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Minutes of Executive Board Meeting 90/176

2:30 p.m., December 17, 1990

M. Camdessus, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
M. Al-Jasser	
G. K. Arora	L. E. N. Fernando
	G. C. Noonan
Dai Q.	
	S. B. Creane, Temporary
	M. E. Hansen, Temporary
J. de Groote	J. Prader
	G. H. Spencer
R. Filosa	N. Kyriazidis
M. Finaish	
M. Fogelholm	
B. Goos	
J. E. Ismael	T. Sirivedhin
	J. R. N. Almeida, Temporary
J.-P. Landau	J.-L. Menda, Temporary
	S. Rouai, Temporary
	L. J. Mwananshiku
D. Peretz	P. Wright
G. A. Posthumus	
	J.-C. Obame, Temporary
	M. Galán, Temporary
A. Végh	A. G. Zoccali
K. Yamazaki	M. Nakagawa, Temporary
	K. Ichikawa, Temporary

L. Van Houtven, Secretary and Counsellor
M. J. Miller, Assistant

Also Present

Administration Department: G. F. Rea, Director; H. J. O. Struckmeyer, Deputy Director; J. D. Huddleston, N. S. Jackson, P. J. McClellan, M. Oka, H. Wiesner, A. A. Zimmerman. African Department: G. C. Dahl. Asian Department: T. T. Do, M. J. Fetherston, S. L. Lam. European Department: M. Russo, Director; P. B. de Fontenay, Deputy Director; M. I. Blejer. Exchange and Trade Relations Department: J. T. Boorman, Director; T. Leddy, Deputy Director; B. B. Aghevli, H.-M. Flickenschild, M. G. Gilman, A.-M. Gulde, P. J. P. Szymczak. External Relations Department: S. W. Kane. Fiscal Affairs Department: D. Mihaljek. IMF Institute: N. Tith. Legal Department: W. E. Holder, Deputy General Counsel; P. L. Francotte. Research Department: J. A. Frenkel, Economic Counsellor and Director; M. Goldstein, Deputy Director; G. Calvo, P. Isard. Secretary's Department: J. W. Lang, Jr., Deputy Secretary; A. Tahari. Western Hemisphere Department: P. J. Quirk. Special Advisor to the Deputy Managing Director: W. A. Beveridge. Personal Assistant to the Managing Director: B. P. A. Andrews. Advisors to Executive Directors: M. B. Chatah, A. Gronn, Z. Iqbal, H.-J. Scheid, B. Szombati, A. M. Tanase. Assistants to Executive Directors: H. S. Binay, Chen M., B. A. Christiansen, J. A. Costa, N. A. Espenilla, A. Fanna, S. K. Fayyad, B. R. Fuleihan, S. Gurumurthi, O. A. Himani, C. J. Jarvis, F. Moss, M. Mrakovcic, L. Rodríguez, J.-P. Schoder, G. Serre, D. Sparkes, C. M. Towe, S. von Stenglin.

1. CURRENCY CONVERTIBILITY AND THE TRANSFORMATION OF CENTRALLY PLANNED ECONOMIES

The Executive Directors continued from the previous meeting (EBM/90/175, 12/17/90) their consideration of a staff paper on currency convertibility and the transformation of centrally planned economies (SM/90/214, 11/7/90).

Mr. Goos stated that he was in broad agreement with the views expressed in the paper.

In assessing the benefits of current account convertibility, the beneficial effects of improved access to production inputs and modern technology offered by a liberal payments system should not be underestimated, Mr. Goos commented. That factor had been recognized in the paper, but it was subsumed under the traditional view of the benefits of current account convertibility. Such effects were particularly important in Eastern Europe, including in the former German Democratic Republic (GDR), where the previously limited access of enterprises to modern inputs went a long way toward explaining the poor state of the economy. By the same token, much of his optimism with regard to an early revival of the economy in eastern Germany was based on the improvement in the supply of efficient production inputs that was expected to result from the integration of the enterprises into the free trade and payments system of the Federal Republic.

It was clear that the risks associated with current account convertibility could not be ignored, and that, depending on the specific circumstances, the adoption of a cautious and more gradual approach might be advisable, Mr. Goos continued. However, it needed to be stressed that there was no risk-free or cost-free alternative to current account convertibility, considering the distortions and inefficiencies which accompanied the controls and regulations in a situation of nonconvertibility. Those costs were undoubtedly all the heavier the more domestic financial policies deviated from the external equilibrium requirements in an unrestricted external environment. That served to underline the desirability of moving as rapidly as possible to current account convertibility, and to keeping transitional arrangements truly transitional. In that context, he was not sure whether he fully understood the concern about the need for the authorities to direct policy instruments toward external stability rather than internal stability, as had been stated in the staff paper. The collapse of the central planning system should have thoroughly discredited the merits of inward-looking and administrative policies.

With respect to the exchange rate issue, he would agree with the staff's emphasis on the need to protect the external competitiveness of domestic enterprises in order to avoid severe dislocations and a surge in unemployment, Mr. Goos observed. Normally, some overshooting devaluation at the time of the introduction of convertibility might therefore be appropriate; policymakers in Germany would have been more than happy to have had that policy instrument available to them at the beginning of the reform process in eastern Germany. However, he had some difficulties with the notion that starting from an appropriately depreciated exchange rate, it might be useful to envision an exchange rate path consistent with current account sustainability at different points in the transformation process--again, as the staff paper had stated. That brought to mind his traditional concern about a gradual exchange rate devaluation over time, which he feared might fuel inflationary expectations and thereby undermine domestic savings and investment performance. Therefore, it would be preferable, in his view, to control the path of the real exchange rate through appropriate anti-inflationary policies, and if necessary, to complement such an approach by further discretionary and infrequent devaluations.

The list of preconditions for the successful introduction of current account convertibility should be extended by one further point, namely, the ability of economic agents to respond to market incentives, Mr. Goos went on. That point had been brought up by several other speakers as well. The ability to respond would point to the need to have in place at the time of the introduction of convertibility at least a minimum set of the kind of structural reforms mentioned in footnote 1 on page 18 of the paper, and among those, clear and transparent rules for private sector activity, the legislative framework for property rights, tight budget constraints for enterprises, and a market-based financial system, would constitute at least the basic ingredients of such a system.

Shortcomings in the implementation of such reforms would threaten to delay the supply response of the economy, a crucial prerequisite for continued public support.

The relevance of the paper went much beyond the reform efforts that were being pursued by the previously centrally-planned economies, Mr. Goos concluded. In view of the important benefits of currency convertibility for efficient and sustainable growth as well as for financial discipline and the availability of external finance, he would encourage the staff in its country work to strengthen its efforts at removing payments restrictions wherever possible. Those efforts should encompass not only the introduction of current account convertibility, but also capital and internal convertibility, notwithstanding the latitude that was provided under the Articles for maintaining restrictions in those areas.

Mr. Obame made the following statement:

> When the issue of market-oriented reforms in planned economies was discussed, it appeared quite clear that in time, currency convertibility would be a crucial objective of the ongoing reform process, and the main challenge facing the authorities of those transforming economies. Indeed, convertibility is at the core of the Fund's Articles of Agreement, which require member

countries to implement appropriate changes in their economies in order to comply with the obligations under Article VIII.

But it is now well established that the process of these changes is a long and painful one. The appendix to the staff's excellent paper shows that historically, these transformations, and the preconditions for currency convertibility, could not be effected overnight. Even in the case of some major developed countries that have established over time a competitive industrial structure, convertibility has been introduced on a step-by-step basis, before the full obligations of Article VIII were accepted.

Therefore, the main question is the speed at which these economies should move toward internal and external convertibility, along with the removal of market rigidities and the reform of the institutional framework that is implied by that objective.

With regard to the major benefits and risks to be expected from currency convertibility, we agree that current account convertibility can introduce a new degree of freedom into the economies that are currently characterized by central planning, and could promote domestic production through better access to foreign capital and intermediate goods, and through the incentives provided by an open and competitive environment. The risks involved in introducing current account convertibility are well covered in the staff paper. We note that too swift a move toward convertibility would require the real exchange rate in the short run to be more depreciated than its long-term equilibrium level; and that the risks of either greater exchange rate instability, or the temptation on the part of the authorities to resort to direct policy instruments for maintaining external stability, rather than internal stability, also need to be borne in mind. In that regard, I would associate myself with the remarks of Mr. Posthumus. It seems that some of the countries currently implementing Fund-supported adjustment programs in Eastern Europe are facing these risks. However, despite these threats, it seems that the long-term benefits from current account convertibility would outweigh the short-term disadvantages. The resolute implementation of macroeconomic and structural reforms is therefore important to ensure that an appropriate balance is struck between the benefits and costs of current account convertibility. We have no difficulties in endorsing the basic prerequisite for establishing current account convertibility as an appropriate exchange rate, an adequate level of international liquidity, sound macroeconomic policies, and incentives for economic agents to respond to market prices. We agree that the first three conditions have to be met in order to ensure that the introduction of current account convertibility does not generate macroeconomic instability, and that the achievement of the fourth condition is necessary to promote economic efficiency and growth. We also recognize that the attainment of these conditions requires a social and political consensus in favor of major institutional reforms, without which the process of reform could be delayed.

While the question of the appropriate pace for establishing current account convertibility is not an easy one to answer, gradualism appears to be advisable. A comparative analysis of the different experiences with convertibility among the major industrial countries in Western Europe after World War II, and our expectations of the suitable timeframe for the introduction of convertibility in the transforming economies of Eastern Europe, might be enlightening in that regard. Also, how does the staff see the convertibility of individual currencies in Eastern Europe fitting into the planned single market in Europe and European monetary integration in 1992? In any case, the experience of convertibility by some countries outlined in the appendix could be a useful reference. It appears that most of the countries concerned--particularly the so-called newly industrializing economies--have chosen to establish current account convertibility early in the economic reform process. By doing so, they have been able to create an environment conducive to the implementation of sound macroeconomic policies and structural reforms. Although in the case of former centrally planned economies this experience could be taken into consideration, transitional arrangements toward convertibility would be worth considering, despite the benefits of moving quickly in that direction. In this regard, given the potential delays that might come about because of the need to establish the preconditions for convertibility, we agree that a transitional system that will allow the authorities to maintain control over the total volume of resources available for imports, while permitting economic agents to bid openly for these resources, would be operationally attractive. In passing, we share the views expressed by Mr. Landau and Mr. Filosa that some sort of tariff protection could also be worth considering. Should this be the choice of these countries, we see an opportunity for them to benefit from the Fund's technical assistance, such as that which is currently being provided to Poland.

The arguments put forward by the staff seem to indicate that the issue of the benefits and costs of maintaining restrictions on the capital account should be examined on a case-by-case basis. Indeed, the question to be resolved is how to encourage long-term capital inflows while limiting capital flight and volatile, short-term capital flows. In the case of the transforming economies in Eastern Europe, we can share the opinion expressed in the paper that countries should not rush to liberalize restrictions on international capital movements.

Finally, we agree with the view that introducing internal convertibility would not be advisable when the country has not yet satisfied the basic criteria of convertibility. Therefore, although internal convertibility could have some beneficial effects--such as channeling foreign exchange resources into the banking system, or unifying exchange rates--it could also entail potential risks if the economic and financial structures of the country are still fragile.

Mr. Spencer made the following statement:

I found the staff paper to contain a useful discussion on current account convertibility and its preconditions, but I found the discussion on capital account convertibility somewhat lacking. Unfortunately, it is this area of capital account convertibility that raises the more interesting and challenging policy issues, and I will focus my remarks there.

I might first comment briefly on the current account discussion. I feel that the political and practical factors involved in a liberalization program are underplayed in the paper.

I have no problems with the four preconditions set out in Section IV of the paper, but it must be recognized that authorities will never have all the preconditions completely satisfied. They will always, to some extent, be working in the dark. The point that needs to be emphasized is that uncertain knowledge of meeting the preconditions should not be allowed to deter the authorities from pursuing current account convertibility. Indeed, the momentum of a reform program is likely to be assisted by the early introduction of current account convertibility--as in Poland, for example. If each piece of the puzzle waits for the other pieces to first be put in place, the picture may never be completed. This is very similar to Mr. Filosa's point this morning.

