Challenges to Economies in Transition:
Stabilization, Growth, and Governance
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Session II: **Monetary and Exchange Rate Policy in Economies with Newly Independent Currencies: Lessons from Recent History**

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It is a great pleasure for me to be here and to participate in this conference commemorating the fifth anniversary of the Kyrgyz som. I was here last exactly five years ago to assist the NBK with the launch of the som. I remember well that on the evening of May 8 it turned cold and snowed all night so that the parades and other ceremonies for the May 9th holiday for World War II were in the snow. On May 10 the som was first introduced and on that day I left Bishkek with my mission for a five day payment system coordinating mission in Almaty. As we crossed the border we gave the border guards their first look at the som. I returned five days later to spend two of the most interesting weeks of my life working with then Governor Nanaev and the NBK staff to help the som get a good start. During the som's first week as sole legal tender of Kyrgyzstan, the NBK held the first credit auction in som, the first foreign exchange auction of dollars, and the first government securities auction. It started its existence with no restrictions on its convertibility or use. Its value rested on sound macroeconomic policies, IMF financial support, and the courage of Kyrgyzstan's leadership. It was a busy and exciting time.

That was my last visit to Bishkek until this week. From there I was reassigned to advise the National Bank of Moldova. So it is with particular pleasure that I comment today on Governor Talmaci's interesting paper.

Moldova has experienced a relatively successful stabilization program since the introduction of its currency, the Moldovan leu, on November 29, 1993. In his paper for this conference, Governor Talmaci has presented a broad outline of the framework and policies that have lead to that success. These included the adoption and adherence to an orthodox policy of tight monetary control, using increasingly indirect, market based instruments of control, and the steady pursuit of a long range program to strengthen the banking sector. What Governor Talmaci did not mention, but which was critical to the success of Moldova's stabilization efforts, was his personal courage and determination to adhere to the program. Without that no amount of outside advise or financial assistance would have been successful.

Governor Talmaci was kind enough to note the important and positive role of the new central bank and banking laws adopted in 1995. It was my pleasure to work with him in the development of these two laws, but it was his political skills that brought them through the Parliamentary processes to final adoption with hardly a change. I have never seen banking or central bank law drafts submitted by a central bank that were adopted with so little change. I remember clearly Governor Talmaci's statement that prior to the adoption of these laws the independence of the National Bank of Moldova came from the program supported by the IMF that he and the Minister of Finance signed and to which they were both very committed.

Like many stabilization programs supported by the IMF, Moldova's initially emphasized as performance criteria quarterly ceilings on the National Bank's ***net domestic assets*** and floors on its ***net foreign assets.*** During 1994 we recommended that the National Bank establish a Monetary Committee, which should include the First Vice Governor and the heads of the foreign exchange, research, and monetary operations departments. As long as Moldova's monetary policy was defined in terms of NDA and NFA, there was little for such a committee to decide and First Vice Governor Ursu politely told me that the Monetary Committee was a good idea but not yet a priority. None the less, he agreed to convene a meeting of the committee, for which the research department would prepare a background paper on monetary conditions and options. I attended that first meeting with great interest. The background paper was not yet very good and directors had other things to do and the Committee did not meet again for a long time.

In formulating monetary policy in 1995, attention gradually shifted at the IMF and the NBM to reserve money, thus opening the possibility of more discussion over whether the reserve money objective would be best met by adjustments in NDA or in NFA. I remember well the meeting of the Monetary Committee held, at my request, during my last mission to Chisinau in May 1996. For the first time the directors of the represented department realized that there was a choice in meeting the reserve money objective between raising the NFA's or the NDA's of the NBM. The directors of the foreign exchange and monetary operations departments became very interested and expressed opinions about the choice. I left that meeting confident that we had turned an important corner and that there were be many more meetings of the Monetary Committee. I was very please to hear Governor Talmaci today say that:

> *The Bank has also established a Monetary Committee, headed by the First Vice Governor of the NBM and convened each Tuesday. This Committee receives proposals from the Departments and Directions of the NBM on the basis of which it establishes the monetary, credit and foreign exchange policies for the current week...*

Governor Talmaci's paper presents a broad outline of the framework in which monetary policy has been formulated and implemented in Moldova in recent years. As one example of the use of that framework when taking a specific decision, Governor Talmaci notes that when the NBM wished to ease monetary policy in June 1994 it might have done so by increasing the amount of its credit auctions (i.e. by increasing the monetary base) or by reducing its reserve requirement (i.e. by increasing the money multiplier). The NBM choose to increase the money supply on that occasion by reducing the reserve requirement in order to reduce the implicit tax they imposed on banks, though the tax reduction objective might also have been achieved by increasing the remuneration of required reserves. I would have appreciated more examples of the factors that underlay policy choices made by the NBM within the general framework presented in the paper.

I would also like to add a few words to Governor Talmaci's description of the NBM's move toward full reliance on open market operations in place of credit auctions. This step has progressed slower than we initially recommended. The real reason for the slow pace of progress in this area I believe, which was not brought out in Governor Talmaci's comments, is that the shift from credit auctions to OMO would impact on those banks, generally a few large former state banks, that relied heavily on credit from the NBM, often to refinance credits they could not repay because of nonperforming loans among their assets. These banks held few, if any, government securities and would be forced to shrink their balance sheets if they were no longer able to borrow from the NBM. The willingness of the NBM to replace credit auctions with OMO by the end of this year, reflects their judgement, I think, that the banking sector and the NBM's banking supervision department, are now prepared to deal with the pressures that this might put on these few banks. If so, that readiness reflects several years of concerted effort to get ready. Moldova's banking sector has improved over that period, as has its banking supervision capabilities, but the job of developing a sound, modern, market based system is for from complete. I wish Governor Talmaci and Moldova well as they continue their work.