

The role and future of the international financial institutions

In the Jane Hodge Memorial Lecture ⁽¹⁾ the **Governor** looks at some of the more important features of the IMF and World Bank as they are today, forty years after the Bretton Woods conference which established them, and goes on to think about their future in the light of the problems with which they have to deal. He concludes:

- 'The Fund is still . . . the only international institution which can provide the expertise, together with the lubricating finance to help economies return to equilibrium'.
- 'The World Bank's role in assisting structural adjustment in developing economies should assume greater importance. To ensure this . . . a general capital increase is likely to be necessary.'
- 'The Fund and Bank need to work more closely together on questions related to developing countries, though we have to recognise that they cannot between them provide all the finance that economies in difficulty are likely to need.'

Introduction

Although my title could be taken to cover a wide field, I propose to focus my remarks on the International Monetary Fund and the main arm of the World Bank group, the International Bank for Reconstruction and Development. Forty years ago, the Bretton Woods conference established what have come to be called the Bretton Woods institutions, and such anniversaries tend to stimulate introspection. More importantly, however, this is a particularly demanding time for the institutions; the criticisms directed at them from some quarters show no sign of abating; and the institutions have themselves begun to re-examine their roles.

The aim of this lecture is twofold. First, to stand back a little and look at some of the more important features of the IMF and Bank as they are today. Second, to think about their future in the light of the problems with which they have to deal. I may say at the outset that I believe the institutions have been responding constructively to difficult circumstances and the world as a whole has benefited from the vital part they have been playing. I appear before you tonight, therefore, in the role of champion rather than critic.

Origins

Although historically the two institutions both grew from the same determination to avoid the chaotic conditions of the inter-war years, and although Keynes referred to them at their birth as 'lusty twins', I am sure he saw them as independent members of the same family, each with its own purposes and functions, and its own financial structure.

The World Bank was seen as an engine for long-term financing of post-war reconstruction and then development more generally. In the early years, this was largely directed towards specific projects to develop the economic infrastructure of the newly independent countries and was soon widened to cover productive investments in industry, agriculture and energy. In pursuit of these objectives, the Bank was given its own share capital against which it was empowered to borrow from the private capital markets.

In contrast, the IMF was placed at the centre of a new international monetary system in which members accepted the disciplines of fixed exchange rates, thereby surrendering some of their sovereignty. It had the task, in which it was notably successful, of constructing an efficient multilateral payments system out of the morass of controls, bilateral arrangements, and multiple exchange rates inherited from the war years.

The IMF's lending function was to be a subsidiary one, supporting the system by financing countries experiencing temporary balance of payments disequilibria. The 'fund' of its title was a pool of resources contributed by all members in the form of a quota subscription, and from which members could borrow in amounts directly related to their quota.

On the one hand, the Bank was to be a permanent long-term lender; on the other, the Fund was intended to revolve, drawing on countries in current account surplus to assist those in deficit to return to equilibrium. It was also assumed that countries in surplus and deficit would themselves alternate over time.

(1) Delivered at the University of Wales Institute of Science and Technology on 3 December.

Subsequent changes

The differences in concept remain important for a proper understanding of the institutions. But the original designs, thanks to the foresight of the drafters, have not prevented a good measure of evolution over the past forty years. In the Fund we have seen a change, accelerating in the last ten years, in the relative importance of its main functions. It is now a lender on a considerable scale, and with that function it has developed as a different kind of force for adjustment through the conditionality attached to its economic programmes. The shift in emphasis can be attributed partly to the breakdown of the par value system in the early 1970s, which came about for a variety of reasons—including the declining willingness of members, especially those in surplus, to accept restrictions on their exchange rate policies, and also the asymmetry of a system in which the key currency, the US dollar, was not subject to disciplines in the same way. But another underlying reason for the shift in the Fund's emphasis has been the changing composition of its membership. It now has nearly 150 members, compared with fewer than 50 when it was founded; and while short-term adjustment to restore equilibrium might have been appropriate for many of those early members, it sits less well on the newer members whose problems and external environment are less tractable and more likely to bring them repeatedly to the Fund for assistance. With the main industrial countries not currently borrowing from the Fund, the developing countries have now become the predominant users of Fund resources.

