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DEVELOPMENT AND INTERNATIONAL ECONOMIC CO-OPERATION

Current international monetary issues

Report of the Secretary-General

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CONTENTS (continued)

I. INTRODUCTION AND SUMMARY

1. This report follows two others prepared for the General Assembly on international monetary issues (A/43/749 and Corr.1 and A/42/555). There are three chapters, dealing with recent trends in monetary variables and international payments, monetary issues in developing countries, and the convertibility of the Soviet rouble (an issue that has attracted much attention recently, in both the Soviet Union and internationally). In an annex, some recent developments are outlined regarding the convening of an international conference on international monetary and financial issues.

2. The period since the crash of the stock market in October 1987 has witnessed increased volatility of the exchange rates of the major currencies; reduced use of monetary policy for exchange-rate management; an upward trend in interest rates; and absence of a steady decline in the trade imbalances of the major market-economies. The instability in exchange rates appears to have stemmed more from uncertainty regarding the course of monetary policy in the United States than the evolution of trade imbalances and differences in interest rates. Economic indicators have been volatile and given conflicting signals, causing expectations to shift between inflation and recession, and between monetary tightening and relaxation. Intervention in currency markets has increased significantly following the meeting of the Group of Seven in September 1989, and has helped to push the dollar down to levels more conducive to trade adjustment. It may no longer be possible, however, to prevent the dollar from rising in the short term without increasing interest rates in Western Europe and Japan. A speculative attack on the dollar could also eventually take place, in which case a sharp increase in United States interest rates would be necessary. In short, defending present patterns of exchange rates may require a rise in interest rates somewhere, whether that defence is against upward or downward pressure on the dollar. The magnitude of trade imbalances may make it very difficult to manage inflation, growth and exchange rates with monetary policy alone. Fiscal policy must therefore become more flexible.

3. In the 1980s, most developing countries have devalued their currencies in order to adjust to declines in export prices, rises in interest rates and cutback in lending. In many cases, particularly where there was a debt overhang, the effect has proved extremely destabilizing. Since the adjustment process has also led to a sharp fall in investment in capacity expansion, continued depreciations designed to switch current output from domestic to foreign markets have been needed. These have triggered distributional conflicts, for total resource availability itself has declined as a result of the collapse of growth and sharp decline in external resource transfers. Depreciations have also destabilized demand and added to budget deficits and hence monetary expansion, by raising the domestic currency cost of debt service and of imports for public investment; those effects have often outweighed the revenue-increasing effect of depreciation in part, because import levels have been cut and tariffs reduced. Moreover, real exchange rates have tended to fluctuate, and the resulting unpredictability has

been unhelpful to exports. It is thus essential to reduce reliance on depreciations and achieve external adjustment by lifting investment, particularly in the tradeable goods industries. A substantial increase in external resources is therefore needed, through debt reduction and other means.

4. The question of the convertibility of the rouble and the liberalization of Soviet external payments arrangements more generally is closely related to the restructuring of the economy of the USSR and its integration with the international trading and financial systems. Convertibility requires that the rouble be given more command over domestically produced goods and services than has proved possible under the régime of comprehensive central planning. This will require (a) the removal of the present rouble overhang and the maintenance of balance between aggregate demand and supply capabilities, (b) radical changes in relative prices and (c) an increased role for enterprises and prices in resource allocation. Appropriate investment, trade and exchange-rate policies designed to increase availabilities of foreign exchange and improve its allocation will also be needed. Success in all these areas is essential before limited liberalization of foreign-exchange control can be followed by full convertibility of the rouble. Achieving the correct sequence of reforms is of crucial importance, as is the development of a new array of policy instruments. There is a danger that premature liberalization of exchange and payments arrangements may generate acute difficulties, such as increasing substitution of convertible currencies for the rouble in the domestic economy.

5. The liberalization of Soviet external payments arrangements must be geared to the overall objectives of economic reform, in particular to making a contribution to the expansion of the exports to, and imports from the Union of Soviet Socialist Republics, and all its trading partners. Thus, measures need to be taken to liberalize not only arrangements vis-à-vis convertible currencies, but also those used in trade with developing countries and with other countries in the Council for Mutual Economic Assistance (CMEA).

II. RECENT DEVELOPMENTS IN THE INTERNATIONAL MONETARY SYSTEM

A. Recent trends in monetary variables and international payments

1. Exchange rates

6. From the Louvre Accord of February 1987 and up to October 1987, the exchange rates of the major currencies became relatively stable. This was largely owing to the international co-ordination agreed to at the Louvre meeting, which consisted of market intervention by central banks and measures of monetary policy. Following the stock market crash of October 1987, however, exchange rates have once again exhibited considerable instability. Whereas the swing (that is, the difference between the highest and lowest values) of the monthly nominal effective exchange rate of the dollar had been about 3.6 per cent of the average value of the exchange rate index between February 1987 and October 1987, from October 1987 to July 1989 it amounted to 11.8 per cent.

7. Over the past two years, periods of downward pressure on the dollar have alternated with periods of upward pressure. After a drop of almost 10 per cent between September 1987 and April 1988, the dollar strengthened markedly from mid-1988 onwards for about five months, before falling back close to its earlier trough by the end of the year. It began to rise again in 1989, and by end-June 1989 its nominal effective exchange rate was back to its February 1987 level (that is, 12 per cent above its lowest level in April 1988). In recent months, the dollar has appreciated considerably against the currencies of the two main surplus economies; from the end of 1988 to September 1989 it rose by 18 per cent against the yen and 13 per cent against the deutsche mark.

