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To: Members of the Executive Board

From: The Secretary

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Background Paper

The attached background paper provides additional information to the paper on financial relations among countries of the former Soviet Union (EBS/93/158, 9/23/93) which will be discussed in a seminar on a date to be announced.

Mr. Coats (ext. 38422) or Ms. Cheasty (ext. 38706) is available to answer technical or factual questions relating to this paper.

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Former Soviet Union: Interstate Financial Relations--Background Paper

Prepared by the European II Department in collaboration
with the Monetary and Exchange Affairs Department

Approved by John Odling-Smee

September 22, 1993

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I. Introduction

Since independence, economies of the former Soviet Union (FSU) have suffered from unstable monetary arrangements and a poorly functioning payments mechanism. In recent months, it has become clear that difficulties in the monetary and payments areas are to an important extent the result of the disorderly attempts of the FSU states to cope with intra-FSU balance of payments disequilibria. The inadequacies of the monetary regime and payments arrangements have, in turn, hindered the ability of these countries to address their financing problems, and, in some cases, have exacerbated existing financing gaps. EBS/93/158 discusses the policy problems facing FSU states in light of their current financial difficulties. This Supplement delineates the institutional background to the financial problem. Section II describes developments in the FSU payments system, and its inappropriate use to control balance of payments deficits. Section III describes monetary arrangements in the FSU, including the July 1993 ruble demonetization, and discusses how the evolution of monetary regimes has been influenced by financing pressures. Section IV outlines the contributions of Fund technical assistance in the payments area.

II. Payments Mechanisms and Foreign Exchange Markets

1. Introduction

The payments mechanism inherited by FSU states from the system of central planning was inadequate to deal with payments between increasingly market-oriented enterprises across the borders of independent countries. Payments took a long time to complete, had uncertain finality, and were made without regard for whether the payer had sufficient funds (see EBS/92/205). Moreover, since mid-1992, the interstate payments system has been used as the main vehicle for containing interstate financing imbalances. These problems have meant that cross-border payments have been slow and uncertain, which in turn has hampered intra-FSU trade and diminished the effectiveness of monetary policy. The interstate payments system has therefore been perceived as one of the most critical areas for short-term reform. This section describes the evolution of this payments system since end-1991, and recent reform initiatives. However, as explained in EBS/93/158, many of the difficulties in the payments system stemmed from financing problems rather than technical shortcomings, so that payments system reform should not be seen as a panacea for resolving interstate financial problems.

Payments reforms have taken place both at the level of central banks and through the development of commercial bank payment arrangements. Reforms have focused not only on improvements in the payments mechanism, but also on alleviating the financial pressures that have hindered payments. Moreover, the payments mechanism has had to shift from a fully ruble-based system to accommodating payments in a multi-currency environment.

In a first step towards reform (aimed largely at enhancing the CBR's control over payments), the interstate payments system inherited from Gosbank was converted into a set of bilateral central bank correspondent accounts, through which payments were not to be processed without funding. However, financing shortfalls generated rising overdrafts which in turn led to the imposition of limits on payments imbalances and a centralization of payments documents in the head offices of the central banks. In recent months, some progress has been made in streamlining the processing of payments between central banks and introducing more efficient accounting procedures. Improvements in the domestic payments mechanisms run by central banks have taken place concurrently.

In the meantime, the Interstate Bank (ISB) has been proposed as an interim multilateral clearing and settlements system. The ISB is seen as a way of facilitating the processing of interstate payments, economizing on scarce settlement reserves through multilateral netting, and in the process reducing the inefficiencies of the current bilateral payments arrangements. In the longer-run, the role of the ISB would be replaced by growing decentralization of the payments system and the achievement of currency convertibility among FSU states in the context of a deepening of foreign exchange markets.

Official restrictions on commercial bank cross-border activity have been relaxed since mid-1992. It is expected that the decentralization of cross-border payments should not only speed payments, but also reduce financing difficulties by enhancing the flow of credit across the borders of FSU states. It is also envisaged that normal enterprise-to-enterprise trade credit should increase over time. Until now, however, interenterprise financing has frequently taken the form of interenterprise arrears, with the result that the elimination of these arrears has become an important prerequisite for the normalization of cross-border inter-enterprise payments relations.

Despite significant progress in the decentralization of payments, payment systems organized by central banks remain pre-eminent in interstate payments, largely because of their financing role. ^{1/} At end-June 1993, the CBR correspondent account system accounted for more than 90 percent of the gross interstate financing provided by Russia, with most of the balance being financed by enterprise arrears (Table 1). Financing from these sources was partly offset, however, by net inflows from other FSU states through Russian commercial banks, which were equivalent in size to more than 9 percent of Russia's interstate financing.

^{1/} Data deficiencies do not permit an analysis of payments turnover. An analysis of gross (rather than net) flows would be necessary in order to assess the contributions of the various components of the payments system to the processing of payments.

2. The central bank payments mechanism 1/

In January 1992, the Central Bank of Russia (CBR) established a system of correspondent accounts for each of the central banks in the newly independent FSU states. Other central banks gradually followed suit, establishing a network of bilateral official correspondent relations. These bilateral accounts replaced the interbranch payments mechanism used by the State Bank of the U.S.S.R. (Gosbank) under the system of central planning, and allowed central banks to begin monitoring payments imbalances in interstate trade. Beginning in April 1992, when significant imbalances began to emerge, the central banks moved to centralize all cross-border payments, in an attempt to contain the extension of credit by Russia to other states. 2/ From July 1, 1992, all of Russia's interstate payments were made through the books of the head office of the CBR. When correspondent balances with the CBR were exhausted, they were either replenished by borrowing in the form of so-called technical credits, 3/ or the CBR suspended payments by the central bank that had run out of ruble balances. The new system significantly slowed interstate payments, not only by curbing access to financing, but also by physically concentrating payment papers in the head offices of the FSU central banks. It thereby added a further round to the processing of payment instructions and greatly taxed the administrative capabilities of the central banks.

In early 1993, with a view to alleviating pressures to use the payments system for balance of payments financing, the Russian authorities shifted the responsibility for financing away from the CBR. They advised the other FSU states that, following the drawdown of existing credits, all further financing would be extended in the form of government loans. 4/ By May 1993, the CBR had practically stopped processing payments through its correspondent accounts (Table 2), 5/ as total credits to the other FSU states approached the limit agreed to in bilateral negotiations of the CBR

1/ This section describes developments in non-cash payments only. Developments in currency, which took on inordinate importance as a means of payment when strains on the non-cash payments mechanism intensified, are described in Section III.

2/ See EBS/92/205 for details.

3/ For a period in late 1992, a distinction was made between borrowing by means of negotiated technical credits, and borrowing by way of an informal overdraft on the correspondent account. In 1993, the CBR redefined technical credits as limits on correspondent account overdrafts.

4/ Even the use of existing credits was contingent on the renegotiation of 1992 payments system financing as medium term debt (see Section III.d of EBS/93/158).

5/ Because of the many changes to the payments system during 1992, it has not been possible to provide comparable figures for that period.

and the FSU central banks. 1/ As a way of alleviating payments demands that rapidly began to build, on June 30, 1993, a resolution of the Russian Supreme Soviet formally discontinued access to financing through the CBR payments system and instructed the CBR to quote exchange rates for non-cash national rubles. The CBR began to quote exchange rates for national rubles from July 16, with the aim of restoring the access of deficit states to the payments mechanism. Those exchange rates were also to be used by commercial banks in accounting for their cross-border transactions.

Events in July were dominated by the demonetization of the pre-1993 ruble (see Section III). From the perspective of payments reform, the delinking of currencies meant that states no longer had an alternative subsidized means of payment that permitted them to bypass the payments system. On August 9, 1993, the CBR reportedly reopened its correspondent accounts with FSU central banks and announced that all transactions would be recorded according to the exchange rates that it had been quoting to the commercial banks since July 16. 2/ The formalization of the exchange rate mechanism should make it easier for deficit countries to contain their payments imbalances from now on; however, the extent to which the accounts may be used for financing purposes in the future is not yet clear. 3/ In the transition economies of the FSU, where interest rates and exchange rates are still not fully effective in equilibrating markets for credit and foreign exchange, pressure on the correspondent accounts will continue until the financing of interstate balance of payments deficits is otherwise resolved.

3. The Interstate Bank

FSU countries currently envisage the establishment of an Interstate Bank (ISB) as a multilateral clearing house within the FSU, with a view to expediting the processing of interstate payments and making them more reliable. The ISB would organize the systematic and standardized clearing of interstate payments, engage in multilateral netting, ensure finality of payments, and, as necessary, make use of the surpluses of member states in its financing of the deficits of others; however, cross-border payments

1/ The comparison in Table 2 is somewhat misleading, however, because aggregate (net) financing includes lending to Kazakhstan, whose borrowing was not subject to a credit limit in the first half of 1992.

2/ There have been conflicting reports, however, as to whether all the correspondent accounts have indeed been reopened.

3/ The operation of the new accounts is similar to the operation of the earlier accounts because it was never possible to make payments through the CBR with non-Russian rubles (without first exchanging them for Russian rubles, which is what the operation of the correspondent accounts did, albeit at par). The new state credits deposited to these correspondent accounts, however, can only be used to pay for specifically authorized Russian exports. Use of the new accounts may therefore be limited to payments for inter-governmental contracts.

imbalances would ultimately be financed elsewhere. The ISB is likely to be most useful during an interim period before sufficient commercial bank correspondent account relationships can be put in place and separate currencies of FSU states become mutually convertible. In the long-run, its most useful role would be as a regional clearing house, which would meet international standards and facilitate private banking transactions.

