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The Free Exchange Rate in Russia: Policy, Dynamics, and Projections for the Future

Summary

This study examines the current exchange rate policy in Russia and the recent dynamics of the ruble's value against hard currencies.

The trust of the paper is to show that there has not yet emerged any perceivable exchange rate policy in Russia. There is a system of multiple exchange rates, and the role of official rates is strictly limited in the main to accounting purposes. The shortages of foreign currency and consumer goods make the private import of consumer goods extremely profitable, and this is one of the main factors that determine the actual value of the ruble.

The current free exchange rate could hardly be considered as a market rate: the bulk of foreign currency is still allocated by the state or used by exporters themselves, the turnover in the Currency Exchange is not great and many political and psychological factors influence the behavior of traders in foreign currency. The near-term economic outlook for Russia does not provide much hope for visible progress in this area. The continuous depreciation of the ruble is the likely result of future actions of the Russian government.

1 This paper was prepared during the stay at the Bank of Finland as a visiting reseacher. I am indebted to Terhi Kivilähti, Glenn Harma, and Kamil Janáček for very fruitful comments. Any opinions expressed are of the author only. All remaining errors are mine.

1 The command economy and the exchange rate

Until 1987 the role of the exchange rate was even less important than the role of money in the command economy of the USSR. The official exchange rate was used only as an accounting unit and had no influence on the current activity of enterprises. Traditionally in the Soviet economy, domestic and foreign prices were kept separate by the state's monopoly of foreign trade and by the special system of "price equalization" for enterprises. Being a pure monopolist in foreign trade, the state accumulated all currency receipts and was responsible for their allocation in the economy. In this situation, the role of the exchange rate was more political than economic. It is well known that the actual official exchange rate was set personally by I.Stalin in the beginning of the 1950s. Then, according to specialists, the exchange rate of the ruble against the US dollar was 14:1. This seemed to Stalin to be politically unacceptable, and he eliminated the "1". Thus the official exchange rate of 4:1 against the US dollar was established. Later it changed due to the Soviet monetary reform of 1961, and in 1983 the ruble was finally pegged to a basket of six currencies, where the share of the US dollar was 42 %. Until now the official exchange rate of the ruble remains 0.6 per USD.

The main obstacle confronting any attempt to evaluate the ruble's "true" exchange rate, was a the seriously distorted Soviet price system. Consumer prices were relatively higher and industrial prices relatively lower than in the world market. In this situation, the evaluation of the exchange rate depended critically on the basket of goods used for comparison. Different approaches gave an exchange rate for the ruble against the US dollar that ranged from 0.2:1 to 4:1 in the 1980s. The basis for the determination of the official rate was the "foreign trade" basket and the level of profitability of foreign trade. The increase in oil prices in the world market in the 1970s strengthened the official viewpoint on the exchange rate.

The minor institutional change that occurred in the Soviet foreign trade regime in 1987 - establishment of currency retention rates and differentiated exchange rate coefficients (DVK) - did not lead to any change in exchange rate policy. It may be explained by the preservation of the state's dominant position in the use of currency (enterprises retained 7-8 % of export earnings on average), and several restrictions on the use of currency by enterprises (until 1989 it had to be spent within a year and only for importing investment goods).

The black market for hard currency cash had existed over a long period in the USSR. Beginning, perhaps, in the mid-1970s, it expanded because of the opening of the country to foreign contacts. The available data on black market exchange rates for the period 1960-1989 (Chart 1) shows that the rate against the US dollar[2] somewhat, from 3:1 to 5.5:1.

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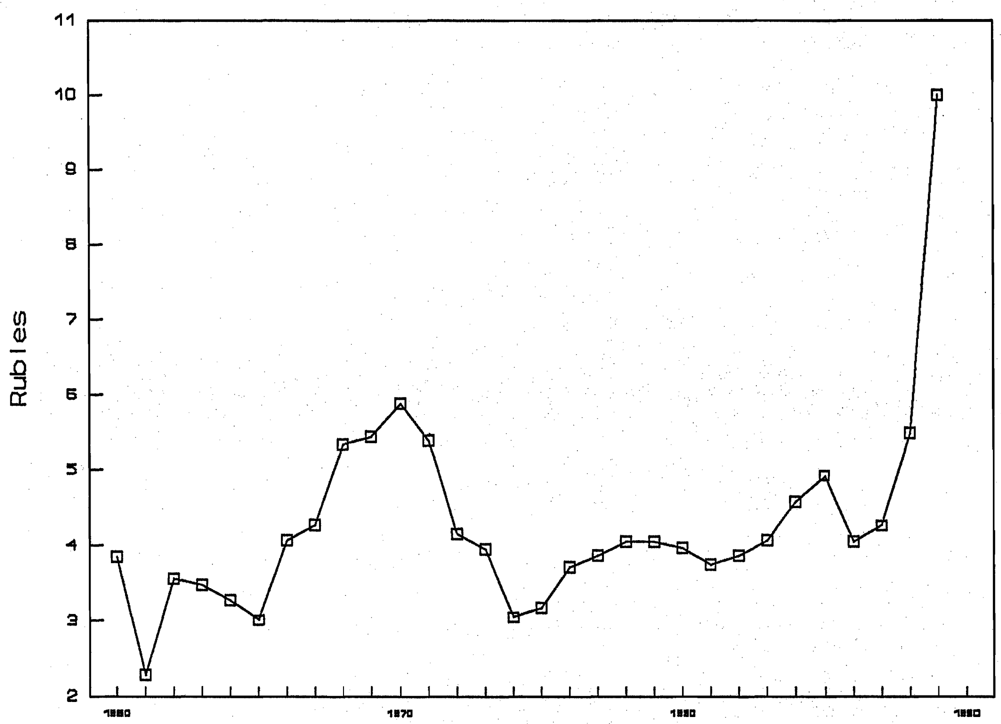
[2] Traditionally, only the US dollar and the D-mark were accepted in the black market in the USSR. And now, non-state entities prefer to trade in these currencies only. Commercial banks publish exchange rates only against these two currencies, though other hard currencies are exchanged. The currency cross-rates are lower than in the world market. For this reason, I shall henceforth speak only about the exchange rate of the ruble against the US dollar.

