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Abstract

This article draws a historical perspective on clearing systems and payment unions examining their manifestations from simple barter systems to EMU. The introduction of commensurability, transferability and convertibility and their cost-saving effects are explained in formal terms and by means of numerical illustration.

The prerequisites for introducing convertibility through clearing unions are discussed generally and in terms of the CIS. Based on the experiences of the Interstate Bank and the Finnish-Soviet clearing system, the author concludes that an arrangement similar to the European Payment Union would not, for a number of reasons, provide a viable solution for CIS clearing arrangements. Rather, the rapidly developing commercial banking sector and multi-CIS financial-industrial groups potentially have the capability to adequately accommodate the problem as long as members pursue sound monetary and foreign exchange rate policies.

Keywords: clearing, payment union, CIS

"...Now the Participant recognized that this was the beginning of the exorcism of the Pentagon, yes the papers had made much of the permit requested by a hippie leader named Abbie Hoffman to encircle the Pentagon with twelve hundred men in order to form a ring of exorcism sufficiently powerful to raise the Pentagon 300 feet. In the air the Pentagon would then, went the presumption, turn orange and vibrate until all evil emissions had fled this levitation. At that point the war in Vietnam would end.

The General Services Administrator who ruled on the permit consented to let an attempt be made to raise the building ten feet, but he could not go so far as to allow the encirclement. Of course, exorcism without encirclement was like culinary art without a fire--no one could properly expect a meal."

extract from Norman Mailer's "Armies of the Night".

1 Introduction

Mailer's comment on absurd pragmatism in the face of pragmatic absurdity applies well to current discussions on devising clearing or payment unions for promotion of multilateral trade and convertibility. To capture the current dilemma, this study reviews experiences with intergovernmental clearing, clearing unions and payment unions, and then considers their viability as a means in promoting international trade among economies in transition. In particular it asks, "Can the experiences derived from the Interstate Bank experience and from the Finnish-Soviet intergovernmental bilateral clearing system be applied to the creation of viable forms of intergovernmental payment arrangements in order to revive trade among the CIS republics?"

Despite the failure of the ISB, the hope for such a system still seems to be very much alive in academic discussion and even as part of certain political agenda. On 14 September 1995, for example, President Yeltsin signed a decree on the political and economic strategy of Russia. One of its main goals was the formation of a payments union among the CIS republics. The objectives of the payment union include "the establishment of common rules of organization of national foreign exchange markets, using market exchange rates determined by supply and demand, achievement of mutual convertibility of national currencies and using the Russian rouble as a reserve currency". Such economic cooperation has a larger geopolitical dimension as it seeks "agreement on the scale of economic, political and military cooperation". Progress has, to say the least, been modest, due to the lack of confidence in the rouble and Russia's unwillingness to become the principal creditor in the payment union (Rossiiskaya Gazeta 23 September 1995; Government of the Russian Federation 1995, p. 35; Afanasev 1995, p. 82).

In the late 1980s interest emerged about using a payment union similar to the European Payment Union to facilitate trade among the Central Eastern European Countries (CEEC) or between the CEECs and the Council of Independent States (CIS). While opinions about the applicability of such a system remained divided, developments supported the view that conditions had changed so much since the postwar years that such arrangements might no longer be helpful or even feasible (see eg Rosati 1992, pp. 76-81).

Intergovernmental payment arrangements have also been a central topic in the discussion papers of the Centre for Economic Policy Research (CEPR) and Centre of European Policy Studies (CEPS). In addition, the IMF has familiarity with payment unions in most parts of the world.

The remarkable attempt to establish an Interstate Bank (ISB) housed with the Central Bank of Russia (CBR) is rather well documented. Excellent historical source material includes the reports of Daniel Gros, who headed the Technical Assistance for CIS (TACIS)-financed 'Advisory Group on Interstate Economic Relations' (AGIR). As it becomes clear to Gros that the IBS is not going to work, his enthusiasm for the project wanes and his commentary turns more critical.

A less-cited, but relevant, inter govern-mental arrangement is the Finnish-Soviet clearing system. As a bilateral arrangement, it had narrower objectives than a payment union, but many of the experiences are quite relevant to the present discussion. A number of articles and studies have been published in English, eg Oblath and Pete, Holopainen (1982, 1983), Kajaste (1993), Sutela (1991, 1992) and Laurila (1995). In addition, the author of this study was fortunate to be personally involved in the day-to-day operations of the Finnish-Soviet clearing payment system for a number of years.

Once the majority of CIS republics had introduced their own currencies, the feasibility and usefulness of a payment union was taken up in the West (Eichengreen 1993, Steinherr - Gross 1995, etc.) and in Russia (Shagalov 1995, Kirichenko 1995, Afanasev 1995, Illarionov 1992, Yevstigneev 1994 and others). In particular, the European Payment Union (EPU) seems a nearly inexhaustible source of inspiration to the proponents of payment unions as it offers a general cure for revival of depressed international trade, ie exactly the kind of message CIS planners want to hear.

This study does not follow the traditional approach of describing the mechanisms of the EPU, CMEA and other payment unions in detail.[1] In this study, the goal is simply to produce a unifying description from which applications can be derived. Clearing arrangements are put into an evolutionary context starting from technically simple forms.

It is important to keep in mind that clearing systems may serve a variety of objectives. Further, clearing is one of the most widely used techniques to minimise transaction costs while assuring adequate precautionary funds necessary to maintain liquidity and solvency. Yet, while clearing arrangements are widely used in banking and various branches of industry, this study confines itself to intergovernmental clearing arrangements and payment unions which take advantage of clearing techniques. Such arrangements are characterized by public sector intervention in an effort to expedite multilateralization of trade and introduce convertibility to local currencies.

The proponents of intergovernmental payment arrangements see them as means to help achieve the above-mentioned objectives or to mitigate harmful social effects during economic transition.[2]

Opponents[3] see such arrangements as "halfway houses" burdened with the risk that they may impede the introduction of multilateralisation and convertibility. Why should countries be satisfied with such a stop-gap solution, opponents argue (eg Eichengreen 1993, pp. 53-54, and Schmieding 1992), when their best hope is to move towards these objectives by letting free markets develop and minimizing governmental intervention?

Both sides, however, concur on the importance of liberalization and stabilization of prices and the inevitability of the structural adjustment process in the economies of prospective trading partners.

This study is organized as follows: in Section 2 various categories of intergovernmental clearing are considered in a historical context and in an evolutionary continuum ranked on the basis of complexity and sophistication. In Section 3, the concepts of clearing and payment unions are given in general terms according to ideas of Bofinger (1990). The Finnish-Soviet clearing system is referred to where relevant. In Section 4, the cases of the EPU, Interstate Bank, the Finnish-Soviet case and the 'zero' alternative of applying no intergovernmental clearing arrangements are presented and further analysed. Based on the

[1] Good descriptions about EPU and its evolution is given by Kaplan and Schleiminger (1989), Bofinger (1991) or, for example, van Selm-Wagener (1995). The Finnish experience is exposed by Oblath and Pete, Holopainen (1982, 1983), Kajaste (1993), Sutela (1991, 1992) and mostly recently Laurila (1995).

[2] Havrylyshyn and Williamson (1991), Dornbush (1992), Gros (1992), and Bofinger and Gros (1992) and Shagalov (1995) all consider the EPU as an appropriate model for revival of trade among the former Soviet republics.

[3] For example (Eichengreen 1993, pp. 53-54, Schmieding 1992).

results, the viability of EPU-type payment arrangement in the CIS context is discussed in Section 5.

