Monetary Institutions during the Transition to a Market Economy

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Money in Transition

There has been a great deal of intelligent discussion about the effects of alternative monetary institutions for the new governments of Central and Eastern Europe. Most of that discussion, whether recognized or not, addresses the issues that bear on the choice of monetary institutions for the long run. The paper by Jim Meigs, however, addresses a more urgent task, namely, the choice of monetary institutions during the *transition* to a market economy.

Leaders in ex-communist countries (ECCs) do not have the luxury of an extended academic debate on the issues that bear on the choice among alternative monetary institutions. They must get on with their job under conditions that most of us would regard as chaotic. What should the officials of these new governments do? Meigs gives an answer that should resonate with market liberals: Get out of the way! Specifically, Meigs recommends that the governments of these countries allow their individuals and firms to conduct *international* transactions in the markets for both goods and capital in some Euro-currency—immediately and without exchange controls.

One should not wait, he recommends, for the development of a stable domestic currency, which will take time and will depend critically on establishing a fiscal policy that is not dependent on central bank financing. For international transactions, any person or firm can immediately "borrow" the monetary policy of the Federal Reserve or the Bundesbank.

One should also not wait for the development of a domestic banking system. Again, for international transactions, any person or

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firm can "borrow" the developed banking institutions of the West.

Abolish Exchange Controls

Meigs also argues, I believe correctly, against any exchange controls on the flow of capital. There is reason to be concerned about capital flight, about "our" saving being used for investment abroad when it should be invested at home. In response, Meigs makes three arguments:

1. Exchange controls raise the cost of moving capital across national borders but are not very effective in limiting capital flight when domestic conditions substantially reduce the security of property rights.
2. Foreign private investment in ECCs is important to promote export sales.
3. Most important, exchange controls discourage foreign investment in the home country, by restricting the repatriation of earnings and the liquidity of the investment.

For these reasons, the termination of exchange controls usually leads to an increase in capital flows in both directions and often to a net inflow to the nation ending these controls.

Benefits of the Meigs Approach

In summary, I suggest, the Meigs approach is the best approach to financing international transactions in the transition period. This approach does not resolve the choice among alternative long-term monetary institutions, but it avoids the different down-side risks of a premature commitment to a specific long-term alternative. One attractive side-effect of this approach is that it would permit the finance ministers of the new countries to tell the boys from the IMF to go home, or go to hell, whichever is closer. I can hardly wait.

Sound Money and a Liberal Market Order

Malcolm S. Forbes, Jr.

Though circumstances and times change, the basic principles of economic progress and sound market order do not. There is no mystery about them. They involve sound money, low taxes, property rights, making it easy for businesses to be set up, and, once they are, not harassing them with excessive regulation and bureaucratic interference. And, of course, free trade. They sound very simple, but, unfortunately, when you see the policies—or lack of them—that we seem to be pursuing, even these simple principles seem to go by the boards.

The thing a country needs first is real, sound money. You cannot have a truly functioning economy without real money. But that fact seems to be lost on many Western policymakers. Having no money is like having a body without blood. It ain't gonna function.

Without a sound currency, other reforms necessary for a vibrant, free economy either are not going to be possible or are going to take a long time coming into effect.

International Handouts No Answer

What the struggling countries of the former Soviet Union do not need are gobs of Western foreign aid. That would only subsidize self-perpetuating bureaucracies and destructive policies. What they do need are open markets and free trade. Free trade and private investment—domestic or international—will do far more than foreign aid.

They also do not need more mindless austerity. Some Western agencies seem to suggest that the poorer you get, the better off you will be, because that builds character.

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