The Interstate Bank Agreement and Charter were signed on January 22, 1993 in Minsk by the heads of state of ten FSU countries--all except Azerbaijan, the Baltic states and Georgia. These documents provide for a regional multilateral clearing and settlement system with limited and well-specified functions. These include: (1) writing operating rules and standards for cross-border transactions; (2) calculating netted positions for the settlement cycle; (3) effecting settlement in Russian rubles on the books of the ISB; (4) holding and management of ruble accounts of participating central banks; (5) provision of limited settlement credit 1/; (6) a funds transfer service; and (7) brokerage for buyers and sellers of the settlement currency. The ISB would improve the predictability and security of payments by executing a fully automatic non-discretionary settlement procedure, with daily posting of outstanding positions and early-warning signals of possible settlement difficulties, and with the imposition of well-specified penalties upon failure to settle. The documents do, however, provide for a settlement period of fourteen days, which endows the system with significantly more risk than the payment systems of industrial countries--where settlement of international transactions typically takes place within two business days. The long settlement period was considered necessary to give participating central banks sufficient time to offset volatility in incoming and outgoing payments, and to marshal the funds needed to settle imbalances. While the settlement currency of the ISB will be the Russian ruble, payments may take place in any currency, converted for settlement at exchange rates posted by participating central banks. The ISB Charter also establishes the management structure of the Bank, which will have on its Council one representative from each member state. The Russian Federation will hold 50 percent of the votes, and other members will be distributed votes according to their share in interstate foreign trade turnover.

Since January, progress in the implementation of the ISB has been slow; although by August 24, 1993 four states (Belarus, Kazakhstan, Turkmenistan, and Russia) had ratified the Agreement and Charter of the ISB. It is envisaged to establish the ISB before end-1993, with the allocation of votes depending on the number of countries which have ratified the founding documents by that time.

1/ At present, countries' limits are set equivalent to one month of their incoming interstate payments, and there is an effective overall limit of rub 200 billion, determined by the CBR's commitment to convert settlement balances into Russian rubles.

The policy considerations underlying the establishment of the ISB and its development, not as a payments union, but as a multilateral clearing and settlement agency (without inherent financing capacity beyond a limited amount of inter-member credit to facilitate settlements) are discussed in Section III.3.c of EBS/93/158. As noted there, the staff views a payments union for the FSU states as involving more risks than it does advantages. Moreover, the design of the ISB, as recommended by Fund staff, requires its use to be voluntary, the convertibility of member balances into the agreed settlement currency to be guaranteed, and the absence of exchange restrictions or discriminatory features inconsistent with Article VIII of the Articles of Agreement of the Fund.

4. Exchange arrangements

In market economies, foreign exchange markets are used for making a large proportion of cross-border payments. Exchange markets give enterprises access to the currencies and financing of their trading partners' countries and, if countries with balance of payments deficits exhaust their reserves, the depreciation of their currencies reduces their demand for foreign exchange. The further development of exchange markets in FSU countries should therefore help eliminate inappropriate demands for financing through official payments arrangements, particularly as hard and soft currency balances become increasingly fungible.

Russia's convertible currency exchange market for the ruble gradually deepened during 1992-93, as additional Russian commercial banks received foreign exchange licenses and the emergence of cross-border correspondent accounts gave banks in other states greater access to the Moscow market. Weekly volumes traded on the Moscow Interbank Foreign Currency Exchange (MICEX) rose from an average of US\$100 million a month in the first half of 1992, to an average of US\$525 million a month in the first half of 1993. By early September 1993, average daily turnover was approaching US\$100 million.

Some exchange markets have also developed for the national currencies of FSU states that have left the ruble area. All countries with national currencies permit trading in U.S. dollars and deutsche marks. Cash and non-cash rubles have been traded in Estonia since end-November 1992, and Belarus, Latvia, Lithuania and Ukraine also trade non-cash rubles. The Kyrgyz Republic has conducted one ruble auction. Until end-January 1993, the Bank of Latvia quoted buying and selling rates for national rubles, mainly based on dollar and deutsche mark cross-rates; its exchange markets attracted so many purchasers of Russian non-cash rubles from deficit FSU states, however, that the Bank decided to close the market.

Within the ruble area, exchange markets for FSU national rubles appeared spontaneously when the financing pressures of 1992, coupled with the payments limitations discussed above, generated differences in the exchange rates for non-cash rubles of various FSU states. In some countries, notably Belarus, auctions were heavily promoted by the Central Bank. As noted, these exchange rates were formalized when the CBR began to

quote buying and selling rates for cross-border payments in July 1993. Section III provides details of the emergence of separate currency regimes.

Since the demonetization of pre-1993 cash rubles in Russia in late July 1993, exchange arrangements have remained unsettled. To the extent that details are available, present arrangements, together with a summary of exchange restrictions, are summarized in Table 3. Just prior to the demonetization--in response to the Russian Supreme Soviet resolution of June 30, 1993 (see Section II.2)--seven states (Azerbaijan, Georgia, Kazakhstan, Moldova, Tajikistan, Turkmenistan, and Uzbekistan) pegged their official exchange rate to the Russian ruble. These official exchange rates were to be used primarily for official transactions (debt service, surrender of foreign exchange, and accounting). All of these countries, with the possible exception of Uzbekistan, operated multiple exchange rate systems, because markets continued to function in which the value of locally issued deposit rubles against hard currencies and the Russian ruble was freely determined by banks and enterprises. From the perspective of interstate payments, it is important that states introducing their own currencies quickly put coherent arrangements in place which allow the unfettered exchange of their own currencies for others--whether those of other FSU states or of non-FSU countries.

In most cases, the exchange systems of FSU countries have been significantly liberalized, although a number of formal exchange restrictions continue to apply, particularly to personal allowances for invisible transactions and on capital transfers. ^{1/} Restrictions also arise because of the delays in payments on the balances on correspondent accounts. Moreover, new restrictions have reportedly been imposed in several countries since the demonetization, aimed mainly at economizing on scarce Russian ruble balances. Table 4 lists the identified restrictions on current international transactions.

5. Payments among commercial banks and domestic payments
system issues

Technical problems have contributed significantly to slow interstate payments. There is a great deal of variation among states' handling of payments, but technical problems tend to be most severe in the geographically largest ones, especially Russia. Some immediate and significant improvement could be achieved by increasing the scope for commercial banks to deal directly with each other, through interstate correspondent banking, and facilitating efficient foreign exchange markets in non FSU currencies, supported by an appropriate regulatory framework, as this would bring private initiative into the search for quicker and more efficient payments. However, recognizing that central banks are likely to play significant roles in most FSU cross-border payments for the foreseeable future, technical reforms are also under way in official payments systems.

^{1/} The exchange systems of FSU countries are summarized in EBS/93/75.

a. Payments decentralization

The gradual relaxation of restrictions on cross-border correspondent accounts of commercial banks, together with the development of foreign exchange markets in FSU states, has reportedly led in recent months to an increase in the use of this channel for international payments. Such payments can be made in one to two days, compared to the two weeks to two months that is common for payments through the central banks. (Recent information on cross-border payment arrangements is summarized in Table 5.) Because commercial bank cross-border payments can create credit exposures that generate systemic risk, the supervisory role of FSU central banks needs to be developed in tandem with the decentralization of payments. 1/

The decentralization of payments was hindered until recently, because the processing of payments by central banks at a more appreciated exchange rate than usually available to commercial banks dealing in discounted rubles created an artificial incentive for centralized cross-border payments. 2/ Moreover, from August 1992 to July 1993, Russian banks were not allowed to open new correspondent accounts in FSU states that had not introduced national currencies; old accounts, however, remained open. In any event, because they faced credit risk and de facto exchange risk, Russian banks reportedly were not interested in holding balances in other countries still using the ruble. On the contrary, banks in other FSU states frequently wished to build up precautionary ruble balances in Russia (see Table 1), and, in order to stem capital outflows, some states restricted the right of banks to open correspondent accounts in Russian banks.

On July 16, 1993, the CBR formally lifted all restrictions on correspondent banking of Russian banks in the other FSU countries. It required interstate payments through the Russian commercial banks to be recorded in new accounts and according to exchange rates (between the Russian ruble and the rubles of the other states), which were set by the CBR on the basis of relevant foreign exchange markets. In their interstate transactions, Russian commercial banks would be subjected only to regulation on open foreign exchange positions. The CBR explicitly does not guarantee

1/ Reforms in banking supervision are not dealt with in this paper. However, the importance of the near-term development of a coordinated FSU supervisory and regulatory framework cannot be overemphasized. The establishment of correspondent relationships, though technically simple, involves exposures to risks that need to be subjected to prudential limits, which most FSU central banks are not yet well equipped to monitor. From the perspective of the commercial banks, it also requires knowledge of the integrity and soundness of partner banks. Correspondent relationships require an element of trust that may take a while to develop, especially in the uncertain economic and financial environment of the FSU states.