The Fund has responded by trying to tailor its lending to longer-term needs and also to the scale of the problems of indebted members—with longer repayment periods and large multiples of quota. This in turn, however, has caused a number of practical and what I might call 'theological' problems, the most obvious of which is that subscribed resources have become inadequate. Thus the Fund has been forced to borrow large additional sums and has departed a long way (some would say too far) from first principles.

The Bank, too, has adapted—in its earlier years by forming the International Development Association as its soft lending arm, directing concessional aid to the poorest countries, and during the 1970s by further enlarging the range of its operations. Most recently, we have seen it step beyond its traditional functions into co-financing, to which I will return later and which is a laudable attempt to increase private capital flows. It has also taken special initiatives to speed up disbursements as a contribution to immediate financing needs. The most significant development has been the introduction of broader forms of lending aimed at encouraging structural and other types of adjustment, to which the Bank has begun to attach more general policy recommendations than was possible or appropriate in the case of its traditional project lending.

Present position

Thus the two institutions have drawn closer together, reflecting joint recognition of the difficult world situation,

and perhaps of the argument that short and long-term adjustment are two sides of the same coin. But the blurring of distinctions and the departure from convention also suggest the need to ask whether the trends are necessarily in the right direction.

The Fund will need to consider how far it can continue with large-scale lending—especially to those countries which have become prolonged users of its resources—and, if it cannot, how it can still act as a force for adjustment. It must also explore different ways of exerting its influence, through more effective general surveillance to replace the powers it lost with the old par value system. The Bank, having discovered it cannot stand aloof from the adjustment process, has to determine how far it should change the direction of its lending towards the encouragement of adjustment; and how it can maintain or expand its overall contribution at a time when there may be considerable pressure on other sources of finance. For both institutions, their increasingly complementary role makes co-ordination more than ever necessary.

The IMF

In considering these questions in relation to the Fund I will look first at its financial constraints; then at the role it plays in member countries through adjustment programmes and associated conditionality; and finally at the prospects for its wider role in the international system.

Financial constraints

Because the Fund has the character of a mutual organisation, it is not sufficient to say that debtors' needs are very great and that the Fund should do more for them. The creditors' view must also be considered. When a member in a strong balance of payments position provides resources to the Fund, he has two important principles in mind. First, the resultant claim on the Fund remains in his reserves and is firmly understood to be withdrawable at need. Second, he is reassured to know that under its Articles of Agreement the Fund is confined to being a short-term lender: it is a monetary institution, not an aid-giver in the development business. The Fund must therefore be sure that its own assets are good and will be repaid on time: hence the insistence by large creditors that its resources must revolve. To ignore their legitimate anxieties about the liquidity of their claims and the overall percentage of their reserves represented by Fund-related assets would risk damaging irreparably the consensus and mutual self-help embodied in the institution, and would make it more difficult to obtain resources in the future.

It is sometimes felt that the Fund is consequently subject to excessive influence from the major industrial nations. But their influence is not disproportionately high in relation either to their economic position in the world or to their financial contribution to the Fund. This influence is in any case not conferred by the Fund; it would be no less, indeed it would probably be greater, if the Fund did not exist.

Conditionality

Let me now turn to the concerns of borrowers. Despite the central role the Fund has played in the adjustment undertaken by many countries over the last few years, it has certainly not won universal praise in the process. On the contrary it has been accused of going beyond its charter in meddling with all the problems presented by international debt; while perhaps the loudest and most persistent criticism is that the policies it advocates are inimical to growth.

I can, I think, dispose quickly of the charge of meddling too far. The restoration of equilibrium in members' economies is the Fund's proper concern. We should recall the consensus, which grew in the wake of the second oil shock, that adjustment rather than financing was the appropriate response. Given also the increasing reluctance of commercial banks to finance current account deficits on anything like the scale they had done in the 1970s, deficit countries turned to the IMF (some, it must be admitted, later than was desirable) to provide them not only with balance of payments support but also to advise on and monitor recovery programmes which would restore international confidence. Without the Fund's presence and the adjustment it encouraged, the necessary restoration of creditworthiness in indebted countries would be considerably further away than it is today.

