

December 27, 1990 - 90/235

The Acting Chairman's Summing Up at the Conclusion
of the Discussion on Currency Convertibility and the Transformation
of Centrally Planned Economies
Executive Board Meeting 90/176 - December 17, 1990

Directors welcomed the opportunity to discuss the role of currency convertibility in the transformation of centrally planned economies, noting that the analysis was relevant to many other countries as well. Much of the discussion focused on current account convertibility, which was widely acknowledged as a desirable medium- to long-run objective, and which members had an obligation to establish under Article VIII.

Directors agreed that there were several important and interdependent preconditions for current account convertibility, including an appropriate exchange rate, adequate international liquidity, the absorption of any liquidity overhang, and sustained and sound macroeconomic policies. They also underscored the importance of hard budget constraints and of an effective incentive structure that induced enterprises to respond appropriately to market prices. Without hard budget constraints and appropriate incentives, the introduction of convertibility would be unlikely to lead to more efficient production and investment decisions. The risks of an early move to current account convertibility, in particular, were also acknowledged, especially those associated with the emphasis that would need to be placed on monitoring external equilibrium and the need to have, in the short run, an undervalued exchange rate. At the same time, it was felt that it might not be possible, or even desirable, for all of the preconditions to be firmly established before moving to current account convertibility.

Directors observed that current account convertibility must be addressed as part of the larger issue of removing restrictions on current account transactions generally. They stressed that such measures could play a crucial role in the transformation process through the introduction of import competition and by aligning domestic relative prices with those prevailing in world markets. Indeed, it was argued that competition and appropriate relative price signals were essential to provide guidance for production and investment, which was now lacking following the collapse of central planning systems.

Directors expressed different views on the speed with which countries should move to current account convertibility. Ideally, current account convertibility should be declared immediately, it was agreed, along with a comprehensive set of reforms sufficient to establish the preconditions for convertibility. In practice, however, it might take time before the preconditions could be sufficiently well established to make it possible to move to current account convertibility in a durable way. The ability to implement sound macroeconomic policies, for example, might require substantial

reform of monetary and fiscal policy institutions in some countries. In that connection, reference was made to the distinctly different views that individual countries held on the appropriate speed for moving to current account convertibility, and the need to approach the issue on a case-by-case basis was thus emphasized. Among the Directors who believed that some countries would be better off with a gradual approach, a few argued that the preconditions for a move to convertibility should include substantial progress on important structural and institutional changes in the economy, including, for example, the clarification of laws defining property rights.

Directors generally agreed on the importance of moving early in the transformation process to unify the exchange rate for current account transactions, to remove quantitative restrictions on trade, to rationalize the system of import tariffs, and to introduce a competitive system for allocating foreign exchange. Some Directors felt that those measures could largely achieve the main benefits of current account convertibility, even if, during a transitional period, countries maintained foreign exchange surrender requirements.

Several Directors commented on the role that tariffs could play as part of a transitional arrangement for cushioning the economy from the impact of a move to current account convertibility. In particular, provided that there was a preannounced and credible system for phasing out tariffs over time, import tariffs--when packaged with measures to unify the exchange rate, to remove quantitative import restrictions, and to introduce current account convertibility--could provide a transitional period for domestic producers to adjust to external competition.

With respect to issues of capital account convertibility, Directors believed that inflows of foreign capital and managerial skills could provide major benefits for the transforming economies, and in that connection, they emphasized that sound policies should be implemented early in those economies, so as to improve their attractiveness to both foreign and domestic investors. A number of Directors favored maintaining restrictions on outflows of domestic capital until late in the transformation process. Some Directors observed that issues surrounding capital account convertibility could have been examined in greater depth in the staff paper. Those Directors advocated an early freeing of capital movements, emphasizing that capital movements could contribute to macroeconomic stability and discipline, and could encourage the development of the domestic financial system.

Directors who addressed the issue of internal currency convertibility believed that limited forms of internal convertibility might be useful for legitimizing transactions that were already taking place, and for channeling existing foreign exchange holdings into the banking system.