably requires monetary policy to bear most of the burden of any "fine tuning" of stabilization policies.

Policy coordination needs to be undertaken at two different levels. First, there is a need to address the constraints that arise in the short term regarding the operating procedures of monetary and fiscal policies. Second, policy coordination also has to deal with the long-term macroeconomic effects that could arise from an unbalanced policy mix. In the short term, policy coordination is meant to ensure the attainment of orderly financial conditions including price stability. The main areas where attention should be focused are monetary policy and public debt management. In the long term, the policy coordination problem rests on how to design a balanced monetary and fiscal policy mix that is conducive to maintaining the economy on its equilibrium growth path-controlling inflation and promoting financial conditions for sustainable growth. This implies limiting the fiscal deficit to a level that can be financed through the operation of the capital markets without creating distortions in the allocation of resources in the economy, without having recourse to direct monetary financing from the central bank, and without relying on an excessive level of external borrowing.

The joint determination of objectives and policies by the monetary and fiscal authorities is a fundamental requirement for efficient policy coordination.

A situation where the different policies are made consistent with each other by the passive reaction in one policy area to the commanding position in the other policy area would not achieve the objective of maximizing the effects of policies. For example, setting a very restrictive monetary policy to offset a lax fiscal policy may crowd out private investment and significantly increase the borrowing costs for the government.

The establishment and development of domestic capital markets require an even greater degree of monetary and fiscal policy coordination. The domestic financial market provides the least distortionary source of financing for the fiscal deficit, while the need to pay market-determined debt service costs acts as a deterrent to large fiscal deficits. At the same time, these markets allow the central bank to conduct monetary policy more efficiently through the use of indirect, market-based policy instruments. Finally, domestic financial markets impose discipline on the monetary and fiscal authorities given their responsibilities in ensuring a stable financial

environment that would be conducive to maintaining orderly and efficient conditions in such markets.

The need for policy coordination also arises in the case of structural reform and liberalization of the financial sector. Such reform can only proceed within the framework of a supportive fiscal policy that provides macroeconomic stability, fiscal discipline, and avoidance of taxes that discriminate against financial activity. If high fiscal deficits persist while the authorities are undertaking the reform of the financial sector, interest rates could reach very high levels or, if interest rates are kept at artificially low levels, either inflation would surge or the demand for credit and distortions in resource allocation would grow significantly. In either case, the financial reform program more than likely will be unsuccessful. The presence of government payment arrears and the way they are dealt with also will impact strongly on the chances for success of financial sector reform.

Phases in the Development of the Coordination Process

The need for policy coordination is present in any economy, irrespective of its stage of development. However, it will take different forms depending on a country's specific situation and the particular characteristics of its economy, including the depth of its financial markets, the exchange rate regime, and other institutional arrangements. In the early stages of development, where there are no local markets for government debt, the central bank tends to finance fiscal deficits almost entirely, except for that part that the government finances abroad. Under these circumstances, formal rules to constrain central bank financing to the budget are needed to avoid an excessive expansion in domestic credit. A framework that projects the demand for broad money and the sources

of domestic credit, i.e., a broad money programming framework is very useful in facilitating a balanced policy mix.

The auctioning of short-term marketable government securities often serves as a starting point for money market development. There is normally no secondary market for these securities yet, the interbank market is still underdeveloped, interest rates could still be controlled by the authorities, and indirect instruments of monetary policy are just being introduced. However, the government's debt service costs are now affected by the actions of the central bank, and policy coordination-still mainly under a framework of broad money programming-will be essential to reduce the cost of debt servicing while ensuring the attainment of the objectives of monetary policy.

As domestic financial markets start to develop, there is greater flexibility in the determination of interest rates. The central bank actively starts to manage overall liquidity levels (despite sometimes still remaining the major source of liquidity for public debt instruments). As the signaling role of interest rates increases in the economy, the use of broad money programming frameworks as a tool for effective monetary and fiscal policy coordination tends to lessen in importance. The monitoring of financial market developments-in particular the money market-becomes critical. In this context, the role of reserve money programming becomes more important to guide central bank interventions in the market.