2 Historical perspectives

2.1 The life-cycle of payment arrangements

From a historical view, clearing systems are a response to crises in international trade. After WWI and the Great Depression, clearing systems were introduced to maintain international trade and save scarce convertible currency reserves for purchases of merchandises not available through clearing. The first clearing system was introduced by Switzerland in 1931. Finland made its first payment agreement with Estonia in 1933. After WWII, European foreign trade was based on a network of hundreds of intergovernmental bilateral clearing arrangements. Finland alone conducted 51 per cent of its total foreign trade on clearing basis in 1951 (Bäckman 1954, p. 47).

If we accept the view that the ultimate goal of trade systems is deregulated, nondiscriminatory trade and that the ultimate goal of payment systems is full convertibility between the currencies of trade partners (ultimately implying a common currency), the following historical continuum can be sketched (Jackson-Linotte-Zahradnik 1993, p.8):

Bilateral clearing systems make two nonconvertible currencies commensurate via a third clearing currency, usually applied as a unit of account. Multilateral clearing systems combine a set of bilateral clearing arrangements and make the currencies of participants transferable. Payment unions are created by supplementing the multilateral clearing with external or internal sources of financing. Thus in Table 1:

1. Bilateral clearing arrangements help support trade and economize scarce convertible reserves. The partners' national currencies are made commensurate through a unit of clearing account;

2. Multilateral clearing unions are organized by lumping together bilateral clearings and making the claims of partners transferable. The further multilateralization of trade also benefits partners and solves certain aspects of balancing. At given costs, a higher level of trade, and thereby accelerated rate of economic growth, will be achieved;

3. Multilateral payment unions represent multilateral clearing unions into which financing, typically from an outside source, is injected (eg aid under the Marshall Plan in the EPU's case) to contribute the structural adjustment of member economies in order to gain sustainable multilateral trade with convertible currencies. The volume of intra-European trade doubled between 1950-1958. The consequent growth in production helped secure high levels of employment and stabilized prices;

4. Multilateral monetary union (eg EMU) represents a further step in minimizing transaction costs and the costs of maintaining foreign exchange reserves by replacing the convertibility between members with a common currency. The monetary union may assume a form of union in which the exchange rates are fixed between members and currencies are fully convertible or, in which there is a single currency for all members.

Multilateral monetary union, although representing the logical fulfilment of the development of trade and payment frameworks, falls outside the scope of this study. It is only included in the table because it shares the objective of freeing funds to earn higher returns.

To a certain extent, the initial obstacles and challenges were shared by all these types of arrangements: low levels of trade based mostly on bilateral barter, inconvertibility of currencies, shortages of convertible currency reserves, absence of banking services to transfer payments and excessively controlled international cooperation during or after major crises (such as war or economic depression).

Three terms should be defined here at this point: commensurability (in bilateral clearing arrangements), transferability (making the clearing units of account transferable) and convertibility. Introduction of convertibility was an instrument for the EPU to make the member countries' currencies convertible.

Table 1. **Various types of intergovernmental bilateral and multilateral clearing arrangements and payment unions**

State of trade	Payment system function	Examples
Little or no trade	**Nonconvertibility** or restricted convertibility	Barter
Bilateral intergovernmental trade systems (governmental trading increases trade, licenses used to preserve balance)	Bilateral intergovernmental payment systems, **commensurability** of nonconvertible currencies	Bilateral intergovernmental clearing
Increased trade achieved through multilateral union, financing with deregulation, adequate rules and institutional setup	Clearing union or (multilateral without financing) or payment union (with financing) **transferability**, watchdog organs to monitor convertibility	EPU, CMEA
Multilateral trade, government intervention minimized	**Convertibility**, international fora for trade and financial cooperation	
Extended home markets for members	**Common currency**, minimizing costs of liquidity holdings and transactions	EMU

Note: even if these "evolutionary steps" lead from the technically simple to more sophisticated and administratively demanding systems, no historical determinism or causality relations should be implied.

Convertibility implies that means of payment can be transferred freely to any entity in any country in exchange for goods and services, financial assets or another means of payment (Kenen, 252-253).

Transferability in the context of payments system prevails when a member country can use its bilateral credit to offset debits in its commercial relations with any other member country (eg Kaplan Schleiminger 1989, p. 24). By definition, transferability requires a multilateral payment system.

In a set of bilateral systems among members with nonconvertible currencies, the unit of account introduces **commensurability** between each two nonconvertible currencies separately.

One might then ask, what prevents countries from jumping directly to systems of convertible trade instead of bothering with special arrangements first? For example, while most consider the EPU as a promoter of convertibility, some critics ask why is that any better than convertibility implemented by devaluing the overvalued European currencies against the US dollar. In fact, there might even be cases where clearing actually impeded the introduction of freely convertible currencies. It is further valid to consider whether convertible currency trade and payments can exist side-by-side with a restrictive payment system and to what extent they are, or can be considered, as supplementary or complementary arrangements.

The difficulties associated with the supplementary or parallel use of convertible currency trade concomitantly with clearing were also visible in the Finnish-Soviet case in the management of clearing; among other things running a separate foreign exchange control system was necessary. Therefore, a recurring question asked by both Finns and Soviets during the time of Finnish-Soviet bilateral trade was whether a move from bilateral clearing to convertible currency trade between the two countries might be preferable. In the Finnish-Soviet case, clearing was eventually replaced by use of convertible currencies, the latter offering greater commercial manoeuvrability than what was allowed under rigid rules of clearing trade.

Chart 1. **Primitive barter: goods for goods (no money exchanged)**

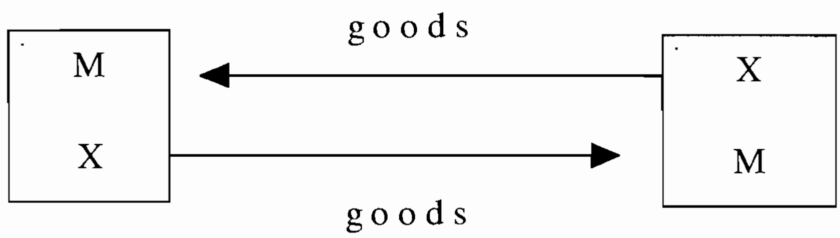
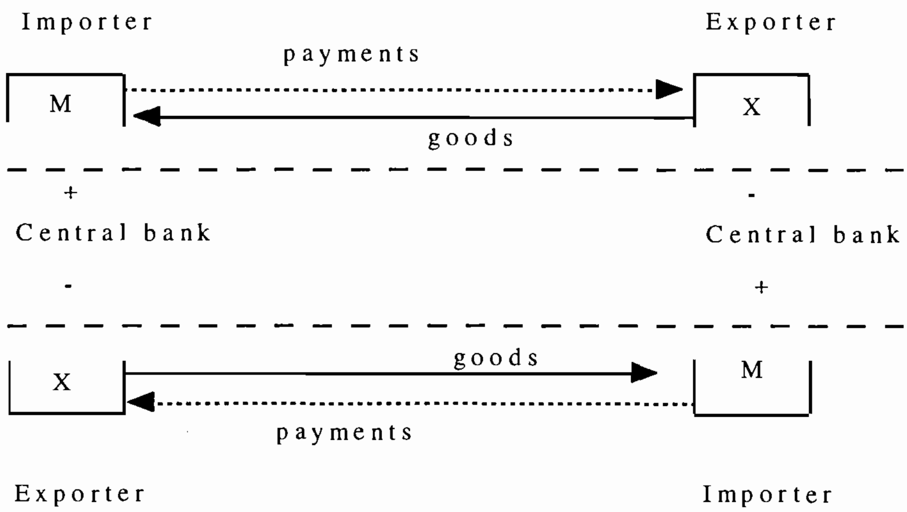


Chart 2. **Bilateral clearing systems**



Note: In bilateral clearing systems, the issue of payments enters the picture. They appear here as units of account, measures of value and preservers of value, particularly in payment unions and clearing systems that allow overdrafts. While they are not instruments of payment, they can be concerted into naitonla currencies. In clearing, the unit of account also serves the important purpose of making the nonconvertible currencies commensurate.

