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NEW IMF STUDY EXAMINES CURRENCY CONVERTIBILITY FOR CENTRALLY PLANNED ECONOMIES IN TRANSITION

High among the reforms on the agendas of countries making the transition from centrally planned to market-oriented economies is the establishment of currency convertibility--the freedom to buy or sell foreign exchange, generally for payments related to international flows of goods, services, or financial assets. The promise and some of the pitfalls of currency convertibility are analyzed in a new IMF study, Currency Convertibility and the Transformation of Centrally Planned Economies, by Joshua E. Greene and Peter Isard, published as Occasional Paper No. 81.

Convertibility for current account transactions, along with measures to liberalize trade and payments generally, can provide a valuable source of competitive discipline and appropriate price signals to guide domestic enterprises toward efficient production and investment decisions. Convertibility for certain types of capital transactions can help attract foreign investment inflows and associated managerial resources and transfers of technology. However, convertibility can also entail major risks, particularly early in the transition process, when economic incentives and legal provisions may not yet be in place to enable markets and macroeconomic stabilization mechanisms to function properly.

This study analyzes when countries should introduce convertibility for current account transactions; it also discusses capital account convertibility and internal convertibility. Preconditions for the successful implementation of current account convertibility are an appropriate exchange rate; adequate international liquidity; sound macroeconomic policies, including the elimination of any monetary overhang; and the ability and incentives to respond to market prices. In addition, the paper considers transitional approaches that could mitigate the risks of convertibility, albeit at the sacrifice of some of the benefits.

Copies of Occasional Paper No. 81 are available to members of the press from the IMF's Information Division (tel: 202-623-7100). Copies can be purchased by the public from the IMF's Publications Services (tel: 202-623-7430) for \$10.00 a copy.