I was disappointed both at the lack of analysis in the area of capital account convertibility, and the implicit view in the papers that capital flows are something that should be kept tied up, where at all possible, in order to avoid capital flight and exchange rate volatility. If capital and current account convertibility are appropriate long-term aims--as expressed early on in the paper--then we will need to know how the transition should be managed for both the current and capital accounts. What are the preconditions for capital account convertibility? For example, how mature do financial markets need to be? Do we need to wait for full trade liberalization before moving on the capital account? And what are the implications of alternative approaches to monetary and exchange rate policy? Might there be situations in which capital liberalization helps to achieve macroeconomic stability? I feel that these are important questions that the Fund needs to address.

Without trying to answer these questions and resolve all the conflicts myself, I would perhaps just mention one or two benefits of capital account convertibility that did not seem to be covered in the paper. While capital flight must obviously be avoided via appropriate supporting macroeconomic policies, the freedom for savers to shift funds offshore provides a strong market discipline for domestic investment projects. While current account convertibility helps to ensure that investment decisions respond to the appropriate set of relative prices, capital account convertibility requires that investment decisions deliver an internationally competitive rate of return. Furthermore, as mentioned in the paper, capital account convertibility will result in a greater inflow, as well as a greater outflow, of funds, with investment diversifications occurring on both sides of the border. This can help make domestic financial markets more robust in the face of domestic economic shocks. It also gives domestic firms scope to diversify geographically in their area of expertise, as opposed to being limited to product diversification within the home market. Free capital flows also place a discipline on economic policy generally. While capital account convertibility will clearly make either the exchange rate or international reserves more sensitive to certain economic and political shocks, this may be a small price to pay for the benefits brought by financial market monitoring of decisions made both by domestic enterprises and by domestic policymakers. While the domestic authorities will have to put up with the vagaries of short-term market fads, they will benefit greatly in the longer term from the rod that is provided to keep policies in line with their stated long-term objectives. I would be interested to hear further from the staff on whether it plans to examine the issue of capital account convertibility more closely in the future.

Mr. Finaish made the following statement:

Let me preface my remarks by saying that unlike a number of Directors who spoke this morning, we have not approached the paper as one which deals exclusively with the economic transformation currently taking place in Eastern Europe. There is a larger group of countries which are in the process of transformation toward market economies, and for which the question of convertibility is also quite relevant. Some speakers indicated this morning that the introduction of convertibility should be immediate simply because the former system has ceased to exist, and what we have now is a state of confusion which makes the issue of transition more or less irrelevant. This may well be the case in some Eastern European countries, where the old payments system was anchored on the U.S.S.R., which itself is undergoing a traumatic change. But there are other countries which are in the process of economic transformation where the questions of transition and short-term costs are not merely academic.

The staff paper provides a useful overview of the question of currency convertibility, particularly in the context of the transformation of centrally planned economies. There can be little disagreement on the longer-term benefits of convertibility in terms of efficiency and resource allocation. It is also probably true that convertibility constitutes an important and conspicuous symbol of openness which can have a significant impact on expectations and the confidence of economic agents. But as the paper correctly stresses, there are significant short-term risks for macroeconomic stability and for the real sector, especially if convertibility is introduced prematurely. Even when the identifiable preconditions for convertibility are met, these risks cannot be eliminated altogether; and hence a cautious approach by governments is quite understandable. While delays in introducing convertibility entail certain costs, these are probably less than the cost of moving prematurely, only to reverse that movement if the short-term impact proved intolerable.

Obviously, one would want to minimize the possible short-term adverse implications of currency convertibility, and we basically agree with the preconditions outlined by the staff for a successful shift toward convertibility. A particularly interesting notion mentioned by the staff is that the more unsatisfactory the prior macroeconomic conditions are, the more likely that the public will support the measures and policies necessary for satisfying these preconditions. This is probably true. But one could also argue that if we start out with a situation of substantial and entrenched macroeconomic instability, inflationary expectations are likely to be more deeply ingrained, thus compounding some of the short-term risks associated with convertibility. Be that as it may, however, it could be argued that caution is particularly warranted where the economy had been artificially spared high rates of inflation and macroeconomic instability in general. The costs of a premature move under such conditions may well extend beyond the short term to the extent that inflationary expectations are substantially altered as a result of convertibility. The staff touches on this issue, including in its discussion of the monetary overhang and the need to absorb excess liquidity prior to the introduction of convertibility.

But another issue which it seems to me did not receive adequate attention in the paper is the impact of an external debt overhang when such a problem exists--and we know that it does, in many cases. In its discussion of exchange rate policy in the context of convertibility, the staff focusses on setting the exchange rate at a level consistent with a balanced external position. It is not clear what this means for cases in which there is a debt overhang. The cost of excessive depreciation is recognized in the paper. But how would one define excessive depreciation when the balance of payments is saddled with a debt burden which casts doubt on viability under any realistic combination of exchange rate and macroeconomic policies? The staff does not address this issue explicitly. But it could be argued that another precondition for successful convertibility is a debt profile, or a reconstitution of a debt profile, which could produce external viability without the need for exchange rate and macroeconomic policies that would threaten the sustainability of a shift toward currency convertibility. This problem is even more serious when capital account convertibility is also involved. Although the staff correctly emphasizes the particular risks associated with capital account convertibility, it also points out that unless macroeconomic policies and prospects are good, restrictions on capital transactions are unlikely to be effective. But to the extent that prospects are clouded by perceptions about the external debt burden, and if we assume that circumventing capital account restrictions is easier in the presence of current account convertibility, then one has to be particularly cautious about introducing current account convertibility in situations in which perceptions about economic prospects, and the external position in particular, are clouded by a heavy external debt burden.

Another question relating to exchange rate policy is the time profile of the exchange rate level which is consistent with external balance. The staff suggests a substantial depreciation, followed by a gradual appreciation which reflects the expected improvement in efficiency and competitiveness. One can understand the logic of the staff's analysis. But it is not fully clear why the exchange rate should be the sole balancing instrument--or, to put it differently, what are the advantages of following the exchange rate path described by the staff compared with an alternative approach which sets or fixes the exchange rate on the basis of medium-term expectations and prospects, while using macroeconomic and trade policies to achieve short term balance of payments objectives? I believe that some analysis of alternative approaches to exchange rate management in the context of convertibility would have been useful. The staff touches on this issue, rather indirectly, in addressing the question of external reserve requirements under a fixed or floating exchange rate regime. But could one say more about the benefits and disadvantages of adopting a floating or fixed rate system in moving toward convertibility? Or is it the staff's view that it really does not matter, as long as the preconditions are met?

I found the discussion on transitional arrangements in approaching convertibility particularly interesting. As the staff points out, even if the preconditions for convertibility are met, some governments may opt for a gradual approach because of concerns about the exchange rate and balance of payments implications. A gradual approach may also be relevant in cases in which some of the preconditions are put in place only gradually. If, for example, the degree of macroeconomic tightening and the availability of external reserves are not sufficient for full current account convertibility, a gradual approach would make sense. What is less clear, and perhaps the staff can comment on this, is whether the same can be said about price reforms. In other words, if all the preconditions are met, with the exception of price reforms--which are to take place over time in the context of medium term structural adjustment program--should convertibility be introduced immediately, or does it matter at all?

I found particularly interesting the footnote on page 22 regarding the theoretical basis of the argument for capital restrictions. I would encourage the staff to pursue this subject in its ongoing research, drawing on the experience of countries with capital controls as a means of sustaining domestic investment. Perhaps the staff would like to elaborate a bit on this footnote.

Mr. Fogelholm made the following statement:

The paper before us is both interesting and topical. Its strength lies in the comprehensive overview of the issues involved. But the approach is one of generalization, and I wonder whether the ability to draw conclusions has not suffered somewhat from that approach. The systemic orientation of the analysis in response to the issue at hand--that is, currency convertibility in the context of the integration of Eastern Europe into the international monetary system--has undoubtedly been one of the reasons for this. We would, however, like to caution against the inclination to overly generalize. Experience so far has been largely limited to nonsocialist countries and to different historical time periods, and, consequently, to different economic circumstances. We would, therefore, maintain that the transition to currency convertibility is an issue largely to be dealt with on a case-by-case basis, and that should also influence the Fund's advice.

Nevertheless, my authorities believe that the strong trend toward economic and political reform in many Eastern and Central European countries should indeed be taken advantage of; the strategy should be to introduce current account convertibility as soon as possible in support of the reform efforts.

Thus, my chair would tend to favor a rapid rather than a slow transition to convertibility, for the reason that it is difficult to maintain effective control of the economy during the transitional phase. But a decision on the pace at which convertibility should be introduced must be taken with due regard to the specific circumstances in each particular case.

Let me make some more specific comments relating to the question of current account convertibility.

First, we agree with the staff's listing of the general preconditions for current account convertibility. The exact composition and content of the various requirements--that is, an appropriate exchange rate, adequate international liquidity, sound macroeconomic policies and incentives to respond to market prices--are nonetheless matters to be dealt with on a case-by-case basis. That it is difficult to generalize is evident on pages 17 and 18 of the staff paper, where the staff analyzes the factors which may influence both the political and economic climate for reform efforts. For example, in Poland, in the then-current political situation, hyperinflation may have facilitated implementation of the reform program, but this may not be a relevant example in different political circumstances.

Second, a transition to convertibility makes no sense without prior price reform. In the same vein, one can maintain that the crucial question of incentives cannot be resolved without radical change in property rights. With the benefit of hindsight, Poland can be regarded as an example of a case in which policy measures ideally should have been implemented in a different sequence. For example, legal issues, including the issue of property rights, ought to have received priority attention in connection with the formation and implementation of the radical adjustment program.

Third, it is clear that the existence of a monetary overhang can endanger macroeconomic stability in the transition to currency convertibility. The starting point should be that this problem is taken care of in advance, or at the latest when convertibility is being introduced. The problem of monetary overhang can be resolved, as suggested by the staff, for example, through the sale of public properties or through monetary reform. The latter alternative is probably easier to implement politically on short notice, as I understand that excess money balances, to a large extent, are held by enterprises in the form of deposits in banks, and are therefore not significantly effecting the public at large. A comment by the staff would be welcomed.

Fourth, I would like to stress that the improvement in economic efficiency which should follow current account convertibility ought also to allow for the introduction of improved production techniques favoring the quality of the environment and more effective use of resources. This holds true in particular for Eastern Europe. My authorities wish to emphasize the importance of these kinds of efficiency gains, as they are beneficial for all.

Let me say a few words on the issues of capital account and internal convertibility. I agree with other Directors that one should not insist on introducing capital account convertibility at an early stage in the reform process. Instead, it should be regarded as a future goal to be gradually attained when firmer macroeconomic stability has been established.

The staff seems to caution against beginning the process toward convertibility with internal convertibility, an approach which my authorities can support. Early introduction of internal convertibility can present a risk that the domestic currency will be out-competed or crowded out by one or several foreign currencies--a development which could be difficult to reverse in the continuing restructuring process. Another risk is that large currency holdings can easily lead to capital flight.

However, there are undoubtedly also benefits to be gained from internal convertibility, which may be hard to obtain through other means; for example, the channeling of private currency holdings to the banking system and gaining control over the black market. These are, clearly, issues that need to be resolved at some point in time during the reform process. Nevertheless, and taking everything into consideration, it would seem reasonable not to give internal convertibility the same priority as introducing current account convertibility.

Mr. Peretz stated that he wished to join other speakers in welcoming the staff's useful and timely paper. He had little to add to the points that had already been made, and even less now that he had heard Mr. Spencer's intervention about capital account convertibility. Clearly, the timing and extent of a move to convertibility depended on a range of factors--the level of the exchange rate, the degree of trade liberalization, the level of the reserves, the institutional framework, the strength and credibility of the macroeconomic policies and, perhaps above all, on the political context, and the degree of general popular support for a rapid transformation of the economy, as opposed to a gradual one. The Polish case demonstrated the benefits of moving forward in a rapid way to introduce a significant degree of convertibility at the same time as other reforms. The Polish case also demonstrated the costs of failing to carry through a radical approach to structural reforms alongside macroeconomic policy reforms--structural reforms of the financial system, in particular.