3 Clearing as a system

A **trade system** applies import and export restrictions. It typically consists of agreed trade negotiations and monitoring (usually a monitoring group or authority authorizing export and import licences a priori). The objective of this activity is to encourage a certain level or increase of trade. Usually the maintenance of the trade balance is a matter of concern is this context, because any imbalance inevitably implies an extension of credit to the trading counterpart. The clearing trade system is related to barter, counter trade, compensation trade, escrow accounts etc. in that all can be operated on a convertible currency basis. Generally such systems are the result of economic crises or a signal that free market forces cannot be counted on to balance the trade between the parties.

A **payment system** typically consists of opening of accounts between two (bilateral) or more (multilateral) banks. In case of intergovernmental clearing, the account keepers are the central banks or government-owned foreign trade banks. The government, usually represented by treasury or the ministry of finance, is the account holder. The conditions of accounts usually define methods of settlements of imbalances and give ceilings for claims which can be maintained on these accounts. Ideally, such ceilings only allow "technical credits", ie the allowance for net accumulation of claims created by the fact that it takes time to transfer payments from one account to another.

3.1 Trading system

The simplest and most primitive form of exchange is barter, ie the exchange of goods for goods (Chart 1). Barter is characterized here as primitive due to its extremely high transaction (and even transportation) costs. Someone wanting to sell something in order to buy something has to find someone else wanting to buy what he has to sell and wanting to sell what he wants to buy. The high costs of finding someone with matching asymmetrical needs, someone with "a double coincidence of wants", and moving the merchandise to him, prevents the volume of trade from expanding. No money is used, but parties act as buyers and sellers in the same person. The volume of trade remains low and qualitatively inefficient.

To lower such high transaction costs, governments may agree to act as traders. The member government invites potential sellers and buyers to place their offers or orders to get them matched with orders and offers of buyers and sellers invited by the partner governments. Member governments turn to their central banks asking them to open corresponding accounts to affect the payment transfers and monitor balances. The central banks promise also to settle the incoming and outgoing clearing payments in their respective national currencies. Every time the central bank sells (directly or through authorized commercial banks) clearing currency to the importer, it obtains national currency (plus sign in Chart 2) that can be used to settle the clearing export earnings, ie the central bank buys clearing currencies from exporters in national currencies.

Clearing can be defined as a restricted arrangement, open only to members, that allows the trade partners with nonconvertible national currencies to pay for their imports and receive their payment for exports in their national currencies. The introduction of convertibility is the objective of payment union. Subsequently, **the nonconvertibility of the involved partners' national currencies constitutes the basic precondition for viability of intergovernmental clearing or clearing union.**

Applying Bofinger (1991 a, pp. 71-73), the above description can be formalized as follows. Given a payment system of n countries, each individual country faces a set of bilateral budget constraints against all other countries:

$$(1) \quad X_{i/j} = e_{j/i}M_{i/j} \qquad (j = 1...n-1).$$

Nominal exports from country i to country j or $X_{i/j}$ have to match nominal imports $M_{i/j}$ of country j from country i, calculated at exchange rate $e_{i/j}$ agreed between the two countries. Here the importing country's imports are denominated in the exporting country's currency. Any expansion of exports or imports requires instantaneous bilateral counterbalancing. This is a clearing account in its strictest sense, accepting cash payments only. Note that the inflows and outflows on the central bank's clearing account may not balance. There are a variety of balancing rules ranging from small technical overdrafts to generous credit limits for financing the growth of trade. Also the rules of settlement may vary from quite strict automatic

Chart 3. **Multilateralization of three bilateral clearings**

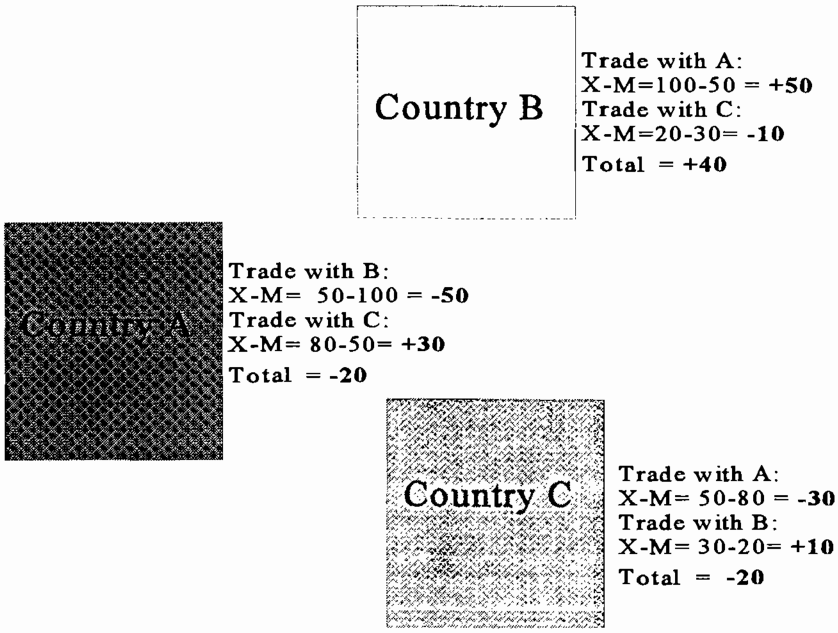


Table 2. **Amounts of hard currencies needed for settlement**

Payments	**I bilateral clearing**	**II multilateral settlements**	**III overdraft of -10**
A pays B	50	20	10
C pays A	30	-	-
B pays C	10	-	-
C pays B	-	20	10
Total hard currency requirement	90	40	20
Additional hard currency savings		+50	+20

settlement rules to relatively loose open ended statements to negotiate about ways and means to bring the clearing accounts into balance again.

To enable importers to buy products from the partner country without the necessity of waiting for accumulation of corresponding export receipts, the strict all-time balancing requirement can be relaxed by introducing an overdraft or swing Si/j limit, ie the maximum overdraft agreed between countries i and j. If country i exceeds the swing, convertible reserves from the central bank of country i to the central bank of country j , that is $R_{i/j}$, have to be transferred and converted using the exchange rate between the domestic country's currency i and the exchange rate z of the currency in which the outside reserves are held. The set of bilateral budget constraints of a country denominated in its own currency[4] is

(2) $X_{i/j} = e_{i/j}M_{i/j} + e_{i/j}S_{i/j} + e_{i/z}R_{i/j}$, (j = 1...n-1)

The outside reserves R may originate from a country outside the system (eg the United States in the case of the EPU), international financial institutions or central banks of the member countries in the payment union.

In bilateral systems, two national currencies are made **commensurate** through a third accounting currency that is not a medium of payment, but is rather a unit of account, measurement of value and preserver value. If the balances are not settled by adjustment of trade flows, the only means of settlement available is to use convertible currencies.

3.2 Payment systems

All payment arrangements share the objective of freeing funds to earn higher returns. In bilateral clearing arrangements, these funds are scarce convertible currencies. In subsequent arrangements, the goal is to further lower transaction costs and reduce the need for maintaining liquidity reserves. From the use of clearing techniques such as netting or matching claims of parties against each other, several benefits can be reached:

* Reduction of credit risk (member fails to clear his obligations due to insolvency. This would imply bankruptcy of the party in the national context, or, as they say in case of countries, a "structural balance of payments problem");

* Reduction of liquidity risk (member fails to clear his obligations in a timely manner, but eventually pays up);

* Reduction of systemic risks (credit or liquidity costs caused by one member's failure, which then triggers a domino effect causing other members of the system to fail to meet their obligations);

* Reduction of credit and liquidity risks by committing the members to comply with the settlement rules.