What, then, of the Fund's alleged bias against growth? The accusation of being indifferent to the sufferings of the populations of countries with Fund programmes is made too often for it to be ignored, though perhaps the role of scapegoat is not the least valuable of the parts the Fund plays. It is true that the most noticeable feature of programmes is the restrictions they place on certain key financial variables, but it does not follow that the Fund is opposed to economic growth. After all, a healthily growing economy which participates increasingly in international trade must benefit all Fund members. The essential distinction, however, is between sustainable and unsustainable growth. Demand has usually been excessive in those countries that have needed to adopt Fund programmes, and the position has become unsustainable. The Fund advises members to attempt to avoid such a situation in the first place or, at the very least, to take immediate corrective action. It is not the Fund's fault if that advice is not taken and, then, when a programme is eventually agreed, economic conditions are considerably worse and the remedies correspondingly more severe. Even then, these programmes do not ignore the need to improve supply-side factors by, for instance, encouraging realistic producer prices and an appropriate exchange rate. But because such measures take time to bite, it is nearly always necessary to reduce demand temporarily to bring the external deficit to a level that can be financed.

Of course, austerity measures are not without social cost. But runaway budget deficits and profligate borrowing also have grave social costs, such as high and accelerating inflation which causes most harm to those least able to

avoid its effects. Also, in nearly all cases the measures traditionally associated with Fund programmes would eventually have to be adopted, whether or not under the auspices of the Fund. Unbalanced economies need to be righted again and lasting growth can occur only when this has been achieved.

There can of course be real tensions, particularly in present circumstances, between the constraints of short-term adjustment and longer-term requirements. The Fund is obliged, however, to focus on short-term balance of payments needs, and its advice therefore concentrates on short-term policies—the sort of policies which can be implemented quickly and whose effect will be prompt. Many members are in any case unwilling to make longer-term commitments themselves. But this does not mean that nothing is done to try to make these policies compatible with the long-term interests of a country. As long as the ultimate aims of the programme are not jeopardised, there are many ways to arrive at the same destination, and it is a major part of the Fund's task to explore them all fully with members.

Role as catalyst: does the Fund need to lend?

The conditionality of Fund programmes also serves to reassure market lenders about the economic soundness of troubled borrowers. Indeed, that feature has meant far more to the major debtors than the amount of money they could get from the Fund, which is necessarily limited. Is there something wrong with the balance here? The fact that Fund lending is relatively small in relation to their needs seems to me more an indication of the scale of their indebtedness than of any inadequacy in the Fund's contribution which is, rightly, related to quotas that reflect relative economic strength. But does this mean that the Fund's role is closer to that of adviser and that it no longer needs to lend?

Perhaps in time the membership could arrive at new obligations which would make this workable. For the foreseeable future, however, I see two main reasons for the Fund to continue to lend. The first concerns conditionality. Unless the Fund actually lends to members they lack the incentive to seek the Fund's advice in the first place, or to accept the conditions and performance targets set out in its programmes, to which the draw-downs of its loans are related. The Fund could, perhaps, confine itself to reporting to the banks, but would then be in an invidious position, policing an agreement between two third-parties, to only one of which (the member country) it had any formal relationship. Of course, where a country has adopted an adjustment programme which has begun to bear fruit to the point where its net borrowing needs, if any, can be met through normal market mechanisms, then, once the programme has come to an end, the IMF can revert to a less active role of surveillance, but one which can still provide reassurance for the country's banking creditors. An interesting example of this is the responsibility to be given

to the Fund in the two-stage multi-year rescheduling agreement between Mexico and the banks, where a report on the Fund's surveillance of the country's economy will be made available to the banks with the full co-operation of the Mexican authorities. I hope that the arrangement will prove successful, but I doubt that it could be of general application. The second reason why I believe the Fund should continue as a lender concerns the commercial banks. It is generally thought that until recently the banks were providing a larger share of countries' financing needs, and moving further away from trade and project finance, than was desirable. In the last two years or so, however, that position has changed, to the extent that there might have been no new bank lending at all to some of the major debtors if they had not been operating economic programmes agreed with the Fund. The condition for the banks' continuing involvement with a country has been a similar commitment on the part of the Fund. In some of the more difficult cases this symbiosis is likely to be necessary for some time to come.