Chart 1. **Black Market Exchange Rate, 1960 - 1989 (SUR per USD) fluctuated**



The determination of this exchange rate was (and is) based on domestic prices for high-quality, advanced consumer goods. It also depended on conditions in the domestic consumer market. For example, we could cite the decline in the value of the US dollar in 1961, which was caused by a contraction of the money supply as a result of monetary reform, and another in the mid-1970s, which was partially caused by an increase in consumer goods imports. Until the end of 1980s, there were certain problems in the use of hard currency by ordinary people in the Soviet Union. Currency trade was punishable under the Penalty Code, and foreign travel opportunities were rare for the majority of people. Purchases in currency retail shops were sometimes controlled by militias (Soviet police).

The situation began to change drastically in 1989. Restrictions on the use of currency earnings were eliminated for state enterprises, new non-state (virtually private) firms were given the right to engage in foreign trade, foreign travel was made easier, perestroika caused great interest abroad in the Soviet Union and, as a result, more foreigners visited the USSR. These developments caused an inflow of hard currency to the Soviet Union and greater opportunity for the use of such currency.

The economic decline then became more evident in the Soviet Union, real output growth came to an end and the budget deficit and monetary overhang continued to grow. This provoked a rise in domestic prices in the "exchange rate" basket and a decline in the market value of the ruble against the dollar.

2 Institutional framework for exchange rate determination

A system of multiple exchange rates operates in the territory of the old USSR. This multiplicity was introduced step by step during the last three years (1989–1991). Though economic transformation in Russia and other republics is now going on, exchange rate policy has become more complicated and less clear. Here, we turn to a discussion of the determination and the effects of exchange rates.

1) An **official exchange rate** still exists, which is mainly used to evaluate claims on foreign countries.

2) On November 1, 1990, the "**commercial exchange rate**" was introduced at a level of 1.8:1 against the US dollar, as compared to the official exchange rate of 0.6:1. (At the same time, the DVK were eliminated and retention quotas increased to 15 % on average). The commercial exchange rate was used for current transactions of enterprises and centralized imports (financed from state currency holdings). The state authorities' intention was to create certain incentives for Soviet exports, but the increase in domestic wholesale prices (60 % in January 1991 and 130 % over the whole year) made the effects of this measure unclear. (Has been eliminated on January 1, 1992).

Beginning in 1992, Russia, as the successor to the USSR, introduced new exchange rates. Two exchange rates for the ruble against the US dollar are determined weekly by the Central Bank of Russia (CBR). Both of them are connected with the CBR's implementation of currency policy.

3) One, a **market exchange rate** of the CBR is used in the surrendering of 10 % of enterprises' currency earnings to the CBR for use in supporting the exchange rate in the foreign currency market. This exchange rate fluctuated from SUR 110 per US dollar to SUR 90, then to SUR 100 during first four months of 1992. 4) The second, a **special commercial exchange rate**, is determined by the CBR together with the Russian Ministry of Finance and is used by the Government for purchasing 40 % (in most cases) of enterprises' currency earnings for the creation of the Hard Currency Reserve of Russia. (The purpose of this Reserve is to service foreign debt and finance centralized imports.) This exchange rate was SUR 55 per US dollar in January-April 1992.

In addition, two accounting exchange rates were implemented in Russia.

5) One replaced the "commercial exchange rate"(point 2) above); it is equal to SUR 5.4 to the US dollar. This rate is used by enterprises to pay for imported goods financed by the Hard Currency Reserve and for certain other Reserve operations.

6) The second (SUR 10 per USD) applies to the tax payments of Russian citizens with income in hard currency.

7) At the end of 1989, the second officially established exchange rate appeared in the USSR - the "**tourist rate**", which was actually ten times the official rate. It was used for private currency operations: at this rate, foreigners were able to officially sell currency in the USSR and Soviet citizens going abroad were allowed to buy USD 200 a year. It was kept between SUR 5.5 and SUR 5.8 until April 2, 1991, when the ruble was devaluated to SUR 27.6 to the US dollar. It had to be changed weekly according to the value of the US dollar on the Currency Exchange (if the turnover in currency exceeded USD 10 million). But in practice it was devaluated by officials at the end of July 1991 (to SUR 32 per USD 1) and once

again at the beginning of November 1991 (to SUR 47 per USD 1). In December 1991 it was replaced by the **floating exchange rate of the commercial banks** that were allowed to trade with private persons in foreign currency.