* Reduction of transaction costs through netting, so that the number of payments to be processed and transferred is reduced. Processing costs are cut. Errors and associated costs are reduced;

* Reduction of the costs of maintaining liquidity and credit holdings. Netting fastens the technical payment transfer procedures, thereby reducing needs for very short-term liquidity of credit holdings.

These benefits result from the **clearing technique proper**, common not only to intergovernmental clearing, and clearing or payment unions, but to all national and international settlement systems currently under development which take advantage of advanced computer and communications technology.

3.3 Multilateralization

Further benefits can be achieved by multilateralizing bilateral clearing trade and/or making the clearing currencies mutually transferable. There are two elements involved: multi-lateralization of trade and transferability of currencies. In the multilateralization of trade, trade is reoriented and

4 The notation i/UA stands for domestic currency i expressed in the UA. This notation will be followed also in what follows. For instance FIM/CLSUR stands for Finnish marks expressed in clearing roubles or SUR/USD roubles in US dollars (whereas USD/SUR stands for USD expressed in roubles).

Chart 4 **The incarnation of a unit of account: one transferable rouble, coin minted at the 25 anniversary of the International Bank for Economic Cooperation of the CMEA**

even new trade created. It becomes possible to compensate for imbalances with third countries.

Some unions maintain clearing arrangements bilateral with multilateral settlement. In such a case, the exports to or imports (ie trade flows) from third member countries cannot be used to balance trade between two partners. Instead, the exchange of goods and services will be balanced between each pair of partners. To the extent they do not succeed in this, the burden for balancing is entirely transferred to the multilateral settlement system.

The multilateralization of clearings reduces the need for hard currencies in both cases. The need for hard currencies is larger in the latter case when currency is made transferable without multilateralizing trade. The benefits are maximized when the trade is multilateralized **and** currencies made transferable.

Transferability does not emerge automatically even if the countries decide to form a multilateral payment union. At least two conditions are necessary for multilateralization. First, member countries must agree on transferability. The surpluses must be attractively covered, ie the potential surplus countries must be interested to use their surplus imports from third member countries. Due to a lack of attractiveness, eg eight OEEC countries were not willing to allow any automatic compensation which hampered efforts to multilateralize the bilateral accounts prior to establishment the EPU (Kaplan Schleiminger 1989, p. 24). Second, prices have to be determined by the market. Otherwise, as in the case of the CMEA, the administrative setting and manipulation of prices efficiently precludes transferability (Kenen 1991, pp. 248-251).

The first step towards transferability is to make bilateral clearing currency units **transferable** by agreeing on a common unit of account (UA). Under transferability the partners' trade restrictions (if we continue to express the importer's budget constraint in the exporter's currency[5])

(3) $e_{i/UA}X_{i/j} = e_{i/UA}M_{i/j}$ (j = 1...n-1).

According to Bofinger (1991a, 71-73), multilateralization involves reducing the set of constraints of a country against other countries to a single budget constraint against k of the n countries participating in the payments union:

$$(4)\ \sum_{j=1}^{k-1} e_{i/UA}X_{i/j} = \sum_{j=1}^{k-1} e_{i/UA}M_{i/j} \pm S_{i/UA} \pm e_{z/UA}R_{i/UA}$$

[5] For example by Havrylyshyn and Williamson (1991), Dornbush (1992), Gros (1992), and Bofinger and Gros (1992) or Shagalov (1995) consider the EPU as an appropriate model for revival of trade between the former Soviet republics.

The budget constraint of country i participating in payment union is alleviated by the fact that bilateral credit limits are now replaced by credits provided from the payments union ($S_{i/UA}$), and bilateral hard currency settlement is replaced by a transfer of reserves between the union and individual member countries ($R_{i/UA}$). The credit limits are denominated in a common unit of account and the settlement has to be converted using the exchange rate of reserve currency z against the unit of account $e_{z/UA}$.

Table 2 explains by using chart 3 by means of a simplified example of how three countries / governments, A, B, and C might gain more room to manoeuvre by making their bilateral clearing currencies transferable. The increase in manoeuvrability takes expression in the decrease of convertible currency requirements (down by 50, which stands for achieved hard currency savings), while the volume of the clearing trade would remain unchanged. Inversely, accepting the hard currency reserve requirement necessary for settlements (90), multilateralization of trade would allow governments to increase the volumes of their clearing trade without increasing the need for hard currency settlements.

Should the governments decide to settle their debts and claims multilaterally, the government B would receive from each government A and C an amount of 20 covering its receivables of 40 (Table 2, column II). Hence, the hard currency requirement would be, thanks to the multilateralisation (that is moving from column I to column II), only 40, or 50 smaller than in keeping the accounts bilateral. In other words, through multilateralization ie establishing a clearing union the hard currency savings achieved would amount to 50.

If all trade balances (exports less imports X-M) were to be settled bilaterally, the amount of hard currencies necessary for settlement would amount to 90 at the end of the transaction period (as shown in table 2, column I).

Application of maximum credit limits of 10 per country would further reduce the hard currency needed for settlement to 20 (Table 2, column III). Should the rules allow the hard currency settlement to be replaced with retroactive adjustment of trade, ie by compensatory changes of trade during a given period (as required in the Finnish-Soviet bilateral clearing), the amount of hard currencies necessary for settlement would be further minimized.

When trade is multilateral and truly adaptable, the hard currency requirement would be further reduced. For instance, in the above example (Chart 3 and Table 2) a surplus government B could reduce its receivables from A by increasing its imports from C by 10, the hard currency requirement would be reduced in multilateral settlement from 40 (Table 2, column 2) to 30. Of course, A could as well reduce its imports from B (or B decide to cut down its exports to A). In the former case, trade would have increased and the multilateralization strengthened, in the latter case trade would contract. Consequently, a thorough multilateralization where the trade itself is adjusted, not only financial claims cleared, further reduces the need for hard currencies required for settlement.

In the EPU total sum of double counted bilateral monthly clearing balances in 1950-1958 was USD 46.4 billion. Multilateral offsetting reduced it to USD 20.0 billion. The use of credit facilities allowed deferred compensation (equivalent to the room of manoeuvre in column III of Table 2) amounting to USD 12.6 billion (Dornbush 1992, p. 36).

3.4 The objectives of payment unions

Trade policy objectives are most often considered when assessing the viability of payment arrangements or determining why clearing systems or payment unions succeed or fail. Another often left out, but still important, aspect is the broader politico-historical context influencing the longevity of a system, which may never reach or have already reached its narrower trade policy objectives. In any case, the similarities and differences in broader politico-historical context deserve more attention.

While the EPU is often trotted out as a model for the CIS, the more recent and regionally coinciding CMEA is virtually never mentioned because it 'failed'. In fact, the CMEA never openly claimed to introduce convertibility. (There was evidently a failed attempt to introduce transferability.) In any case, the rouble never became a common currency among member countries. Rather, the CMEA's purpose was to economize on scarce hard currency reserves, generate trade, and exert Moscow-centred political influence. Established in January 1949, the CMEA was Stalin's response to western boycott by creating a 'separate socialist market'. The CMEA's powers were increased in 1961 and ' further deepening of Socialist integration' was introduced in 1971. In retrospect, the CMEA was a surprisingly permanent arrangement (Ferreira 1995, pp. 73, 89-90, and Schiavone 1981, pp. 13, 27-42).

The CMEA lacked a market mechanism to determine prices and exchange rates. In fact, it was seen as ideologically unacceptable to create such mechanisms. To iron out the effects of cyclical changes in world market prices, the CMEA adjusted the intra-CMEA prices annually by using moving averages for the five preceding years during 1975-1990. Using complicated and cumbersome coefficient system, the value of exports and imports between the CMEA members was annually 'balanced' by manipulating trade prices, volumes and exchange rates of members national currencies. Transferable rouble surpluses were considered quite unattractive by the CMEA member because there was quite little that a transferable rouble could buy.