Even when the case for continued Fund lending is accepted, there is another difficult judgement to make. Looking to the future, in due course I would like to see the scale of the Fund's operations come closer to what can be financed from quota resources and from the General Arrangements to Borrow—those long-established arrangements set up initially to provide additional resources to the Fund in the event that any of the major industrialised nations would turn to it for assistance, but which have now been enlarged and are partly available for other countries as well. Additional borrowing arranged more recently, some of which continues today to support the Fund's expanded lending, has been essential to meet exceptional circumstances, but it should not become a permanent feature. It would obviously be unwise to predict that there will never again be occasions when the Fund may need to be temporarily enlarged on the basis of extra borrowing—ideally from official sources (since the expansion in its lending can itself happen only with government agreement). But as a general aim it will be important to take the opportunity whenever possible to wind down facilities meant for exceptional circumstances. We must fight against the temptation to treat the exceptional as the normal.

Yet in present circumstances and in many countries the timescale necessary for adjustment to take place is likely to be more protracted than in the past. Even in the most obdurate cases—where it is clearly sensible that aid and other forms of development assistance should provide the bulk of a country's needs—it would be very difficult for the Fund to cut itself off completely. Provided genuine attempts are being made by the country to achieve a sustainable solution to its problems, the Fund should continue to make resources available, on however a limited scale, to support those attempts. Long-term problems, however, usually require long-term strategies and the involvement of the World Bank in these cases will also be essential.

Surveillance

I now turn to the Fund's more general influence, under the heading of surveillance. Now that the major countries are no longer obliged to maintain fixed (but adjustable) exchange rates, the Fund has lost much of its influence over their policies, which was in any case never very strong on those countries in balance of payments surplus. Another weakness is that the multilateral payments system has become distorted by the reintroduction of restrictive devices which had earlier been largely eliminated by the Fund.

It is therefore encouraging that, following the Williamsburg Summit, the search is now on for ways in which the Fund can more effectively discharge its duty to help maintain systemic order. As a result of decisions taken at Williamsburg, the Group of Ten countries are making a study of the ways in which the international monetary system might be improved.

We should not allow our expectations to run too high—for instance, by looking for a rapid return to a structured fixed exchange rate system. What I would hope to see, however, is general agreement that we should build on the existing annual consultations which the Fund holds with its members individually and begin to set these into a wider frame, involving particularly those countries whose currencies are components of the special drawing right, or SDR, with a view to assessing the effects of one country's policies on others. Behind that concept is a growing recognition of the need for greater co-ordination and complementarity between the policies of major nations in wider areas than simply exchange rate adjustment as envisaged at Bretton Woods. It is also clearly desirable that this surveillance should be more symmetrical and applicable to all members than the present arrangements allow. To make this truly effective would imply some surrender of sovereignty, but that might not mean less freedom if it also reduced the adverse effects of policy decisions in other countries.

To the extent that such new procedures eliminated misunderstandings and mutually damaging policies, they would be helpful. My hope, also, would be that through this new multilateral surveillance, together with its periodic assessments of the world economic outlook, the Fund would be in a better position to promote consensus views on macroeconomic issues for the benefit of the whole membership. It would, however, be foolish to hope that more effective surveillance could fully override political realities.

International liquidity and the SDR

Another problem which has to be faced in time is the Fund's surveillance of international liquidity. Despite a system of floating exchange rates, where theory suggests that the possession and growth of reserves should be less important, it is clear that in practice—and for various reasons—countries set considerable store by an adequate and indeed rising stock of reserves. World reserves largely comprise foreign exchange holdings, some 70 per cent of which are in US dollars. The major source of supply is,

therefore, the external deficits of the United States, and there is no mechanism to ensure that the 'correct' volume is supplied, even if it could be measured. We saw the dangers of such haphazard arrangements in the 1970s: a rapid expansion of international liquidity as a counterpart to large US external deficits prompted many countries to embark on what were in retrospect excessively expansionary policies; and, subsequently, the scope for obtaining reserves to spend expanded greatly through the ready availability of funds on the international markets. While such borrowings fulfilled a useful function in channelling capital between surplus and deficit countries, they have made it far more difficult to control official international liquidity. Perhaps ironically, during the same period many governments have been strengthening their control of domestic liquidity through changes in monetary policy. But stronger control of official international liquidity would require national governments to surrender a further degree of sovereignty to the Fund, and we have a long road still to travel before that comes in reach.

However long that road proves to be, a greater measure of international control of the supply of reserves remains a desirable objective. It would mean that the world would acquire the reserves it needed rather than those which appeared as the result of the policies of the major reserve centre. Moreover, if there were to be a weakening of the principal component of the current system, or indeed the development of a shortage of dollars (unlikely though that might seem at the moment), weaknesses in the structure could rapidly be exposed. The appropriate response at that stage cannot be stated in advance. But one potential remedy could be a resumption of regular issues of SDRs linked to a substitution exercise in which reserve currencies would be deliberately replaced by SDRs. The IMF could by these means begin to exercise the greater surveillance over international liquidity which is lacking under current arrangements.