8) On November 3, 1989, a **quasi-market exchange rate for enterprises** was introduced for the first time in the Soviet Union and the first currency auction took place in Moscow. USD 14.3 million were sold, and the average rate was SUR 8.92 per USD. At first, only state-owned enterprises were allowed to buy foreign currency, but later the only precondition for buying currency was possession of an importing contract or a guarantee that profits would be repatriated. Monthly currency auctions became common. In October 1990, they became biweekly, and beginning April 9, 1991, they were transformed into the "Currency Exchange" - virtually an interbank foreign currency market. From April 1992 trade in the Currency Exchange takes place twice a week. Access to this market is free to all enterprises (through intermediary banks) that either have importing contracts or repatriate profit. It was only a short time, June-July 1991, before restrictions were put on the use of foreign currency for importing certain goods (computers, cars, consumer goods and food). The average monthly volume of sales was about USD 15 million to 20 million in 1991, while the value of the dollar increased from SUR 8.92 (November 1989) to SUR 60 (October 1991), and to SUR 230 (January 1992), after which it declined to SUR 150 (March-April 1992) (Chart 2). The total volume of sales in 1991 was about USD 270 million, or approximately 5 % of enterprises' (after tax) hard currency earnings. The volume of sales in the first quarter of 1992 was USD 148 million, or 3.5 % of enterprises' earnings in hard currencies plus the Stabilization fund of the CBR.

9) Beginning in August 1991, enterprises were allowed to trade directly in currencies. These transactions were registered at the Gosbank of the USSR. According to estimates, the volume of such trade is slightly higher than the turnover of the Currency Exchange, and the exchange rate is lower by 10-20 %.

10) The black market for hard currency is spreading over the territory of the former USSR. The **black market rate** has been varying in different regions of the old USSR from SUR 125 to SUR 145 (April 1992) against the US dollar, though the process of exchange rate equalization is moving forward. The reform plan of the Russian government foresees the legal liberalization of trade in hard currency for private persons, and virtually the black market now is transforming into the currency market for private persons.

It is clear that all fixed (by the state authorities) exchange rates are now very artificial or play only an accounting role (5, 6), or are only "buying" rates for the state (3,4), or are used for the state's purposes only (1). In fact, there are only two legal ways (8, 9) for enterprises that are not buyers of centralized imported goods to purchase currency[3].

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[3] There is actually one more (illegal) way - so-called "currencies transfer": it is based on an agreement between a domestic firm and a foreign firm to exchange certain amounts of their currencies at an agreed rate. The domestic firm does not receive money on its account, but it receives access to money provided by the counter-partner, who is able to finance the transaction in its own country. This is prohibited by Russian authorities, but it still exists. No precise data on the amount of such transactions is available. But, as usual, the exchange rate used is higher (stronger ruble) than in the Currency Exchange.

Two possibilities exist for private persons. First, they are allowed to buy hard currency from banks for private travel abroad[4]; second, there is the black market.

We should not refer to the existing practice of foreign currency trade as a market: a small share of currency is circulating inside this framework, and several restrictions on access to these facilities are still in place. It is really a quasi-market, but, nonetheless, there is no other forum for monitoring changes in exchange rates except of the Currency Exchange and the black market. For this reason, I shall henceforth focus mainly on these free rates.

[4] This possibility was introduced long ago by the state. At that time such trips were rare, and the amount of sales was relatively small. The usual purchase was USD 200. When the number of Soviet tourists abroad increased and the shortage of foreign currency became severe, Vneshekonombank became unable to supply the needed amounts. In the end of 1991, for example, VEB was in a position to sell no more than USD 200,000 per day. When, in December 1991, commercial banks obtained the right to trade in currency, many virtually adopted the $200 norm, though it was never officially established by the state; others sell foreign currency only to their customers.

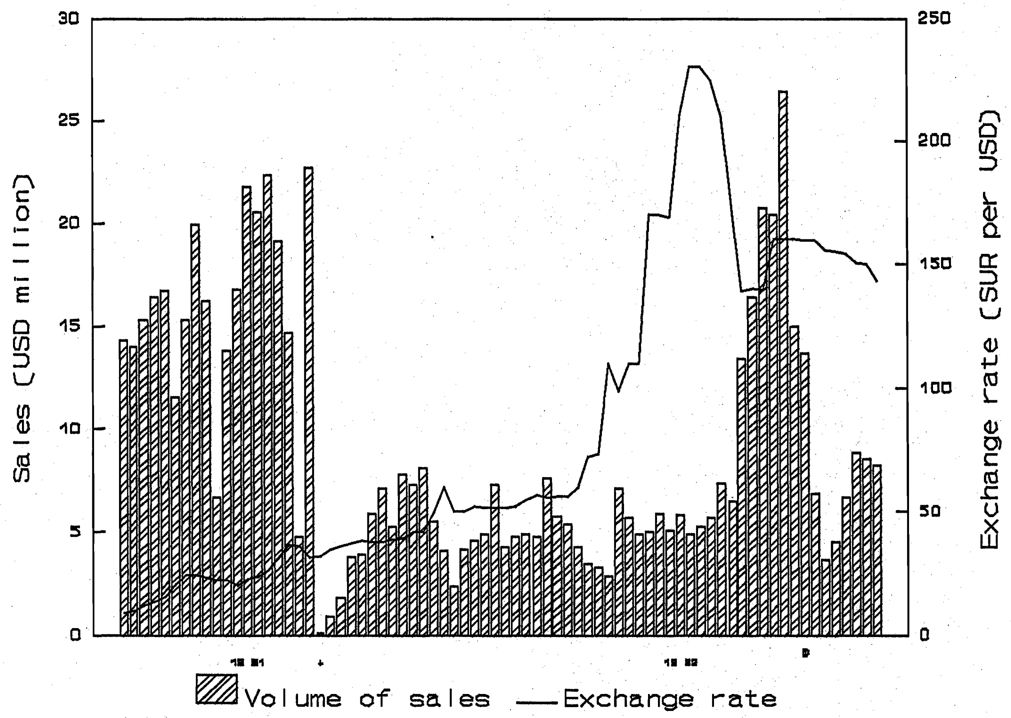
3 Factors that determine the free exchange rate