If he had a criticism of the paper, it was that he, like Mr. Spencer, believed that it focused too much on current account convertibility, and might have gone further on capital account convertibility, Mr. Peretz commented. Obviously, that could only be done in cases in which the authorities had the will and some degree of popular support for tight macroeconomic policies. Where there was such support, however, the policy of full convertibility had much to recommend it, and the sooner countries could get there, the better. It was only with such convertibility that the pursuit of exchange rate stability as a policy would give the right signals for domestic monetary policy. If it was believed that the pursuit of exchange rate stability was a useful anchor for policy, then it was an even more useful anchor with full convertibility, because that helped to bring the right signals through. As long as the right policies were followed, he did not believe that capital flight should be a problem. That was, of course, above all a question of establishing a track record of credibility in domestic policy. The countries that were the object of the discussion--namely, those formerly centrally planned economies--mostly started with a clean slate, and they had the opportunity to establish that track record.

The countries under discussion had very underdeveloped domestic financial institutions and markets, Mr. Peretz observed. The Polish case demonstrated that it was essential to develop those financial institutions and markets quickly. The quickest and surest way to do that was by pursuing an open policy in encouraging free capital flows, free access to overseas financial institutions, and free access by domestic businesses to international capital and banking markets. That pointed again to moving quite quickly toward capital account convertibility.

There was also the question mentioned by Mr. Landau earlier about whether, under current conditions, capital controls could actually be made effective, or at least, anything other than extremely leaky, Mr. Peretz went on. He suspected that that would rapidly prove to be a factor in the economies under discussion. On a specific point, in speaking about complete, as distinct from only current account, convertibility, there was a question of how much international liquidity would be required to support complete convertibility. Obviously, adequate international liquidity would be needed to support convertibility in the face of volatility in the balance of payments and exchange markets, but reserves that were too large could tempt countries to delay adjusting domestic policies in the face of changes in domestic conditions for too long. The required amount of liquidity was therefore subject to judgment, and he saw no reason why it should be the same for all cases--three months' imports, for example. The amount of liquidity needed depended on the degree of exchange rate stability being aimed for, and the shocks expected. He therefore hoped that the staff would seek to identify ex ante, and justify on a case-by-case basis, the projected buildup in reserves for each of the programs that came to the Board.

Whatever transitional arrangements were chosen for individual countries--whether as staging posts to internal, capital account, or current account convertibility--they should be reviewed regularly, with the aim of moving to full convertibility as soon as circumstances allowed, Mr. Peretz concluded.

Mr. Noonan made the following statement:

Like earlier speakers, I agree with the importance of the four preconditions for the successful introduction of currency convertibility set out in the paper. However, I would like to elaborate a little on the fourth precondition, since it is the introduction of effective competition in a free market environment which, to my mind, seems to be the most radical aspect of the transformation of centrally planned economies.

In this regard, while the elements of the fourth precondition identified by the staff--price reform and the hardening of firms' budget constraints--are certainly necessary, I fear that they may understate the full menu of microeconomic policies necessary for the proper working of a market economy. For example, it will also be important to ensure that domestic competitors do not face a more restrictive regulatory environment than that faced by their external competitors. This will require that new domestic entrants to the marketplace are not obstructed and are given reasonable access to risk and working capital. In addition, the regulatory environment should not place undue administrative barriers on either the entry, or the day-to-day operations, of either domestic or foreign enterprises.

As regards price reform, not only must prices be adjusted to appropriately reflect domestic costs, but they must be allowed to adjust freely to changes in both the external and the domestic environment. This point is especially relevant given the dynamic nature of the transformation of a centrally planned economy, which will require continuous adaptation to changes in domestic relative prices and in the real effective exchange rate.

I suggest that the freeing of prices and the emergence of markets are more likely to act quickly as an effective discipline for small, owner-managed, firms. In the case of emerging centrally planned economies, however, large state enterprises represent an important share of economic activity. As is noted in a recent paper by Professors Frydman and Rapaczynski, this has become an important issue in Poland. The difficulty there is that, while state control over enterprises has been dismantled, it has not been replaced by a more effective management system. As a result, managers of these larger enterprises have, in many cases, been able to continue to operate without regard to the return on capital, and avoid losses by using up sources of credit or cutting back on investment.

Thus, for the market system to work effectively, the administrative and legal framework to assure appropriate responses by managers must be in place. In the case of state enterprises, this requires what Professor Sachs has called corporatization--that is, formalizing the state's relationship with these enterprises by appointing Directors with supervisory responsibility over such firms. In addition, for managers to operate enterprises efficiently, and for owners to gauge their managers' performance, the accounting framework necessary to ensure timely and accurate monitoring of financial performance must be introduced. Indeed, it is difficult to conceive of subjecting enterprises to the dis cipline of the bottom line, or to harden firms' budget constraints, when the bottom line cannot be measured.

Finally, even if all the preconditions, including the elements which I have specifically mentioned, were in place, it is important to bear in mind that domestic agents will require time to learn how to operate effectively within a market economy. While domestic agents are on the learning curve, exposure to the full rigors of external competition could pose more of a threat to the survival of much of the domestic productive base than an incentive to transform and succeed.

The second set of issues I would like to touch on relates to the transitional arrangements for achieving currency convertibility. Implementing the full menu of reforms required by centrally planned economies may be a drawn-out process. Nevertheless, even if the prerequisites for currency convertibility are not fully in place, there are interim measures which would enable many of the benefits of convertibility to be realized.

In this regard, the paper notes three possibilities: one, the use of a highly depreciated exchange rate; two, the use of tariffs; and lastly, the use of transitional restrictions on currency convertibility. While these possible measures are not mutually exclusive, we would caution against the use of the latter approach. The introduction of foreign exchange surrender requirements and quasi-markets for import licenses or foreign exchange, in our view, imposes substantial costs, including an administrative burden, scope for abuse, and price distortions, all of which could outweigh any benefits. Perhaps just as important, the uncertainty surrounding these types of arrangements will tend to discourage much needed foreign direct investment, since concerns will arise regarding the repatriation of profits, as well as access to foreign exchange.

Like some other speakers, I would therefore prefer the use of an exchange depreciation, in concert with temporary tariff barriers, to indirectly facilitate the import of needed capital and other inputs. This approach would likely be less distorting, and would also yield needed fiscal revenues. However, care would have to be taken to avoid becoming addicted to such protective measures.

Mr. Végh stated that he favored the sort of massive and immediate approach to the implementation of currency convertibility and market-oriented reforms that had been defended by Mr. Posthumus, Mr. Filosa, and Mr. Landau. Mr. Posthumus had said that it was clear that in most of the cases under discussion, and especially in the case of the U.S.S.R., the command economy had ceased to exist, and therefore it was not a matter of moving in an orderly way from one point to another, but of creating something new out of chaos.

He would like to point out the connection between the subject currently under discussion and a very interesting paper presented in the previous week by Professor Dornbusch at a seminar organized by the Fund's Research Department on the subject of monetary overhang and reforms in the 1940s, Mr. Végh continued. It was very clear that a monetary overhang was a matter of the highest priority, and indeed, in that respect the market had perhaps already overtaken the theoretical studies. Mr. Gorbachev would thus be well advised to follow the example of Mr. Stalin. In his memoirs, Mr. Paul Nitze recalled that at the time of the Berlin blockade in 1948, when Nitze was an assistant to George Kennan at the U.S. Department of State under Dean Acheson, he had asked the Soviet Deputy Minister how the U.S.S.R. had gone about controlling inflation. The answer had been that all bank accounts were put on computers, which enabled the authorities to monitor debits and credits in all the accounts. When it became clear in 1948 that too much money was chasing too few goods, a computer program was implemented switching old roubles for new ones at a ratio of 100:1, except for accounts of less than 100,000 roubles, for which a range of smaller ratios applied. Inflation had thus been eliminated at a stroke.

The events that were now occurring in the U.S.S.R. had in fact been predicted two years before in an essay entitled "The Coming Soviet Crash", Mr. Végh pointed out. Local currencies, or at least currencies in fact if not in name, had replaced the rouble in the U.S.S.R. In the Ukraine, for example, new coupons issued by the republican government had effectively rendered rouble-denominated savings worthless, because the coupons, as well as the roubles, were required to make purchases. That had the effect of cutting wages by about 30 percent. If other republics copied the technique of the Ukraine, the days of the rouble as a currency might be numbered; the Russian and Byelorussian republican governments were already thinking of replicating the Ukrainian scheme.

That example was more a matter of currency substitution or creation than of currency convertibility, of course, Mr. Végh concluded. The currency was worthless already. In those circumstances, it might be better to adopt another currency, such as another European currency, or the ECU of the European Community. That might meet with greater success than trying to underpin a currency that had already been repudiated by the public.

Mr. Al-Jasser commented that currency substitution was not only a Stalinist solution to inflation. The German monetary reform of 1948 had been along similar lines.

Mr. Dai made the following statement:

> Today's discussion on this interesting subject may be viewed as an opportunity to refresh our memories on the fundamental reason for the inception of this institution and the GATT. We welcome this discussion, and congratulate the staff on preparing such an informative paper, with its comprehensive analysis of the basic issues regarding currency convertibility in general, and its relationship to the transformation of centrally planned economies, in particular.
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> The question of the benefits of convertibility is indeed a theoretical one, and, if answered from that perspective, there would not be much disagreement. Since the major benefits of current account convertibility derived from free trade are indirect, the direct benefits from free trade would have a significant bearing on the efficiency of domestic production and investment. Needless to say, free trade policy is the logical conclusion of pure trade theory, which bases its analysis primarily on a barter economy and without reference to the exchange rate, the balance of payments, existing trade patterns, or the division of labor. However, things are not always ideal in the real world. Our concern is that, if trade theory is applied to the specific conditions of individual countries--instead of in the abstract--all the conclusions with regard to the benefits of free trade would be somewhat different from those advocated by free trade policies. This is especially so given current world trade patterns and the international division of labor, in which many centrally planned economies and most of the developing countries are primary commodity exporters, and manufactured goods importers. The fact is that the expansion of world trade induced by lowering tariffs--let alone free trade in itself--has always benefitted the industrial countries more than the developing countries. In reality,

the benefits to the developing countries would be much more diluted than expected, thereby also eroding the major benefits to them of current account convertibility. That is not to say that we object to the opening up of an economy, but that old-fashioned trade patterns for developing countries, which may date back a century, make a limited contribution to the growth of developing countries. It is thus necessary for the developed countries to reduce their import restrictions and their trade protectionism and open their markets to the developing countries. A more cooperative approach is essential, and is an even more important prerequisite for the success of currency convertibility.

It is well recognized that currency convertibility would not be possible without some basic preconditions. However, we would appreciate it if the staff could discuss in depth some of the more difficult questions, such as what would be the appropriate exchange rate and what would be an adequate international liquidity level when applied to a specific country. Some kind of quantitative framework may be needed in order to assess the conditions, or to adjust the exchange rate to an appropriate level for the purpose of currency convertibility, not only in the short run, but also the long run. Besides the preconditions outlined by the staff, we still believe that economic strength may also need to be emphasized as another precondition. In a historical perspective, this may be one of the many reasons why so many countries preferred to have currency convertibility at a later stage of their development, rather than at the initial stages. A number of developed countries have only permitted full currency convertibility within the last decade. Adequate international liquidity not only includes the magnitude of foreign exchange reserves, but also access to foreign financing. In this context, developments in the international monetary system and in international financial relations at the time would also have had a bearing on successful currency convertibility in a broader sense.

We agree that currency convertibility is a long-term objective. The shortage of foreign exchange is not only a long-run constraint for most developing countries, but affects also the transformation of many centrally planned economies, regardless of the stage of the reform process. In the long-term process of economic development, the debt problem would continue to be a long drawn out issue for many of these countries. The international community, therefore, needs to display a favorable attitude to help these countries re-establish themselves and become more self-sufficient, and to attain the financial strength needed for currency convertibility.

The staff has suggested two transitional approaches--to unify the exchange rate for current account transactions, and to liberalize trade policy by removing quantitative restrictions and rationalizing the system of import tariffs--and we do not argue with these points. Unfortunately, however, rising protectionism from industrial countries--even those which claim they have currency convertibility--may undermine the efforts of those developing countries which are called upon to have currency convertibility. The increase in trade regionalism is also suspected by some as favoring countries in the region over those outside it. The suspension of the Uruguay Round of trade negotiations only adds to our anxiety. Sometimes things are more easily said than done.

