JEL Classification Numbers:
E52, F32, F33

Summary of
WP/94/96

"Adopting Currency Convertibility: Experiences and Monetary Policy Considerations for Advanced Countries" by Peter Quirk

An increasing number of countries, including relatively advanced developing countries, are considering moves to full currency convertibility in the light of the increasingly close integration of industrial countries' financial markets. This paper focuses on the issues for developing countries with relatively strong structural balance of payments. The issues for this group are somewhat different than those for developing countries with weak balance of payments for several reasons. First, paradoxically, developing countries' external sectors have generally strengthened following capital liberalization, while post-liberalization external sector performance in the industrial countries, to which the advanced developing countries are in some ways more closely related, has been mixed. Second, because of their different starting points, priorities for the stronger developing countries are oriented more toward ensuring stability of their domestic financial markets, including issues for monetary policies. The respective roles of the international organizations in this process are noted.

The paper provides evidence from monetary indicators for the industrial countries that the effects of capital liberalization have been very much sterilized. Despite overall increased volatility of foreign and domestic credit aggregates, interest rates, and exchange rates, the variability of broad money declined following capital liberalization. Empirical evidence from studies of individual industrial countries is, however, less conclusive.

In terms of policy implications, the outcome for the industrial countries suggests strongly that liberalization of exchange controls must be supported by greater flexibility of monetary policy and development of the instruments necessary to achieve this. Fiscal policy can also play an important role, except in the very short run. It is suggested that newly liberalizing countries need not fear that their domestic currencies will be subject to internationalization. Finally, the important role of strengthened supervision and improved market information in heading off speculative bubbles that might otherwise result from the liberalization is emphasized.