8. The nominal effective exchange rate of the yen moved symmetrically with the dollar. Owing to considerably lower-cost inflation in Japan, however, the yen underwent a significant depreciation in real terms - something clearly unhelpful for correcting the payments imbalance. Similarly the pound sterling strengthened considerably between early 1987 and the beginning of 1989, despite the rapid widening of the British current-account deficit during 1988 and early 1989; this and inflation raised the real effective exchange rate by as much as 15 per cent between mid-1987 and mid-1989. No "fundamental" changes in the pattern of economic performance have occurred to warrant such movements in exchange rates. It appears that, over the past 10 to 15 months, trade balances have lost influence over currency developments, while monetary and financial factors have gained.

9. Both the magnitude of swings in exchange rates in 1988/89 and the direction of changes since late 1988, when trade adjustment slowed down, indicate that exchange rate management has been much looser than in the immediate aftermath of the Louvre Accord. Intervention in foreign exchange markets has been less pronounced after the October 1987 stock market crash, and barely any action taken on interest rates has been designed with exchange rate considerations at the forefront.

Table 1. Exchange rates of major currencies

Date	Nominal effective rates a/			
	United States dollars	Yen	Deutsche mark	Pounds
February 1987	100.0	100.0	100.0	100.0
May 1987	96.5	107.7	99.4	106.2
September 1987	97.0	106.3	99.0	105.9
December 1987	90.1	113.4	102.2	109.8
April 1988	89.0	117.1	100.3	113.4
June 1988	91.0	117.1	98.6	110.6
September 1988	95.6	114.0	97.2	109.4
December 1988	89.8	120.2	98.2	112.9
March 1989	94.0	117.0	96.4	110.5
June 1989	95.5	109.3	95.5	105.0

Date	Index of bilateral exchange rates (dollar per currency units)					
	Yen	ECU	Deutsche mark	Pounds	Swiss francs	Canadian dollars
February 1987	100.0	100.0	100.0	100.0	100.0	100.0
May 1987	109.3	102.3	102.2	109.2	105.0	99.5
September 1987	107.3	101.2	101.1	107.5	102.7	101.4
December 1987	119.4	111.9	112.3	119.6	116.0	102.0
April 1988	122.9	109.8	109.6	122.9	111.5	108.0
June 1988	120.4	104.8	104.0	116.5	105.6	109.6
September 1988	114.3	98.3	97.9	110.0	97.8	108.8
December 1988	124.2	104.8	104.0	119.6	104.3	111.5
March 1989	117.5	98.7	97.9	112.4	96.1	111.6
June 1989	106.7	92.7	92.4	101.5	90.6	111.3

Source: IMF, International Financial Statistics, various issues.

a/ According to the IMF Multilateral Exchange Rate Model.

2. <u>Balance of payments</u>

10. The process of adjusting global payments imbalances slowed down considerably after mid-1988 despite a more favourable geographical pattern of global demand. After falling substantially in 1988, the United States current account deficit virtually stopped falling in late 1988 and the first quarter of 1989 with both prices and volumes of imports picking up again; interest payments abroad continued to rise, causing the services balance to turn negative. More recently the United States trade balance seems to have improved again, but the trade deficit for 1989 is not likely to be smaller than in 1988. The United Kingdom, as mentioned, moved deeper into deficit in 1988 and 1989; this reflected a rapid increase in imports alongside the strengthening of sterling.

11. The surpluses of Japan and the Federal Republic of Germany both widened once again, but with a striking difference in their geographical distribution (see table 3). The bilateral surplus of the Federal Republic of Germany with the United States has continued to fall in 1988 and 1989, but this has been more than offset by a large increase in its surplus with its other trading partners which are mainly in the European Communities. By contrast, the Japanese surplus on trade with the United States has increased since the fourth quarter of 1988, almost entirely owing to a volume effect; 1/ on the other hand, the figures for the first quarter of 1989 suggest that its surplus with Western Europe has shrunk. Whereas the Japanese surplus on trade with the United States is likely to reach $53 billion this year, which is not much less in nominal terms than in 1986, United States trade with Western Europe will be more or less balanced, after a swing of around $30 billion over the three-year period.

12. This disparity in trade adjustment cannot easily be explained by changes in exchange rates or in the pattern of domestic demand growth. Since September 1985 the dollar has depreciated by much the same margin against the deutsche mark and the ECU (European Currency Unit) as against the yen. Real domestic demand has grown faster in Japan than in Western Europe, whose composition of demand growth has been no more conducive to United States exports than Japan's. The surprising rigidity of the United States trade imbalance with Japan has led many observers to attribute it to trade policies. Be that as it may, it has fuelled protectionist sentiment in the United States and may have played an important role in the adoption of the Omnibus Trade Expansion and Competitiveness Act of 1988.

13. In 1985 to 1987, a number of East Asian economies registered rapidly growing surpluses, particularly with the United States. More recently, however, these surpluses have been reduced. A dramatic change has taken place in the external balances of the Republic of Korea, where rising wage costs and currency revaluation (amounting to around 23 per cent since February 1987) have eroded the country's competitive advantage. Thus, after reaching a new record level of more than $14 billion in 1988, that country's current-account surplus in the first four months of 1989 dropped to around half the level of the previous year, mainly due to reduced exports.