2/ Turnover figures (though partial) suggest that payments from Russia have been decentralized faster than payments to Russia, because of the artificial exchange rate and the availability of CBR financing.

the claims of these banks on the other states. There is no surrender requirement applicable to proceeds from Russian exports to the other FSU states. As indicated in Table 5, few limitations are imposed on the cross-border correspondent relations of commercial banks in the FSU states, except for Uzbekistan, where they are not permitted.

It had been envisaged that the decentralization of payments would alleviate financing constraints by allowing Russian banks to lend to enterprises in deficit countries where capital was scarce. As noted, however, in the months since restrictions began to be eased, Russian commercial banks appear to have been reluctant to accumulate claims in rubles on their correspondents in other FSU states (Table 1). Indeed, CBR data suggest a capital inflow to Russia from other FSU states through the banking system beginning in late 1992 and accelerating in 1993. During the first six months of 1993, the net inflow amounted to Rub 266 billion. The outflow of capital from deficit states tended to increase the discount on their non-cash rubles.

The behavior of commercial banks may reflect their uncertainty about the liquidity of claims on deficit FSU states, but it also suggests that payments reform alone will not be sufficient to alleviate financing constraints. Despite evidence of increasing payments decentralization, ruble financing of Russia's interstate trade imbalance is borne fully by the CBR (and more recently by the Government through the newly negotiated state credits) and by Russian enterprises. In fact, Russian commercial banks account for the bulk of Russian ruble liabilities to the other FSU states, reflecting, on the one hand, the fact that ruble deposits at the CBR are almost exclusively used to pay for priority state imports and are therefore kept close to zero and, on the other hand, the fact that non-Russian banks of the ruble zone are willing to accumulate deposits in Russian banks. These deposits have increased at the same time that enterprises in some other FSU states were in arrears to their Russian suppliers. Thus, for payments decentralization to reduce the financing difficulties of deficit states, it seems clear that related reforms are imperative in the direction of economic stability, the liberalization of interest rates, currency convertibility, and a coordinated supervisory and regulatory framework for containing counterparty risk.

All of the countries that have left the ruble area continued to maintain central bank correspondent accounts with ruble area states. Generally, however, the introduction of the separate currency element into official cross-border transactions (together with the limits to financing, which particularly affected most of the countries that left the ruble area) appears to have stimulated the decentralization of payments to commercial banks--including in several cases official payments. In Estonia, use by the central bank of its account with the CBR is limited mainly to payments on account of the resident Russian army. With few exceptions, Ukraine uses its CBR account only for government to government transactions.

b. Technical reforms in domestic payments systems

Technical improvements in domestic payment processing and settlement constitute an important aspect of expediting cross-border payments. Table 6 summarizes the status of reform in domestic payments systems. For many FSU countries, steady progress has been made in improving courier services and the organization of payments, streamlining of processing, and in developing more efficient accounting procedures. Expedited payments of large value items are already operating in Russia and Ukraine and more refined large ruble value transfer systems are being developed. Clearing houses have been licensed in Russia and Ukraine, are scheduled to open soon in Armenia, and are under active discussion in a number of other countries. In Kazakhstan, commercial bank accounts have been consolidated, to streamline payments and facilitate liquidity management.

In Russia, in addition to several short term improvements in processing and operations, a wide variety of reforms in different facets of the payments system have been initiated, with high priority given to the large value transfer system. There is some evidence that these reforms are bearing fruit, since payments float appears to have been cut in half in the first half of 1993, although its measurement is subject to difficulties. But despite some impressive efficiency gains in individual countries and regions, large-scale systemic changes in other FSU countries remain as yet limited. Progress in some countries has been slow because of the time needed for the authorities to recognize fully the requirements of payment systems in market economies, because of an apparent bias in favor of high technology solutions which could take many years to develop and are expensive, and because changes in the processes of payments are complex and involve many people and institutions. 1/

6. Interstate interenterprise arrears

Cross-border arrears of enterprises continue to be an important feature of interstate trade. However, while Russian enterprises owed firms in other FSU states Rub 250 billion as of mid-1992, by mid-1993 Russian enterprises had become net creditors of nearly Rub 500 billion, mostly with Ukraine (Table 1). 2/ While such a position is consistent with the financing needs implied by Russia's trade surplus with the rest of the FSU (see Section III of EBS/93/158), it specifically reflects the outcome of a formal

1/ Several countries have established formal or informal committees for payments system reform as a means of developing broad-based involvement.

2/ There appear to be no comprehensive data on interstate interenterprise arrears between non-Russian states of the FSU. Therefore, reference can only be made to the records of the CBR, specifically to arrears ("file number 2" accounts) or credits extended by the CBR to cover arrears between Russia and other FSU states, for which a consistent, albeit partial, data series exists. Nevertheless, even these data are subject to considerable uncertainty, and anecdotal evidence suggests that arrears could be higher.

exercise conducted by the CBR to clear interstate arrears in conjunction with the 1992 payments system reform. Credit expansion by the CBR during the clearing exercise may have permitted net debtor Russian enterprises to become more or less current in their payments, suggesting in turn that the remaining interstate receivables of Rub 500 billion are actually gross arrears. 1/

The formal netting of interstate interenterprise arrears reportedly began in September 1992, following agreements reached by the CBR with all FSU state central banks, except those in the Baltic States and Azerbaijan, to process each other's enterprise claims. The clearing was originally designed to apply only to pre-July 1992 claims. However, the clearing process continued into 1993, suggesting that the cut-off date was changed. By May 1993, recorded arrears to Russian enterprises remained only for Ukraine and Turkmenistan. According to CBR data, those arrears are no longer a burden on net creditor Russian enterprises as they have been allowed to exchange the claims for claims on Russian banks backed by CBR credit.

III. Monetary Arrangements

On July 24, 1993, in an instruction that was subsequently modified, the Central Bank of Russia (CBR) announced the demonetization in Russia of pre-1993 cash rubles. This section describes the monetary arrangements in the FSU up to the time of the demonetization, and evolving monetary arrangements in its aftermath.

1. Monetary arrangements in the FSU up to July 1993 2/

At the time of the demonetization, the ruble area consisted of ten FSU states: the Baltic states, Ukraine, and the Kyrgyz Republic had each introduced national currencies. Each of these countries continued to use the ruble as legal tender, although in several countries (Azerbaijan, Belarus, Georgia and Moldova) coupons had been introduced which circulated in parallel to the ruble. Azerbaijan and Moldova had announced their intention to leave the ruble area, but without a precise timetable. Monetary arrangements in the FSU before and after the demonetization are tabulated in the appendix to EBS/93/158.

1/ At various times during 1992, net interenterprise arrears in many states were estimated to be less than half of gross arrears--in Russia, net arrears were 17 percent of gross arrears. This appears to have encouraged the authorities in most FSU states to eliminate the gross arrears by extending the much smaller amount of credit needed to cover the net arrears.

2/ For a fuller description of evolving monetary arrangements in 1992, see EBS/92/205.

a. The emergence of national currencies

Ideally, a common currency area would have simplified payments among FSU states and provided a solid basis for macroeconomic stabilization. During 1992-93, however, divergent credit policies and emerging restrictions on payments across the ruble area, combined with competitive inflation that exacerbated financing imbalances, meant that most benefits of a common currency area were not being realized.

(1) New currency regimes

Estonia was the first FSU country to leave the ruble area. It introduced a currency board arrangement on June 20, 1992 by which its currency, the kroon, is pegged to the deutsche mark at a rate of EEK 8 per DM. It was quickly followed by Latvia, which had earlier introduced a parallel currency, the Latvian ruble, in reaction to the cash shortage. The Latvian ruble became sole legal tender on July 20, 1992 in a floating regime. Latvia shifted to a permanent currency, the lats, over a four-month period ending June 28, 1993, from which time all prices were required to be posted in lats. 1/ Lithuania also introduced a parallel currency, the talonas, in May 1992. It became sole legal tender in Lithuania on October 1, 1992, also with a floating rate regime. On June 25, 1993, the talonas was replaced by the litas, over a three-week conversion period. Reflecting relatively tight monetary policies in all of the Baltic states since their currency reforms, the currencies have remained stable or even appreciated against the U.S. dollar, and inflation has been contained. The three states maintain full current account convertibility, with relatively few restrictions on capital account.

Ukraine had already introduced rationing coupons in 1991, and expanded their role in January 1992. In November 1992, the coupons were designated as a transitional national currency, the karbovanets. Since its introduction, the karbovanets has dropped in value substantially against both the U.S. dollar and the ruble, reflecting highly expansionary domestic policies. 2/ Current account convertibility was established in March 1993, but has been recently eroded by new surrender requirements at an official exchange rate that is significantly more appreciated than the market rate.

1/ There was no fixed conversion period. The Bank of Latvia will convert Latvian rubles at the original conversion rate indefinitely. Also, it is still legal to use other currencies in transactions if the parties agree to do so.

2/ During late August, 1993, the karbovanets fell to a low of Krb 15 per Russian ruble, and Krb 19,050 per U.S. dollar. This compares with November 1992, when the karbovanets was introduced at par with the ruble, and was quoted at Krb 425 per U.S. dollar.

The Kyrgyz Republic introduced the som on May 10, 1993. Following some uncertainties about its acceptance (and regarding payments arrangements with neighboring trading partners), the establishment of a floating regime has permitted full convertibility to be maintained. After its introduction, the new currency appreciated sharply, but the appreciation was subsequently reversed and in mid-September the som was trading at about 6 soms to the U.S. dollar, well below the initial exchange rate of about 4 soms to the U.S. dollar.