Essentially, this manipulation implied that the Soviet Union agreed to buy inferior machinery, equipment and consumer goods from other CMEA member countries in exchange for oil, gas, chemicals and minerals, and other commodities marketable on the world markets. The Soviet Union accepted this price as compensation for political and strategic benefits (Bond 1991, p. 23, Kenen 1991, pp. 248-252).

4 Viability of CIS payment union

4.1 Lessons from the EPU

The division of labour applied by Soviet central planners made the former Soviet republics dependent each other. Production units were large and the marginal substitutability of production factors low. The economies of republics and regions in the Soviet Union were more closely integrated to each other than, for instance, European Community countries to each other. After the dissolution of the Soviet Union, intra-CIS trade was 80% of GDP whereas the corresponding figure for the EC countries varied at about 40-65% (Pisani-Ferry & Sapir 1992, p. 15, Table 1.). This made the collapse of the intra-CIS trade exceptionally severe.

Intra-CIS trade collapsed from about 65-70% of total foreign trade in the 1980s to about 20-25 % presently. The distribution of wealth between the CIS countries are increasing and their economic policies gradually diverge. Thus, need for scrapping and forgetting the old patterns of thinking and action have made the reintegration process more complex compared to simple integration process. Still, there does not seem to be any clear elaborated strategy of political, social and economic development to reintegrate CIS countries. The more radical the reform proposal, the more reserves it needs (more in Sutyrin's article 1996 "Problems and prospects.." in this volume). Although a period of laissez faire or status quo might be welcomed after an long period of central planning and forced division of labour to allow necessary reorientation of production and trade in each individual CIS country, the collapse of intra-CIS trade should be still a legitimate concern. The shortage of hard currencies has led the partners resort to barter deals and clearing arrangements (Shagalov 1995, p. 39).

In these circumstances, transition from a common currency to national currencies would make the republics open and vulnerable to foreign trade disruptions and exchange-rate instability. High liquidity and solvency requirements would put pressure on foreign exchange reserves and lead increasing quantitative foreign exchange restrictions or bilateral clearings. To avoid economic disaster and to save the inter-republican trade from collapse, many writers felt that an EPU-type of multilateral payment system with most of the CIS republics as members should be designed and established. Furthermore, the arrangement could be extended to cover some of the CEEC's and countries in southeastern Europe to revive some traditional trade (Bofinger-Gros 1992:II, pp. 16, 22-23).

The advocates of payment union for the CIS countries (CISPU), enumerate a large number of similarities in the circumstances of postwar Europe and the present CIS (Shagalov 1995, 40):

* Transition from depressed crisis economies to market economies;

* Economies with nonconvertible national currencies and acute shortage of convertible reserves (US dollars and gold); and

* Extensive trade restrictions based on quantitative controls, mostly based on bilateral clearing arrangements or barter trade.

Shagalov sees a multilateral payment system as a compromise between overly conservative and restrictive bilateral intergovernmental clearing systems and the more radical direct imposition of mutual convertibility of national currencies (Shagalov 1995, 42). Shagalov further claims that the structural creditor problem can be solved; ie that financial requirements can be determined in advance by setting sufficiently stringent rules for CISPU membership. The financial needs of the CISPU fund have been estimated at ECU 3-4 billion, perhaps more, provision of which would hardly constitute an unsurmountable problem (Gros 1992:I; p. 17-18, 26-28). Shagalov also points out that the structural creditor problem between the Russian Federation and rest of the CIS republics will continue to exist irrespective the system of settlements for years to come (Shagalov 1995, p.42).

Also, a closer reading of CIS trade statistics may lead to more modest conclusions. The available statistics show that during the first half of the 1990s trade between the CIS republics declined as trade with the West increased (Sutyrin 1996). Gravity-model exercises produce similar results, further supporting that a radical reorientation of trade of former Soviet republics towards the West is in progress. These developments are most clearly manifested in the trade of the most reformist former-Soviet Republics, ie Estonia and other Baltic countries (Gros - Steinherr 1995, pp. 372-378). Notably, the trade reorientation of the Russian Federation also follows this pattern.

These developments also make it possible to infer a basis for closer economic cooperation and integration between the CIS and the European Community. Further, when comparing the USA-EPU constellation in the 1950s and the Russian Federation, it should be noted that the non-Russian republics make better comparable pairs. Therefore one might suggest that non-Russian republics should perhaps consider establishing a payment union in order to orient their intra-CIS trade towards convertibility.

The problem of making temporally displaced comparisons, ie Europe then and Russia now, is that prices in the East have been far more distorted than they ever were in postwar Europe. Competition was nonexistent for more than 70 years under communism, and the banking sector was virtually dead until ten years ago. Russia's and other CIS republics' commercial banking sector today is fragile and still for a large part embryonic. It lacks the technological capabilities and expertise to handle payment transfers promptly and reliably between (for that matter, within) republics. Therefore, state-supported trading houses (intergovernmental trade agreement) to bring prospective clients together and a state-supported clearing house to see that payments are duly effected through the central bank accounts may have great relevance.

4.2 The Interstate Bank

The Interstate Bank embodied the hope that it was possible to avoid a considerable part of the Intra-CIS trade by multilateralizing the negative, rapidly growing balances in the corresponding accounts the CIS republics maintained with Russia, while also improving the intra-CIS payment system in general. The ISB could have solved part of the problems created by the disappearance of the rouble zone by granting limited convertibility to new currencies (Gros-Steinherr 1995, pp. 396, 404).

Originally, the ISB was designed to provide an interim solution that would not impede the development of a more decentralized system. The ultimate goal was to create a decentralised system, where interstate payments were carried out by commercial banks, supported by well functioning interbank and foreign exchange markets. The economic and financial adjustment was to be implemented in an orderly and controlled manner. The need for structural reform, adequate financial supervision, legislation on foreign exchange, financial legislation and financial supervision were all foreseen. To accomplish all this, however, Russia and the other CIS republics were expected to finance sizeable balance-of-payments deficits over a number of years.

The plan to establish an **Interstate Bank (ISB)** was initiated at the Bishkek CIS summit in October 1992. The treaties were drawn up with the assistance of 'Advisory Group on Interstate Economic Relations (AGIR) financed by the Technical Assistance for CIS (TACIS). The advisory group was led by Daniel Gros, a long standing proponent of Eastern Payment Union. Based on this plan, the agreement on 'Interstate Bank' was signed by 10 member states[6] at the Minsk CIS summit of 22 January 1993. The operation was due to be launched in December 1993. According to the plan, the Central Bank of Russia would operate as clearing house and provide a credit line of 200 billion roubles. The Russian rouble would serve as the unit of account and balances on the accounts would be netted once during each banking day and settled every month's 15. day. Debtor members could accumulate their clearing debts up to one month's export receipts. Russia held 50 % of the voting power on the Board of Management, and the other votes were divided among the other republics in proportion to their intra-Soviet Union trade in 1990. Decisions could be ratified with a three-quarters majority of the weighted votes (Eichengreen 1993, pp. 49-50, more details in Gros 1994b).

A range of variants was considered in this context. Technically, a more efficient solution might have been bringing together a set of bilateral clearing accounts. A maximal approach whereby several months debit or credit positions might be allowed, would be based on the commitment of the dominant creditor member and any other financial source. A minimal approach would have involved very limited short-term credit lines, eg intra day overdrafts. This kind of clearing union would only support transfers of payments, but nevertheless could have been particularly useful between non-Russian republics (IMF 1992, p. 20). Ultimately, though, the ISB was operated as a multilateral clearing mechanism and not as a payments union. It was expected to improve the predictability and security of payments by "executing fully automatic, nondiscretionary settlement procedure" (IMF Survey, 21.2.1994, p. 54).