Table 2. Balance of payments on current account, exports and imports in the United States, Japan, Federal Republic of Germany and selected countries in Asia, 1986-1989

(Billions of dollars, unless otherwise specified)

	1986	1987	1988	1989 a/
United States				
Current account balance	-138.8	-153.9	-135.1	-125.0
Trade balance	-144.5	-160.3	-126.3	-118.0
Merchandise exports	224.0	249.6	320.1	368.0
Merchandise imports	-368.5	-409.9	-446.4	-486.0
Changes (percentage)				
Export volume	5.9	14.5	22.1	11.0
Import volume	13.5	4.5	6.9	5.0
Japan				
Current account balance	85.8	87.0	79.3	80.0
Trade balance	92.8	96.5	95.0	100.0
Merchandise exports	205.6	224.6	259.8	292.0
Merchandise imports	-112.8	-128.2	-164.7	-192.0
Changes (percentage)				
Export volume	-0.6	0.4	4.3	10.0
Import volume	10.6	9.0	16.7	10.5
Federal Republic of Germany				
Current account balance	39.9	45.6	48.6	48.0
Trade balance	55.7	69.9	78.6	78.0
Merchandise exports	231.0	278.1	308.9	324.0
Merchandise imports	-175.3	-208.2	-230.2	-246.0
Changes (percentage)				
Export volume	1.3	2.3	5.8	7.0
Import volume	6.1	5.0	6.6	7.0
Major exporters of manufactures in Asia b/				
Current account balance	23.1	30.5	26.0	22.0
Trade balance	18.8	25.2	18.5	15.0
Merchandise exports	130.2	175.3	218.6	252.0
Merchandise imports	-111.3	-150.1	-200.1	-237.0

Table 2 (continued)

	1986	1987	1988	1989 a/
Changes (percentage)				
Export volume	20.6	22.3	15.7	11.0
Import volume	10.5	25.1	23.1	15.0

Source: International Monetary Fund, World Economic Outlook, April 1989; OECD, Economic Outlook, No. 45 (June 1989); and OECD, Main Economic Indicators (September 1989).

a/ Projections.

b/ Hong Kong, Republic of Korea, Singapore and Taiwan Province of China.

14. The deficit of African countries widened as terms of trade worsened and export volume stagnated (notably in sub-Saharan Africa). Latin America's deficit on current account hardly changed in 1988, despite an increase in export earnings of $13 billion. One third of this was absorbed by higher international interest rates, but imports increased by around $9 billion, all of which was reflected in higher United States exports. Consequently, while the region's trade surplus with Europe and Japan increased (by around $7.5 billion), its surplus with the United States shrank (by more than $4 billion). The improvement in the United States nominal trade balance with Latin America (three quarters of which are accounted for by Mexico) was thus in the same order of magnitude as the improvement in its balance with Japan. The United States trade balance with Latin America has continued to improve in 1989.

15. A further strengthening of the developing countries' import capacity, which is badly required to give new momentum to their development, could facilitate the solution of the remaining payments imbalances among the developed market economies, in the first place by increasing United States exports. There has been a tendency for international payments disequilibria to be turned into bilateral problems, in particular between the United States and Asian countries, and between the Federal Republic of Germany and other European countries. Bilateral imbalances would cause less trade and exchange rate friction if global trade balances were broadly in equilibrium. Currently, the continuing weakness of the import capacity of developing countries renders further progress in the reduction of the United States external deficit more difficult without a reduction of its bilateral trade imbalances with other developed market economies. It is questionable, however, whether the current pattern of exchange rates is conducive to such a bilateral correction.

Table 3. Changes in bilateral trade balances a/ of the United States, Japan and the Federal Republic of Germany, 1987-1989

(Billions of dollars)

	Change over same period of previous year					Trade balance
	1987	1988	1988 Quar. III	1988 Quar. IV	1989 Quar. I	1988
United States trade with:						
Japan	-1.3	4.3	1.2	-0.7	-0.2	-52.1
Canada	11.7	-0.4	0.2	0.9	0.7	-11.7
Western Europe:	2.6	13.2	3.6	3.3	2.5	-12.3
Germany, Federal Republic of	-0.8	3.1	0.6	0.7	1.1	-12.2
United Kingdom	0.7	3.6	1.1	0.9	0.6	0.4
Developing countries:	-14.7	12.8	5.4	4.3	2.1	-49.9
Latin America	-1.2	4.0	1.1	1.9	1.3	-8.8
Major exporters of manufactures in Asia b/	-6.3	5.8	1.9	0.2	1.1	-28.4
Japanese trade with:						
Western Europe	3.5	2.6	0.6	0.3	-1.1	25.6
Developing countries:	-4.1	2.1	1.4	3.5	0.6	9.4
Major exporters of manufactures in Asia b/	3.1	4.0	1.2	1.7	0.7	24.8
Trade of the Federal Republic of Germany with:						
Western Europe:	14.9	12.7	2.9	2.0	4.0	66.2
United Kingdom	2.7	3.3	0.8	0.7	0.8	12.7
France	2.0	1.4	0.3	-0.1	1.1	10.4
Developing countries	-1.5	-2.3	-0.0	-0.8	1.0	-1.0

Source: OECD, Monthly Statistics of Foreign Trade, various issues.

a/ Figures are for imports (c.i.f.) and exports (f.o.b.) for Japan and the Federal Republic of Germany, and for imports (f.o.b.) and exports (f.a.s.) for the United States. A negative sign indicates a deficit, or a move towards deficit.

b/ Hong Kong, Republic of Korea, Singapore and Taiwan Province of China.

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3. Interest rates and financial markets

16. Short-term interest rates have been rising sharply since the middle of 1988 onwards. After some relaxation following the stock market crash of October 1987, monetary policy became much more restrictive, especially in the United States, the United Kingdom and the Federal Republic of Germany. Short-term interest rates in the United States shot up from under 6 per cent in 1987 to more than 9 per cent in 1989 and, with the inflation rate up 1 percentage point, so did real interest rates. Much the same was true for the Federal Republic of Germany, where short-term rates rose by 2.7 percentage points between 1987 and 1989, and Japan, where the rates rose by 1 percentage point. The tightening of monetary policy and the rise in interest rates have largely been a reflection of the increased concern of central banks, particularly in the United States and Western Europe with inflation. Long-term interest rates have either risen much less or even fallen. With inflation and nominal short-term interest rates rising in the deficit countries, interest rate differentials tended to widen in their favour during the second half of 1988.