Finally, when domestic financial markets become fully developed, interest rates are completely flexible, the market ensures the liquidity of public debt instruments, and the central bank manages liquidity at its own initiative, using flexible market-based instruments. In such an environment, financial markets react rapidly and strongly to monetary policy signals. In particular, the credibility of monetary policy is critical in maintaining orderly market conditions. The independence of the central bank, which is not always present in earlier stages, will normally have been established and is interpreted by the markets as a guarantee against the resurgence of macroeconomic imbalances-including fiscal imbalances-and inflation. However, such "institutional credibility" needs to be supported by "operational credibility." In particular, achieving the objectives of monetary policy depends not only on the law that protects the

independence of the monetary authority, but also on the practical arrangements between the monetary and fiscal policy makers and the degree of fiscal discipline. No matter how much independence the law gives the central bank, in practice the central bank can only successfully pursue monetary policies that are well understood and accepted by the government and the public.

Impact of Monetary Policy on Public Debt Management

The actions of the monetary authority will affect the management of public debt through a variety of channels, including the stance of monetary policy, the choice and design of central bank instruments, and the measures taken to promote the development of the domestic financial markets.

1. The stance of monetary policy

The capacity of the government to place debt at a low financial cost depends to a large degree on the stance of monetary policy. An expansionary monetary policy would initially permit the placement of public debt in the market at low interest rates. However, if inflation follows the implementation of such a lax monetary policy or if the budget deficit grows rapidly given the prevailing low financial costs, nominal interest rates would tend to increase implying a capital loss for investors; in the event, investors would demand higher interest rates to cover for perceived risks, debt service costs would climb and the fiscal authority would have to lower the primary deficit to match available financing. On the other hand, a restrictive monetary policy could initially increase the cost of debt service for the government, but if applied in a coordinated fashion with a responsible fiscal policy it would help to build up credibility, which would eventually lead to no expectation of capital loss, and thus lower interest rates and a more sustained development of the domestic financial markets.

If the monetary authority conducts restrained policies without a certain degree of coordination with the fiscal authority, the results could be counterproductive mainly because, as mentioned above, it will be very difficult for monetary policy to be credible if fiscal policy is not. In this case, the appropriate degree of monetary restraint could

further aggravate the budgetary cost of debt service, which could undermine the sustainability of the fiscal position (the so-called snowball effect). In the extreme case, a contractionary monetary policy could end up leading to a perverse expansionary effect on aggregate demand through the increased public sector interest payments. If the monetary authority is not willing to abandon its firm policy stance because the goal of price stability would be seriously jeopardized, the fiscal authority must then strive to increase the primary fiscal surplus. Additionally, tightening monetary policy could worsen the fiscal situation as the resulting higher interest rates may dampen economic activity and thus reduce tax revenues, while at the same time the lower rate of growth could cause an increase in the debt-to-GDP ratio. Finally, as a result of the lower rate of economic growth, the expansion of reserve money will decelerate and seigniorage will be reduced.

2. The instruments of monetary policy

The choice and design of monetary policy instruments also have a direct impact on the capacity of the fiscal authority to place debt in the financial market in the desired amounts and at a reasonable cost." In particular, the monetary authority can help lower the cost of public debt service by enhancing the liquidity of government securities through their open market operations and the modalities of rediscount and reserve requirement regulations.

In carrying out open market operations, the central bank must decide whether to intervene by transacting in its own paper or deposits, or in government securities. The choice between these two instruments depends on the characteristics of the financial market and on the ability of the monetary and fiscal authorities to coordinate policy targets and operational procedures. The ideal choice from the point of view of the operation of the financial market is to have the central bank conduct its open market operations in government securities in the secondary market, while the treasury places debt in the primary market. This permits the fiscal and monetary authorities to pursue their own objectives simultaneously, while government securities stand to gain in liquidity. However, in the absence of a secondary market, both the fiscal and monetary

authorities would need to operate in the primary market; in this case, the importance of policy coordination cannot be overstated if the goals of both monetary and fiscal policy are to be achieved.

If coordination between the central bank and the treasury is difficult to achieve, the central bank could issue its own securities for monetary policy purposes while the treasury issues government paper to support debt management objectives. However, even in this case some degree of coordination would be necessary to achieve efficient market segmentation (for example, by dealing in securities of different maturities). This would help to avoid head to head competition between the fiscal authorities-who try to reduce the costs of debt service-and the monetary authorities-who try to maintain interest rates high enough to prevent an excessive build up of liquidity. Such a confrontation would end up increasing the borrowing costs for both.

The characteristics of rediscount and reserve requirement regulations are also of relevance in determining the liquidity of government securities. In the case of a rediscount facility where the central bank is ready to rediscount government securities or to accept them as collateral for its loans, the demand for such securities would increase. Considering the reserve requirement system, the greater the uncertainty regarding the amounts to be deposited at the central bank, the larger the demand for assets-including government securities-which can easily be liquidated. Such uncertainty increases if reserves must be maintained on a daily basis as opposed to an average over a certain period of time, and if reserve requirements are determined on a contemporaneous basis rather than on a lagged basis.