Currency supply. The export sector in the republics of the former USSR was, and is, very narrow: oil, gas, gold, some other raw materials and weapons together account for about 80 % of export earnings. The total volume of export earnings was USD 33.5 billion in 1990 and 31.8 billion in 1991 (excluding gold sales, which are totally under state monopoly), of which 85-90 % was surrendered to the state. In 1992, the surrender rate was reduced to 50 % in Russia, and a very complicated system of ruble taxation of exports was introduced, resulting in a substantial decline in exports in the first quarter of 1992. The experience of other East European countries shows that the private sector can not produce substantial export growth in the short run. The virtual bankruptcy of Vneshekonombank at the end of 1991 led to the freezing of about USD 3.5 billion on the accounts of enterprises and USD 5.4 billion on private accounts. It is very unlikely that these deposits will become more liquid in the short run.

One must understand that today the influence of supply on the exchange rate is very weak. The available data (Chart 2) gives no indication of a strong dependence of the value of the US dollar in the Currency Exchange on the volume of sales. Rather, we might conclude the opposite: the decline in the value of the ruble in January 1992 did not cause the increase in sales, while the increase in sales two months later was accompanied by a continuous rise in the value of the dollar.

Demand. During the last two decades the economy of the USSR became very dependent on foreign equipment and industrial goods and semi- manufactures. Today, every sector of the economy depends on imported goods. Despite being only loosely integrated in the world economy, the Soviet Union imported more than 50 % of its equipment needs in the textile, chemical and steel industries as well as 60 % of its trams and more than 20 % of its agricultural machines. Even smaller figures would indicate a lack of substitution possibilities inside the country. A decline in imports of industrial goods indicates a decline in output. In the old system, the state was responsible for financing these imports, whereas in the economies undergoing transformation that responsibility has to be given to enterprises themselves. And it is virtually impossible for them to earn foreign currency because their products are not competitive in the world market. Furthermore, these enterprises are unable to buy foreign currency in the market, previously because of fixed prices for their products and now because of low import efficiency of industrial goods (see below). This is the main reason for preserving centralized importing and a special exchange rate for this purpose.

Chart 2. **Turnover in the Currency Exchange, 10/1990 – 4/1992**



\+ – Beginning in April 1991 trade sessions are weekly.
@ – Beginning in April 1992, trade sessions take place twice a week.

Import efficiency. The free exchange rate, as mentioned above, is based on imports of several goods the sales of which may be more profitable. The ratio of net profit from sales of these goods (sales minus external price, multiplied by the exchange rate, minus all taxes) converted into hard currency to the amount of hard currency spent initially in import transaction is called the import efficiency among businessmen (virtually the rate of return). The import of consumption goods is much more profitable nowadays in all republics because of the high quality and advanced nature of such goods and because of increasing demand on the part of the society's of growing nouveau-riche strata. At the same time, traders are analyzing the domestic and world markets regularly, monitoring the change of import efficiency inside the country and new suppliers abroad.

According to some estimates, the marginal import efficiency for industrial goods would be positive if the free exchange rate of the ruble against the US dollar had been 20:1 (for equipment 12:1), in autumn 1991, when the actual free exchange rate was about 60:1.

Inflation. This was evidently a factor in the continuous increase in the value of the US dollar in the USSR, although there is no strict correlation between the general consumer price index and a change in the value of the "exchange basket".

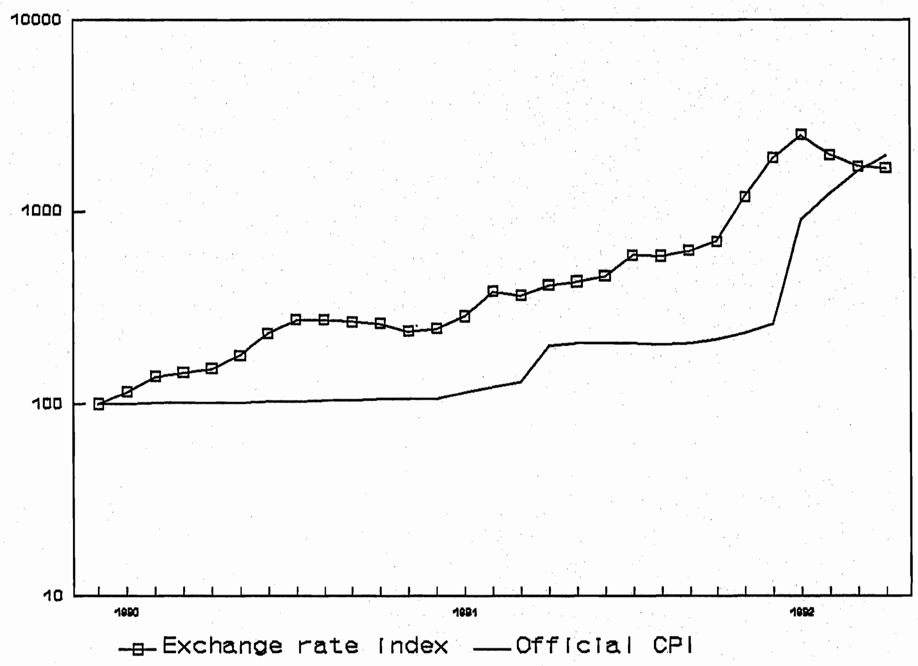
The significant factor in determining the exchange rate is the **uncertainty** of currency regulation in the USSR, and now in the republics. As usual, there are several rules and a lot of exceptions concerning certain exported or imported goods and certain exporters or importers. During the first quarter of 1992, these rules were revised three times. At the same time, the pressure coming from the state-owned enterpriser-exporters is always strong, and the state from time to time reduces the individual surrender rates for oil, coal etc., moving farther from a clear exchange rate policy.