17. Changes in short-term interest rate differentials <u>per se</u> appear not to have been the driving force behind capital movements and the resulting changes in exchange rates. On the two occasions when the dollar strengthened against the deutsche mark (that is, April-August 1988 and November 1988-June 1989) the short-term interest differential in favour of the dollar was narrowing. Also, the two phases of a weakening dollar (early 1988 and October-November 1988) both saw a rising interest differential in favour of the dollar. Similarly, the dollar depreciated against the yen during the last quarter of 1988, just when the interest rate differential widened in favour of dollar assets.

18. This suggests that market sentiment regarding the future value of the dollar has been a more important determinant of the dollar exchange rate. Market sentiment has been quite volatile, as witnessed by the sharp swings in the dollar since the end of 1987. A full explanation of speculative behaviour is difficult, but one factor stands out. Since the stock market crash, there has been much uncertainty regarding the course of United States economic performance. Movements in main indicators such as prices, unemployment and capacity utilization have been volatile and sometimes given conflicting signals, causing markets to alternate between fears of inflation and fears of recession. Consequently, there has been much uncertainty over the future course of monetary policy and its potential effects on both interest and exchange rates, all the more as the external payments situation has not been an explicit goal of monetary policy in the United States. Perhaps the main reason why movements in the trade balance have not exerted a significant influence on exchange rates is that the trade deficits have not been expected to trigger corrective policy action whether monetary or fiscal. However, the relatively long phase of dollar appreciation since late 1988 indicates that market sentiment has been firming around the expectation that the stance of monetary and fiscal policy will remain constant for some time. With financial markets expecting existing short-term interest rate differentials either to persist or to widen and seeing only a small likelihood of a dollar depreciation, private capital flows into the United States have picked up, financing the current-account deficit.

Table 4. Short-term nominal interest rates a/ in selected OECD countries, 1985-1989

	United States	Japan	Federal Rep. of Germany	United Kingdom	France	LIBOR
1985	8.1	6.5	5.4	12.2	10.1	8.4
1986	6.5	5.0	4.6	10.9	7.7	6.9
1987	6.9	3.9	4.0	9.7	8.1	7.2
1988	7.7	4.0	4.3	10.3	7.8	8.0
1988 Quarter I	6.7	3.8	3.4	9.0	7.9	7.0
Quarter II	7.2	3.8	3.5	8.3	7.8	7.5
Quarter III	8.2	4.0	5.0	11.3	7.6	8.4
Quarter IV	8.8	4.2	5.1	12.4	8.1	9.0
1989 January	9.2	4.2	5.6	13.1	8.6	9.4
February	9.5	4.2	6.4	13.0	9.1	9.7
March	10.1	4.2	6.6	13.0	9.1	10.3
April	9.9	4.2	6.4	13.1	8.6	10.2
May	9.6	4.3	7.0	13.1	8.8	9.8
June	9.2	4.5	7.0	14.1	8.9	9.4

Source: Federal Reserve Bulletin, various issues; IMF, International Financial Statistics, various issues.

a/ National rates are for three-month interbank loans, except for the United States (Certificate of deposit rate), and Japan (Gensaki rate). LIBOR is for three-month Eurodollar deposits.

19. While capital movements from surplus to deficit economies are a necessary counterpart to the pattern of current-account balances, private flows in that direction require an incentive in the form of favourable profit expectations which, in the case of the purchase of financial assets, depend on both interest rate differentials and exchange rate expectations. If that incentive is not strong enough, either the exchange rate of the deficit country has to fall or the deficit on current account has to be settled officially through intervention, implying the sale by central banks of currency of the surplus country against currency of the deficit country. That had been the experience of 1987, when huge amounts of foreign exchange reserves were accumulated by central banks in surplus countries in an effort to stabilize the dollar. By contrast, in 1988/89, there has been a tendency for private "overfinancing" of current account deficits, hence the weakening of the deutsche mark and the yen, and strengthening of the dollar. Such "overfinancing" may well occur through a kind of bandwagon effect, if markets regard the fact that a current-account deficit is being privately financed as a proof that the deficit is sustainable. Such a view will strengthen "confidence", triggering new capital inflows, including long-term capital movements (which have, indeed, been growing).

4. Foreign exchange reserves

20. In 1988, world foreign exchange reserves expanded by $31 billion compared to $173 billion in the previous year. Central banks intervened much less in foreign exchange markets, and, when they did so, it was generally to keep the dollar from rising. Official dollar reserves fell sharply and there was a marked change in the currency denomination of foreign exchange reserves. Deutsche mark reserves grew by almost $30 billion, reflecting in part official support purchases by the United States and member countries of the European monetary system, and in part diversification of official reserve holdings by other countries. 2/

21. Japan accumulated foreign exchange reserves of almost $16 billion, and Canada, the only country of the Group of Seven whose currency appreciated against the dollar after mid-1988, increased its non-gold reserves by more than $8 billion. The Federal Republic of Germany sold more than $20 billion in foreign exchange market interventions, equivalent to 75 per cent of the amount it had accumulated during 1987. The reserves of all developing countries taken together rose for the second consecutive year. While the reserves of oil-exporting countries in the Middle East fell by 10 per cent, those of the other developing countries rose by 5 per cent. The Republic of Korea stepped up its official reserve holdings by close to $9 billion. More than 40 per cent of the foreign exchange reserves of developing countries are now held by the newly industrialized economies in Asia. The liquidity problems of many other developing economies in Africa and Latin America remain unresolved.