Impact of Public Debt Management on Monetary Policy

Just as monetary policy has a direct impact on the ability of the fiscal authority to place debt in the market, so the financing strategy of the government affects the conduct of monetary policy and places constraints on the operational autonomy of the central bank. The modalities of public debt management will affect interest rates, while the financial operations of the government more generally will complicate the central bank's task to maintain an orderly behavior of the monetary aggregates. In addition, public

debt management may alter money demand and influence the development of the local financial markets.

The perceived sustainability of the public debt will affect interest rates. In particular, if debt growth is viewed by market participants as unsustainable, the credibility of the overall policy mix is reduced, and interest rates will rise. In countries where the capital account has been liberalized, the high interest rates, in turn, will attract capital from abroad which will require monetary sterilization operations by the central bank, further complicating monetary management.

The sustainability of the public debt is a function of the size of the stock of debt, its average maturity, and the relationship between the average interest rate and the rate of growth of GNP. A high level of public sector debt relative to GNP is seen by market participants as a threat to the credibility and effectiveness of monetary policy since it could entail the risk of its future monetization or could be an indication of an underlying weak fiscal policy stance. These problems are greatly compounded as the average length of maturity of the public debt decreases and the ratio of financing needs of the government to the monetary base increases, thus reducing the room for maneuverability available to the fiscal authority. Finally, if the real interest rate exceeds the growth rate of real GNP, the stock of debt will grow as a ratio to GNP if the government's primary balance is not positive.

If a problem of debt sustainability is present, the only realistic solution is to implement a program of fiscal adjustment that would reduce the financing needs of the government and, eventually, generate a budget surplus that would produce the resources to reduce the stock of debt to sustainable levels. The fiscal authority should avoid addressing the problem of a rising level of public debt by replacing market-based financing with central bank credit, which would lead to inflation, or with forced debt placements, which would mean financial repression.

Either alternative would end up complicating rather than easing the task of the monetary authority. Public debt management can affect the demand for money in several ways. First, an increase in the holdings of government securities, in the absence of Ricardian equivalence," could give rise to a positive wealth effect, with the result that real balances demanded would tend to increase. Second, liquid government securities could be a substitute for money balances, which would depress the demand for the latter. Finally, a level of public debt perceived as unsustainable would create expectations of future inflation, as mentioned previously, and would thus reduce the demand for money.

In addition to public debt management, other financial operations of the government have an impact on monetary policy. In particular, swings in government deposits at the central bank immediately change the outstanding monetary base, which the central bank might have to offset through open market operations. Furthermore, how the fiscal authority decides to split its financing between domestic and foreign borrowing affects monetary growth, and is, therefore, of interest to the monetary authority in deciding how to carry out its monetary operations.

Finally, as in the case of monetary policy, the operation of public debt policy could help develop the domestic financial market. A moderate expansion of the stock of public debt could help develop the financial market, while a very rapid expansion of the debt could stifle such development.

.Monetary and Fiscal Policies under Different Exchange Rate Regimes

Fixed exchange rate regime

Under a fixed exchange rate regime, a small country faced with perfect capital mobility and with no nontraded goods will find fiscal policy particularly effective in influencing aggregate demand, while monetary policy remains entirely ineffective. Fiscal policy is particularly effective in influencing aggregate demand since changes in the fiscal stance do not affect the interest rate (which will always remain equal to the international interest rate) or the exchange rate (which is fixed by a policy decision). In such circumstances, expansionary fiscal policy would not give rise to any crowding out of private sector activity. In this case, there would be no question regarding what the

optimal monetary and fiscal policy mix should be. However, the position of fiscal policy would weaken, and that of monetary policy strengthen, the lower the degree of perfect capital mobility, the stronger the presence of nontraded goods in the economy, and the larger the country relative to foreign markets. In this case, the optimal policy mix would be determined by the structural characteristics of the economy.

The lack of effectiveness of monetary policy under a fixed exchange rate regime arises from the fact that any expansion in the level of domestic credit will be offset by an equivalent reduction in the level of net international reserves, with no effect on the monetary aggregates. The initial increase in the money supply following an expansion of domestic credit will prompt a drop of local interest rates; as a result, capital outflows will take place which will in turn be reflected in a loss of international reserves and a reduction of the money supply. The capital outflow will continue until the local interest rate climbs back to its original level. Ultimately, the only effect of the expansionary monetary policy will have been a change in the composition of the sources of money supply, with no modification of the overall level of the monetary aggregates or the interest rate.

