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CONFERENCE REPORT

MANAGING CAPITAL FLOWS IN EASTERN EUROPE

Proceedings of an international conference

The European Centre of the International Centre for Economic Growth organised its first conference on “Managing Capital Flows in Eastern Europe” in Budapest on May 18–19, 2001 supported by the Ford Foundation.

The meeting brought together the project participants and numerous external experts from the academic, banking and policymaking circles to discuss the initial findings of the papers, to determine the areas of further research within the project, and to think about the region-specific lessons and problems related to the management of capital flows in transition economies.

The participants of the meeting assessed the major issues related to the management of capital flows in transition economies based on the experiences of individual economies. The papers discussed the problems of capital flows in several advanced and less developed transition economies, allowing comparisons of different country experiences, drawing the first general and very tentative conclusions from these cases.

Boris Vujčić (National Bank of Croatia) analysed the lessons learned from Croatia regarding capital inflows and their management. After presenting a brief overview of the major macroeconomic developments in the economy – which can be clearly divided into two periods before and after 1999 – the author analysed the magnitude and structure of capital inflows to the economy. In his presentation Mr. Vujčić also discussed those instruments that were applied by the monetary authorities to mitigate the adverse impact of inflows, which have been relatively smaller compared to the average of transition economies.

Pekka Sutela (Bank of Finland) described in his presentation the experience of the small Baltics’ economies with managing capital inflows. While in several macroeconomic and institutional respects (size, openness, per capita GDP), these economies are very similar, there are significant differences between them, which affected the magnitude, structure and management of capital inflows. These differences were presented by the author, who elaborated some aspects and lessons

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from the Baltic cases on the relationship between exchange rate regime and financial sector reform on the one hand, and capital flows on the other.

Sergei Drobyshevsky (Institute of Transition) described the macroeconomic developments and capital flows in Russia. His paper demonstrated that the Russian economy was different from the most of transition economies, since it has been characterised more by capital outflows than inflows. The author analysed the sources, costs and consequences of capital outflows, as well as the recent developments following the currency crisis of August 1998.

Dariusz Rosati (Warsaw School of Economics and National Bank of Poland) discussed the theoretical framework for assessing capital flows and their management, with a focus on the Impossible Trinity hypothesis and the sterilisation problems. In his presentation on Poland he showed the waves of capital inflows, and the major structure and reasons behind this behaviour. He discussed the role of fiscal and exchange rate policies in the management of capital flows and presented evidence on the behaviour of major monetary aggregates following the shift from exchange rate targeting to inflation targeting.

Thomas Holub (Czech National Bank) presented his joint paper written with his colleague Zdeněk Tůma presenting the Czech experience that differed sharply before and after the currency crisis of May 1997. He showed how the structure of inflows changed after the crisis, and identified the major concerns for monetary authorities in the recent years. His presentation reflected the importance of prudent fiscal policies and fiscal adjustment, as well as a sound financial sector in the management of capital inflows.

Alexander Mintchev (Center for Economic Development) described in his presentation the experience of Bulgaria with capital inflows, which have been relatively modest before the establishment of a currency board in 1997 due to macroeconomic instability and slowness of structural reforms. Following the hyperinflation and currency crisis, the currency board brought deep changes in macroeconomic stability, and this combined with accelerated structural reforms, led to sizeable capital inflows. Although the economy has been hit by a series of adverse exogenous shocks, the adherence to the currency board and the tough fiscal and income policies helped in managing capital flows.

Vladimir Lavrać (Institute of Economics) analysed the case of an economy, which has had a money-targeting framework coupled with managed floating since the establishment of monetary independence. Although Slovenia has not been the economy attracting most of the capital inflows, there were periods when sizeable inflows were recorded. Mr. Lavrać described the experiences with unremunerated reserve requirement used similarly in the Chilean case. The presenter also analysed the dilemmas faced by monetary authorities in times of significant capital inflows, which have however subsided in the recent years.

Gábor Oblath (Kopint Datorg) and Gyula Barabás (National Bank of Hungary) described the very special case of Hungary with its crawling peg exchange rate regime. The regime, combined with improving macroeconomic stability and rapid structural reforms, has been a source of significant capital inflows, which reached extreme volumes in certain periods. The authors analysed the structure of inflows pointing to the dominance of foreign direct investments. They also assessed the efficiency of macroeconomic policy measures aimed at managing flows, showing that while sterilisation has been wide, the costs remained manageable. On other hand the loss of monetary policy independence as well as the worsening inflation performance forced the authorities to replace the earlier tightly managed exchange rate regime with a more flexible one in 2001.

Daniel Daianu (CEROP) assessed the performance of the Romanian economy and its experience with capital inflows. As the economy experienced repeated crisis cum boom-and-bust cycles, capital inflows have been relatively insignificant. The presentation focussed therefore more on the internal macroeconomic problems of the economy, pointing to the lack of fiscal prudence, low level of credibility of policymakers, and persistent and very unstable inflation. While these problems were at times aggravated by the inflow of mostly short-term speculative capital, they served mainly as hindrance for more significant and long-term capital inflows.

Frantisek Hajnovič (National Bank of Slovakia) analysed the case of Slovakia, presenting the very different macroeconomic conditions before and after the currency crisis of 1998. He showed that the implementation of a macroeconomic adjustments program and simultaneous acceleration of privatisation and liberalisation has contributed to the increase of capital inflows since 1999, which had previously been relatively low in the economy. The author has also elaborated on the instruments that have been applied by the central bank in the current monetary and inflation-targeting framework to manage capital inflows.

Presenting the joint paper written with Claudia Buch, Ralph Heinrich (Institute of World Economics, Kiel) gave an account of the microeconomic aspects of capital inflows. Giving a detailed theoretical overview of the banking sector developments, as well as of international capital flows, the author presented their views on the links between capital flows, financial vulnerability and currency issues. They stressed the role of a sound financial sector, the presence of appropriate regulatory and supervisory tools, and the need to avoid the build-up of unsustainable net foreign positions. The authors described the special features of capital inflows and net foreign asset position of advanced transition economies versus other emerging regions.

David Begg (Birkbeck College, London) compared the experiences of capital flows in transition economies with economies recently joining the EU. He assessed the structure and macroeconomic consequences of capital inflows to Greece, Portugal, Spain plus Italy and Ireland, and drew some conclusions for the transition economies. In relation to this group, he presented the links between financial openness, exchange rate regime and monetary policy, and capital inflows. In his paper he expressed the role of fiscal adjustment in managing capital flows, especially in cases when monetary independence is seriously restricted.

Since the papers are subject to review by their authors, their final versions may differ from the ones presented at the conference.

Pál Gáspár