(2) Conversion arrangements for the new currencies

In all of the countries that left the ruble area, the conversions generally were orderly, partly reflecting the lack of any confiscatory element. Each of the Baltic states recovered three-quarters or more of recorded ruble issue. 1/ In each case, agreements were signed with Russia regarding the suspension or repatriation of the rubles, but to date, no repatriation has taken place. In Ukraine, only around 50 million rubles were recovered (around 0.1 percent of ruble issue to that state), reportedly because a devaluation of the karbovanets against the ruble (which took place immediately after conversion) was widely anticipated. The Kyrgyz Republic collected 27 percent of ruble issue and agreed to repatriate this currency; rubles that had been shipped from Russia but were not recovered during the conversion were converted into a medium-term debt to Russia (see Section III.1.d of EBS/93/158).

b. Monetary relations in the ruble area

Despite the generally favorable experiences of most states that had introduced their own currencies, the other countries in the ruble area were reluctant to leave during this period, for several reasons. First, it was recognized that the credibility of a new national currency depended on its short-term performance, and some states preferred to postpone the introduction of a new currency until the prerequisites for macroeconomic stabilization were firmly in place. Instead, interim arrangements, such as the use of coupons and parallel currencies, were introduced in some countries. Second, there existed administrative constraints on the speed at which national currencies could be designed, printed and delivered. 2/ Finally, the authorities in some countries tended to view continued access to financing and subsidized energy imports from Russia as being dependent on the nature of their monetary arrangements. In early 1993, this perception may have been strengthened by the announcement that Kazakhstan--long a

1/ It is likely, however, that these states had been important recipients of ruble migration, and that the recovery rate with respect to currency actually in circulation was lower.

2/ Many states are now quite advanced in the precautionary preparation of their own currencies, so that these impediments no longer appear significant. However, in some states the counterfeiting of new currencies has begun to create problems for the monetary authorities.

strong proponent of a reunified ruble area--would not be subject to a limit on technical credits received from the CBR.

The ten states remaining in the ruble area used a common currency issued by the CBR, 1/ but their central banks each conducted independent credit, reserve and interest rate policies. Divergences in national monetary policies, together with interstate balance of payments disequilibria of varying sizes and restrictions on payments introduced by the CBR in mid-1992, led to the emergence of a different discount on the non-cash ruble of each state vis-à-vis the Russian ruble. Widening discounts, coupled with cumbersome delays in the payments system, generated increased demand for cash rubles, the accumulation of bank deposits in Russia, and a shift into convertible currencies. 2/

The cash shortage of the first half of 1992 was eliminated in the third quarter by the printing of larger denomination notes. Since the fourth quarter of 1992, the CBR appears to have followed a policy of providing currency on a relatively unrestricted basis to other states in the ruble area. However, other states were issued 1992 bills with a denomination of less than Rub 10,000, while a growing share of the value of currency in circulation in Russia consisted of Rub 10,000 notes printed in 1992, and banknotes printed in 1993.

During the first four months of 1993, the premium on cash rubles changed little, because deficit states generally had ample access to Russian credit under the terms of the technical credit agreements negotiated for 1993. But by late April, many deficit countries were approaching their credit limits (see Section II), and the CBR notified them that payments restraints would be applied to unfunded payments. Recognizing that financing constraints would create difficulties in interstate payments, the Supreme Soviet of Russia decreed on June 30, 1993 that the CBR should begin to quote exchange rates for non-cash national rubles. Official differential exchange rates for non-cash rubles began to be announced on July 16, thereby formalizing the dual-exchange rate system for cash and non-cash rubles.

As credit limits were approached and new state credits were still being negotiated, the financing potential of cash holdings took on much more importance. While evidence remains partial, it appears that from April the demand for new cash issue increased very rapidly; in the period April-July 21, currency issue to the other members of the ruble area increased by Rub 674 billion, compared to Rub 97 billion during the previous 3 months (Table 7), and yet reportedly there was still an excess demand for currency

1/ Until mid-1992, newly issued banknotes still carried the imprint of Gosbank, even though it was by then defunct. The CBR then began to issue notes with the imprint of the "Bank of Russia."

2/ These developments are described in EBS/92/205.

in many of these states. 1/ The inflow of rubles into Russia, in payment for Russian exports, is thought to have risen significantly during this period. In countries such as Azerbaijan, Belarus, Georgia, and Moldova, in which rubles circulated in parallel with national coupons, the rapid issue of these coupons freed up additional ruble notes for purchases in Russia. 2/ Finally, on June 30, the Russian Supreme Soviet announced that the shipment of cash rubles outside the framework of government-to-government loans was to be blocked, in order to put an end to cash financing.

2. The demonetization of old rubles

On July 24, 1993 the CBR announced that pre-1993 ruble banknotes would no longer be legal tender in Russia after July 26. Russian citizens could convert up to Rub 35,000 into new rubles, within a two-week period, and deposit the balance of "old" rubles in savings deposits to be frozen for six months (and yielding a negative real rate of interest). Non-residents were permitted to convert only Rub 15,000 of old banknotes. On July 26, a Presidential decree eased the terms of the conversion, permitting citizens to exchange up to Rub 100,000 of old banknotes, and extending the deadline for conversion until end-August 1993. Moreover, Rub 10,000 banknotes issued in 1992 were permitted to be exchanged in unlimited amounts, and small denomination old notes were to be allowed as legal tender until end-August so as to facilitate small-scale transactions. 3/

The revised terms for conversion would appear to have eliminated any significant confiscatory element of the currency reform for Russian citizens. However, other FSU states still using the ruble, and to which no 1993 rubles had been issued, were not immediately in a position to emulate the Russian currency exchange. Apart from the disruptions caused in the early days after the announcement of the demonetization, the main impact of the action was therefore to delink the cash component of the money supply of the other ruble area states from that in Russia.

In response to the demonetization, states now had several options: (i) they could continue to use the old rubles as legal tender, but this ran the risk of a destabilizing inflow of banknotes from countries in which these rubles were no longer legal tender; (ii) they could shift quickly to

1/ In the last column of Table 2, cash ruble deliveries to other states (also distributed through the correspondent accounts) can be seen to grow significantly as credit becomes constrained.

2/ Moreover, some of these countries, notably Azerbaijan, are said to have experienced a substantial inward migration of rubles, which presumably augmented the pool of rubles that became available for spending in Russia when they issued coupons.

3/ In late August, the CBR announced an extension of the period during which small denomination notes up to Rub 10 would remain legal tender, to end-1993.

independent national currencies, an option that was relatively easy for countries in which parallel currencies were already in circulation; or (iii) they could choose to remain within a reconstituted ruble area and negotiate for deliveries from Russia of new banknotes in exchange for the old notes.

The Russian authorities announced that, pending agreement on a viable monetary framework with states wishing to remain in a ruble area, these states could obtain new rubles on the same terms as non-cash financing, but only within the negotiated limits on state credits. This meant that states with unused credits could borrow in cash, but that states which had already reached their financing limits would have to run a payments surplus with Russia in order to be eligible for currency deliveries.

3. Monetary arrangements in the FSU since the demonetization

Since the demonetization, four states have announced their departure from the ruble area, while five countries have signed a framework agreement with Russia and (except for Kazakhstan) supporting bilateral agreements, committing themselves to a new ruble area. ^{1/}

Georgia formally left the ruble area on August 2, 1993. Coupons had been circulating widely there since April 1993 at a steadily depreciating exchange rate; Georgia was therefore in a position to shift quickly to a completely coupon-based regime. The authorities have indicated their intention to introduce a permanent currency, the lari, by October 1, 1993. Azerbaijan withdrew all pre-1993 rubles (except for small denominations) immediately and is in the process of replacing them with its widely-used parallel currency, the manat. There is still no definite timetable, however, for adoption of the manat as sole legal tender. Since Turkmenistan reportedly had been relatively unaffected by the 1992 cash shortage, no parallel currency had been introduced. The Turkmeni authorities have indicated they will continue to use the old rubles as legal tender until a national currency, the (Turkmeni) manat, is introduced on November 1, 1993. Moldova has already replaced the larger denomination old rubles with coupons, with a view to shifting to a national currency, the leu, as soon as stabilization is assured.

Kazakhstan and Uzbekistan signed a trilateral agreement with Russia on August 6, committing the three countries to a new ruble area with monetary policy to be set by the CBR. Both countries indicated their intention to withdraw old rubles on the same terms as Russia, and Uzbekistan has begun to receive shipments of new rubles. The Uzbek Parliament had earlier (in May 1993) passed a decree relinquishing all control of monetary policy to the CBR. Prior to the demonetization, Kazakhstan had made technical preparations to introduce a national currency, and debate on its possible introduction has continued.

^{1/} See the appendix to EBS/93/158.

