<u>JEL Classification Numbers</u>
E61, F33, N24

Summary of
<u>WP/93/3</u>

<u>"Stabilization Programs and External Enforcement:
Experience from the 1920s" by Julio A. Santaella</u>

Since the early 1980s, international institutions have played an increasing role in helping to design and implement the stabilization and reform programs undertaken by developing countries and, more recently, by a number of formerly centrally planned economies. This paper examines the role that external institutions can play in assisting an adjusting country. It analyzes the reasons that may motivate a country to rely on an "external agent" to assist in implementing a stabilization program. The examination is based on the experience of six European countries that implemented currency stabilizations under the auspices of the League of Nations during the 1920s.

Countries may seek external advice in the design and "enforcement" of a program for several reasons. First, national authorities alone may lack the reputation needed to make a stabilization program sufficiently credible to be implemented successfully. Second, external institutions can help the adjusting country to obtain the financial resources needed during adjustment. Using a simple model to illustrate the credibility problem and the role of external enforcement, the paper shows that the extent of nominal instability is likely to be a major determinant of an external institution's involvement in a stabilization or reform program.

Within this theoretical framework, the paper examines the extent to which external institutions were involved in the European currency stabilizations that took place during the 1920s. The evidence indicates that these stabilization programs sponsored by the League of Nations were comprehensive and stressed the need to achieve a balanced budget, monetary discipline, and institutional reform. External enforcement was a crucial element in increasing the national authorities' credibility and in ensuring their commitment to the program.

The paper presents empirical evidence in support of the view that the goals of enhancing credibility and resolving financing problems were important in determining whether a country decided to rely on an external agent to assist its stabilization. Countries with greater nominal instability tended to rely more heavily on external enforcement to stabilize their currencies. The League's programs appear to have been effective in enforcing fundamental changes in the monetary and fiscal regime.