Many of the problems pointed out in the paper need to be dealt with on a priority basis for economic reform to take place in the centrally planned economies. However, since not all centrally planned economies have the same goal for economic reform, a somewhat different approach toward currency convertibility needs to be explored. For those centrally planned economies where exports and imports are still managed by the state, there would be no problems or restrictions on current payments and convertibility, as long as exports and imports are in conformity with the trade plan. This situation is different from that in other types of economies. In addition, the shortage of foreign exchange is still a restraint for some of these countries; therefore, strengthened management of foreign exchange, not necessarily by administrative means, would still be needed to regulate supply and demand and to achieve a basic equilibrium in the balance of payments. With growing economic strength and progress in economic reform, foreign exchange controls would be relaxed, and the degree of convertibility increased. Different countries, including the centrally planned economies, at different phases of economic development and reform, can have different formats and timetables for currency convertibility, on a case-by-case basis. However, I am skeptical about the conclusion in the summary that the political feasibility of moving quickly to convertibility may require widespread and deep popular discontent with the initial macroeconomic situation. That would imply that the more severe the macroeconomic instability, the faster the success of convertibility. This conclusion seems to be premature, and is probably drawn from the limited experiences of a few Eastern European countries.

Mr. Al-Jasser made the following statement:

I concur with the staff's view that currency convertibility is both desirable and essential in the long run for the smooth functioning and development of an open economy. However, it is equally obvious that convertibility cannot be viewed in isolation, and must be regarded as one feature of a widespread and comprehensive transformation effort. The staff paper clearly indicates that when the major pillars of a modern market economy are in place, convertibility would not lead to major economic imbalance. Consequently, we face a dilemma whereby convertibility is essential for an efficient market economy, while its success depends on the existence of such an economy.

The benefits of convertibility have been well stated in the staff paper. Nonetheless, due regard must be paid to the potential short-run costs of these measures. Current account convertibility unleashes pent-up demand, thereby significantly increasing the consumption of imports, while fostering substantial unemployment and a drastic contraction of the productive sectors. Import competition may force the economy to specialize in low growth-enhancing sectors, which would move the economy onto a low growth path. Naturally, competitiveness may be partly retained through a drastic exchange rate depreciation which not only threatens the productive structure of the economy through a major increase in the price of inputs, but could also involve a dramatic decline in the disposable income of a large segment of the population.

Moreover, capital account convertibility facilitates capital flight, while internal convertibility promotes currency substitution. One can argue that capital flight and currency substitution would have occurred anyway. However, it seems that initially, the introduction of full convertibility leads to a disintegration of the old system, thereby promoting capital flight, currency substitution, hoarding of goods, and a contraction of the economy. It is only after a new legal and institutional structure is installed that agents will gradually regain confidence in the new system so as to repatriate capital and remonetize the economy. Hence, during the transition period, major economic dislocations may develop, which could threaten the transformation process. Clearly, the crucial issue revolves around the length of the transition period, and the willingness of the population to maintain its support for the adjustment process. In this connection, the experience of post-war Europe and some East Asian countries should prove helpful.

The staff paper lists the necessary preconditions for the introduction of convertibility. It may be necessary to envisage an exchange rate path which identifies levels of a real exchange rate that is consistent with current account sustainability at different stages of the transformation process. However, the difficulty of determining equilibrium real exchange rates may point to the impracticality of having stable exchange rates. I wonder whether the staff has a view on how to determine the appropriate exchange rate regime to be adopted in such situations.

Obviously, the importance of sound macroeconomic policies cannot be overestimated, particularly the ability to eliminate the liquidity overhang prevailing in these economies. If this is not achieved, seeking convertibility will become an exercise in futility. It is essential to absorb the liquidity overhang without inadvertently unleashing inflationary pressures.

It seems that the most crucial factor for the success of a transformation process is the ability of domestic agents to adapt to dramatic changes and incorporate price signals into their decisionmaking. This clearly presents a strong case for gradualism, since most of the preconditions listed by the staff are not readily met.

In this respect, there is a need to devote greater attention to an appropriate transitional arrangement that will pave the way for convertibility in the future. Conceptually, the McKinnon alternative--confronting firms immediately with world input prices, but granting temporary protection to output to give them a chance to adjust--is interesting, as it limits the role of the government. Nevertheless, in practice it suffers from many problems. Therefore, far more work is needed along these lines.

In conclusion, the main problem goes beyond convertibility, and rests with the ability to make these economies productive again. This will not only require massive capital inflows, comprehensive legal and institutional structural changes, and confidence in future economic prospects, but also the ability of agents to respond adequately to market signals. Indeed, this promises to be a long and painful process.

Mr. Nakagawa made the following statement:

I would like to commend the staff for preparing an interesting and well structured paper. Although the paper's main purpose is to address issues related mainly to establishing currency convertibility in the process of transforming centrally planned economies into market-oriented ones, the points covered in the paper are also interesting and instructive from the viewpoint of establishing currency convertibility in the process of economic development in general. I can endorse most parts of the staff paper.

I would like to stress the importance of considering the issue of establishing currency convertibility in relation to the policy objectives and the policies that are already in place. In this sense, as many others speakers have stressed, this issue should be dealt with on a case-by-case basis.

The staff quite rightly pointed out that current account convertibility is significant as a source of competitive discipline that can play a major role in guiding domestic resources toward efficient production and investment decisions by exposing the economies to the international competition. Therefore, I will join the widespread agreement that convertibility is desirable as a long-run policy objective.

However, it is all the more important that the decision of the authorities to establish convertibility in their economy is well balanced against the other policy objectives, such as exchange rate stability, the effectiveness and efficiency of domestic monetary policy, and overall sustainability of economic growth. The staff is also right to point out that the relative importance of these objectives may change as countries move through different stages of economic development and transformation. In this sense, convertibility should be viewed as one of the structural axes that determine the relative importance of the policy objectives in designing development programs.

I agree with the staff as to the four elements mentioned in the paper as the basic requirements for current account convertibility. However, the staff's argument with regard to the second element, namely, adequate international liquidity, appears to need clarification. The staff mentioned an adequate level of international liquidity, and referred to foreign reserves amounting to at least three months' imports as encouraging. Moreover, the staff takes up Poland's case, where reserves and external lines of credit equivalent to about 4.5 months of imports was available, and expresses it as instructive. But the staff does not provide any reasonable explanation for these specific figures. Like Mr. Peretz, I do not think that an adequate amount of international liquidity for current account convertibility can be decided ex ante. I would be pleased to hear from the staff about the reason for the reference to a specific number in the staff paper.

I would like to stress, like previous speakers, the central importance of sound macroeconomic policies among the four prerequisites for current account convertibility. As Poland's case clearly shows, a combination of strong fiscal and monetary policies is necessary to stabilize the economy and thus sustain current account convertibility.

In this regard, the staff only mentioned fiscal and monetary control. However, as this chair and Mr. de Groote pointed out in the board discussion on exchange rate policy and analytical issues relating to Fund advice, more attention should be paid to the flexibility of wages as a stabilizing factor for the real exchange rate, thus maintaining a stable environment for convertibility.

Mrs. Hansen made the following statement:

The paper is a helpful guide to the semantics of convertibility and some of the policy considerations convertibility involves. I will make a few brief comments on questions raised for discussion.

We agree with the staff paper as to the major benefits of current account convertibility. The importance of subjecting domestic enterprises to international competition and providing rational price signals to guide investment cannot be overemphasized. In our view, however, the emphasis on the risks is somewhat misplaced. No doubt there are major uncertainties in the transformation from a centrally planned to a market economy. But we would see the major risk in establishing convertibility as being the perception that domestic policies are not sufficiently strong to support current account convertibility. If policies are perceived to be very strong from the outset, then there is much less risk that either of the two risks identified in the paper would arise. Indeed, with regard to the potential conflict between external and internal policy objectives, as Mr. Goos noted, the formerly centrally planned economies would do well to avoid inward-looking policies.

Fiscal policies directed toward balanced budgets and monetary policies aimed at domestic price stability will ultimately save both external and internal objectives.

We would tend to agree that it would be desirable to establish the four preconditions at the time of, or before the introduction of, current account convertibility. Mr. Spencer is correct in noting the dangers of waiting for each of these conditions to be fully present before proceeding. We trust that these four factors are not listed in order of importance or desirability. If so, we would expect to see "sound macroeconomic policies" at the head of the list. Indeed, it only makes sense to discuss whether an exchange rate is set at an appropriate level in the context of the policies which are in place to support it. If policies are inadequate, even a highly depreciated rate may be difficult to maintain, and no amount of liquidity will be sufficient to inspire confidence in the currency.

We would say that current account convertibility should be established, in principle, immediately. In practice, however, it will have to depend on the country's individual circumstances, especially the strength of its policies, which will in turn be affected by the political consensus on the need for reform of the system as a whole. If a country really is serious about transforming its economy, it is hard to see how such a transformation can be achieved without the benefits which import competition would have for improving the competitiveness of domestic industry, and which international price signals would have for improving the efficiency of domestic resource allocation.

Transitional approaches may have some merits, but they also risk sending the wrong signal about the authorities' confidence in their own ability to implement and sustain strong adjustment policies. They also run the risk of being reversed before full convertibility is achieved. To the extent that the authorities take a wait-and-see attitude about establishing current account convertibility, investors may be more inclined to take a wait-and-see attitude about investing.

Indeed, the uncertainties concerning the prospects for repatriation of profits and capital are a tremendous disincentive to foreign investment in many areas of the world, to the detriment of growth and employment. In fact, the impairment of the store of value function of money through capital controls--and the fear of such controls--can actually increase the demand for external assets and capital flight. Indeed, there are a number of examples of the self-defeating nature of capital controls. The paper implies that full capital account convertibility would be premature, and that provisions for the repatriation of profits capital can be handled through the investment code. But capital controls are not ideal in the long term, especially if domestic policies are insufficient. We would hope, therefore, that countries would aim toward the more ambitious goal of full current and capital account convertibility.

Mr. Galán made the following statement:

We welcome the interesting paper prepared by the Research Department, and we agree with most of the ideas it puts forth. However, I was excited by one comment in it which is not developed. The paper warns that a differentiation should be made between restrictions on convertibility and restrictions on external transactions. However, much of the discussion in the paper would not be affected if we substituted "external liberalization" for "convertibility"--the discussion on preconditions for and timing of convertibility is symmetrical to that on external liberalization. In fact, one could devise a scenario of full convertibility combined with autarky, with no effects on convertibility, and, moreover, analogous to a situation of nonconvertibility combined with full external liberalization. The differentiation is quite semantic and formal, and may be irrelevant, although it is obvious that freedom of payments is a necessary condition for external liberalization--liberalization of "transactions" being the binding constraint. I would appreciate further comments from the staff on this issue.

Full convertibility is a desirable long-run objective, but the main concern is about sequencing, timing and velocity with regard to the policies and preconditions required in the program. In economics, comparative assessments are often made of two different equilibrium states; however, it is not that common to study how the different paths which join together the two equilibrium states affect welfare over time. One example of that kind of study is a recent IMF working paper in which Guillermo Calvo and Carlos Végh study the credibility and the dynamics of stabilization. Our problem, then, is to identify which of the many trajectories is the optimal one from a welfare perspective, which may however not be easy. There may be multiple optimal solutions associated with the problem--an example is the binding relationship between current account convertibility and trade restrictions.

The preconditions needed for current account convertibility take time to set in place. A sound macroeconomic policy will have to be accompanied by a strong reputation and credibility, which might take years, or even a decade, to accomplish.

With respect to the sequencing of the program, once the preconditions are met, convertibility of the long-term current account balance and the introduction of long-term capital inflows should be considered in the first stage of the program, leaving the short-term current and capital accounts for the second stage. We recognize that there is no simple or unique solution to the process, and that the solution should be country-specific.

Mr. de Groote observed that the possibility of having a free market for capital movements had not been much considered in the staff paper. While he would not try to pretend that such a free market was an ideal solution, in a period of transition it might ensure some form of full convertibility, while protecting reserves against capital movements. That being said, he wondered whether it should be looked at as part of the whole spectrum of possibilities that were being considered for those countries.