4 Analysis of exchange rate dynamics in 1990 - 1992

There have been two distinct elements in Russian exchange rate dynamics during the last two years. The first element is the continuous depreciation of the ruble, and the second is effect of periodic shocks change on the value of ruble.

There is no doubt that the main trend in the ruble exchange rate over the period 1990-1992 is the ruble's continuous depreciation against the US dollar. The reason for this is clear: increasing financial disequilibrium in the Soviet economy, and now in the republics. Individuals and firms have had very high inflationary expectations during the last two years, and now the situation is continuing. We can see from Chart 3, that the price of the dollar increased faster than the official CPI until the beginning of 1992. On the one hand, this means that the exchange rate in the USSR was based on forecasted price changes, and that the change in the ruble exchange rate foresaw future price changes. (The slight fall of the ruble before price reform in April 1991 and its more serious decline at the end of 1991 are the best indicators of this behavior.) On the other hand, we have to remember that until 1992 inflation in the USSR took two forms - open and hidden - and while the official statistics measured only open inflation, the exchange rate was influenced by both types of inflation.

Chart 3. **Inflation and the Exchange Rate, 11/1989 – 4/1992 (11/1989 = 100, logarithmic scale)**



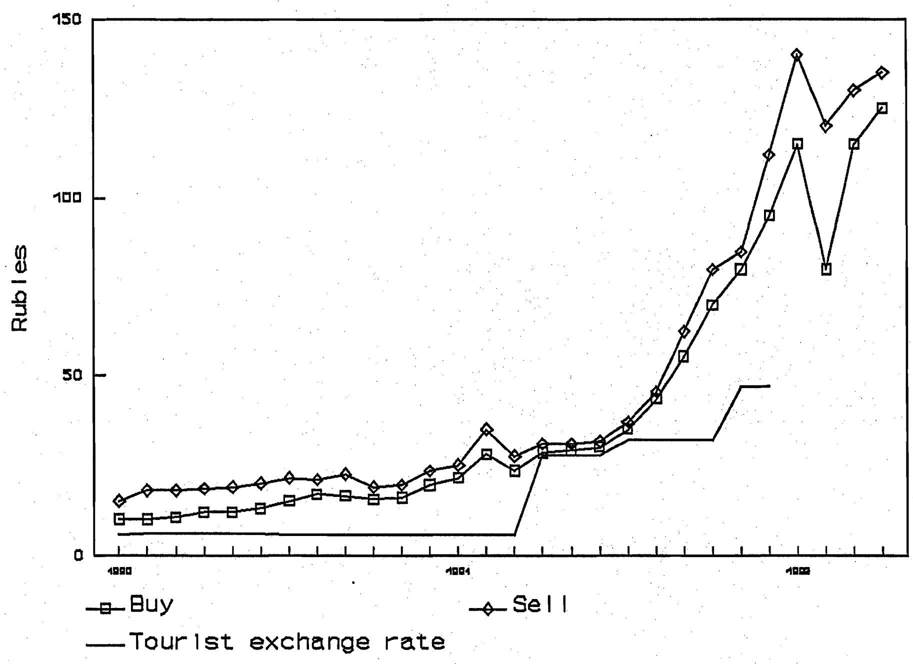
The second basis for the change in the ruble's value during the period 1990-1991 was political instability and uncertainty in the old USSR. This became clear in autumn 1991, when Russian leaders began to implement a policy leaning toward the disintegration of the USSR. A rapid rise in the value of the US dollar took place in the second half of October 1991, when several articles appeared in newspapers on the future of Russian economic policy. At this time Mr.Gaidar (first deputy prime minister of Russia) and his colleagues strongly pronounced for not only of the disintegration of the USSR, for also of the immediate introduction of Russian currency. The price of the US dollar increased from SUR 55-56 to SUR 70-72. And Mr.Yeltsin's official presentation at the end of October of his economic plan, which included price liberalization, led to a further depreciation of the ruble in the market to SUR 110 against the US dollar. Originally, the liberalization of prices had to take place in mid-December, and the value of the ruble declined by 50 % just before this date, both in the Currency Exchange and in the black market. This decline was supported by continuous talk on monetary reform in Russia. All this, together with inflationary expectations based on price liberalization, took place on January 2, 1992 and caused an unprecedented depreciation of the ruble in the market. The exchange rate in the Currency Exchange fell to SUR 230 against the US dollar or four times lower than it had been three months previously. For individuals, the decline of the ruble was much less than that for enterprises (SUR 140 against the US dollar or only 87 % lower than in October). At the end of January, the value of the ruble began to rise.

There were only two instances of a significant rise in the value of the ruble prior to 1992: in autumn 1990 and in February of 1991. Both were short-lived and caused by psychological reasons, in my opinion. The difficult debates on economic reform took place in autumn 1990 among the political leaders. Radical reform was anticipated by the market. The failure of the "500 days" plan in October 1990 and the decision on price reform at the beginning of November 1990 interrupted the rise.

The second instance, in February 1991, took place only in the black market and was connected with a certain contractation of money supply as a result of a quasi-monetary reform at the end of January 1991, when 50 and 100 ruble bank notes were exchanged with a small degree of confiscation (about 8.5 % of notes were not exchanged in total). But the market was expecting a continuation of this reform and the value of the ruble fell.

