On a recent trip to Russia, I got an up-close look at some of its economic and political problems. The risks in the situation were evident, but it also seemed that the political turmoil might create opportunities for basic institutional changes. At times like these, drastic new policies sometimes become politically feasible, and it is therefore worth considering reforms that might otherwise be unthinkable.

One attractive proposal is a currency board, whereby the central bank would limit its activity to exchanging the ruble for foreign currency at a fixed rate. Since large quantities of U.S. $100 bills are already circulating and since many domestic transactions are viewed effectively in dollar terms, the natural unit would be a new ruble that equaled one U. S. dollar. But the system could also work in terms of the German mark, euro, or another currency.

The central idea of a currency board is to eliminate exchange-rate volatility and hyperinflation as threats to the economy. The experiences in Argentina and elsewhere have shown that this system can work effectively. However, it is crucial to recognize that a currency board is not a cure-all. It must be combined with an effective economic team and with a broader program that includes fiscal discipline, legal reforms, and improvements in the banking system.

STABILITY

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The key matter is whether the impending money creation is temporary—a drunkard’s last drink that precedes the implementation of lasting reform—or a permanent policy that goes along with hyperinflation and the return to a statist economic regime. The reform choice is by no means assured, but its probability would be raised by the presentation of a coherent economic plan, which includes a currency board. Also central is a budget program that involves improved tax collections, reductions in tax rates in areas where collections are minimal, and cuts in public outlays at the federal and regional levels. Another good idea would be the conversion of the domestic and foreign public debts—practically in default now—into long-term, dollar-denominated bonds.

The implementation of a currency board also provides the International Monetary Fund with a useful lending option. Instead of providing funds to Russia that basically disappear and are used as excuses not to carry out budget reforms, the IMF could lend only for the purpose of strengthening the currency board’s reserves. To begin, something like $5 billion to $10 billion would be needed to raise international reserves from $12 billion to $13 billion at the required level, which I estimate at around $20 billion. With this policy, the IMF would not only be doing something economically useful but also be raising the probability that its old loans would be repaid.

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