The above conclusions would need to be qualified if capital mobility is less than perfect or if there are nontraded goods. If capital mobility is less than perfect, fiscal policy will lose part of its effectiveness, since domestic interest rates now will move in response to changes in the stance of fiscal policy. This, in turn, would lead to some crowding out of the private sector. By the same token, monetary policy will gain some effectiveness, since interest rates can move following policy actions on the part of the monetary authorities, and thus will affect the level of aggregate demand.

In the presence of nontraded goods, fiscal policy also would lose part of its effectiveness, while monetary policy would have some effect on the level of aggregate demand. For example, an expansion in the supply of money would not only affect the balance of payments but also output levels of nontraded goods; the higher the share of nontraded goods in total output in the economy, the more effective monetary policy will be even under a fixed exchange rate regime.

Even though under a fixed exchange rate regime the economy is shielded from nominal shocks from abroad, it becomes more prone to real shocks. Given the relative effectiveness of monetary and fiscal policies as discussed previously, the role of shock absorber in the event of exogenous shocks would fall mainly (or entirely, in the case of a small country with perfect capital mobility and no nontraded goods) on fiscal policy.

Nonetheless, there are limits to the effectiveness of fiscal policy under a fixed exchange rate regime (other than those arising from relaxing the assumptions of **perfect capital mobility and absence of nontraded goods**). These limits, which remain stronger the longer the time period considered, arise from the weakening of confidence on the exchange rate peg that could follow from an expansionary fiscal policy. Such a policy would lead to a deficit in the current account of the balance of payments; over time, a current account deficit becomes unsustainable, and market participants would expect a devaluation, which would lead immediately to a hike in interest rates. Also, an expansionary fiscal policy would lead to inflation, which would erode competitiveness.

Flexible exchange rate regime

In the case of a flexible exchange rate regime, monetary policy can be used to raise the level of domestic output while fiscal policy loses all effectiveness. In the presence of perfect capital mobility and absence of nontraded goods, there is no question that theoretically the optimal policy mix in a flexible exchange rate case consists solely of monetary policy.

However, if the structural characteristics of the economy are different, there would also be a role for fiscal policy to play even under a flexible exchange rate regime: Moreover, at a practical level, prudent fiscal policy will always be necessary to establish overall policy credibility and to avoid overburdening monetary policy.

Under a flexible exchange rate regime, the monetary stock is fully under the control of the authorities. A monetary expansion, for example, would initially lower the domestic interest rate prompting an expansion of output. However, since the domestic interest rate now lies below international interest rates, capital outflows would ensue. The

capital outflows will lead to a depreciation of the exchange rate, which improves competitiveness and raises output levels even further. Owing to such higher output levels, now money demand also would increase. The exchange rate will continue depreciating until income conditions are such that monetary equilibrium is again reached at the going international interest rate and new higher level of money supply.

An expansionary fiscal policy, however, would be totally ineffective in influencing aggregate demand, as it would crowd out private sector activity. An increase in the domestic public debt needed to finance a higher level of fiscal expenditure would give rise to an initial increase in interest rates. As a result, capital inflows would take place- until interest rates come down to international levels- and the exchange rate would appreciate. The resulting loss of competitiveness would reduce the profitability of the private sector which, then, would effectively have been crowded out by the fiscal expansion.

Under a flexible exchange rate regime the economy is more prone to nominal shocks from abroad. In this case monetary policy assumes the main role as shock absorber, the more so the higher the degree of capital mobility and the smaller the number of nontraded goods. Nonetheless, just as fiscal policy was not completely independent in the case of a fixed exchange rate regime in the longer term, there also are limits on monetary policy in the case of a flexible exchange rate regime. In particular, continued monetary expansion could lead to an unsustainable process of exchange rate depreciation and domestic inflation.

Relationship Between the Central Bank and the Treasury

Typically, the legal framework for public debt management authorizes the treasury or the Ministry of Finance (MOF) to borrow on behalf of the government, whereas the central bank normally acts as fiscal agent for the government. To some extent, such an organization is a legacy of the past, when central banks were originally set up as multi-functional institutions with the intention of keeping their government fully financed. These institutional arrangements facilitate policy coordination but may sometimes lead to a conflict of interest between the central bank's duties as monetary authority and as fiscal agent. In case of conflict, the central bank is likely to give priority to its duties as

monetary authority. The arrangements that are appropriate for a particular country are likely to change over time, in line with economic progress and development in the areas of financial sector liberalization and reform.