B. Exchange rate management and international policy co-ordination

1. Changed orientation of monetary policy

22. The Louvre Agreement on exchange rate management encompassed agreement to take measures of monetary policy to underpin intervention, but stopped short of co-ordinating macro-economic policies. It therefore put a strain on monetary policy, which eventually triggered the sharp rise in interest rates, which, in turn, prompted the stock market to crash in October 1987. Monetary policy was then eased, particularly in the United States. This succeeded in containing financial market turbulence and in avoiding a recession, but it also meant a relaxation of exchange rate management: monetary policy became oriented to domestic objectives. The perception of an inflationary danger mounted as output growth intensified, and the choice between exchange rate and domestic stability in deficit countries came increasingly to be decided in favour of the latter. For instance, lower United States interest rates might have checked the recent dollar appreciation, but this was considered to be inimical to domestic price stability. Exchange rate management has therefore tended to consist simply of concerted intervention.

23. Inflation rates in many developed market economies, however, have remained well below their level of the early 1980s. Much of the rise in inflation in the United States since mid-1988 has been due to the sharp increase in food prices caused by drought. In Japan and the Federal Republic of Germany, rising import

prices resulting from world commodity markets and currency devaluation were an important factor in the rise in the consumer price index in the course of 1988 and 1989. In the Federal Republic of Germany, the swing in consumer price inflation in 1988 can almost entirely be attributed to the rise in import prices. Moreover, there was no sign of a return of the cost-price spiral of the 1970s. This suggests that inflation could have been kept at a low level by overall demand management without depressing growth. Indeed, there was widespread uncertainty about the extent to which demand growth had to be restrained by monetary tightening. 3/

2. Perspectives of policy co-ordination

24. A key question that arises in any co-ordination exercise is the extent to which payment imbalances are sustainable and for how long. There is no fixed rule, and sustainability needs to be judged in the light of the effects of the deficit on other economic variables. Those effects may change considerably over time, as shown by the different reaction of both policy-makers and financial markets in 1987 and 1988/89. One effect of external deficits is on the interest burden; this will consume an ever-increasing share of export revenues if the latter grows more slowly than debt, in which case new external financing or a reduction of domestic absorption will eventually become necessary.

25. There is an inherent risk of a "hard landing" of the world economy if payments imbalances of the order recently experienced persist, since these may trigger a loss of confidence by financial markets in the deficit economies, leading to a collapse of the exchange rate and/or a recession. Either way, the world economy will be damaged. For example, a steep decline of the dollar can become a major problem for Japan not only via trade, but also finance, since a large proportion of the assets of Japanese savings institutions are denominated in dollars whereas their liabilities are mostly in yen. Such institutions therefore have an incentive to support government efforts to avoid undue downward pressure on the dollar, but even their full co-operation may not suffice in the face of a generalized attack on the dollar.

26. Given the volatility of markets, a speculative attack cannot be ruled out. The international monetary system appears to have little scope under present circumstances to defend the dollar against a sharp decline. The scope for demand expansion in the surplus countries appears now more limited than two or three years ago and monetary policy has been tending to tighten. If the risk of a downslide of the dollar, renewed turmoil on stock markets, and recession are to be avoided, the burden of exchange rate management will need to be shared among the Group of Seven countries. On the other hand, a cyclical slow-down of economic activity in the United States could also be dangerous. If fiscal policy remains rigid, the decline in interest rates required to fight it could be large enough to cause a sharp fall in the exchange rate.

III. MONETARY ISSUES IN DEVELOPING COUNTRIES 4/

A. Exchange rates and inflation

27. The general trend in the developing countries during the 1980s has been to devalue substantially the currency in real terms. In many countries it has been the single most important response to the intense foreign exchange scarcity. Its effectiveness depends, *inter alia*, on increasing profits in tradeable production and raising the prices of tradeables relative to wages and to prices of non-tradeables.

28. Many developing countries have attained substantial changes in those relative prices, but have often had to devalue several times to keep ahead of inflation. In most cases, the *real exchange rate* against the dollar, which is an approximate measure of the relative prices of tradeables with non-tradeables, fell considerably between 1980-1982 and 1985-1987, in some by more than 50 per cent. The *real effective exchange rate*, measured in terms of prices of manufactures in domestic markets relative to those in export markets, has also declined considerably in most countries, particularly in highly indebted countries and where the currency had previously appreciated strongly.

29. Few developing countries have, however, achieved stability in the real exchange rate over the past seven years. Exchange rate instability (as measured by the standard deviation of the annual rate of change of the real effective exchange rate) has been greater in countries with very steep real depreciations and very pronounced price instability. It has been relatively low in several countries of East and South-East Asia, and some other countries with a policy of steadily depreciating their currency in real terms.

30. In many developing countries, including most debt-troubled countries, inflation rates in the 1980s have been higher than in the 1960s (which was a period of relatively low inflation world-wide) and the 1973-1982 period (when prices rose world-wide by some 12 per cent per annum). For the highly indebted countries, 5/ the averate rate of inflation was 90 per cent per annum during 1983-1988, compared to less than 40 per cent during the 1970s, and 15 per cent during the 1960s. Some countries experienced hyper-inflation during certain periods. Almost every country in which inflation is or has been a major problem is debt-troubled.

31. The increase in the average rate of inflation has been accompanied by larger fluctuations of inflation rates, particularly where the average annual rate of inflation has exceeded 30 per cent. A number of countries have succeeded in bringing down inflation considerably for a while, only to face a new and sometimes even stronger upsurge afterwards. A major reason was that attempts to change relative prices, in particular through sharp devaluations, exacerbated conflicts over the distribution of income.