The effort failed due to a lack of political initiative. The surpluses of Russia's oil exports to most of the other republics were larger in bilateral clearing balances than they would have been in multilateral clearing. Cutting down these imbalances was not high on any party's agenda. From Moscow's point of view, the larger the unsettled claims of other republics, the greater their political dependency. On the other hand, the oil and gas importers-debtors were counting on their ability to continue to freely accumulate debt on a bilateral basis. Obviously, submitting to stricter multilateral settlement scrutiny was not a particularly attractive for neither parties.

A second major reason was the lack of financial discipline. Difficulties in transferring payments were already anticipated in 1993 (Eichengreen 1993, pp. 52-53). In central banks, middle and lower level officials in charge of running the arrangements were in the best cases incompetent (ie unable to effect the payment in an orderly and disciplined manner) or otherwise simply corrupt.

Also are also other explanations for failure. According van Selm Wagener, the ISB implementation failed mainly due to EU-subsidized supply. Most of the Russian authorities obviously had not grasped the idea of the payment union and felt no commitment to fulfill the plan. The ISB president Mr. Valeri Savanin was not willing to cooperate with the AGIR (van Selm Wagener 1995, pp. 32-33). Nor wanted the IMF, which supported the plan, expand the ISB from multilateral clearing to payments union, because this, in the opinion of the IMF, would lead the Member States to focus their energies on creation of new bureaucracy and slow down the progress toward decentralised market relations (IMF 1994, pp. 19-20).

A final blow to AGIR came in March 1994 agreement, where the concept of payment union was definitionally reduced to a flat introduction of convertibility. Noting that the proposal of direct and full convertibility goes much further than the proposed payment union, the AGIR seems to have surrendered. The AGIR maintained its stand that the payment union was a good idea, but the CIS states seemed to be more interested in obtaining cheap credit and oil from Russia while the advantages of an efficient payment system were dimly perceived (Gros 1994b, pp. 34, van Selm Wagener 1995, pp. 33-34).

Upon quitting his assignment, Daniel Gross stated that "private commercial banks have become much more adept at resolving the payments problems. In my own view the Interstate Bank project has been overtaken by events, though in 1992 or 1993 it would have made sense to create a payments mechanism such as the one embodied in the Interstate Bank." (Gros 1994c, pp. 55-56).

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6 Georgia and possibly Baltic countries were supposed to join later. Azerbaijan was likely to stay entirely outside.

Table 3. **Financing of the current account deficits of the Finnish-Soviet clearing**

	1961-1990	1961-1970	1971-1980	1981-1990
Clearing balance decrease (+)	0.2	0.6	0.8	0.0
LT capital inflow (+)	-0.7	1.3	0.8	-1.3
ST capital inflow (+)	-3.7	-0.7	3.2	-6.1
Cumulative current account surplus (+)	4.2	-1.2	-4.8	7.4

Note: Financing of the annual average changes of current account balance by importing (+) or exporting (-) long-term (LT) and short-term (ST) capital and resorting to decrease (+) or increase (-) of the tied CLSUR reserves [net imports of clearing funds (+) = net decrease of surplus or net increase of deficit in the clearing balance in favour of the Bank of Finland. Annual average changes as per cent of the gross clearing trade.

van Selm and Wagener point out, however, that in the background there are much more worrying developments than the opportunity lost of Interstate Bank or payment union, namely the ex-Soviet governments' general problem implementing treaties: "- - It is precisely the spirit that brought about EPU, together with the OECD and Marshall Plan, which are lacking today, and not necessarily these institutions alone." (van Selm Wagener 1995, p. 35).

4.3 The case of Finnish-Soviet clearing

The Finnish-Soviet clearing system was a bilateral intergovernmental clearing arrangement. It never served the purposes of multilateralization and achievement of convertibility, and as stated earlier, it was a fairly permanent arrangement (1945-1990). Its demise followed the collapse of Soviet political and economic decision making structures.

The Finnish-Soviet clearing relationship also had a unique historical and political background. From the Soviet side, the high level of trade was advertised as a "manifestation of good relations" and as an "example about flourishing trade between small capitalist and large socialist country" (Laurila 1995, pp. 96-97). For Finnish industrialists, this trade, aside of being fairly lucrative, gave counter cyclical market benefits and the extra protection of a backup market. By pragmatically simultaneously integrating and isolating the Finnish side of the of the clearing arrangement vis-à-vis the rest of the Finnish market economy, Finland could focus on operating its main export markets with the market economies (trade with which on average represented 84% of Finland's total foreign trade in 1945-1990).

Three factors relate the Finnish-Soviet experience to development of clearing systems. First, it provides a case where, in the presence of special or political factors a country with convertible currency, parties agreed to introduce a separate currency regime to trade with a country of inconvertible currency or a country delaying its current account convertibility for more than a transitional period (Schmieding 1992, pp. 22-23). Second, as noted above, payment union can be considered as a combination of several individual bilateral clearing arrangements. Knowing something about the circumstances under which it has been possible to operate and manage an individual bilateral clearing with the Soviet Union, it should therefore be possible to infer on the basis of that experience the challenges of operating and managing several simultaneous bilateral clearings. If one failed to operate individual clearing connections, or if similar conditions did not exist in the CIS, how would it be possible to run a technically more complex and administratively more demanding arrangement, a payment union? Third, Finland is a small, open market economy in proximity with Russia. Over 80% of its trade took place with the western market economies on convertible currency basis and under a deregulated payments and capital transactions regime as soon as these regimes were gradually adapted by its trade partners. Running parallel regimes of convertible and nonconvertible currencies created problems, most likely similar to those which will be met by CIS republics should they opt for clearing arrangements or unions aside with developing convertible currency trade.

The experience from the Finnish Soviet clearing underline the importance of applying world market prices and exchange rates in clearing trade. Moreover, Finland paid much attention to use the export earnings in investments in export promoting or import substituting industries while availability of foreign currencies for imports of consumption goods and services was prohibitively regulated still in the 1970s. These two factors saved Finland from becoming 'structural debtor' in its trade with the Soviet Union.

Particularly after the early 1970s, two highly volatile determinants of Finnish-Soviet trade became prominent: the oil price and the external value of the US dollar. Trade volumes could not be rapidly adjusted to the large fluctuations of the value of imports caused by the volatility of the oil and energy prices and the exchange rate of the US dollar. Thus, the fluctuations in Finnish-Soviet trade were larger than in Finland's trade with the West.

In summary, there were large imbalances in Finnish-Soviet clearing trade created by a number of reasons:

1. The inclusion of large projects and deliveries into clearing trade, financing of which brought clearing out of balance;

2. Volatility of world market prices of oil and the external value of the USD;

3. The maintenance of a two currency regime required foreign exchange controls which became increasingly ineffective in an increasingly deregulated environment;

4. The increased complexity of the clearing system itself reduced manageability. The clearing became more complex as it attempted to challenge the flexibility of convertible trade (freer access to financing, accommodation of more sophisticated transactions such as direct investment, trading, transit traffic, credit card operations etc.) during the late 1980s.

The effects of Finnish-Soviet clearing arrangement on convertible currency reserves is ambiguous and therefore deserves to be analysed in some detail.

Particularly for the Soviet Union, the clearing arrangement freed up scarce convertible funds that could then be used for paying for other purchases from hard currency countries. Finland was the only country where the Soviet Union could purchase hard currency goods without spending its hard currency reserves. Indeed, Finland occupied the largest share of the Soviet foreign trade with industrialized market economies until the end of the 1970s. On a few occasions the Soviet leaders openly expressed their unwillingness to spend their scarce foreign exchange funds on purchases from Finland (eg. Suomi 1994, p. 144).