In the meantime it would be prudent to continue attempts to make the SDR more attractive. As an official reserve asset it still has some way to develop—for example in its liquidity and transferability—if it is to match other reserve assets. As an international unit of account it has lived up even less to earlier expectations. A few years ago commercial banks began taking deposits denominated in SDRs, but there was no great enthusiasm as the banks could find few SDR-based assets in which to invest. Perhaps if the Fund itself had borrowed in private markets, as was contemplated at that time, the private use of the SDR might have expanded in the same way that the ECU seems to have benefited from borrowing by institutions of the European Community. The ECU has also come into demand as a hedge against a fall in the US dollar, which the SDR is to only a limited extent. When the composition of the SDR basket was revised in 1980, the dollar weight was set as high as 42 per cent—and currency movements have since increased this figure to no less than 54 per cent. The problem will require some thought in future reviews of the SDR basket.

The World Bank

Let me now turn to the World Bank. The IBRD's contribution to world finance is illustrated by the fact that its outstanding loans amount to some \$40 billion. It is less reassuring to look at the latest year, 1983, when the non-oil developing countries ran current account deficits totalling \$50 billion. In that year the IBRD's gross disbursements of \$8 billion were in fact less than those of the Fund (at \$10 billion); and if we press the analysis further by offsetting repayments and interest costs of earlier loans, the Bank's contribution to the developing world was then only about \$2½ billion—with another \$2 billion provided by the International Development Association. While we may expect some reduction in overall financing needs in the future, we cannot ignore the likelihood that commercial bank lending and other sources of official finance will continue to be restrained, including the probability that Fund finance will be reduced as the current exceptional situation returns to some normality. It seems right, therefore, to look to the Bank, and to think there may be a case for enlarging the scale of its lending.

If we now look at the Bank's functions, the case becomes stronger. I have already referred to its prime function as a long-term lender for specific projects, which accounts for the bulk of its operations and which I would not wish to see changed. There have, however, been other developments whose importance we need to assess and which also indicate that the Bank may have a wider role ahead of it.

One important function which I believe needs encouragement is that of catalyst, in order to make the most efficient use of the Bank's available resources and to respond to the call for greater private capital flows. Here I refer to the part the Bank can play in co-ordinating aid donors and agencies; the role of its other arm, the International Finance Corporation, in encouraging private equity and portfolio investment; and the efforts of the Bank to associate private lenders with its own operations. The Bank has long tried to gear up its lending by inviting other sources of finance—such as governments, export credit agencies and commercial banks—to join in supporting its projects. But despite the reassurance which is given by the Bank's acknowledged expertise in the preparation and monitoring of projects, this co-financing, as it is called, has not appealed to the commercial banks as strongly as was hoped. Commendable efforts are now being made to improve techniques, for instance by direct World Bank participation in loan syndications. It is an area which will be even more important in the future, and attempts to refine techniques and to improve communication should be continued. In this regard, the idea has emerged of establishing a banking subsidiary—a World Bank bank—which would be closer to the market place than its parent. Despite a number of technical and legal difficulties, the suggestion merits further consideration.

Broader policy-based loans

The other recent development to which I wish to draw particular attention is the introduction of new forms of lending associated with broader policy changes. In my view, these are an important adjunct to the Bank's more traditional operations, as well as a useful complement to the Fund's efforts to encourage adjustment, as they are designed to deal with institutional, structural and management rigidities which have often proved to be as important a hindrance to development as any lack of investment itself. They finance a transitional period during which old institutions and practices can be reformed or replaced, and in so doing help to create a sounder base for economic development more generally. An example of this is the series of structural adjustment loans to Turkey, in which World Bank finance helped to accelerate trade liberalisation, improve the system of export incentives, facilitate the mobilisation of domestic resources, restrain growth of public expenditure and improve the efficiency of State enterprises. The loans were put in train relatively quickly thanks to the fast-disbursing nature of structural adjustment lending. As each tranche in the series was disbursed, it was subject to economic monitoring and conditionality which had not been so important on project loans.