32. In most countries with severe inflation, and hence fluctuating competitiveness, real depreciation has failed to stimulate exports. Particularly where there is wage indexation and in highly import-dependent economies, a nominal depreciation has tended to fuel inflation, and domestic price inflation has quickly

nullified the initial exchange rate adjustment, thereby triggering a further round of devaluation, further inflation, and so on.

B. Fiscal and monetary management

33. In many countries, currency depreciation, together with other measures taken to deal with external payments, has also added to demand pressures by widening fiscal imbalances. These had been building up since the early 1980s, in large part owing to external shocks: the rise in international interest rates had raised the interest bill of the public sector; and the collapse of commodity prices had reduced tax revenues from exports and direct export earnings of the public sector. Cutbacks in external lending had also affected public sector finances. Many countries have been able to accommodate declines in net transfers and, in the terms of trade, by cutting import volumes and/or raising exports only to find the external transfer problem transformed into a budgetary transfer problem. To the extent that the required trade surpluses were generated through import cuts or export expansion by the private sector, private incomes had to be transferred to the public sector in order to meet the latter's need for foreign exchange to service its external debt. The transfer needed was made all the larger by the adverse effects of trade adjustment measures on public finances. Resistance by the private sector to making such transfers formed an important element in the struggle mentioned above between different income groups over the distribution of domestic resources.

1. Effects of trade adjustment on fiscal balances

34. Cuts in public sector investment and imports have provided part of the foreign exchange needed by the public sector to cover the swing in its net external transfers. However, currency depreciation and trade policy liberalization, together with stagflation, have worsened the fiscal balance. Reduced imports by the private sector and tariff reductions have increased budget deficits, particularly where tariffs and other import charges were an important source of government revenue.

35. For a sample of 20 countries, 6/ the combined effects of import cuts and changes in implicit average effective tax rates (measured as trade tax revenues expressed as a percentage of the import bill and export earnings) was to lower government revenue from import taxes by 1 per cent of GDP between 1980-1982 and 1985-1986, the losses being particularly heavy where import taxes were initially high. Declines in the implicit average effective tax rates were much more pronounced for exports - on average more than 3.5 percentage points of GDP. Export taxes were raised in a few commodity-exporting countries, but eliminated or reduced in many others. The effect of increased commodity export volume on export earnings was more than offset by declines in world commodity prices. Indeed, had 1980-1982 price levels been maintained, government revenues from export taxes during 1985-1986 would have been higher by between 0.4 and 0.8 per cent of GDP in a number of countries.

36. The evidence thus suggests that trade policies, import cuts and commodity price declines in the 1980s have, on average, lowered government revenue by 1.5 per cent of GDP. In the long run, tariff reductions may benefit output and growth by stimulating efficiency and competitiveness (with a consequent increase in government tax revenues), but only if imports expand. That has generally been prevented by foreign exchange shortages.

2. The impact of currency depreciation

37. While real currency depreciation can improve trade performance, it can also damage the fiscal balance. Depreciations have raised real government revenues from trade in a number of countries where trade taxes have been an important source of revenue, but generally not enough to offset the revenue losses stemming from import cuts and commodity price declines. They have also raised the costs of Government and hence expenditures. The domestic currency value of interest payments on external debt rises in real terms when the rate of depreciation exceeds the rise in the domestic price level, even if nominal government revenues keep up with the latter. Since every dollar of interest payments absorbs a larger amount of real revenue, Governments face a need to tax the private sector if they are to maintain the real level of public spending domestically without enlarging the budget deficit in real terms.

38. Depreciation has increased the real burden of interest payments abroad by more than 1 per cent of GDP in the most highly indebted countries, and even more in some low-income countries, which undertook very sharp devaluations. In many countries in both groups, the domestic currency value of interest payments in real terms rose by more than 40 per cent.

39. The impact of exchange rate changes has also depended on the net external borrowing of the public sector. Where this exceeded interest payments (that is, net external transfers to the public sector were positive) - as in many low-income countries - devaluations improved the fiscal position, allowing Governments either to reduce monetary financing and domestic borrowing or to raise spending. However, few countries have combined positive net transfers with currency appreciation because of a need to improve the trade balance. In countries with negative net transfers, currency depreciations, on average, necessitated the mobilization of an additional 0.5 per cent of GDP by Governments to finance the net transfer.

40. Another effect of currency depreciation is that it raises the cost of public sector investment, which has a high import content (generally about one third in countries at relatively high levels of development, but exceeding one half in low-income countries). 7/ Despite drastic cuts in public investment, this effect raised the resource needs of the public sector on average by 0.6 per cent of GDP and in a number of countries by as much as 1 per cent of GDP.

41. A number of conclusions emerge when those various effects are put together. If a government derives most of its revenues from the non-traded goods sector while spending heavily on traded goods and debt servicing, real depreciations worsen the fiscal balance. This has been the usual case, except where public ownership in the

export sector and trade taxes have been important, net transfers abroad have been small (or where there has been a net transfer from abroad), and public investment has been moderate in size. Indeed, in many highly indebted countries, a real depreciation of 10 per cent raises the budget deficit by about 0.5 per cent of GDP; the record shows that the rate of depreciation in many countries has exceeded 30 per cent.