The increase in the value of the ruble in February 1992 was more significant and provoked a lot of discussion. In three weeks, the price of the dollar in the market fell by approximately 40 %, both in the Currency Exchange and in the black market. (Though in the black market the value of the dollar in "sell" transactions declined only by half as much.) The Russian government stated that it was the result of its stabilization efforts, but other experts were not so narrow minded in their views.

Chart 4. **Black Market Exchange Rate in Moscow, 1990–1992 (SUR per USD, unweighed average)**



In my opinion, this change in the free exchange rate took place for several reasons. Firstly, it was evident that the actual price of the US dollar might not be explained by economic factors. The autumn decline in the value of the ruble was caused mainly by political and psychological factors, and a backward movement of the exchange rate was needed to eliminate the previous extra margin entailed in it. Secondly, of course, the policy of the Russian government produced some results: the total money supply fell by approximately 70 % in January 1992 from the previous month. In addition, at that time, there was a severe problem regarding the printing of notes, which is still present. The indebtness of the banking system in cash payments to enterprises and private persons is over SUR 25-30 billion (20 % of the total cash ruble stock in Russia). Thirdly, due to the price liberalization, hidden inflation was eliminated and hence its influence on the exchange rate also disappeared. Forth, the Central Bank of Russia tried to maintain the new free exchange rate through intervention. According to the newspaper Commersant's data, the share of the CBR's supply in the total amount of sales was 75-85 % in mid--March 1992. Due to the currency resources of the CBR, the value of the US dollar, after having increased by 15 %, remained stable during the next eight weeks. There is one more hypothesis regarding the causation of the change in the value of the ruble: financial gambling based on hysterical behavior after a small decline in the value of the dollar value could have had a significant impact on the market.

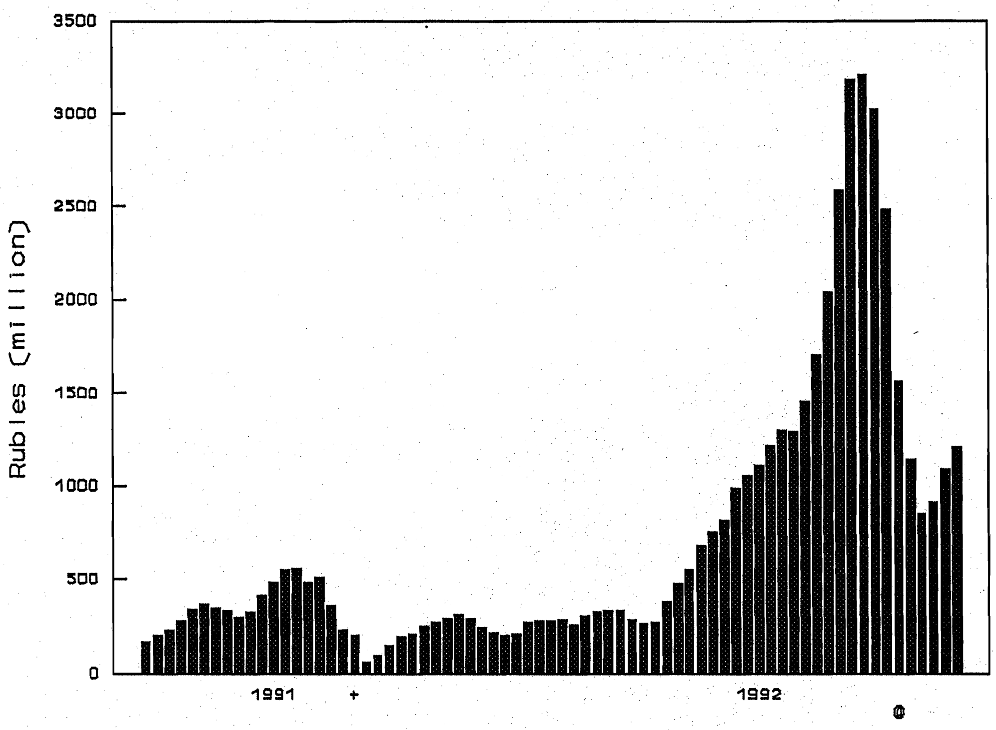
It should be pointed out that the fall in the black market exchange rate was not continuous: after ten days the price of the US dollar began to increase, reaching it's pre-decline value at the end of March. It can be partly explained by the natural equalization of the exchange rate in the black market and the Currency Exchange: in the beginning of April 1992 the difference was only 12.5 %,compared to about 40 % in mid-February. Part of the explanations lies in the substantial growth of cash emissions that took place beginning at end-February. The shortage of notes was slightly eased. At the same time, the credit policy of the CBR remained extremely restrictive during the first quarter of 1992, leading to an unprecedented increase in inter-enterprise indebtness: twenty-fold during the quarter.

After the four-weeks period of stability of the free exchange rate (March 1992) the value of the dollar began again to fall (from SUR 160 to SUR 143 per dollar), and the increase in the ruble's value was even more significant in the first week of May (SUR 128 per dollar). The main reason for this change, in my opinion, was the negotiating process of Russia with the IMF and a wait for the promised inflow of hard currency to Russia (Stabilization fund). The volume of supply virtually was stable during this period, while the volume of demand was decreasing.