Currently, however, there is a trend toward a "divorce" between debt management and monetary policy which in some cases involves a reduction in the role of the central bank as fiscal agent while increasing the responsibility of the agency in charge of debt management regarding policy decisions in the field of government financing. However, there are preconditions for such a "divorce" to permit the achievement of the overall objectives of economic policy, including a stable economic framework, market development, and the adoption of indirect instruments of monetary control. It is in the context of a "divorce" between debt management and monetary policy that the coordination of monetary and fiscal policy has become so important these days. The following section discusses developments in this area from the point of view of the allocation of debt management functions between the MOP and the central bank.

Location of debt management functions

Public debt management comprises a number of separate but related functions which involve the formulation of instruments (the policy function), the projection of fiscal requirements and the formulation of a debt program (the planning function), selling arrangements (the selling function), the management of government cash balances (the fiscal function), the management of the stock of government debt (the secondary market function), the provision of advice to the treasury on the above debt management functions (advisory function), and the management of records of debt management and stock of government debt (the accounting function).

These functions can be situated in either the treasury, the MOF, or the central bank. There is no clear pattern as regards their preferred location. Historical, socio-political, and economic factors play a role, and arrangements are likely to evolve in line with economic progress and the scope for the implementation of a market-based debt management strategy. At one end of the spectrum, there are countries where the central bank is the sole financial agent of the government and sells securities in the primary market. The central bank may also be requested to provide direct credit to the

government. As already mentioned, the setting up of multi-functional central banks, with responsibility for keeping their governments fully financed, motivated the assignment to the central bank of most debt management functions.

At the other end of the spectrum, the MOF either does the work itself, or relies for the execution of its decisions on an agency under its direct supervision. The main objectives of public debt management will be critical in determining the location of debt management functions. When the development of the secondary markets is the main debt management objective, the central bank may be given considerable scope in key decisions concerning issuance, type, size, and timing. This would be typical of countries in a transitional stage of the coordination process. On the other hand, for countries in the

developed stage, interest cost minimization may become the main objective, and the treasury generally manages most aspects of the debt policy. For instance, the Bank of Canada, acting as financial agent of the government, used to exercise significant influence on public debt management policy. However, the treasury took a much more forceful role after the mid-1980s as interest cost minimization became the overriding concern. In the United States, where the secondary market for government securities is well developed, interest cost minimization is also the main objective, and the treasury manages most aspects of public debt policy. In France, ever since 1986, the government's issuing policy has been to attract international investors, with a cost minimization objective in mind; the treasury is in charge of most of the key functions, and in particular, of the policy, planning, fiscal, and secondary functions.

Establishment of a separate debt management office

An issue deserving special attention in the context of market-based debt management strategies is the establishment of a separate debt management office, which allows for a formal separation of objectives, instruments, and functions. Such a path has been followed by some countries like New Zealand, Sweden, and Ireland in which the development of financial

markets has allowed significant scope to adopt cost minimization as the main objective of public debt management. However, the establishment of a separate debt

management office does not lessen the need for coordination between monetary and fiscal policies. This is confirmed by the specific arrangements implemented in those three countries which provide for formal or informal means for coordination. However, in countries where markets are still undeveloped and rudimentary, setting up a separate debt management office may complicate rather than assist a smooth development of the various debt management functions.

Coordination committees

Coordination in the execution of monetary and fiscal policies can be achieved through formal or informal committees for debt management purposes. These committees—normally composed of officials of the MOF, the treasury, the debt office, and the central bank—meet on a regular basis to exchange information regarding the government's financing requirements, to discuss and analyze the results of the government's cash balance projections, to monitor overall liquidity and market developments, and to discuss the strategy for achieving public debt and monetary management objectives.³³ These committees are particularly important in the early stages of market development—the transitional stage in the evolution of the coordination process highlighted earlier in the paper. They provide a means for members

to learn about each other's objectives and operating procedures, while helping to build a consensus on how debt and monetary management should be conducted to be mutually reinforcing. Later, as progress is achieved in a mutual understanding of objectives and operational arrangements, effective coordination can be based on informal contacts, and the frequency of formal meetings may be reduced.

CONCLUSION

The main objective of macroeconomic policy is to achieve sustainable economic growth in a context of price stability and viable external accounts. To meet this objective, this paper has shown that it will be essential to reach a close degree of coordination among the monetary and fiscal authorities. Only by achieving effective policy coordination will policy makers ensure that they will realize their stated objectives in the most efficient manner.

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