Following several rounds of discussion, a framework agreement on a new ruble area was signed in Moscow on September 7. The agreement was designed as an elaboration of the trilateral August agreement, but its signatories included--in addition to Kazakhstan, Russia and Uzbekistan--Armenia, Belarus and Tajikistan. The agreement envisages a reunified currency area, after a transition period during which signatories will continue to use existing currencies (or introduce new ones). They will not necessarily receive new rubles from Russia in the interim. 1/ During the transition, countries will establish their commitment to a common monetary regime by maintaining stable exchange rates between their currency and the Russian ruble. Exchange rate stability is to be achieved by the coordination of financial policies (notably the money supply, the fiscal deficit, and interest rates). All countries other than Kazakhstan have signed supporting bilateral agreements with Russia on the modalities of the coordination, and the Kazakh agreement is under discussion. The available bilateral agreements provide for harmonization or unification of a wide range of financial and non-financial policies. Full compliance with the terms of the bilateral agreements would imply de facto economic union as well as monetary union. 2/ States will apparently need parliamentary ratification of the agreements (or possibly evidence of a domestic consensus strong enough to ensure that coordinated policies can be implemented), before they enter into force.

The demonetization has spurred several countries to accelerate their plans to leave the ruble area, while others have reaffirmed their commitment to close macro-policy coordination within a revived ruble area. While this represents a potential further step in the removal of the uncertainty over monetary relations in the FSU, the effective control of monetary policy in the coming months will depend on the resolution of several issues.

First, for those countries which may now leave the ruble area more quickly than previously envisaged, it is important that appropriate macroeconomic policies accompany the shift to a national currency so that the currency earns the confidence of the population from the outset.

Second, as long as some countries continue to use the old rubles, they are at risk of an inflationary inflow of these rubles from countries where the currency has already been demonetized. Reflows could have a relatively large impact on small countries such as Armenia and Tajikistan and it is difficult to see how administrative arrangements of the type envisaged can

1/ Uzbekistan, however, has already received Rub 50 billion, although these have reportedly been stamped, and may not be legal tender outside Uzbekistan.

2/ The issue of an economic union of various states of the FSU is discussed in a companion paper, "Trade Policy Reform in the States of the Former Soviet Union" (SM/93/215).

prevent an influx of rubles. ^{1/} Hence, the demonetization could prove costly to these countries, and their intended arrangements may not be sustainable. Indeed, reports from Russia now indicate a surge of inflation, ascribed to wholesale attempts by non-residents to convert their old rubles into Russian goods before the end of the conversion period.

Third, the difficulties in monetary cooperation which fragmented the ruble area in 1992 still remain to be resolved among those countries intending to maintain a common currency regime. There are not, as yet, any mechanisms in place to ensure the consistent management of fiscal and credit policy among these countries. The proposed draft agreements on these issues outline the objectives of the participants, and practical steps to be taken, but these will require changes in the legislation of participating countries which would effectively provide the CBR with the authority to conduct monetary policy throughout the ruble area. Moreover, the existence of potential alternative choices for these countries (such as a complete shift to the rubel in Belarus, and the introduction of a national currency in Kazakhstan) may complicate ultimate agreement on an adequate degree of coordination within a reconstituted ruble area.

4. A note on seigniorage

Arrangements governing the sharing of seigniorage by countries using the ruble have been uncertain throughout 1992-93. Ruble area states receive a different assignment of seigniorage depending on whether they receive currency deliveries free of charge or in exchange for non-interest-bearing long-term liabilities to Russia. To the extent that they receive currency in return for interest-bearing liabilities, all the seigniorage accrues to Russia. The question of which countries have shared in ruble seigniorage is closely related to the question of the coverage of the Russian 1992-93 debt agreements and the terms on which Russia has agreed to grant credits during the second half of 1993.

During the first half of 1992, currency was delivered free of charge to members of the ruble area. Until May 1992, the issuing authority was the Currency Emission Department of Gosbank--the only economic entity of the U.S.S.R. to survive into 1992. At that point, the Currency Emission Department was officially taken over by the CBR, and currency issue was recorded in the same way as non-cash financing of other ruble area states. After the cash shortage was alleviated, the CBR was committed to delivering currency on demand to ruble area participants. By then, the financing system had been modified (see Section II) and the CBR had begun to record the currency deliveries to some countries in the new correspondent accounts.

^{1/} These arrangements include the use of identity cards, stamps, border controls, and other types of monitoring to ensure that only those specified as eligible are able to engage in ruble transactions.

The recent debt agreements with Russia cover, on average, three quarters of the imbalances in the 1992-93 payments accounts of these countries with Russia, if these imbalances are defined to include currency emission to other states of close to Rub 1 trillion during this period. The staff does not yet have details of the coverage of the debt agreements. If currency is not included in the debt agreements, ruble area states may be said to have received all of the seigniorage on ruble issue. To the extent that currency is included in the coverage of the debt, the seigniorage received by the other FSU states reduces to the foregone interest on the currency--because payments imbalances were not subject to interest charges in 1992. (Indeed, since the debt has been indexed to the dollar, the effective interest foregone is likely to be modest.) Since the demonetization, it appears that--at least for an interim period while longer-run ruble area arrangements are being put in place--countries that wish to receive new ruble deliveries will have to pay for them on the same terms as their balance of payments financing. During this period, therefore, all seigniorage will accrue to Russia.

As regards countries leaving the ruble area, most had signed a 1992 multilateral agreement committing themselves either to repatriate their ruble stock or recognize it as a financial liability to Russia (with interest charges to be determined). However, for rubles that are no longer legal tender, the nature of the liability is not clear.

IV. Technical Assistance in the Area of Interstate Payments

Fund technical assistance in the interstate payments area is most immediately focused on the Interstate Bank, with an IMF-coordinated workshop due to take place in October 1993, leading up to the final preparations for the opening of the ISB. However, given the Fund's role in international payments, the ultimate aim of technical assistance is to decentralize interstate payments to commercial banks using conventional payments instruments and with access to efficient exchange markets. The structural reforms needed to achieve this concept of interstate payments fall into three categories: well-coordinated reforms of national payments systems; the establishment of efficiently functioning foreign exchange markets for FSU currencies; and supporting reforms in the regulatory and supervisory framework for the payment and banking systems.

With the aim of developing national payments systems, the IMF, cooperating central banks, other international and regional organizations (the World Bank, the EBRD, the EC and the OECD) and various groups (notably the Russian-American Bankers' Forum) have been providing technical assistance in such areas as large-value transfer systems, clearing mechanisms, and accounting systems. Fund technical assistance in this area is currently focused on helping the individual FSU central banks develop and implement a strategy for further reforms of the payments system so as to allocate their limited resources in the most effective way, and the training of payments systems managers. Moreover, following the development by Fund

experts of a new chart of accounts for FSU central banks, further advice on the central bank accounting reforms will be needed, in order to support the ongoing reforms of monetary and payments arrangements. The Fund and cooperating central banks are also providing ongoing technical assistance in foreign exchange markets and operations and the supporting prudential regulations and supervisory systems, with special consideration of issues arising in connection with the development of decentralized payments arrangements based on interstate correspondent banking.

The Fund has also been active in technical assistance to improve the statistical base for analyzing interstate payments, both through the preparation of balance of payments estimates and methodology, and through the training of FSU officials. However, given that the compilation of balance of payments statistics is a new initiative for FSU states, progress in setting up collection systems has been slower than in other areas of statistics. The most complete data available relate to correspondent accounts, but, as noted in EBS/93/158, serious questions arise about the contents of these accounts and their reconciliation across countries. Moreover, since the breakdown of the Soviet system, the quality of enterprise reporting has seriously deteriorated. Hence, Fund staff have had to make rough estimates for most interstate current account and non-governmental transactions. Missions have recommended, in particular, the introduction of new enterprise surveys to measure capital flows and service transactions.

TABLE 1: FSU: Financial Position of the Russian Banking System in Interstate Payments 1/
(In billions of rubles)