The relative stability of the ruble demand for currency in the Currency Exchange is an important fact (Chart 5). This data proves that the actual exchange rate is not reasonable for the largest part of enterprises. The average (trade sessional) volume of exchanged rubles was between 250 million and 300 million from April 1991 (beginning of regular trade) and October 1991, i.e. during the period of monotonous increase in the dollar's value. The jump in the value of the dollar (end 1991) caused the adequate increase in amount of exchanged rubles, and the growth of currency supply accompanied by the decline of the dollar's value resulted in the increase in average amount of exchanged rubles up to 3 billion per session. The following decline in the value of the dollar, connected with a wait for Stabilization fund, virtually did not influence the demand for hard currency. Even more, there was a short term fall in the volume of the ruble supply. During April 1992 the average volume of demand for currency did not exceeded 1.4 billion rubles, having become lower in the first week of May.

The important moment of change in exchange rate dynamics over the last 15 months is the equalization of cumulated rates of inflation and ruble depreciation (Chart 3). Virtually all inflationary monetary overhang that existed in the USSR disappeared at the beginning of 1992. The potential influence of hidden inflation on the rise of the value of the dollar was eliminated at this point. It is natural that later on exchange rate dynamics will have to be more closely tied to the inflation rate in Russia.

Chart 5. **Ruble demand for hard currency in the Currency Exchange (floating four-sessions average)**



+ – Beginning in April 1991 trade sessions are weekly.
@ – Beginning in April 1992, trade sessions take place twice a week.

5 Projections for the future

It is evident that there has not yet been any apparent exchange rate policy on the part of the government in Russia. Actual official exchange rates are very artificial and are used within strict limits. Free ruble's exchange rates cannot be accepted as true rates and the value of the ruble is determined mainly by political and psychological factors. The market turnover is very small and can change substantially in a few days. The influence of speculative factors is also great. This is why it is very difficult to forecast changes in the free exchange rate, though I shall try to pinpoint which factors may influence the ruble exchange rate in the Russian market in the coming months and how it may come about.

First, we might consider the Russian government's Memo on Economic Policy and its further additions. According to the government intentions, a unified exchange rate for all current transactions has to be implemented from July 1992: it would float freely during a month and then would be fixed, allowing to fluctuate within a wide band – 7.5 per cent up or down. This means that the CBR will cease to implement the policy of artificial exchange rates. According to official's statement (Financial Times 06.05.1992) the exchange rate would possibly emerge at SUR 80 per dollar.

Second, it is evident that the first stabilization attempt of the Russian government failed, and inflation is high (above 30 % per month in February-April). The second stage of stabilization was postponed until May-June, and, as it is based on future increases in oil prices, will lead to a general rise in prices. On the other hand, it is a law of economics that you cannot maintain the value of your currency if you want to increase prices. This means that the exchange rate of the ruble will necessarily fall. There is therefore a contradiction between means (price liberalization) and ends (strengthening of the value of the ruble).

Third, the financial support promised by the G7 group, including the creation of a stabilization fund for the ruble may help to implement exchange rate policy and to strengthen the ruble. But this measure needs as a basic precondition the agreement between the republics on the future of the common monetary system and the coordination of their monetary policies. Until now, nothing has been done in this sphere. On the other hand, the difference between the actual market value of the dollar and the marginal acceptable (for domestic producers) value is too great. In this situation, there is a danger that the stabilization fund will be spent for private consumption (through purchasing of hard currency for importing consumer goods) without a significantly influencing the exchange rate of the ruble.

Fourth, the continuous change in foreign currency regulations will not help calm the market. The chaotic foreign trade regulations add to the confusion; and the general economic decline will lead to a decline in exports, first in manufactured goods. Furthermore, the decline in oil production is continuing, whereas the domestic consumption of oil has not decreased as has been anticipated by the government. The limited technical capacity to increase oil exports also has to be taken into account: there is no agreement with Latvia and the Ukraine on the use of oil pipelines in their territory and their specialized ports (Odessa and Ventspils). All this will lead to a slowing of the inflow of foreign currency. At the same time, the demand for currency will grow because of greater trade activity and imports of consumer goods, and because the importing of industrial goods is one of the most effective instruments in the struggle against industrial decline. The deferral of foreign debt servicing might have a beneficial effect, but most forecasts indicate a negative current account balance for Russia in 1992, and the situation in the other republics is much worse. The aid package promised by the G7, if realized, could ameliorate the situation.

Fifth, it is evident that state enterprises are not very competitive internationally. This portends an inevitable contradiction between the government's financial and industrial policies. Improving the viability of the production process requires that the industrial sector have access to foreign currency, presumably, through the re-introduction (or non-elimination) of its own special exchange. This will place a substantial burden on the budget. And the tight financial policy will produce a freeze of the production process and an avalanche of bankruptcies. An economic collapse is certainly possible outcome.

6 Conclusion

The transformation of command economies in former socialist countries is accelerating. The experiences and actual results differ among the different countries. Nevertheless, there is a widely held viewpoint that the internal convertibility of the domestic currency could be used as an effective instrument of the transformation in the earliest stage of the reform[5]. The Russian government supports this idea and intends to introduce internal convertibility of the ruble in the near future. In this situation, the political decision on the initial exchange rate is crucial.

During the Conference organized by the IIASA in summer 1990, the dominant viewpoint was that a reasonable and competitive exchange rate for the ruble would be SUR 5-6 against the US dollar. Now, domestic prices are twelve times higher and they could continue to rise. A simple extrapolation shows that (after ex post depreciation) a reasonable exchange rate for the ruble would be about SUR 50-60 per US dollar today, provided the state could support it. Taking into account the ongoing inflation, the governmental target (ex ante) might be an exchange rate for the ruble of about SUR 100 per US dollar. If oil prices are liberalized or increased two- or three-fold, a future significant depreciation of the ruble is inevitable.

[5] In my opinion, the opposite viewpoint is more likely to hold: convertibility is a result of economic development and economic transformation. I do not beleive that the depreciated exchange rate of the domestic currency will prove to have significant positive effects on the economy. But this is a topic for another paper.