3. The combined effect of depreciation, trade tax revenues and public sector exports

42. Although currency depreciations have raised government revenues from trade, that effect has not been strong enough to offset their expenditure-raising effects, let alone the fiscal impact of import cuts and export price declines. The following conclusions emerge from the evidence for a number of countries:

(a) Revenue losses from trade taxes due to the combination of import cuts, declines in export prices and tariff reductions have enlarged the budget deficit on average by about 40 per cent of the deficit actually incurred by those countries in recent years;

(b) In many countries the positive effects of depreciations on trade tax revenues were weaker than their effects on real government spending, especially in countries with substantial net negative transfers and a high level of public sector investment;

(c) In almost all countries, the fiscal impact of currency depreciations and changes in trade taxes taken together were adverse: for the highly indebted countries, they amounted to about two thirds of the average budget deficit incurred during 1985-1986; in six countries, for about one half; and in another three countries, for more than the entire deficit; 8/

(d) The fiscal impact of changes of export earnings accruing directly to the public sector differed considerably. In a few countries the combined effect of changes in public sector exports and currency depreciation was positive, but in almost all oil-exporting countries the loss of export revenues was too large to be offset by currency depreciation.

4. Financing of the deficits, monetary expansion and inflation

43. In general, fiscal adjustment in the 1980s has involved spending cuts rather than revenue increases. In the few countries where revenues rose, it has been largely due to increased prices of public sector goods and services, and sales of public assets. In most countries tax revenues have declined or stagnated, along with slower economic activity and faster inflation, which has reduced real tax revenues due to collection lags and the tax deductibility of corporate interest payments. Primary government spending (that is, spending excluding interest payments) was cut in most countries, in many by more than 5 per cent of GDP. The burden fell primarily on capital spending, which fell by more than half in a number of countries.

44. Increased interest payments abroad, however, have made it very difficult to reduce the public sector borrowing requirement despite drastic cuts in spending. Cutbacks in lending have forced Governments to shift the financing of deficits to domestic markets, and higher domestic interest rates have added further to fiscal deficits. Sharp increases in real interest rates on domestic debt have been needed to check capital flight, while the acceleration of inflation has pushed nominal rates to very high levels; in most countries domestic real interest rates have been much higher in recent years than at the beginning of the decade, the increases exceeding 15 percentage points in a number of countries. In some countries those factors have given rise to an unprecedented pace of domestic debt accumulation. The public sector borrowing requirement in most highly indebted countries in 1986-1987 was higher, on average, by one half of a percentage point of GDP than in 1978-1979, whereas interest payments were higher by 3 percentage points; about two thirds of the latter was due to increased interest payments abroad.

45. In most countries there has been a close correlation between the evolution of public sector deficits and borrowing from the central bank. Such borrowing averaged about 1 per cent of GDP during 1978-1979, but rose to 3 per cent in the early 1980s. By 1986-1987, central bank financing and public sector deficits both fell back to the levels of the late 1970s. Since net external borrowing by the public sector was considerably smaller, however, the financing of public sector deficits with domestic debt or from the central bank were correspondingly higher. In most countries central bank financing of public sector deficits has gone hand-in-hand with monetary expansion.

46. While there can also be little doubt that inflation cannot accelerate indefinitely without monetary accommodation, budget deficits and monetary aggregates in the 1980s have been largely endogenous and passive: they have not assumed an autonomous, independent and leading role in inflation. The acceleration of inflation has reflected, in large part, increased incompatibility of income claims, as was the case in the developed market economy countries during the 1970s. Where conflicts between income groups have been especially tense and incomes rigidly indexed, inflation has become self-perpetuating. The close link between fiscal deficits and inflation, on the one hand, and income distribution, on the other, may explain why orthodox policies relying on budget cuts and monetary restraint have been able to reduce inflation only temporarily and have sharply increased unemployment. The resulting deterioration of income distribution has often exacerbated social tensions, often leading to even more rapid inflation. 9/

C. Some policy implications

47. There can be little doubt that there is an urgent need for stabilization in debt-troubled developing countries. That would involve a considerable drop in inflation; moderation of public sector deficits; reduction in the pace of public domestic debt accumulation; substantial slow-down in monetary expansion; reduction and stabilization of real interest rates; stabilization of real exchange rates; and lessening of the degree of currency substitution and capital flight. But lasting stability requires higher growth, for otherwise the incompatibility of income claims, one of the main sources of instability, will remain.

48. Lifting growth requires a substantial reduction of the external debt burden. In a number of countries, however, the attainment of orderly macro-economic conditions would take some time even if a substantial amount of debt relief were provided and even if, at the same time, appropriate domestic policies were pursued by the debtor countries themselves. The crisis has been allowed to persist for too long for the damage to be undone swiftly. The difficulty of attaining stability after a prolonged period of turbulance is demonstrated by the experience of the major developed market economies; after their external environment had improved, it took those countries almost half a decade to restore macro-economic order.

49. Inflation that has reached three-digit levels and is accelerating demands negotiated prices and incomes policies, as well as demand management. Stability in the real exchange rate is also needed and can only be attained as the need to resort to currency devaluations is reduced by an increase in the capacity to produce tradeable goods. Domestic real interest rates could then also be reduced, since repeated devaluations would no longer be expected as a matter of course. The key, therefore, lies in increased levels of investment and hence in an improved flow of external resources.

IV. ROUBLE CONVERTIBILITY AND THE LIBERALIZATION OF SOVIET EXTERNAL PAYMENTS

A. Introduction

50. Discussions of convertibility usually focus on the conversion of a national money into other currencies. That approach is broadly valid for market economies where money is automatically convertible into goods (and vice versa). The question of "commodity convertibility", however, inevitably arises in the case of centrally-planned economies such as the USSR, where for many decades resources have been allocated through a system of administrative commands formulated in physical terms that assigns to payments in money a largely passive role.