It seemed to be accepted that when reform was in the air, it had to go in the direction of the elimination of subsidies and of price adjustments, Mr. de Groote commented. The possibility of blocking excess liquidity seemed not to be considered. He wondered why that was so, and what was the ideological background for that choice. It might be noted that the first liquidity blocking operation to which speakers had already drawn attention--the German monetary reform after World War II--had been the inspiration of Mr. Camille Gutt, who had subsequently become the Fund's first Managing

Director. He wondered why the Gutt approach--also advocated by Dornbusch--was now generally abandoned in favor of price adjustments. Blocking liquidity had the enormous advantage of influencing expectations immediately and once and for all, whereas price adjustments had to be applied and watched over for years and years, with the potential for building into the system inflation and inflation expectations through the very mechanism that was designed to eradicate them.

Mr. Goos commented that currency overhangs were still being eliminated by means other than a price adjustment. For example, in Germany, the conversion rate that was set between the Deutsche mark and the ostmark had served to remove much of the liquidity overhang that had existed in the former German Democratic Republic.

Mr. Rouai made the following statement:

> It is becoming rather difficult to dispute the potential benefits of currency convertibility in an international environment characterized by decisive moves toward the establishment of market-based economies and the increasing international and regional integration of markets for goods, services, and capital. As it appears from the staff paper, currency convertibility enhances competitiveness and efficiency, and also contributes to the elimination of price distortions. In addition, convertibility, which is generally associated with liberalism and openness, plays a supportive role in the promotion of export-oriented strategies. More precisely, the removal of import controls and capital restrictions dictated by the introduction of convertibility creates generally a supportive and competitive environment for enhancing domestic investment and attracting foreign direct investment, as well as long-term capital inflows.
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> Although the staff paper concentrates on currency convertibility in the context of the transformation of centrally planned economies, we believe, like Mr. Finaish, that this issue is relevant to all developing countries pursuing strong and comprehensive adjustment programs. In this context, it is interesting to note that in many of these programs, the establishment of convertibility is not explicitly spelled out. Perhaps this is because it has been recognized that before moving to currency convertibility, a set of preconditions must exist. In other words, the move toward currency convertibility constitutes generally a departure from the longstanding practices of relying on controls on domestic prices and restrictions on imports and payments in order to achieve a sustainable balance of payment position over the medium term.
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> First among these preconditions is the need to achieve a realistic exchange rate. This objective requires, in most cases,

the introduction of mechanisms designed to clear an increasing portion of international transactions at a market-based exchange rate, and also the gradual unification of rates between the official and the parallel markets.

In addition to the implementation of an appropriate exchange rate policy, sound monetary and fiscal policies should be introduced and sustained. These policies should help the authorities to manage a stable exchange rate, and, what is most important, to supplant the tendencies to rely on restrictions to safeguard the country's external position. In fact, any decisive and credible move toward current account convertibility requires the liberalization of international transactions through the removal of restrictions on goods, services, and investments. The role of macroeconomic policies is precisely to supplant these restrictive practices, and to contain domestic demand, which tends generally to expand after the lifting of trade controls and payment restrictions.

The third precondition is to extend the liberalization efforts to internal markets by removing price controls for goods and services, with the objective of attaining better resource allocation. Equally important is the extension of internal liberalization to financial markets so as to achieve positive real rates of return on financial assets, and to provide domestic savings with appropriate and attractive financial instruments in order to help channel resources to the domestic banking system. This is all the more critical if the risk of capital flight and speculative short-term capital flows is to be countered.

Since currency convertibility requires the removal of price controls and restrictions on payments and transfers, it is important for the authorities to introduce safety nets. The first of these is mechanisms to shelter the poorest segments of the population from the adverse impact of adjustment. While these mechanisms are necessary even before the introduction of convertibility, for political and social reasons, the move toward convertibility, particularly if it occurs at the initial stage of the adjustment process, could accentuate the transitional social costs.

The second safety net is the existence of adequate international liquidity, including foreign exchange reserves or access to external financing. The amount of this safety net is generally an indication of the authorities' preparedness to face exceptional balance of payments shocks, and constitutes a strong element in the enhancement of market credibility. However, this is perhaps one of the major obstacles facing countries willing to embark on currency convertibility. In fact, many countries face tremendous difficulties in financing the already depressed level of imports and in honoring their debt obligations. To add to these constraints the desirable objective of building up additional precautionary foreign exchange reserves could be difficult, particularly at the current juncture, characterized by limited access to international capital markets for most of the developing countries. For these reasons, we believe that the Fund should play a decisive and leading role in this area, by designing access not only to provide the necessary financing of programs, but by allowing the constitution of second lines of reserves to be used if unforeseen external developments occur by those countries embarking on convertibility.

It is clear that the pace of establishing current account convertibility depends on the particular circumstances of each country. The real issue here is the speed in implementing the necessary preconditions, which will help the authorities achieve a sustainable balance of payments position without undue pressures on the exchange rate. The move toward convertibility could be further facilitated if accompanied by transitional arrangements designed to allow for temporary protection for local enterprises--in particular, infant industries--and to help cushion in general the short-term pressures on the balance of payments. It is important, however, that these transitional arrangements not contribute to the nullification of the potential benefits of convertibility by maintaining unnecessary regulations and preferential treatment.

With regard to the issues of capital account and internal convertibility, we recommend that, given the inherent risks, a cautious and gradual approach be taken. On capital transactions in particular, efforts should be directed to providing the necessary incentives to encourage long-term capital inflows and direct foreign investment, through reforms of investment codes and easing of transfer regulations.

In conclusion, we agree with the staff that convertibility has become a key symbol of openness and economic freedom that may be important for the acceptability and credibility of difficult reform programs. We must, however, emphasize that the establishment of current account convertibility, which constitutes a recognition by the country of the virtues of free international trade and payments, should also be supported by partner countries through a reduction of protectionism, as well as through the enhancement of direct investment and nondebt creating flows.

Mr. Filosa commented that in the case of Poland, the major part of the money supply, and thus the monetary overhang, was denominated in U.S.

dollars. Thus, in the Polish case, a liquidity blocking exercise, along the lines of that implemented in Germany after World War II, would have to be initiated by the United States to be effective. He was not certain whether the United States would wish to take that role.

Mr. Mwananshiku made the following statement:

Current account convertibility as defined in the staff paper has a strong relevance to reform programs being undertaken by developing countries with the support of the Fund. The discussion, although confined to centrally-planned economies of Eastern Europe, could also be meaningful to those developing countries undertaking adjustment programs.

Currency convertibility is a desirable long-term objective. It is perhaps one of the final stages of economic reform, feasible at a relatively higher level of industrial development.

Developing countries face many practical problems in implementing reforms, which the paper has not addressed adequately. The problem of a single export commodity that faces wide import price fluctuations and a poor terms of trade can place severe constraints on rapid current account convertibility.

Although an adequate external reserve position is important, this does not mean that overall external conditions are necessarily favorable. Other factors are equally important, including external trading conditions such as tariff and nontariff barriers, the movement in the terms of trade, exogenous shocks, and lack of access to foreign financing.

The question of exogenous shocks has implications even for the transitional arrangements discussed in the paper. For example, a sharp decline in the terms of trade of those economies with only one or two export commodities is likely to put market clearing arrangements, such as foreign exchange auctions, into a spiralling state of disequilibrium.

In general, it can be argued that benefits, as described by the staff, can derive from subjecting domestic industry to foreign competition. However, the downside risk of unemployment is high in developing countries the industries of which could be overwhelmed by mass-produced imports and aggressive marketing techniques. In the short run, new investments may not be forthcoming, and the unemployed may not be absorbed. Under these conditions, the invisible hand that is supposed to lead to a general state of improvement may not be present.

The preconditions for current account convertibility are important. The question is one of the speed in introducing reforms. In many instances, particularly in developing countries, these reforms require the careful sequencing of adjustment measures in order to avoid perverse responses from market participants. For example, a sequencing of adjustment measures in the financial sector may be necessary before liberalizing and attaining positive real interest rates. Moreover, although the currency convertibility question has been discussed largely as a macroeconomic issue, for the developing countries in a state of transition, the microeconomic issues--those related to diversification and increased productivity, for example--must be stressed.

The staff representative from the Research Department stated that some Directors had commented that the list of preconditions for currency convertibility was incomplete. For the fourth precondition--the existence of incentives to respond to market prices--to be satisfied, agents would need the ability to respond as well. That implied the existence of coherent rules for private sector activities and clearly defined property rights, as well as tight budget constraints for enterprises and market-based financial systems. Establishing all of those features in the economic system would take much time, leading some speakers to stress the necessity of not waiting until all of the preconditions were firmly in place before moving in the direction of convertibility.

The issue of how firmly the preconditions should be in place had to be judged in a forward-looking context, the staff representative commented. Perhaps yet another precondition--not mentioned in the paper, but suggested by the Board's discussion--was confidence in the authorities' ability to carry through with the institutional and structural reforms quickly enough, and effectively enough, to keep the program and popular support for it alive. There needed to be a conviction that in the end, the authorities' program would succeed.

A number of Directors had noted that the paper had paid very little attention to the issue of capital account convertibility, the staff representative recalled. The staff had believed that the Board's main interest was in establishing a market price system for guiding production and investment, and indeed, that the balance of opinion was that some degree of caution should be exercised in the area of moving quickly toward capital account convertibility. Also, the Fund's Articles did not stress capital account convertibility. The paper had briefly addressed the question of whether capital controls could be effective. A number of Directors had pointed out that that depended very much on whether policies were sound and whether prospects for the country were attractive. Another issue addressed briefly in the paper was whether or not capital controls could be justified. Mr. Finaish had asked for some elaboration on the type of analysis that seemed to be suggested in the footnote on page 22 of the paper. Basically, the type of analysis that the staff had in mind was not very sophisticated. It was simply a question of comparing costs and benefits. Some of the benefits were the portfolio diversification that was possible when restrictions on capital flows were removed, and the possibility that capital account convertibility would force the authorities to be more disciplined. On the cost side, there was the risk of capital flows destabilizing the macroeconomy in the short term, and of losing savings through capital flight.

There was an argument that capital flight posed negative externalities, the staff representative remarked. Economic agents in a country with uncertain prospects might indeed have strong incentives, individually, to move capital out of the country, even though, from the collective point of view, all of them might be better off if the capital could be retained in the home country, contributing to more domestic investment and a better growth performance.

In response to a question raised by Mr. de Groote, foreign exchange surrender requirements were not inconsistent with the meaning of current account convertibility under Article VIII, according to the Legal Department, the staff representative concluded.

The Economic Counsellor and Director of the Research Department stated that, as many speakers had observed, there could be no blueprint for the introduction of the different types of convertibility that had been discussed. That was not to say that the general principles of convertibility did not apply, but rather, that convertibility might need to be put in place in different ways, and under different time horizons, as part of a comprehensive set of coordinated policy actions. As Mr. de Groote had noted, the introduction of convertibility in Czechoslovakia and Hungary would follow different patterns, even though it was to be hoped that both countries shared the common goal of working toward the implementation of a durable economic transformation.

The timing of the introduction of convertibility was often a bedeviling question, the Economic Counsellor went on. The academic literature was awash in warnings about the need for the appropriate sequencing of different measures. The danger of taking those warnings too much to heart was that movement toward convertibility would effectively never begin. The key was to respond as fast as possible on all fronts, and that whatever measures were taken, they be as comprehensive as was practicable, recognizing that implementation would proceed at a different pace for different parts of the program.

The most important prerequisite for the success of a program of economic transformation was credibility, the Economic Counsellor observed. Without credibility, incentives and market signals simply would not be responded to, even if the signals were in fact in place.

The stock of external debt was thus a determinant of the success of the introduction of convertibility, in that it either added to or detracted from the program's credibility, the Economic Counsellor pointed out. The debt stock would have an effect on the program's sustainability. It was in that sense that external debt needed to be seen as an important factor in introducing currency convertibility, as Mr. Finaish had called attention to. However, other kinds of debt--enterprise debt, domestic debt, and government debt--also had a bearing on that issue.

There had been a divergence of view among Directors concerning the appropriate timing and speed for the introduction of capital account convertibility, the Economic Counsellor recalled. Some speakers had held the view that convertibility of the capital account could well be left for some time later, after currency convertibility, whereas others had said that there was a real value in a somewhat faster pace for the introduction of capital account convertibility. In fact, capital account convertibility should be part and parcel of the program design; but it need not necessarily be implemented simultaneously with current account convertibility, in his view. There might well be reasons for delaying it, and he took the arguments that had been made about savings and capital flight in that connection. Nevertheless, at the start of the transformation process, it could be useful to provide a rough idea of when capital account convertibility would be introduced. Investors would need to be assured that at some point, capital account convertibility would be introduced. Moreover, the importance of foreign direct investment should not be downplayed, and without convertibility for some types of capital flows, foreign investment would be restrained. Taking some early steps toward capital account convertibility might also serve as a visible and convincing signal to foreign investors about the direction the authorities wished to be moving in, as well as their commitment to it.