Finland, running parallel foreign trade operations in two monies, made efforts to insulate these two systems from each other so as to avoid financing the clearing rouble trade from its own convertible currency reserves.

The needs of economizing foreign exchange reserves were not equally served. According to the Finnish-Soviet agreement, all clearing payments were immediately to be released in national currencies. This created asymmetry in the sense that the Soviet foreign trade bank could use nonconvertible roubles whereas the Bank of Finland had to use convertible markkaa. The Soviet Union was able to economize its convertible reserves, while for Finland, the foreign exchange reserve economizing effect remained modest.

The net clearing deficit increased the convertible reserves with the Bank of Finland because the Finnish importers purchased clearing roubles by Finnish markkaa from the Bank of Finland. However, the net clearing surplus did not decrease the convertible reserves with the Bank of Finland. When buying clearing roubles earned by Finnish exporters against Finnish markkaa, the Bank of Finland lost its opportunity cost of placing these markkaa to alternative uses so as to earn interest. The use of the overdraft in the Finnish-Soviet clearing was free except in 1990, when stricter clearing conditions were agreed upon. This arrangement cost the Bank of Finland on average about FIM 200 million a year in the 1990s (Laurila 1995).

Whenever the Soviets extended financial loans or advance payments (for ship deliveries and implementation of major construction projects in the Soviet Union) through clearing, the disbursements were financed by the Bank of Finland in Finnish markkaa (the Foreign Trade Bank of the USSR sent a CLSUR denominated payment order to the Bank of Finland asking it to disburse to the Finnish shipyard, construction firm, etc. the equivalent amount in Finnish markkaa). These losses of convertible reserves could be compensated for only by increasing clearing imports from the Soviet Union.

As shown in Table 2, from 1961 to 1990 an average of more than 4% of total trade was financed by exporting capital (with lagged clearing payments), of which 0.2% materialized as increases in the clearing debt. The clearing 'borrowing' in the form of financial loans and advance payments from the Soviet Union were actually financed by the Bank of Finland from its convertible currency reserves.

This financing materialized in the 1960s and particularly in the 1970s, when an average of 4% of total trade (and almost 8% of exports to the Soviet Union) were financed from the convertible currency reserves of the Bank of Finland. In the 1990s, as mentioned above, annually convertible funds equivalent to almost 7.5% of the total clearing trade were annually used to buy clearing roubles from Finnish exporters without any compensation of foregone interest returns.

The reversal of the situation in the 1990 was due to the flexible upwards adjustment of the Finnish exports to fill the room created by the expensive oil imports, and rigidity in downward adjustments after oil prices had collapsed in 1986. Although the clearing account proper was brought into balance by the time clearing was to be dismantled at the end of 1990, about FIM 2.5 billion clearing-related claims were left to be rescheduled in the Paris Club.

On the one hand, deviation from strictly cash-based clearing by allowing leads, lags, trade related advance payments and financial loans to be funnelled through clearing, reduced the transparency, predictability and ultimately, the manageability of clearing. When a substantial part of capital flows filled the gap between the current account and clearing account, only 'the top of iceberg' became visible on the clearing account used for monitoring and forecasting trade developments.

On the other hand, a rigorous barter clearing system produces no 'economies of clearing' in the form of reducing the size of the precautionary convertible currency reserves, nor does it support growth of trade. For instance Eichengreen rightly points out that if trade was kept in a strict balance at any given moment, in principle no precautionary foreign exchange reserves would be necessary (Eichengreen 1993, pp.46-47). The larger the current account imbalances of the clearing trade are, the greater are the reductions of the requirements in maintaining the precautionary foreign exchange reserves which can be achieved by using the clearing techniques. On the other hand, the less credits is used in clearing trade, the easier it is to administrate it.

In real life, clearing accounts are nearly always out of balance both in the technical sense (an instantaneous all-time technical match is virtually impossible), and because of seasonal leads and lags as well as major deliveries or projects, which as a rule are based on credit agreements. Indeed, achieving an increase of trade almost inherently implies continuous financial fuelling. Most clearing arrangements between western European governments and the Soviet government were disbanded because a single major delivery would have brought the clearing account out of balance and the clearing partners were not prepared to grant clearing credits or loans to each other so as to extend the delivery related payments over a longer period of time.

The turn-over Finnish-Soviet clearing trade was large enough not to be brought out of balance by major deliveries; in addition, clearing credits were granted, as already noted above. Both parties could obtain goods through clearing, which otherwise were only available in convertible currencies. The Soviet Union paid for its imports from Finland by oil and oil products which consisted 2/3-3/4 of the total Soviet imports to Finland. This oil was priced at world market prices in US dollars. Also the rest of the imports as well as the Finnish exports were priced according to commercial negotiations in which world market prices were used as references where available. Finnish enterprises were invited to participate on a voluntary profit-seeking basis.

The possibilities to maintain the clearing trade in balance were decisively reduced by the fact that the imbalances in the clearing trade were not reflected in the markka values of the clearing rouble. The markka value of clearing rouble was derived from the Bank of Finland's USD/FIM and from the Gosbank's USD/rouble quotation. The central bank always traded clearing roubles at this neutral exchange rate unaffected by the clearing trade balance. The Bank of Finland could have auctioned the available clearing roubles earned by exporters and necessary to importers. Instead, administrative methods (negotiated trade quotas, licencing, foreign exchange regulations) were resorted to in order to bring trade and clearing payment flows into balance.

According to the Finnish-Soviet clearing agreement, all commercial payments had to be effected in clearing roubles. Still some parallel convertible currency trade was permitted, which necessitated separate foreign exchange controls to be maintained by the Bank of Finland in order to defend the clearing system against imbalances caused by the use of convertible currencies instead of clearing roubles. Soviet traders always preferred to pay in clearing roubles, but if, and whenever possible, they preferred to obtain their export proceeds in convertible currencies. These pressures increased particularly as soon as Russian exporters started to become licensed to receive convertible currency payments. Accommodation of more complex transactions such as direct investment, trading etc., in the bilateral currency regime increased regulation problems. Nevertheless, leaving them outside would not have reduced control problems. The fact that Finland simultaneously deregulated its payments and capital movements made the defending of the isolated island of clearing payments an ungratifying task.

5 Summary and conclusions

The introduction of convertibility is dependent on progress in liberalization, price stabilization, and the degree to which each member country has been successful in restructuring its industrial production for global competitiveness. In the process of structural adjustment, hard currency earnings from exports logically should be directed in the first place to finance structural adjustment, ie to create new export industries or import-substituting industries, rather than pay for current consumption. If member countries do politically commit themselves to austerity policies that favour investment at the expense of current consumption, this should create adequate credibility to motivate the members and international financial organizations to support the union.

It is noteworthy that aid under the Marshall Plan was granted on the condition that member states liberalize their foreign trade and irrevocably deregulate their payment and capital movements. Subsequently, the IMF and the OECD actively acted as watchdog organizations to ensure that member governments complied with their obligations after the discontinuation of the EPU. Faced with insufficient political commitment from the CIS republics and an inability to implement the agreements, as in the case of the ISB, it would hardly be reasonable to expect even from the potential participants an adequate financial support for a full-fledged CIS payment union (Government of the Russian Federation 1995, p. 35).

The new constellation of world politics that emerged after the WWII explains the political commitment and the relatively good performance of the EPU. The high toll of the war and the political polarization after the war evidently compelled EPU members to cooperate. Fairly adequate national institutional, financial and jurisdictional infrastructures, supporting free market economy and democracy principles and traditions, already existed. A new European institutional superstructure was established to enable and guarantee the cooperation in securing peace (the European Coal and Steel Community), increasing welfare (the Economic Community, E.E.C.) and also the military strength (EURATOM).