	22-Sep 05:15 PM	JUL92	AUG92	SEP92	OCT92	NOV92	DEC92	JAN93	FEB93	MAR93	APR93	MAY93	JUN93
Central Bank of Russia: Ruble Correspondent Accounts 2/													
Claims on FSU correspondents		0.0	16.3	122.0	176.5	407.0	963.8	1,309.4	1,661.9	2,016.3	2,470.0	2,635.6	2,832.3
Liabilities to FSU correspondents		90.2	89.7	24.5	40.4	33.3	12.1	17.9	13.8	13.3	12.3	6.8	5.2
NET FINANCING		(90.2)	(73.4)	97.5	136.1	373.6	951.7	1,291.5	1,648.2	2,003.0	2,457.7	2,628.8	2,827.1
Central Bank of Russia: Ruble Technical Credits													
Granted		0.5	200.0	215.0	254.5	372.0	198.0	40.0	40.0	40.0	40.0	40.0	40.0
Received		69.8	70.0	66.0	65.0	50.5	50.5	0.5	0.5	0.0	0.0	40.0	40.0
NET FINANCING		(69.3)	130.0	149.0	189.5	321.5	147.5	39.5	39.5	40.0	40.0	0.0	0.0
Total Central Bank of Russia		(159.4)	56.6	246.5	325.6	695.1	1,099.2	1,331.0	1,687.7	2,043.0	2,497.7	2,628.8	2,827.1
Commercial Banks: Ruble Correspondent Accounts 3/													
Claims on FSU correspondents		0.5	1.6	2.3	4.0	25.7	32.4	54.5	49.4	59.2	103.6	165.7	128.2
Liabilities to FSU correspondents		0.8	0.0	4.9	41.5	47.4	62.7	67.1	101.8	176.9	246.7	402.3	416.6
NET FINANCING		(0.3)	1.6	(2.6)	(37.6)	(21.7)	(30.3)	(12.6)	(52.5)	(117.8)	(143.1)	(236.6)	(288.4)
Sberbank: Ruble Correspondent Accounts													
Claims on FSU correspondents		0.0	0.0	0.0	0.0	9.3	9.3	9.3	9.3	40.6	40.6	96.4	1.8
Liabilities to FSU correspondents		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.8	0.0
NET FINANCING		0.0	0.0	0.0	0.0	9.3	9.3	9.3	9.3	40.6	40.6	94.7	1.8
Total banks		(0.3)	1.6	(2.6)	(37.6)	(12.4)	(21.0)	(3.3)	(43.2)	(77.2)	(102.5)	(141.9)	(286.6)
Total Banking System		(159.8)	58.1	244.0	288.0	682.8	1,078.2	1,327.7	1,644.5	1,965.8	2,395.2	2,486.9	2,540.4
Interenterprise Ruble Arrears 4/													
Claims on FSU clients		0.0	0.0	170.9	168.2	159.7	223.4	438.0	652.1	504.8	521.7	519.0	517.8
Liabilities to FSU suppliers		0.0	0.0	39.3	63.2	136.6	60.7	48.3	78.8	32.3	26.5	23.6	23.0
NET FINANCING		0.0	0.0	131.6	105.1	23.2	162.7	389.6	573.3	472.5	495.2	495.4	494.7
Total		(159.8)	58.1	375.6	393.1	705.9	1,240.9	1,717.4	2,217.8	2,438.4	2,890.4	2,982.3	3,035.2
Memorandum item: commercial banks' share in													
Claims on FSU correspondents		49.2%	0.7%	0.7%	0.9%	3.2%	2.7%	3.9%	2.8%	2.7%	3.9%	5.6%	4.3%
Liabilities to FSU correspondents		0.5%	0.0%	5.1%	28.3%	36.1%	50.0%	78.5%	87.7%	93.0%	95.2%	89.2%	90.2%
Memorandum item: share in net ruble financing													
Commercial banks		0.2%	2.8%	-0.7%	-9.6%	-3.1%	-2.4%	-0.7%	-2.4%	-4.8%	-5.0%	-7.9%	-9.5%
Sberbank		0.0%	0.0%	0.0%	0.0%	1.3%	0.7%	0.5%	0.4%	1.7%	1.4%	3.2%	0.1%
CBR		99.8%	97.2%	65.6%	82.8%	98.5%	88.6%	77.5%	76.1%	83.8%	86.4%	88.1%	93.1%
Enterprises		0.0%	0.0%	35.0%	26.7%	3.3%	13.1%	22.7%	25.9%	19.4%	17.1%	16.6%	16.3%
Total		100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Central Bank of Russia.

1/ Based on banking system balance sheet data. Corresponding numbers in tables contained in EBS/93/158 and this supplement include non-balance sheet adjustments not shown.

2/ Includes ruble cash shipments after November 1992.

3/ Excluding Vneshekonombank, and non-resident dollar denominated deposits in commercial banks.

4/ As reported to the CBR in the context of the clearing of arrears. The CBR has allowed the enterprises to exchange their claims on their FSU clients for deposits in the banking system backed by CBR credits.

Table 2. Cumulative Interstate Ruble Turnover through the CBR Payments System between January 1 and July 28, 1993

	Outgoing Payments	Incoming Payments	Net Balance	Credit Limit	Cash Issue ^{1/}
3/24	280	671	391	784	122
3/31	274	805	531	734	123
5/5	314	1,171	857	865	274
5/12	322	1,183	861	865	274
5/19	332	1,188	856	865	--
5/26	354	1,210	856	865	435
6/2	362	1,216	854	865	435
6/16	377	1,241	864	865	613
6/23	384	1,246	862	865	613
6/30	394	1,255	861	875	613
7/14	413	1,275	862	863	854
7/21	420	1,292	872	883	854
7/28	429	1,304	875	894	854

Source: Central Bank of Russia.

^{1/} Cash shipments are not included in Net Balance. Cash figures vary slightly from those in Table 7 and Table 1 of EBS/93/158 because of differences in definition.

Table 3. FSU: Exchange Arrangements and Exchange Restrictions

(Position as of June 30, 1993) ^{1/}

	Armenia	Azerbaijan	Belarus	Estonia	Georgia	Kazakhstan	Kyrgyz Republic	Latvia	Lithuania	Moldova	Russia	Turkmenistan	Ukraine	Uzbekistan
Legal tender ^{2/}	r	o, r	o, r	o	o, r	r	o	o	o	o, r	r	r	o	r
Exchange arrangement														
<u>Main</u>														
Freely negotiated														
Ruble	X										X			
Other							X	X	X					
Official rate based on:														
Market indicators			X											X
Auctions													X	
Official peg														
Ruble		X			X	X				X		X		
Other			X	X										
<u>Other</u>														
Freely negotiated		X	X		X	X				X		X		
Auction		X	X			X				X				
Special rates														
Investment			X											
Surrender			X			X						X	X	
Exchange restrictions														
Imports			X											X
Invisibles		X	X			X				X		X	X	X
Correspondent accounts	X	X	X		X	X	X	X		X		X	X	X
Bilateral payment arrangements ^{3/}	X		X				X	X		X	X	X	X	X
Surrender requirements ^{3/}		X	X	X	X	X				X	X		X	
Capital transfers	X	X	X	X						X	X		X	X

^{1/} Exchange arrangements and restrictions may have changed significantly since events related to the demonetization of July 24, 1993; partial information available subsequent to June 30 has been reflected in the table where possible.

^{2/} r = ruble; o = own currency; o, r indicates that both the ruble and own currency circulate.

^{3/} Does not necessarily imply restrictive features.

Table 4. Identified Restrictions on Current International Transactions in FSU Countries as of June 30, 1993 ^{1/}

Country	Exchange Restrictions and Multiple Currency Practices
Armenia	<p>It would appear that there are no restrictions on payments for current international operations under Article VIII.</p> <p>The operation of the system of correspondent accounts between the central bank and the central banks of the other FSU states, by restricting transfers related to payments for current international operations, constitutes a restriction subject to the Fund's jurisdiction under Article VIII, 2(a). There may also be restrictive features involved in the operation of Armenia's bilateral clearing arrangements with Turkmenistan.</p>
Azerbaijan	<p>The following measures are maintained in accordance with Article XIV, Section 2:</p> <ol style="list-style-type: none">1. Exchange restrictions in the form of a US \$1,000 limit on foreign exchange allowance for travel abroad (tourism or business) or invisible remittances (e.g. for education, medical treatment, etc.).2. Exchange restrictions arising from the operation of the correspondent account system with other FSU countries.3. Multiple currency practices arising from the application of different implicit exchange rates for the surrender of a portion of export proceeds.
Belarus	<ol style="list-style-type: none">1. The multiple currency practice arising from the tax on convertible currency export earnings. This multiple currency practice is subject to approval under Article VIII, Section 3.2. The multiple currency practice arising from the spread between the free market rate and the investment/surrender rate. This multiple currency practice was maintained under Article XIV, Section 2. It was abolished end-July 1993, with the exception of export receipts from contracts signed before August 1993. The spread on the latter is to be phased out by end-1993.3. The multiple currency practice arising from the tax on the repatriation of profits by nonresidents. This multiple currency practice is maintained under Article XIV, Section 2.4. An exchange restriction arising from the approval requirement for payments for certain categories of imports. This restriction is maintained under Article XIV, Section 2.5. Exchange restrictions arising from the approval requirements for the availability of foreign exchange for current international payments and transfers for certain invisibles. This restriction is maintained under Article XIV, Section 2.6. An exchange restriction in the form of specific limits on the availability of foreign exchange for tourism abroad. This restriction is maintained under Article XIV, Section 2.
Estonia	<p>Payments agreements have been signed with the majority of the states of the FSU. None of them give rise to an exchange restriction.</p>
Georgia	<p>The only exchange restrictions identified are those arising from the delays in settling balances accumulated in the correspondent accounts with other FSU countries, and these restrictions are maintained under Article XIV.</p>
Kazakhstan	<p>The staff have identified the following exchange measures maintained under Article XIV, Section 2:</p> <ol style="list-style-type: none">1. The multiple currency practices arising from the spread between the official exchange rate and the auction rate, the banks' rate, and that applied at foreign exchange bureaus.2. The multiple currency practices arising from taxes on convertible currency export earnings.3. An exchange restriction arising from the limitation on tourism travel allowances.4. An exchange restriction arising from the failure to settle balances within a 90-day period from the correspondent account arrangement with Russia.