Appendix 1. **Black market exchange rate in Moscow**

						Tourist
1960	3.85	1990	January	10.0	15.0	5.60
1961	2.28		February	10.0	18.0	6.01
1962	3.57		March	10.5	18.0	6.12
1963	3.49		April	12.0	18.5	6.07
1964	3.28		May	12.0	19.0	5.97
1965	3.02		June	13.0	20.0	5.98
1966	4.08		July	15.0	21.5	5.86
1967	4.28		August	17.0	21.0	5.64
1968	5.35		September	16.5	22.5	5.69
1969	5.44		October	15.5	19.0	5.54
1970	5.89		November	16.0	19.5	5.51
1971	5.40		December	19.5	23.5	5.64
1972	4.16	1991	January	21.5	25.0	5.52
1973	3.96		February	28.0	35.0	5.56
1974	3.05		March	23.5	27.5	5.84
1975	3.18		April	28.5	31.0	27.6
1976	3.72		May	29.0	31.0	27.6
1977	3.87		June	30.0	31.5	27.6
1978	4.05		July	35.0	37.0	32.0
1979	4.05		August	43.5	45.5	32.0
1980	3.98		September	55.5	62.5	32.0
1981	3.75		October	70.0	80.0	32.0
1982	3.88		November	80.0	85.0	47.0
1983	4.08		December	95.0	112.0	
1984	4.59	1992	January	115.0	140.0	
1985	4.93		February	80.0	120.0	
1986	4.06		March	115.0	130.0	
1987	4.27		April	125.0	135.0	
1988	5.50					
1989	10.00					
1990	20.00					

Source: 1960-1990. A.Meyendorf "The Black Market for Foreign Currency Berkley-Duke Occasional Papers on the Second Economy in the Paper N 32, December 1991.
1990-1992. Commersant (various issues).(mid-month, unweighted average)

Appendix 2. **Trade in the Currency Exchange** (Moscow) $ mill (SUR per USD)

Date	Volum	Exchange rate	Date	Volum	Exchange rate
Nov. 3,89	14.3	8.92	Sept. 3	4.8	52.20
Jan. 17,90	14.0	10.27	Sept. 10	4.9	55.00
Feb. 21	15.3	12.32	Sept. 17	4.8	57.00
Apr. 05	16.4	13.52	Sept. 24	7.6	56.00
May 10	16.7	15.91	Oct. 1	5.8	56.50
June 22	11.6	20.59	Oct. 8	5.4	56.50
July 19	15.3	24.17	Oct. 15	4.3	60.10
Aug. 31	19.9	24.17	Oct. 22	3.5	72.30
Oct. 9	16.2	23.47	Oct. 29	3.3	73.10
Oct. 25	6.7	22.29	Nov. 5	2.9	110.00
Nov.15	13.8	22.29	Nov. 13	7.1	98.80
Nov.30	16.8	20.18	Nov. 19	5.7	110.00
Dec.14	21.8	22.88	Nov. 26	4.9	110.00
Jan. 8,91	20.5	24.11	Dec. 10	5.0	170.10
Jan. 24	22.3	26.40	Dec. 17	5.9	169.90
Feb.13	19.1	31.68	Dec. 24	5.1	169.20
Feb. 28	14.7	36.96	Jan. 14,92	5.85	210.0
Mar. 14	4.8	36.08	Jan. 21	4.92	230.1
Apr. 5	22.7	31.68	Jan. 28	5.3	230.0
Apr. 9	0.1	32.35	Feb. 4	5.73	224.5
Apr. 16	0.9	35.00	Feb. 11	7.38	210.0
Apr. 23	1.8	36.30	Feb. 18	6.52	170.0
Apr. 30	3.8	37.10	Feb. 25	13.45	139.0
May 14	3.9	38.40	Mar. 3	16.38	140.1
May 21	5.9	38.00	Mar. 10	20.72	140.0
May 28	7.1	37.90	Mar. 17	20.42	160.5
June 4	5.3	38.60	Mar. 24	26.43	160.4
June 11	7.8	39.60	Mar. 31	14.95	160.3
June 18	7.3	42.00	Apr. 2	5.25	160.0
June 25	8.1	42.00	Apr. 7	6.87	159.7
July 9	5.5	49.60	Apr. 9	3.68	155.7
July 16	4.1	60.00	Apr. 14	4.56	155.0
July 23	2.4	50.00	Apr. 16	3.93	154.0
July 30	4.2	50.00	Apr. 21	8.85	150.5
Aug. 6	4.6	52.10	Apr. 23	5.54	150.0
Aug. 13	4.9	52.00	Apr. 28	8.25	143.6
Aug. 20	7.3	51.90			
Aug. 27	4.3	51.90			

Source: Ekonomika i zhizn, Izvestia, Commersant (various issues)
Trade sessions beginning in April 1991 took place weekly.
Trade sessions beginning in April 1992 took place twice a week.

Appendix 3. **Official consumer price index in the USSR/ Russia**

1989 November 100.0

1990	January	100.4	1991	January	114.3	1992	January	900.4
	February	100.8		February	121.1		February	1234.8
	March	101.3		March	129.0		March	1620.7
	April	101.8		April	199.9		April	1944.8
	May	102.3		May	203.9			
	June	102.9		June	204.5			
	July	103.6		July	203.7			
	August	104.1		August	203.3			
	September	104.7		September	206.3			
	October	105.4		October	215.0			
	November	106.1		November	232.4			
	December	106.9		December	257.3			

Source: Goskomstat.

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