In contrast, the political cohesion and cooperation of the CIS republics have been relatively weak. The CIS, as an intergovernmental superstructure, has been unable to gather all the republics under a common umbrella. The speed of economic transformation varies from republic to another. This variety does not support global interstate solutions. For these reasons the CIS would not yet be in a position to reap the fruits of a possible payment union.

A similar situation prevails within the Russian Federation, where republics and regions to varying degrees defy the legal powers vested to the federal government located in Moscow. One of the reasons is the high speed of transition process not allowing enough time for creations of necessary institutions necessary to take care of implementation of laws and agreements and arbitrate disputes between the centre and the periphery.

The political, economic and institutional developments which have taken place in the former Soviet republics, particularly in Baltic countries, but also in the Russian Federation (eg the emergence of commercial banking and financial markets), are outstanding in many respects, not least for the reason that the transitional period extends only over 5-10 years and was launched in many aspects from a sub-zero starting point. Naturally, the national institutional development of CIS republics still lags behind postwar western European countries.

In summary, the political, economic and institutional environments of the postwar West on the one hand, and the present CIS on the other, are not sufficiently similar to justify the application the EPU model to CIS. The CIS countries do not have the luxury of having a well-disciplined and tested financial and commercial institutions to support the CIS payment union. The CIS republics have to try to catch up with industrialized and commercialized world market economies by implementing everything as fast as possible from void. The 'West then' and the 'CIS now'exist politically, technically, commercially and financially in different worlds.

This conclusion, subscribed also by a number of other writers, is further confirmed by the experience from the Interstate Bank and the technical problems in managing the Finnish-Soviet clearing arrangement. The individual observations in the both cases seem to substantiate arguments about the necessity of political commitment and adequate institutional maturity in making the payment arrangements operational, particularly as the element of credit in clearing or payment union gets larger.

In principle, the benefits or resorting to payment union in the process of multilateralization of trade and introduction of convertibility could be maximized, if 1) the shortage of precautionary reserves actually restricts the emergence of trade and improvement of competitiveness of domestic industries, and 2) the central bank is really the guardian of convertible reserves.

Currently, in most CIS republics convertible currencies, or at least a substantial part of them, are in the hands of the parallel economy. In the Russian Federation alone, estimates of the convertible currency reserve that have escaped the hands of the Central Bank of Russia, range from USD 40 billion to USD 110 billion, the latter figure coming close to the defaulted external debt of Russia.

And what happens if 'more efficient uses' is interpreted as taking the convertible currencies legally of illegally abroad or spending export earnings for current consumption instead of domestic investment in export promoting or import substituting projects? The potential benefits from a clearing or payment union would be more or less wiped out in these circumstances.

Thus, in the absence of hard budget constraints, with inefficient allocation of funds, and with sizable runaway of foreign exchange reserves to abroad, the economies achieved by means of payment union would probably remain marginal and more or less vasted.

Should a plan for a payment union lack credibility, its members would hardly be willing to agree on adequate quota financing ('a membership fee'). Nor would Western or international financial institutions make financing available to the payment union. In case of the EPU, the financial markets were narrower and more comprehensively regulated than today and the fiscal and financial discipline was superior to that of the CIS.

If the EPU were to serve as a model for the CIS payment union, according to correct interpretation the Russian Federation, in its capacity of structural creditor, should accept the position of the US as a provider of Marshall Plan-type aid. Also the central role the Russian Federation in the "Strategic course of Russia with the CIS" (Rossiiskaya Gazeta 1995) would call for that role. Still, there are views according to which Russia is under no obligation to assume major responsibilities in funding the possible CIS payment union[7].

Instead of a full-fledged payment union, therefore, it seems prudent to consider if modified or more restricted clearing arrangements are possible. Two such cases will be substantiated: 1) the trade increasing effects by partner governments acting as traders within a clearing or payment union, and 2) the possibilities for political control and regulation.

According to Gros, some balanced trade is much better than no trade at all (Gros 1992:I, pp. 4,7). Under a system of strict barter, no benefits from clearing materialize. The larger is the clearing credit component, the larger is the amount of reserves clearing frees up for alternative, more profitable uses. Beyond clearing benefits, the partner governments act as traders bringing together supply and demand of enterprises which otherwise never would have met due to inefficient or nonexistent marketing and advertising. In addition, the involvement of government and central banks constitutes at least a formal guarantee for the receival of payment. These trade-creat-

[7] For instance: "The only reason for establishment of a CIS payment union is that the (potential) member countries have denounced the convertibility of their respective currencies. This implies that they themselves have brought on their present difficult situation. Russia is not obliged to pay for the consequences of their economic choice" (Afanasev 1995, p. 82).

ing and supporting effects were significant in the Finnish-Soviet clearing arrangement.

There are concerns that clearing arrangements might delay the developments of free market conditions and convertibility. Therefore, some authors regard clearing or payment unions out of hand as harmful 'halfway stations'. They argue that convertibility could have been most easily be attained by means of pragmatical exchange rate policies without introducing any special arrangements (Gros Steinherr 1995, pp. 400-401). In the opinion of eg Schmieding, a sufficient devaluation of the western European currencies against the US dollar would have removed the rationale for restrictions on trade and payments and made the EPU obsolete (Schmieding 1992, pp. 67)

Although the objective of the Finnish-Soviet clearing arrangement was narrower than the one of clearing or payment union, the Finnish experience shows that, ultimately, deregulated trade and financial markets with commercial banking better served entrepreneurs than bureaucratic clearing. Subsequently, the Finnish-Soviet clearing arrangement was more or less crowded out by convertible currency trade as soon as the Soviet Union granted its foreign trade organizations the authority to engage in direct hard currency trade in the second half of the 1980s.

Political considerations are always involved in the establishment of clearing or payment unions. As noted above, adequate political commitment is necessary to infuse spirit into the arrangement. In certain proposals for a CIS payment union, one can read in an implicit wish on Moscow's part to tighten its administrative grip. Of course, as the structural creditor it already exerts that influence theoretically.

Aside with the sheer power policy aspirations, the most serious argument for clearing unions would be to allow the governments and responsible authorities reasonable room to manoeuvre in order to execute efficient social policy in politically precarious situations. For example, when prices are liberalized to the extent that the prices of nontradable goods rise beyond the reach of the majority of population. Here, the funds economized through successful use of clearing or payment union could be used to cure this problem. This system was applied in the EPU in the country examinations of the IMF or the OECD, in which the member countries were invited to withdraw their reservations and derogations acknowledging the concerns of the member governments' authorities. The exercise started from the post war situation, when in the foreign exchange controls everything was forbidden, what was not specifically permitted. The collapse of the Soviet system created at least momentarily the opposite situation in the CIS republics: everything was permitted, what was not forbidden. As already noted above, this might create problems for creation of a payment union for CIS: a reasonable amount of regulation and control is necessary to run a payment union successfully.

The experience of Finnish-Soviet clearing serves as an example here. Even in the fortuitous situation that market prices are observed in the clearing trade, given a dominant position of oil and oil products in trade, the volatility of oil world market prices (and possible also the exchange rate of the US dollar) would instantaneously change the value of trade to the extent that the governments would be forced to excessively regulate the trade volumes to maintain the clearing balance.

The recent rapid growth of the commercial institutions and banking have persuaded many former proponents to modify their opinions and agree that the payment union would not be a feasible or appropriate solution for revitalizing the trade between the CIS republics and introduction of convertibility. In fact, the currencies of the CIS republics are already convertible against the rouble and increasingly against each other. New solutions seem likely to emerge, possibly as multi-CIS-republican financial-industrial groups accommodating clearinghouses (Yevstigneev 1994, p. 39). These groupings seem to be able to solve by internalizing many of the problems which were thought to be solved by clearing or payment unions. The trade pattern has also changed favourably, not towards integration of CIS trade, but more towards integration of the CIS trade and towards trading with the rest of the world and with the European Community countries in particular.

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