Table 4 (concluded). Identified Restrictions on Current International Transactions in FSU Countries as of June 30, 1993 ^{1/}

Country	Exchange Restrictions and Multiple Currency Practices
Kyrgyz Republic	--
Latvia	--
Lithuania	Debts vis-à-vis other FSU countries that were accumulated before Lithuania became a member of the Fund give rise to exchange restrictions, which are covered under the transitional arrangements of Article XIV.
Moldova	<p>Exchange measures maintained under Article XIV, Section 2:</p> <ol style="list-style-type: none"> 1. The multiple currency practices that arise from the spread--which is not confined to 2 percent--between the Moscow Interbank Foreign Currency Exchange rate set by the government for the surrender requirement and for most valuation purposes and the market rate for transactions between commercial banks, individuals purchase of travel allowances, and purchase of foreign exchange from tourists. 2. Exchange restrictions arising under the operation of the correspondent accounts with other FSU countries. 3. Exchange restrictions that arise from the limitations on invisible payments, in particular limitations on tourist and business travel allowances. 4. External payments arrears by importers resulting from restrictions on the availability of foreign exchange at the MICEX rate. 5. Exchange restrictions that arise from limitations on imports exceeding US \$20,000, for which an advance payment of more than 30 percent is required.
Russia	<p>Exchange measures subject to Fund jurisdiction:</p> <ol style="list-style-type: none"> 1. Exchange restriction in the form of limitations on the transfer by nonresidents of balances held in N accounts that are the proceeds from current international payments by resident (including payments for services and sales of merchandise performed by resident intermediaries). This restriction is maintained under Article XIV. 2. Exchange restrictions arising from the delays in settling outstanding net balances under inoperative bilateral payments agreements with Bulgaria, the former Czech and Slovak Federal Republic, Egypt, Poland, and Syria. These restrictions are maintained under Article XIV. 3. Exchange restrictions in the form of restrictions on payments to the Federal Republic of Yugoslavia (Serbia/Montenegro) applied in accordance with United Nations Security Council resolutions. These restrictions have been notified under Decision No. 144-(52/51).
Tajikistan	...
Turkmenistan	...
Ukraine	<ol style="list-style-type: none"> 1. Exchange restrictions in the form of limitations on the purchase of foreign exchange by individuals for current international transactions and by firms for business travel abroad. 2. Exchange restrictions on the transferability of balances on correspondence accounts with other FSU countries. 3. As of August 16, 1993, 50 percent of foreign exchange earnings were required to be surrendered at a fixed exchange rate different from that prevailing in the auction market. This constitutes a multiple currency practice. The measure, when introduced, was envisaged as temporary.
Uzbekistan	<ol style="list-style-type: none"> 1. Exchange restrictions arising from the centralized allocation of foreign exchange for imports. 2. Exchange restrictions in the form of limitations on purchase of foreign exchange for travel abroad. 3. Exchange restrictions arising from delays in settling balances accumulated in the correspondent accounts with other FSU countries.

^{1/} Restrictions on international transactions may have changed significantly following the ruble demonetization of July 24, 1993. These are noted in a few cases, where information is available.

Table 5. Cross-Border Payment Arrangements in FSU Countries as of June 30, 1993 ^{1/}

Country	Republics with which Central Bank Maintains Correspondent Accounts	Commercial Bank Operations Through Correspondent Account	Foreign Exchange Markets
Armenia	All FSU republics. Technical credits agreed with Russia and Ukraine.	No limitations. Accounts have been opened with other FSU countries.	12 banks are licensed to trade foreign exchange in a liberal regulatory environment. The exchange rate is freely determined. Promstroibank has been particularly active.
Azerbaijan	All FSU republics.	No limitations. Several banks have opened accounts.	12 banks trade in foreign exchange with International Bank being the most active. Auctions of foreign exchange commenced in April 1993. Banks are required to have closed positions at all times and do not trade with each other.
Belarus	All FSU republics. Technical credits agreed with Russia. Accounts have been blocked by Russia, in that payments could only be made when payments were received from Russia.	Banks (27) are licensed to open correspondent accounts with other FSU states and 13 with all countries.	FSU currencies purchased through commercial banks in the auctions can be used only for FSU imports. There is an active parallel exchange market.
Estonia	All FSU republics.	In late 1992 commercial banks were permitted to open correspondent accounts with their counterparts in Russia.	There is not yet a well developed interbank market in foreign exchange, although banks are free to transact between themselves. The auction market set up in late 1991 continues to function and serves primarily as a forum for trading rubles on account for U.S. dollars, deutsche mark, and kroon.
Georgia	All FSU republics. Technical credit limits established with Lithuania.	No limitations.	The foreign exchange market is not well developed.
Kazakhstan	All FSU republics.	Since January 1993, banks have been allowed to open correspondent accounts with banks and central banks in other republics. In late July 26 banks had 82 such accounts. 26 FSU (including Russia) banks also have 82 such accounts in Kazakhstan.	The foreign exchange market is not well developed. While 10 banks are considered to be active in the market the volume of trading between them is small. Forward transactions are virtually non-existent. A foreign currency auction is scheduled weekly, but has never enjoyed much volume and occasionally is canceled for lack of foreign exchange offers.
Kyrgyz Republic	All FSU republics. However, currently (late July) the account with Uzbekistan is not operating.	No limitations. Ten Kyrgyz banks are operating 24 correspondent accounts with banks in Russia (19), Kazakhstan, Ukraine and Belarus. In addition commercial banks from other countries have opened correspondent accounts in the Kyrgyz Republic.	Banks licensed to trade in foreign exchange can do so freely at freely determined exchange rates. There are weekly US dollar auctions since the introduction of the national currency.
Latvia	All FSU republics.	No limitations.	Latvia is evolving as a money center for the FSU, e.g., several banks with a foreign exchange license are actively brokering transactions between parties in other FSU republics. The interbank market is beginning to develop. An on-line domestic information system on foreign exchange transactions is connecting all major financial institutions. the 14 major commercial banks have established a netting system in foreign currencies on the basis of correspondent accounts, and credit margins have been agreed between participating banks.

Table 5 (continued). Cross-Border Payment Arrangements in FSU Countries as of June 30, 1993 ^{1/}

Country	Republics with which Central Bank Maintains Correspondent Accounts	Commercial Bank Operations Through Correspondent Account	Foreign Exchange Markets
Lithuania	All FSU republics.	No limitations.	18 banks are licensed to conduct foreign exchange operations. Banks mainly broker foreign exchange transactions.
Moldova	All FSU republics.	Correspondent accounts have been opened with banks in other FSU countries.	Limited foreign exchange auctions exist. The interbank foreign exchange market is virtually non-existent. Non cash rubles are traded for Russian rubles in an informal market. Cash Russian rubles started to trade at bureaus of exchange in August 1993.
Russia	<p>The CBR maintains <u>ruble</u> correspondent accounts (C/As) with all FSU central banks, except Estonia.</p> <p>As of May 1993, the CBR had extended overdraft credits on the ruble C/As of all states, except Estonia and Lithuania. These overdrafts (O/Ds) were capped, except in the case of Kazakhstan. When caps were reached, payments to Russia were accepted only to the extent that they are balanced by payments from Russia.</p> <p>Overdraft credit extended by the CBR has mainly been used for the financing of state trade. Other interstate ruble payments were intermediated by commercial banks.</p> <p>As agreed under the STF for Russia, outstanding O/D credits are to be rolled over into loans from the Russian government.</p>	<p>Russian commercial banks with a general foreign exchange license (69 banks as of 12/31/92) could in principle hold <u>ruble</u> correspondent accounts in any republic. However, since August 6, 1992, Russian banks were not allowed by the CBR to open <u>new</u> ruble C/As in most countries of the FSU. The exceptions were Estonia, Latvia, Lithuania since October 1, 1992, Ukraine since November 19, 1992, the Kyrgyz Republic since May 15, 1993. Authorized Russian banks were allowed unlimited correspondent banking rights with the FSU as of July 16, 1993. Accounting is done according to exchange rates of the ruble with the currencies, ruble or otherwise, of each FSU state published by the CBR based on market conditions.</p> <p>Interstate obligations intermediated by commercial banks may also be settled in convertible currencies. There are no separate data on such intermediation.</p>	<p>The frequency of the dollar/ruble auctions of the Moscow Interbank Foreign Currency Exchange (MICEX) increased from two to five days a week in June 1993. Auctions are also held in St. Petersburg, Rostov, Yekaterinburg, Novosibirsk, and Vladivostok in (depending on the location) U.S. dollars, deutsche mark, yen, and finnish markka. In Moscow, auction trading in Ukrainian Karbovanets has been erratic. There are no organized markets for the exchange of non-cash rubles of other FSU states.</p> <p>The requirement to surrender foreign exchange to the CBR was eliminated in June. Remaining is the requirement to sell 50 percent of earnings in the domestic foreign exchange market within 14 days of repatriation. Certain regions/enterprises are exempted.</p> <p>The CBR began to enforce open position limits for banks dealing in foreign exchange in May 1993. There are no data on interbank turnover. However, for Moscow banks, it is estimated to be 1/3 of the auction turnover. The exposure limits apply to the national currencies of the FSU as they emerged after July 24, 1993.</p> <p>Restrictions on nonresidents to sell foreign exchange directly on the Russian currency market were lifted on July 15, 1993. Restrictions to buy foreign exchange for current account transactions are to be lifted on September 1, 1993.</p> <p>The CBR intervenes on MICEX to smooth out movements in the exchange rate.</p>

Table 5 (concluded). Cross-Border Payment Arrangements in FSU Countries as of June 30, 1993 ^{1/}