In that connection, the policymakers were entering into a new universe, which would require them to change fundamentally their attitude toward policymaking and how it was carried out, the Economic Counsellor noted. The need for the marketplace and the financial instruments to carry out monetary policy, and for the appropriate tax instruments to carry out tax policy, would have to be acknowledged. Decisions could no longer be taken simply by decree.

Several Directors had raised the question of the need for international reserves at the beginning of the process, the Economic Counsellor recalled. Indeed, the frontloading of large international reserves would probably continue to be critical in the context of current and forthcoming programs of economic transformation. The point had been made that too large a cushion of international reserves might be disadvantageous, in that it might lessen the resolve of the authorities to go forward with the program in a disciplined way, and deter the implementation of adjustment measures. That notwithstanding, the staff tended to be on the side of large international reserves, especially at the beginning of the transformation process, chiefly because the reserves would, in some way, strengthen the credibility of the program and make up for the lack of a track record. In the previously centrally planned economies, the big political leap had already been taken, and the entire political strategy rested on the economic transformation. Given the stakes, an excessive stock of reserves appeared to be a smaller danger than an inadequate stock, and it was thus advisable to err on the upside. Moreover, if the stock of reserves turned out to be less than had been envisaged, other parameters of the program would have to be changed to adapt to that, changing the characteristics of the adjustment strategy.

In the Polish case, for example, the Economic Counsellor went on, a large foreign exchange stabilization fund had been set up which, in the event, had not been not used; it might be argued, on the one hand, that therefore it had not been needed. On the other hand, however, it could be argued that the stabilization fund had not been used because it had been put in place--and that, indeed, seemed to be the more accurate observation, if credibility was the real issue. The reserves were needed to prevent a lack of confidence from breaking the program; in fact, the reserves were needed to ensure that the reserves would not be used--perhaps the best use of reserves that could be thought of.

In that connection, a few speakers had asked what the staff judged to be an appropriate stock of reserves, and how it made such a judgment, the Economic Counsellor remarked. In recent Fund programs, reserves equal to about three months of imports had been judged as appropriate. In some other cases, when the country had adopted flexible exchange rates, even a smaller stock of reserves had been viewed as appropriate. In the context of the previously centrally planned economies, however, a larger stock of reserves would be needed, because of the lack of a track record. At the outset of the reform program in Poland, for example, reserves plus external lines of credit had amounted to the equivalent of about 4-1/2 months of imports.

The question had emerged as to what was an appropriate rate of exchange, and an appropriate exchange rate system, for a country undergoing a process of transformation to a market oriented system, the Economic Counsellor observed. The fact that there was no blueprint for convertibility also suggested that there was no single exchange rate regime that should be implemented. One program might center on a very fixed rate system, capitalizing on the exchange rate as a nominal anchor, while another might have a more floating rate system.

In the paper, the staff had suggested that an initial overdevaluation of the exchange rate might be appropriate, in order to provide some leeway for the future so that if inflation crept up, the competitiveness of the economy would not be immediately jeopardized, the Economic Counsellor continued. The point had been made, however, that such a step might in fact plant the seeds of inflation. The staff did not recommend overdevaluation in all cases; however, it needed to be recognized that if a devaluation was implemented in the very early stages of the program, before structural adjustments had taken place and when the system was thus still relatively inflexible, a larger devaluation might be needed at that point to get the same results as a devaluation at a time when the system was more flexible. Therefore, the extent of the initial devaluation that could be recommended was a function of the point in time in the program at which the devaluation was introduced.

The staff's comment that a precondition for convertibility might be widespread and deep popular discontent with the initial macroeconomic situation may have been misinterpreted, the Economic Counsellor stated. The staff was not recommending bad policymaking as a means of generating the discontent that would support a change. The point was that drastic measures tended generally to be thought of only as a last resort, at the edge of the abyss. The challenge for policymakers was to generate and maintain political support for change without getting so close to that abyss.

The question of gradualism versus swiftness in implementing the reforms remained to be addressed, the Economic Counsellor continued. The case for gradualism centered on the need to give domestic agents time to adapt to the new situation. The experience of western Europe in the 1950s had been recalled in that regard. Nevertheless, there were also strong arguments against gradualism. To ensure credibility required that the political cost of turning back be made prohibitively high; that could be achieved by taking a big initial leap. Countries without credibility would require strong action; countries with credibility would require a political commitment that could be followed by action. As an analogy, the process of European economic union due to be in place by 1992 had required the existence in the 1980s of a pre-announced path leading up to 1992. That path had a great deal of political weight behind it, which had given it credibility. Thus, because of that preparation and the existence of credibility, extreme measures would not be needed when 1992 actually arrived. Without credibility, extreme measures would be needed sooner rather than later.

Economic agents would need the ability, as well as the incentive, to respond to market signals, the Economic Counsellor agreed. That assumed that the appropriate legal infrastructure--property rights, bankruptcy laws, among others--was in place. He did not agree, however, that learning how to operate under the new legal infrastructure would necessarily take a long time. The very fact that the transformations that were occurring were indeed taking place argued for the robustness of incentives. Guidance to the enterprise sector would be provided in the form of prices, once price reform was put in place.

Many speakers had called attention to the importance of transitional arrangements, the Economic Counsellor continued. However, there had been no support for replicating in East Europe the type of European Payments Union (EPU) that was created in western Europe after World War II. Such an arrangement would obviously be inappropriate, for the reasons Mr. Landau had given. Whatever transitional arrangements were chosen, it should be assured that they did not move in the wrong direction, and, as Mr. Goos had said, that they be truly transitional.

An exchange rate overdevaluation and transitional tariffs had been mentioned as part of possible transitional arrangements, the Economic Counsellor went on. Indeed, under certain circumstances, both might be appropriate. On the question of tariffs, he would warn that selective tariffs introduced the possibility of arbitrariness in managing them, the likely prolongation of the central planning machinery in order to regulate and manipulate them, and the temptation to preserve an administrative element in the decision as to which industries should benefit from them. The voice of the market in making such determinations would thus be weakened. Uniform tariffs were perhaps not as objectionable, but it needed to be borne in mind that, on the import side, they obtained only what the exchange rate could obtain equally well, and that on the export side, they provided nothing at all. With respect to devaluation, however, there was always the danger that devaluation would create inflationary pressures, and that the role of the exchange rate as anchor would thereby be eroded.

A number of speakers had put forth ideas about how to deal with a monetary overhang, the Economic Counsellor recalled. The Research Department hoped soon to publish a working paper on the subject. In principle, a monetary overhang could be eliminated via a once-and-for-all increase in prices. Another method would be via raising the demand for money by making the holding of money more attractive through higher interest rates. However, he would advise caution about moving in the direction of the latter in the formerly centrally planned economies, because, since most of the banks were government owned, higher interest rates would increase public debt servicing costs and risk putting pressure on the state budget.

Yet another method would be to make available for sale publicly owned facilities such as apartment buildings and factories, thus absorbing liquidity, the Economic Counsellor continued. The question which arose in that connection was which assets should be sold first. On the one hand, highly profitable enterprises might be the easiest to sell and might fetch the highest prices for the state, but they also contributed to the state's revenues, which the state would forego once the enterprises were sold. In that case, it would be advisable first to have a suitable system of taxation in place. On the other hand, the least profitable enterprises might be hard to sell in the first place, and, because they might not attract high bids, their sale would not absorb much liquidity. At the same time, the tax resources which they provided to the government would be gone. That underscored again the importance of having an appropriate tax system in place before embarking on the sale of state enterprises.

He recalled that a number of speakers had pointed to the adoption of a foreign currency as yet another method of dealing with a liquidity overhang, the Economic Counsellor went on. Indeed, that was an interesting solution in theory, but he wondered about its political palatability. In the previous century John Stuart Mill had commented on the fact that, despite the inconvenience and expense, nations nevertheless insisted on having their own currencies, and Mill had hoped that the day would come when the folly of that position would be generally acknowledged. Even at the end of the 20th century, a multitude of individual currencies persisted, suggesting that the political will to curtail the practice was not yet present, despite the nascent moves in that direction that might be taking place in Europe. In any case, it would not be an easy task.

Mr. de Groote had pointed to means for blocking excess liquidity, by a government decree freezing the use of deposits or limiting their withdrawal, the Economic Counsellor noted. The question of the enforceability of such a step needed to be addressed in that connection. For example, a country in Latin America had recently embarked on such a project, with only mixed results. Another question was whether such a freeze was the only way to tax holders of wealth, and what the distributional implications of it might be. The staff would continue to look at it, however, as part of the menu of options to address the problem of a liquidity overhang.

It had not been the staff's intention to suggest that, because the implementation of the preconditions for currency convertibility was so onerous and would take so much time, the establishment of convertibility would be long and drawn out, ultimately taking place only in the far distant future, the Economic Counsellor concluded. Rather, the staff had hoped to stress that the benefits of convertibility were so great that all precautions should be taken to ensure that the move in the direction of convertibility would end in success. In that respect, the staff had emphasized the importance of an adequate level of international reserves, an appropriate exchange rate, the existence of macroeconomic balance, and private and public sector reform. The length of time it might take to set the preconditions in place only increased the urgency of moving in that direction, to ensure that when convertibility was ultimately established, it would be durable.

Mr. Spencer commented that the Economic Counsellor had noted the importance of capital account convertibility in attracting foreign direct investment, but that current account convertibility was nevertheless even more essential. He wondered if the Economic Counsellor could explain at what stage he would recommend that capital account convertibility be put in place.

The Economic Counsellor replied that the benefits of capital account convertibility were so great that, if the conditions consistent with capital account convertibility were in place, it should be implemented early in the process. However, by the same token, the benefits of current account convertibility were so great that the opportunities for assuring that the preconditions for current account convertibility were put in place should not be missed, and in that sense, the emphasis would tend to be placed on current account convertibility preceding capital account convertibility. The costs of a delay in adopting capital account convertibility seemed to be lower than the costs of adopting it prematurely. The problem was that capital account convertibility would not be successful without credibility, which the government clearly would not have, and which it might gain through the implementation--first--of current account convertibility. Capital flight was always a danger. Of course, current account convertibility without capital account convertibility did not provide any assurance that capital flight would be prevented, but it made it a bit more difficult.

Responding to a question from Mr. Obame, the Economic Counsellor said that the move toward a single European market had a bearing on currency matters in Eastern and Central Europe. In particular, it provided a reason for rejecting the European Payments Union as a model for conducting transitional clearing arrangements in Eastern Europe. The intention, after all, was to break, not perpetuate, the old trading patterns in Eastern Europe, and integrate those countries--economically, and possibly politically--into the rest of Europe. Indeed, it was reasonable to conceive of the transformation of the economies of Eastern Europe as part of the process of European economic integration as a whole, including from the trade and finance perspectives, as that process unfolded.

The Acting Chairman then made the following summing up:

> 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.
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> 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 maintaining external equilibrium and the possible need to have, in the short run, an undervalued exchange rate.

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 arrangment 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 channelling existing foreign exchange holdings into the banking system.

The Acting Chairman added that since the staff paper had been judged helpful in focusing on the role of convertibility in the transformation process, he would suggest that it be made available to a broader audience, perhaps as an Occasional Paper.

2. ADMINISTRATIVE BUDGET, FY 1991 - SUPPLEMENTARY APPROPRIATION AND INCREASE IN STAFF CEILING

The Executive Directors considered a memorandum from the Managing Director on a request for a supplementary appropriation and an increase in the staff ceiling under the FY 1991 administrative budget (EBAP/90/312, 11/29/90).

The Chairman stated that as he had indicated in his 1991 budget statement in the spring of 1990, the demands on the Fund continued to grow. In addition, the work of the Fund had become more complex, requiring greater coordination internally as well as with other public and private institutions. Coordination brought many advantages, but also a disadvantage, in the form of much additional work. The events since the spring of 1990 had of course only reinforced those trends.