Policy conditions

Policy conditions are not a new concept for the Bank. But the form they took in the past was applied in piecemeal fashion mainly through policy covenants attached to project lending. These have not proved easy to monitor or to enforce. The long lead times needed to prepare projects and arrange co-financing have inevitably raised the costs of delaying or suspending a project in the light of adverse policy or institutional developments. Even now, the Bank's newer 'conditionality' is not always as precise and well-monitored as it might be. In this context loans which make the release of funds dependent on explicit measures are more valuable than those which rely on general exhortations and are not drawn down in tranches.

With this new emphasis, some would say that the balance has already swung too far away from traditional project finance. What is important, however, is not so much to aim for a specific balance in aggregate but rather to achieve an appropriate mix of instruments for individual countries, in order to assist the process of adjustment; and to fit these into a more co-ordinated medium-term framework for country lending. This is not to argue for a large switch away from project lending as the mainstay of the Bank's operations. Broader policy-based lending should rather be seen as a complement to, and not a substitute for, traditional lending.

Financial constraints

Given the importance of such lending, and if we also accept the continuing need for project finance and for sufficient World Bank input to induce other flows of finance, we have to consider the financial and operating constraints on the Bank. It is no surprise that these are rather different from those affecting the Fund.

Nevertheless, they do exist and by examining them we can identify a number of problems to which the Bank should address itself in the period ahead.

First, the lending side. The Bank has to observe a statutory one-to-one gearing ratio between subscribed capital and reserves on the one hand and outstanding loans on the other. Thus, if lending continues to grow faster than capital, the Bank's ability to take on additional loans will disappear. Although we have not yet reached this point, we could soon be worryingly close to it. Continued growth in loan commitments would seriously erode the headroom presently available and would require the Executive Board to focus quickly on expanding the institution's lending capacity. The Bank may be able to sustain its current rate of lending for another year or two without needing a capital increase. But without further growth the net flow of funds to developing countries—loan disbursements less repayments—would decline more steeply than currently projected, and the Bank might well find itself a net taker of funds from developing countries as a whole in two or three years' time. That would do little to enhance the World Bank's policy leverage. The message is, therefore, quite simple: an enhanced role requires general agreement on the need for an expansion of the Bank's lending authority—and sooner rather than later.

Gearing ratio

It would, of course, be possible to increase the Bank's lending if its gearing ratio were increased and it borrowed more on the markets. There are, however, inherent risks which in my judgement outweigh the advantages. The main attraction of this option, as canvassed by the Brandt Commission, is that it is apparently cost-free to the major shareholders. On the other hand, the Bank's statutory one-to-one ratio is uniquely conservative and represents one of the main pillars of its high credit rating. While we cannot be certain that a change in the gearing ratio would diminish its creditworthiness, it could be interpreted by the markets as a breach of faith and as a reduction in shareholder confidence and support. If so, the change could carry unfortunate implications for the Bank's market access and borrowing costs, which would in turn rebound on the volume and price of its lending. Ultimately, of course, it is the shareholders whose capital would be called in the event of a serious collapse of investor confidence. I thus regard the 'cost-free' aspects of this proposal with some suspicion.

Funding strategy

A substantial capital increase, on the other hand, would enlarge the Bank's lending authority without raising any such doubts, though it would not, of course, increase its ability to borrow from the markets. The continued success of its funding strategy rests on its access to as wide a range of markets as possible, and its ability to avoid saturating any one of them. The Bank has in fact successfully maintained a margin of 'excess capacity' by diversifying its borrowings across an ever wider range of currencies, markets and instruments. It is a process we

support and which has been continuing as rapidly as considerations of cost and prudence allow. The Bank still relies, however, on the permission of member governments to borrow in their currencies, and this permission has not always been forthcoming.

One particular problem which the Bank faces, in common with other multilateral development agencies, is its relations with its shareholding governments, of which the industrial countries provide the major part of its capital backing. Among these countries there can be shifts in attitude, or doubts about the relative merits of multilateral as opposed to bilateral aid; and it is understandable that governments should often share the view of exporters in their country that bilateral aid ought to be distributed in a manner which benefits them as well as the recipient. Probably the wisest answer is that there should be room for both types of aid in major countries' budgets. Nevertheless, it is arguable that the channelling of aid through multilateral bodies may offer the best chance of avoiding wasteful duplication and of achieving greater efficiency all round. By allowing for international competitive bidding in procurement, multilateral bodies such as the Bank are best placed to ensure the efficient allocation of scarce aid resources. (And it is worth mentioning, parenthetically, that the United Kingdom's procurement record for contracts funded by multilateral aid has been relatively strong in recent years.)