Country	Republics with which Central Bank Maintains Correspondent Accounts	Commercial Bank Operations Through Correspondent Account	Foreign Exchange Markets
Tajikistan	...	...	...
Turkmenistan	All FSU republics. The account with Russia has been blocked because of the build up of a debit balance put at rub 196 billion. Turkmenistan did not block accounts with other states in spite of overdrafts exceeding preassigned technical limits. Claims on other republics are estimated at rub 268 billion. Practically all payments and receipts in rubles pass through the central bank's accounts.	Three banks have been granted a license to deal in foreign exchange and have been authorized to open correspondent accounts with banks in other states of the FSU. Two commercial banks, which manage the foreign exchange reserves have experience in international payments procedures.	There is no formal foreign exchange market. Enterprises have rights to retain certain foreign exchange earnings or to sell them to other enterprises. Import payments can be made freely with an enterprise's retained foreign exchange, or foreign exchange acquired from another enterprise. A new foreign exchange law has been drafted.
Ukraine	All FSU republics. Ukraine has a large trade deficit with Russia and Russia from time to time has blocked the account, but in each case technical credits have been provided to unblock the account.	Commercial banks are permitted to open correspondent accounts with their counterparts in other FSU republics and many have done so. So far, only four Russian banks have opened correspondent accounts in Ukraine. There are no restrictions placed on those accounts other than the exclusion to purchase energy products from Russia. The larger banks in Ukraine and several smaller ones appear to have the capacity to operate a system of international correspondent accounts. Several banks are now being trained to participate in SWIFT.	The foreign exchange market is just beginning to develop. Until recently, taxes on export revenues, a lack of repatriation requirements and restrictions on interbank foreign exchange transactions combined greatly hindered the development of the foreign exchange market. However, the recently enacted Foreign Exchange Decree lays the basis for the development of an interbank foreign exchange market. There has been a weekly auction for U.S. dollars since fall of 1992. More recently, weekly deutsche mark, ruble and other CIS currency auctions have been started. The volume of trading has grown significantly.
Uzbekistan	All FSU republics. Payments with the Baltic republics and the Ukraine have been suspended due to the introduction of national currencies.	Since October 1992 the Central Bank forces banks to centralize all interstate payments through the CBU network by decree. The technical and institutional capacity of a few private banks may be sufficient to operate a system of correspondent accounts for international payments. Some of them were active in these operations until October 1992.	The foreign exchange market is almost non-existent. The National Bank for Foreign Economic Activity holds the official foreign exchange reserves, and the attempts by the CBU to create a foreign exchange market have been unsuccessful so far. Foreign exchange is allocated by administrative procedures (application and approval by the Cabinet of Ministers).

^{1/} Restrictions on international transactions may have changed significantly following the ruble demonetization of July 24, 1993. These are noted in a few cases, where information is available.

Table 6. FSU: Status of Progress in Payments Systems Modernization, July 1993 1/

	Armenia	Azerbaijan	Belarus	Estonia	Georgia	Kazakhstan	Kyrgyz Republic
<u>Central bank payment capabilities</u>							
1. Organization of payments at central bank	-	-	+	-	-	+	+
2. National Payments Council	-	-	+	-	-	+	+
3. Role of central bank in payments	-	-	+	-	-	+	+
4. Regulation/oversight	-	-	-	-	-	-	-
5. Practice and policy in risk management	-	-	+	-	-	-	+
6. Strategic planning for payments reform	-	-	-	-	-	-	-
<u>Specific payments projects topics</u>							
1. Central bank computer centers	+	-	+	+	+	-	+
2. Improvements in liquidity management	-	-	+	-	-	+	+
3. Large-value transfer system	-	-	-	-	-	-	-
4. Float analysis and reduction	+	-	+	+	+	-	+
5. Telecommunications	-	-	-	-	+	+	-
6. Clearing houses	+	-	-	-	-	-	-
7. Intrabank networks	-	-	+	-	-	-	+
8. Retail payments	-	-	-	-	-	-	-
9. New payments instruments	-	-	-	-	-	-	-
10. Securities clearing and settlement	-	-	-	+	-	-	-
11. Training	+	-	+	-	-	-	-

Source: MAE technical advisory reports.

1/ + = some significant progress in payments work in this area; - = only minor progress in this area.

(Continued)

Table 6 (concluded).

FSU: Status of Progress in Payments System Modernization, July 1993 1/

	Latvia	Lithuania	Moldova	Russia	Turkmenistan	Ukraine	Uzbekistan
	2/						
<u>Central bank payment capabilities</u>							
1. Organization of payments at central bank	-	+	+	+	-	+	-
2. National Payments Council	-	-	-	+	-	-	-
3. Role of central bank in payments	-	+	+	+	-	+	-
4. Regulation/oversight	-	-	-	+	-	-	-
5. Practice and policy in risk management	-	-	+	+	-	-	-
6. Strategic planning for payments reform	-	+	-	+	-	+	-
<u>Specific payments projects topics</u>							
1. Central bank computer centers	+	+	+	+	+	+	-
2. Improvements in liquidity management	+	-	+	-	-	-	-
3. Large-value transfer system	+	-	-	+	-	+	-
4. Float analysis and reduction	-	-	+	+	-	-	-
5. Telecommunications	-	-	-	+	+	-	-
6. Clearing houses	-	-	-	+	-	+	-
7. Intrabank networks	+	-	+	+	-	+	-
8. Retail payments	+	+	-	+	-	-	-
9. New payments instruments	-	-	-	+	-	-	-
10. Securities clearing and settlement	-	-	-	+	-	-	-
11. Training	-	-	-	+	-	-	-

Source: MAE technical advisory reports.

1/ + = some significant progress in payments work in this area; - = only minor progress in this area.

2/ Introducing giro system.

Table 7. FSU: Stocks of Ruble Currency Issued, 1991-93 1/

	1991 Dec.	1992 March	1992 June	1992 Sept.	1992 Dec.	1993 March	1993 June	1993 July	1993 Latest Sept. 8
(In billions of rubles)									
Total	271	370	608	1,272	2,421	3,635	6,635	...	...
Russia	173	250	453	1,010	1,890	2,994	5,523	...	...
Other ruble area	98	120	155	254	491	601	1,041	1,262	1,989
of which:									
Armenia	5	6	7	11	19	19	43	43	71
Azerbaijan	5	6	7	14	22	22	28	28	28
Belarus	5	6	10	15	38	38	89	109	125
Estonia	3	3	3	*	*	*	*	*	*
Georgia	7	7	10	14	28	28	28	28	*
Kazakhstan	15	21	32	77	156	205	440	541	801
Kyrgyzstan	3	3	5	10	18	31	*	*	*
Latvia	2	2	2	*	*	*	*	*	*
Lithuania	3	3	3	*	*	*	*	*	*
Moldova	2	3	3	5	11	11	20	20	20
Tajikistan	2	3	3	8	15	15	32	42	76
Turkmenistan	4	7	12	20	65	67	118	138	301
Ukraine	31	32	32	32	*	*	*	*	*
Uzbekistan	12	18	26	48	119	165	243	313	567
Rubles outside the ruble area			--	8	40	40	71	71	99
(Percent of total)									
Total	100	100	100	100	100	100	100	...	...
Russia	64	68	75	79	78	82	83	...	...
Other ruble area	36	32	25	20	20	17	16	...	...
of which:									
Armenia	2	2	1	1	1	1	1	...	...
Azerbaijan	2	2	1	1	1	1	0	...	...
Belarus	2	2	2	1	2	1	1	...	...
Estonia	1	1	*	*	*	*	*	*	*
Georgia	3	2	2	1	1	1	0	...	*
Kazakhstan	6	6	5	6	6	6	7	...	...
Kyrgyzstan	1	1	1	1	1	1	*	*	*
Latvia	1	1	*	*	*	*	*	*	*
Lithuania	1	1	*	*	*	*	*	*	*
Moldova	1	1	0	0	0	0	0	...	...
Tajikistan	1	1	0	1	1	0	0	...	...
Turkmenistan	2	2	2	2	3	2	2	...	...
Ukraine	11	9	5	3	*	*	*	*	*
Uzbekistan	4	5	4	4	5	5	4	...	...
Rubles outside the ruble area			--	1	2	1	1	...	...
(Percent change in period) 2/									
Total	...	36	64	109	90	50	83	...	...
Russia	...	45	81	123	87	58	84	...	...
Other FSU	...	22	29	64	93	22	73	21	91
of which:									
Armenia	...	20	24	59	73	0	126	0	64
Azerbaijan	...	14	24	90	57	0	27	0	1
Belarus	...	25	58	56	153	0	134	22	41
Estonia	...	7	9	*	*	*	*	*	*
Georgia	...	7	41	34	100	0	0	0	*
Kazakhstan	...	41	48	143	103	31	115	23	82
Kyrgyzstan	...	28	50	92	80	72	*	*	*
Latvia	...	16	0	*	*	*	*	*	*
Lithuania	...	3	0	*	*	*	*	*	*
Moldova	...	16	0	95	120	0	82	0	2
Tajikistan	...	29	0	189	88	0	113	31	136
Turkmenistan	...	60	74	69	225	3	76	17	155
Ukraine	...	4	0	0	*	*	*	*	*
Uzbekistan	...	52	44	83	148	39	47	29	133
Rubles outside the ruble area				...	400	0	78	0	39

Source: Russian authorities; and staff estimates.

1/ Stocks of rubles delivered to states which remain in the ruble area. An asterisk (*) denotes a country which has left the ruble area. Its rubles are assumed not to have migrated to other FSU states. This has been confirmed for the Baltic states, but not for Ukraine or Kyrgyzstan. Figures in the table are rounded, but the derived ratios are based on the unrounded data. The data are preliminary and subject to revision.

2/ In July and September 1993, changes are shown compared with June 1993.