During the previous six months, an intensive effort had been under way to examine the full implications of those developments for the size and structure of the institution, its working practices, and its personnel policies and practices, the Chairman continued. That effort--which was seen as evolutionary in character--had involved the participation of all departments in the Fund; it should be differentiated from the reorganization effort of the World Bank a few years previously, as he saw no need for such a reorganization. Indeed, he believed that it would be counterproductive.

New and changing demands on the Fund during the previous six months had been met through a redeployment of staff, limited staff increases, use of more experts in the area of technical assistance, and a closer scrutiny of work priorities, the Chairman pointed out. For example, some policy papers had been postponed, and less urgent country missions rescheduled. In addition, staff were utilizing the greater flexibility allowed by the Board under the surveillance procedures. In spite of those efforts, work pressures on the staff remained intense.

As part of an effort to relieve short-term pressures on the staff, he would shortly outline to the Board in a memorandum ways in which Directors and member countries could help the Fund better manage work pressures associated with country mission work, including technical assistance and area department missions, the Chairman went on. It should be possible to reduce the workload a bit, while doing the work more effectively.

Each department had been developing its own views on how it saw the evolution of its size and structure over the medium term--three to five years--in the light of current and prospective demands on the Fund, the Chairman related. In addition, discussions had been taking place on how to improve coordination and working practices among departments, and also on how to avoid duplication of effort. By early February 1991, he hoped to have a paper for the Board's consideration outlining the main organizational issues the Fund faced over the medium term, and their broad implications for the budget in Financial Year 1992 and in the medium term. He would also address in that paper the broad implications for personnel policies and practices. In that regard, he believed that it would be critical to clearly identify the major pressure points on the staff, and the ways to relieve them. One of the main conclusions that he had drawn from the recent Staff Association Committee (SAC) survey and the Ombudsman's report was that supervisors needed to be able to allocate more time to handling personnel matters, and to staff development. However, when work pressures were heavy, personnel relations activities tended to be sacrificed, and the institution suffered from that at present.

Given the role of the Fund, the Fund must continue to maintain an organizational structure and a quality staff that was able to adapt to changing demands and conditions, the Chairman concluded. The decision-oriented work of the Fund and the ability of the Fund to respond to changing circumstances must never be lost.

Mr. Goos stated that he wondered if it would not be useful for the management to undertake a survey of the staff, and not to rely entirely on the survey conducted by the SAC, and the report of the Ombudsman. It was important that the information on which the Board based its decisions be perceived as being neutral.

The Chairman commented that management was considering taking a survey of its own, notwithstanding the respect it had for the SAC survey and the Ombudsman's report. The problems that had surfaced concerning personnel management were a part of a larger organizational problem, for which a broad policy approach, based on a wide variety of views, was necessary.

Mr. Fogelholm stated that he had noted that the study on the economy of the U.S.S.R. would cost the Fund $2 million. It seemed fair to assume that, once the study was completed, it would be made available to the Fund membership at large roughly at the same time as to those countries which were responsible for initiating it, since the entire membership was bearing the cost. He also recalled that when the matter of the study had first been taken up by the Board, it had only been in an informal context, with the assumption that the study's costs could be absorbed within the framework of the Fund's usual operating costs. Of course, that had not been possible.

He wondered why two resident representatives were needed in Poland, whereas only one was needed in other Eastern European countries which were basically in the same position, Mr. Fogelholm commented. He would appreciate more information on that from the staff.

He had noted that the cost of business travel had increased due to a continued increase in the number of short-term technical assistance missions in support of country operational work and a sharp expansion of Fund involvement in Eastern Europe, Mr. Fogelholm went on. Perhaps the management and staff could exercise more restraint in that respect, as an extraordinary number of technical assistance missions had been sent to certain countries in the past year. In the case of Egypt, for example, a large number of missions had been sent, and no agreement with the country had yet been reached. Perhaps more thought should be given to determining whether any useful results were likely from such missions before undertaking them. Another possibility would be to request representatives of member countries to travel to the Fund, rather than vice versa.

He wondered whether the proposed decision on the increase in the appropriation of $4.8 million was consistent with the Fund's income target for the financial year, and with the current level of the Fund's charges which the Board had decided on only recently, Mr. Fogelholm concluded.

Mr. Ismael stated that he assumed that the US$2 million expenditure for the study of the Soviet economy was the Fund's share in it. Since the study was supposed to have been a joint one, he wondered what the expenditures were of the other institutions which were participating in the study, and how the total cost was being shared.

He also wondered about what would be done with the space currently being used by the Task Force, which involved an expense of US$200,000, once the report was completed? Would the Task Force become a permanent feature of the Fund?

The Chairman replied that the Task Force would have to continue working to finalize its report for a few additional weeks. Also, the background papers for the study--amounting to more than 1,000 pages--would have to be completed by January or early February 1991.

It was clear that the exact character of the Fund's relationship with the U.S.S.R. would have to be debated by the Executive Board, as well as the next steps to be taken in that regard, the Chairman remarked. It was also clear that the Fund would need to commit staff to working on aspects of the economy of the U.S.S.R. in 1991, and to continue to broaden its knowledge of the country, whatever the outcome of the proposals that had been put forward by a number of countries for associate status of the Soviet Union in the Fund.

The European Bank for Reconstruction and Development had not been heavily involved in working on the study because the organization had no staff at present, the Chairman pointed out. The World Bank had fielded a number of very important missions on regional matters in the U.S.S.R. in connection with the study--more important in some respects than the Fund's--the cost for which must have been comparable to what the Fund was bearing. The OECD had also been heavily involved. The management had tried to absorb the cost of the study in the ordinary budget, but because of the study's complexity--in some respects, surprisingly complex--that had not been possible.

Mr. Ismael said that since the study had been made at the request of the Houston Summit, he wondered whether there was a possibility that the participants in the Summit would share its costs.

The Chairman commented that enough interest had been shown in the subject of the U.S.S.R.'s economy--which indeed had systemic implications--to justify the Fund's undertaking the study at its own expense, if necessary. Moreover, the Summit did not have the institutional or administrative mechanisms to enable it to perform the study on its own.

Mr. Posthumus stated that he supported the request for a supplementary appropriation. During the discussion on the administrative budget for financial year 1991, he had foreseen the desirability of expanding the Fund's staff. He looked forward to the reports which the Chairman intended to present to the Board on the staffing issues.

The current discussion appeared to be the first time that the issue of the study of the Soviet economy had been on the Board's agenda in a formal way--at the end of the process, not at the beginning, Mr. Posthumus observed. At the informal discussion, he had supported the study completely, but he had thought at the time--and he still thought--that it should have been approved first by the Board in a formal sense, and much earlier in the process. The decision to embark on a study of such importance--including from the systemic perspective--should have been taken formally. He would therefore formally request that the study be submitted to the Board as soon as possible, and not later than the time of its submission to the G-7 countries who had taken the initiative. He also hoped that the new proposals by the U.S. for a special status in the Fund for the USSR would be discussed in the Board--formally--first, before any decision on how to proceed in that regard was taken.

The Chairman said that the question of the status of the U.S.S.R. in the Fund would be taken up in a formal Board meeting.

Mr. Wright made the following statement:

> My first point concerns the timing of the request. The report circulated by the staff gives details of a number of expenditure overruns, which give rise to the need for a supplementary appropriation of $4.85 million. There is no information, however, on whether there are any offsetting savings elsewhere in the budget. I understand that there will be some information on this in the midyear review, which is going to be circulated in January, and I just find it slightly odd that the Board is being asked to approve the additional appropriation now--quite late on in the financial year--but in advance of the midyear review, which would give us a better indication of how the budget as a whole is turning out in relation to the initial projections. I would be grateful if the staff would explain why this request is made now.
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> My second point relates to the increase in staff positions. I note in passing that the existence of the contingency arrangements for employing more staff obviously provides a welcome degree of flexibility, but there seems to be an overwhelming likelihood, particularly in the present circumstances, with the demands on the Fund, that where such a contingency arrangement exists, it will be taken up, and the positions will become permanent. This seems to have been the case in the latest three financial years, the number of staff members having increased by a total of 13 in this manner. While I have no wish to quibble with the increases involved, it seems to me that there is a danger that staff increases will become quasi-automatic under these circumstances.
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> As far as the increase in Executive Directors' remuneration is concerned, I would be grateful if the staff could tell me why

some allowance for the increase is not made in the original budget. I understand that the working assumption in the original budget was for no increase, so that the full amount of the increase has to be reflected in the supplementary appropriation.

Finally, I had considerable difficulty in understanding the workings of the Staff Contingency Fund, and I would be grateful for clarification. This is of some importance, because there is an overrun of $0.4 million this year in that Fund, for which a total of $11 million was originally budgeted for the year. In the example that is given in the paper, it seems that there is considerable expense incurred when the staff member returns from assignment as a resident representative before being reassigned. I found that hard to understand. If the individual is on the Fund's books throughout, why is there not an offsetting saving elsewhere?

Miss Creane made the following statement:

Many of our concerns are in line with those voiced by Mr. Wright. For example, we agree with his questions regarding the need for a large Staff Contingency Fund. We also find the timing of this request for a supplementary appropriation a bit odd, given the size of the request and the fact that a midterm review should be scheduled in about a month, in particular.

However, we recognize that there has been an increase in the demands on the Fund's resources, in large part due to unexpectedly rapid developments in Eastern Europe. But it is not clear that thorough attempts to meet the new requirements through redeployment of staff resources have been made, particularly with respect to the request for additional staff positions. Many areas of the Fund operate under a great deal of strain, while some others appear to be overstaffed.

Overall, we continue to believe that there is a strong need for a detailed review of the Fund's financial policies, including a focus on forecasting methods and procedures, as well as line management accountability. The allocation of human resources should be made an integral part of this review. The efforts described by the Managing Director today might go some way toward addressing these concerns. In any case, we look forward to a more thorough discussion of these points, including the reorganization of positions away from activities the importance of which has diminished.

Mr. Dai made the following statement:

> We can, in principle, endorse the request for a supplemental appropriation of US$4,850,000 for the present financial year, and an increase in the staff ceiling of four positions. I have only two questions.
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> First, a few months ago, when the Managing Director initiated the study of the Soviet economy, I raised a question as to what procedures should be taken by the Board, as the U.S.S.R. is not yet a member, although we supported the Fund's response to the call made on it by the G-7 at their summit in Houston to conduct studies on the Soviet economy. However, I wonder whether it would have been more appropriate, from the legal and procedural points of view, to take a formal Board decision on the study, accompanied by the estimated additional cost at the time of taking the decision, rather than taking a decision at the present juncture, when the study has been completed.
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> Second, with regard to the increase in the staff ceiling, we share the concern of management and support the request. We have taken note of the increase of five positions in the African Department in 1989 and eight positions in the European Department in financial years 1990 and 1991. We do not yet know how the extra four positions will be distributed, but we would like to stress that these much-sought-after positions should be used not only for meeting urgent needs in the short run, but for serving the medium-term requirements.
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> With a number of new members joining the Fund, the technical assistance workload has increased greatly in such areas as debt strategy development and economic reform assistance. We therefore believe that departments offering technical assistance should be given top priority when the four extra positions are distributed.

Mr. Noonan stated that, given the tangible increase in demands on the Fund and the responsible manner in which the Fund's budget and staff resources were being managed, he would like to support the proposed decision. Indeed, given the importance for the rest of the world of the major changes going on in Eastern Europe and the U.S.S.R., there should be no serious question that the Fund's important role in relation to those changes should be prejudiced by the relatively tight budgetary constraints that had been imposed on the 1991 budget.

Mr. Ichikawa stated that he supported the proposed decision. He would like to comment on the expansion of the technical assistance program.

Japan had been supporting the Fund's technical assistance partly through an administrative account that had been set up at the beginning of the current financial year, Mr. Ichikawa continued. However, Japan's external financial support had, and should continue to have, only a supplementary role in the Fund's own budget. Therefore, he would appreciate the Fund's own efforts to augment its technical assistance budget in response to the recent increase in demand. As his authorities recognized the importance of technical assistance, they considered that the Executive Board should conduct a general review of the Fund's technical assistance activities and its work schedule at an early stage, in order to see how the Fund could respond best and most efficiently to the rapidly increasing demand for technical assistance by member countries. Such considerations might include seeking better coordination and communication with other international financial organizations in undertaking technical assistance projects. In that respect, he would convey the Chairman's message made at the beginning of the discussion on the matter to the Japanese authorities, which he was sure they would find encouraging.