However, questions are occasionally raised by governments and others about the efficiency of the multilateral development banks, and it will be vitally important for these agencies to prove their capabilities and to instil greater confidence. For the World Bank, the way ahead is to improve the functions I have been describing and to ensure, in particular, that its contribution to structural and other adjustment needs is based on sound conditionality. The solution here is in fact in the hands of the shareholders, who, I am tempted to suggest, should also consider redressing the relationships between the Bank's staff and its Executive Board. Some of the governments' doubts would be allayed if the role of the Executive Board could be enhanced to enable it to transmit shareholders' views more authoritatively.

Fund/Bank co-operation

My last theme is the question of co-operation between the Fund and the Bank. Since so many countries' short-term difficulties are plainly the result of structural problems, it is sensible for them to look to the Fund and Bank for coherent policy advice as well as for financial assistance. The Fund will have to take account of the Bank's more prominent part in encouraging and monitoring adjustment efforts, and the Bank will need to rely on the Fund's advice in areas which lie within that body's competence—for example on exchange rates and credit policies. Both have a common interest in such subjects as appropriate external debt management policies in borrowing countries, and closer liaison between them, could only be helpful.

The need for greater co-operation is now widely accepted and real attempts are being made to bring it about. It will not be easy, however, and there are obvious limitations to the process. As I have already explained, the institutions have separate identities, and it would be wrong to push them so close together as to compromise their distinct responsibilities or to dilute the purity of analysis and advice they now bring to their individual spheres of activity. This would be in nobody's interests, least of all those of borrowing countries.

Yet there is certainly room for something to be done. Fundamentally, we are talking about making the institutions more aware of and sensitive to each other's work. In practical terms it is not difficult to think of measures to promote the process of further co-operation: for example, more staff interchange to familiarise personnel with the workings of their sister institution; more joint staff missions; improved cross-fertilisation of research work; amalgamation of support services (such as the provision of debt statistics); and attendance at Bank Board Meetings of senior officials from the Fund (and vice versa) where general discussion of a country's economic performance is likely to be of relevance to both bodies. Modest organisational reforms will not resolve all the problems, of course, but if they improve lines of communication it should be possible to avoid the requirements of one institution running directly counter to, and thereby impeding assistance from, the other.

Conclusions

In conclusion, the main points I want to leave with you are these. First, the Fund is still, I believe, the only international institution which can provide the expertise, together with lubricating finance, to help economies return to equilibrium. In that context conditionality is essential, primarily as a helpful discipline to borrowers but also as a form of reassurance to other Fund members, on whose continuing commitment the existence of the Fund depends. Over time it would be helpful to confidence if Fund surveillance could be extended effectively to the whole membership, one consequence at least being the opportunity to eliminate some of the restrictive practices which have developed since the end of fixed exchange rates. Second, I think that the World Bank's role in assisting structural adjustment in developing economies should assume greater importance. To ensure this, without prejudice to project lending, a general capital increase is likely to be necessary in the fairly near future. Third, the Fund and Bank need to work more closely together on questions related to developing countries, though we have to recognise that they cannot between them provide all the finance that economies in difficulty are likely to need.

Finally, I think that both Fund and Bank have stood up remarkably well to the challenges of recent years; and both deserve our gratitude for the constructive flexibility with which they have responded to the problems thrown up

by world recession. The greatest mistake would be to risk throwing away what we already have. That is why I believe it right to work through existing institutions and to speak in terms of controlled evolution rather than of fundamental reform. But I also believe, especially at a time when the institutions are playing a more vital role than ever, in the need to maintain and reinforce our support. We need a strong IMF not only because of the demands placed upon it at present but also because, as in the recent past, it should be ready and able to meet

contingencies. We shall also need it as a fulcrum of the next phase of evolution in the international monetary system, whatever that may be. We need a strong World Bank because clearly it will be called upon to continue its long-term financing of development in the years ahead, and also because in its newer role I see it sharing the IMF's tasks of encouraging adjustment and pursuing those very necessary efforts into the medium-term and beyond. I have no doubt that these 'lusty twins' have at least another forty years of beneficent life in them.