Mr. Prader stated that the question of whether or not the request for a supplemental appropriation was appropriate and justified had to be judged against the background of the historic changes which had taken place. On that basis, the supplemental appropriation and the budget overruns they implied appeared to be more than justified. He would like to give some words of praise, in particular, to the Fund's technical assistance program, as there were a number of countries in the constituency of his chair which had benefited from the Fund's quick and flexible response in that regard, as well as in the area of the design of adjustment policies. He believed that the flexibility and adequacy of the Fund's response in that connection was often ahead of the bilateral response of some countries, which should be acknowledged. He himself had been somewhat critical of the Fund's efforts to respond to the changes in Eastern Europe, and he had been pleasantly surprised to find that those criticisms were now misplaced. He had been particularly satisfied with the technical assistance the Fund had provided to a number of Eastern European countries, especially when the enormous technical assistance efforts the Fund had made in the case of Poland alone was taken into account, which it could have been assumed would have absorbed all of the Fund's resources.

Given the scope of the problems of the U.S.S.R.'s economy and the size of the financial demands which would have to be met by European countries, an expenditure by the Fund of $2 million for the Soviet study was relatively small, in his view, and indeed represented only a fraction of the final costs of the process of transforming that economy, Mr. Prader commented. If the Fund could limit its expenditure to $2 million when all was said and done--which he hoped would be possible--it would have gotten off lightly.

He would nevertheless agree with the points made by Mr. Posthumus on the need for a formal discussion of certain questions concerning Fund assistance to the U.S.S.R., including the issue of a special status for that country in the Fund, Mr. Prader concluded. It was not encouraging to be confronted with a newspaper report taking up those issues, and then to be asked by the authorities why they had not been informed about them. He also would appreciate it if the study in the U.S.S.R.'s economy could be transmitted to all the member countries.

The Chairman said that the study would be distributed to all Executive Directors almost simultaneously with its transmittal to the seven Heads of State of the G-7 countries and the President of the European Community.

Mr. Menda stated that he fully supported the request, and would like to join Mr. Prader in his praise of the work of the Fund over the previous few months. He looked forward to seeing in January 1991 the Chairman's proposals for alleviating the increasing pressure on the Fund's staff.

Mr. Kyriazidis stated that like Mr. Menda, he would like to support the proposed supplementary appropriation, and to place himself with Mr. Prader in the latter's praise of the institution. Like Mr. Fogelholm, however, he wondered how the supplementary appropriation affected the Fund's income position. He had the impression that perhaps it could be accommodated easily, given the decline in the rate of interest on the SDR.

Mr. Al-Jasser stated that he could support the proposed decision. He perceived increasing demands on the Fund, which should have the capacity to respond adequately to the demands that were being placed on it.

In the past, his chair, like those of Mr. Wright and Miss Creane, had been concerned about whether or not the possibility of redeploying staff had been fully exhausted, Mr. Al-Jasser went on. The staff had stated in the paper that it had attempted to pursue the redeployment of staff before asking for a supplementary appropriation. It would be helpful to those who had expressed concern on that question to be informed as to how far the redeployment had gone, and if all the possibilities had been exhausted, so that the Board would not have to return to the matter at the time of the midyear budget review.

He agreed with the Chairman that there did not appear to be a need for a reorganization of the Fund, which might indeed be damaging even to talk about, Mr. Al-Jasser concluded. Nevertheless, the Board should be assured that all the avenues had been explored in the area of the redeployment of staff before new positions were approved. In that connection, he joined Mr. Dai in wondering to which departments the four additional positions would be distributed.

The Chairman commented that even in a small organization like the Fund, there would always appear to be room for redeployment, because of the shift in priorities and changes in duties and responsibilities. Management would try to ensure that redeployment was pursued before new staff members were brought on board, but the search for redeploying staff would never be finalized, and the process would never be a perfect one, because of the frequency and speed of changes that the Fund had to confront as an organization.

The Deputy Managing Director commented that the staff also had to deal with changing demands for staff in different departments. For example, several years previously, the expectation had been that staff would be redeployed out of the European and Middle Eastern Departments. Because of developments in Eastern Europe, staff had to be redeployed to the European Department, not out of it. In the case of the area and technical departments, which had to be prepared to move quickly as events unfolded, it was not possible quickly to move large numbers of staff members in and out. That notwithstanding, a fair amount of redeployment had in fact been achieved in the past. The study of the economy of the U.S.S.R. had been dealt with in that way, along with the various new demands emanating from Eastern Europe.

Mr. Al-Jasser said that he accepted the impossibility of moving large numbers of staff from department to department in an organization with the Fund's responsibilities. Nevertheless, in discussions on the budget, the staff might provide the Board with information on what had actually been accomplished in the past with regard to redeployment. Perhaps some indicators of performance in the various departments could be presented every few years, and reviewed by the Board in the context of its review of the budget. Some departments might, through efficiency, be able to increase the amount of work they undertook without increasing the number of their staff, while others might not be using the same efficient methods, which should be brought to the attention of management. In that way, potential efficiency problems could be identified before they became intense. There should be some mechanism to allow the Board to make a judgment on the possibility of redeploying staff.

The Chairman stated that any arrangements for the association of the U.S.S.R. with the Fund would be effected by the Executive Board, and discussed in a Board meeting.

The Deputy Director of Administration stated that two resident representative positions had been assigned to Poland partly because Poland was the first instance in which a resident representative office had been established in an Eastern European country in the process of transformation from a centrally planned to a market oriented economy, and in that sense, the staff had seen it as a showcase. The tasks were so great that they could not be handled by one person alone, and it had been believed that one senior and one junior staff member would constitute an appropriate team. One of the staff members was a native speaker of Polish, which had contributed to the efficiency of the office from the beginning. The staff hoped to gain some experience in the Polish case that could be used in establishing other resident representative offices in other Eastern European countries.

The space that would be vacated by the Task Force on the Study of the Soviet Union Economy when that study was ultimately completed would be added to the office space reserve, of which the Fund was badly in need, the Deputy Director pointed out. At present, there were only two unassigned offices in the headquarters building and the leased space in International Square. The Task Force space--about 10 offices--would be available for visitors, consultants, and other purposes on a short-term basis.

The staff had intended to place the matter of a supplementary appropriation before the Board somewhat earlier than had in fact proven to be possible, the Deputy Director went on. There had been some internal slippage in the timetable. The staff had believed that it would be appropriate to submit a separate request--separate from the midyear budget review--because of the urgency of having the Board approve some expenses which had arisen that had not been included at all in the original budget, and others of which the staff knew that they were clearly on a path in excess of the budgetary provisions. The staff had therefore believed that it would be advisable to apprise the Board as soon as those trends became evident, and request the additional appropriations.

Two of the four additional positions that were being requested for the Staff Contingency Fund had already been allocated to the Central Banking Department, the Deputy Director continued, as it was precisely that Department which had received the greatest number of requests for a myriad of technical assistance projects, and which was in dire need of immediate relief. Management intended to distribute the two other positions in accordance with need, but no firm decision had been taken.

The Staff Contingency Fund was not a backdoor for permanent increases in the staff ceiling, the Deputy Director stressed. Rather, it was a useful instrument to overcome rigidities in staff assignments, which would otherwise be very constraining on the Fund's operations. For example, the Staff Contingency Fund made it possible for the Fund to effect more smoothly temporary exchanges of staff with other international organizations, as it covered whatever overlapping assignment period might be unavoidable. It was not always possible to match perfectly the assignment dates of the staff members that were being exchanged, and the Staff Contingency Fund bore the cost of any overlapping. The Contingency Fund also allowed, for example, to return a staff member to headquarters from an overseas position on time, even though his position was still occupied by a colleague who was winding up some previous mission commitments. In that sense, the Staff Contingency Fund served as a mechanism that allowed temporary double-booking. The same was true with respect to newly recruited staff. In cases in which a person was wanted for a particular job, it had not always proven possible to coordinate perfectly the departure of a current staff member and the arrival of his replacement, and the Contingency Fund covered the cost of any overlapping of the two employees' terms of service. Not to have such flexibility would risk jeopardizing the scope of the Fund's choice in filling its most important positions. The Contingency Fund was very important for the smooth functioning of the Fund's mobility program, which would probably be much more difficult to implement in its absence. It was important to note, however, that in cases of imperfect timing of personnel shifts, the Staff Contingency Fund was charged for any short-term double occupancy, while equally frequent vacancies were not deducted, but rather were listed under the Department where they occurred.

No allowance had been made for increases in the salaries of Executive Directors because the staff did not wish to prejudge the decision of the Board of Governors in that regard, in the same way as potential general salary increases for the staff were not included, the Deputy Director remarked. Those additional costs had thus traditionally only been introduced into the budget after the appropriate decision had been taken.

The staff representative from the Administration Department stated that several Directors had asked about the impact of the supplementary appropriation on the Fund's income position. The projected interest rate of the SDR, given the U.S. dollar exchange rate assumption, had the effect of reducing the Fund's administrative expenses projections in SDR terms from SDR 181 million to SDR 179 million. The impact of the supplementary appropriation on the Fund's income position would be marginal.

The Deputy Managing Director observed that the term "contingency position" had been used in two different ways in the paper. The Deputy Director of Administration had explained the first usage. With respect to the five contingency positions that had been allocated to the European Department, it was true that the expectation was that those positions would in fact become permanent, and in that respect, for those particular positions, Mr. Wright's observation was accurate. Those positions had been placed in the budget because management had believed that it was highly probable that they would be needed, but it had not been sure exactly how they would be allocated across departments. At the beginning of the year, the staff presented a very detailed structure of anticipated expenditures and manpower deployment; the deviations from those projections were then accommodated later, such as through the current request for a supplementary appropriation, and in the category of "contingency staff positions".

Mr. Wright commented that he had not meant to suggest that the contingency positions should not have been filled. The presentation of what constituted a contingency and how it was dealt with might be presented in a more transparent way, however. He still found it hard to understand why the amount that had been budgeted for the Staff Contingency Fund was as large as it was, even though he understood the need to accommodate some friction and overlapping in staff assignments. He was further confused by the fact that offsetting reductions in staffing were not reflected in the account of the Contingency Fund, but in those of the Departments. If that were so, he would expect that the offsetting would be seen in the Fund's overall accounts, and that it would not thus be necessary to identify it specifically.

The Deputy Director of Administration replied that to convey the correct information, the Staff Contingency Fund amount would have to be set against the value of vacancies obtaining in each and every Department. Nevertheless, in the final analysis, there was no question that the Staff Contingency Fund created some additional use of manpower. The alternative, however, would be an attempt to time new recruitment with retirements and resignations exactly, with the possibility of losing desirable candidates.

Mr. Wright remarked that on the assumption that each professional position cost the Fund \$100,000, the Staff Contingency Fund would account for about 200 people in the course of one year.

The Deputy Director of Administration replied that the sum of \$100,000 per year did not cover the average cost of a professional position, including benefits. The Contingency Fund was composed largely of professional positions. It was very often easier to time recruitment and departures more finely for support positions.

The staff representative from the Administration Department said that if the Staff Contingency Fund were broken down into its constituent categories, it would be easier to understand. Of the amount of \$10.4 million, one category--accounting for \$1.3 million--pertained to assistants and temporary staff charged against vacant positions. A second category--accounting for approximately \$1.5 million--was for agency temporary staff taking the positions of full time staff on leave. A third category was for data processing contractual staff--amounting to about \$4 million. The fourth category was for seasonal and special workload requirements--about \$3.6 million.

The Deputy Managing Director commented that while most of the statistics in the paper were based on staff positions, the concept of total manpower included other concepts, such as contractual positions and other vacancies. If the concept of total manpower were used in all of the statistics, there would be less need for a large contingency element, as at present. He agreed that the presentation could be made clearer, perhaps by breaking the category of contingency positions into its constituent parts.

The Executive Board then took the following decision:

The Executive Board approves the supplementary appropriation and increase in personnel ceiling as set forth in EBAP/90/312 (11/29/90).

Adopted December 17, 1990

APPROVED: September 19, 1991

LEO VAN HOUTVEN
Secretary