51. This central planning system was designed to achieve rapid industrialization at a time of involuntary isolation from the rest of the world economy. Despite its neglect of opportunity costs, it succeeded in that objective by extracting resources quickly and on a large scale from households and the countryside, and directing them towards heavy industry. In the process, it increased the use of labour and other resources, maximized self-reliance and concentrated the scarce managerial capabilities available. The system also proved effective in wartime and workable during post-war reconstruction which took place in the context of intense international tensions. Central planning thereafter, however, progressively lost its dynamism as the room for raising output by increasing the quantum of labour and other inputs diminished. Soviet economic growth increasingly required (a) the achievement of all-round progress rather than specific tasks, (b) the provision of material incentives for effort rather than the extraction of savings, (c) the acceleration of productivity growth rather than of the pace of investment, (d) taking proper account of relative costs rather than simply increasing the rate of resource utilization, (e) the development and use of managerial and entrepreneurial abilities rather than the concentration of decision-making in the

central planning mechanism, and (f) fuller participation in the international division of labour. Once it was perceived by a new generation of leaders that the existing system was no longer an accelerator but a brake, it became politically imperative to restructure it radically and to place greater reliance on markets.

52. Market mechanisms require pecuniary incentives and disincentives to exert a strong influence on the behaviour of economic agents, including enterprises. The domestic currency must thus have wide command over goods and services, and be allowed to function not only as a unit of account, but also as a means of payment and store of value. That applies to the use of the rouble in both domestic and external transactions. Basing the system of external payments on "commodity/money" relations means that domestic residents must be allowed considerable freedom (within parameters set by trade policy) to exchange their roubles for foreign currencies to spend on imports of goods and services, and non-residents must be allowed to convert into foreign currency roubles earned through export.

53. The logic of *perestroika* thus naturally raises the issue of eventual rouble convertibility. The problems of radical change in the areas mentioned, however, are enormous. Restructuring needs to be wide-ranging in order to be effective in stimulating greater efficiency in the economy. But action on a multitude of fronts quickly and simultaneously entails many risks, especially when adequate instruments of macro-economic policy are not yet available. The uncertainties are made all the greater by the absence of a detailed blueprint of the new system that is sought. The transition process is thus fraught with dangers, whether it is piecemeal or comprehensive. Reforming a large and developed centrally-planned economy is a process for which economics provides few guidelines.

B. Comprehensive central planning and role of the rouble

54. Under comprehensive planning such as that in the USSR, household incomes can be used to buy consumer goods, but the availability of such goods is not assured, since both output and prices are insulated from demand pressures. Furthermore, enterprises face tight limits in the extent to which they can make use of liquid balances for purposes not prescribed by the plan. The use of the domestic currency is even more circumscribed in external transactions. The domestic currency cannot be converted into foreign exchange for purchasing imports, since such exchange is distributed, like other inputs, through administrative decisions. That technique helps not only to control aggregate imports, but also to fulfil specific plan quotas. Export levels are for the most part also determined by the planners.

55. A number of different arrangements have long predominated in international payments between the USSR and its trading partners. Payments in its trade with OECD countries are normally made through bank accounts denominated in convertible currencies. Payments between the USSR and several countries that maintain tight exchange restrictions, in particular many of its main trading partners among developing countries, are governed by bilateral agreements. Such payments are debited and credited to special accounts with the central banks of the two countries. The accounts are denominated in an agreed currency (often the United States dollar) and, since debits and credits rarely balance at any particular time,

the two banks agree to extend to each other "swing credit" of a specified amount. There are commonly provisions for settling imbalances at the end of agreed periods in a convertible currency. Various arrangements are possible for payments between the USSR and its partners in CMEA. Payments for trade transactions may be made in transferable roubles through the clearing mechanism provided by the International Bank for Economic Co-operation (IBEC) or (principally in the case of commodities in demand in the markets of OECD countries) through settlement in convertible currencies. Some payments for non-trade transactions (tourism, business travel, diplomatic services, family remittances etc.) may be made with national currencies, within prescribed limits.

56. The present official exchange rate for the rouble is based on a rouble/gold parity of 0.987412 grams established in 1961. This rate is of little practical significance, however, for any of the different payments arrangements described in the previous paragraph. Relative domestic prices in the USSR are divorced from relative international ones, "differential currency coefficients" (DCCs) serving to equalize external and internal prices for enterprises. The DCCs differ among product groups and, even in some cases, for similar goods. 10/ Since the official exchange rate does not serve as a link between domestic and international prices, it plays no role in resource allocation.

57. Those features of the system of planning in the USSR and the allocation of foreign exchange have not only caused plans themselves rather than the availability of roubles to be the determinant of enterprises' ability to acquire convertible currencies, but have also created a structural imbalance between the demand for imports and import capacity. That imbalance has also been increased by a number of policy-related factors. For instance, expenditure has tended to be set at high levels and plan implementation has given relatively low priority to the production of consumer goods. The consequent shortages have led to a large accumulation of excess cash holdings, which would result in higher imports and lower exports were it not for the system of rationing foreign currency and planning exports. In addition, planners have tended to favour strongly production for domestic needs and to develop export capacity only to the extent needed to pay for essential imports. This autarkic bias has been accentuated by the organization of export trade that has insulated most enterprises from actual and potential foreign customers, and thus limited the range and quality of export supplies to those prevailing at home. Lack of flexibility in responding to external demand patterns has been an important reason for the weakness of the export performance of the USSR in manufactured goods, particularly with countries where foreign trade is not centrally organized.

C. Economic openness and the role therein of rouble convertibility

1. The rationale of greater economic openness

58. Underlying the rationale of the move away from reliance on comprehensive central planning in the USSR is the expectation that micro-economic performance will improve as a result of greater reliance on markets. It is anticipated that the improvement will follow from such measures as the introduction of competition,

better incentives, and cost accounting based on values more closely linked to true opportunity costs. The improvement will be manifested in a more rational pattern of supply, a higher quality of goods and faster technical progress.

59. A major part of the consequent reform is the opening up of the economy of the USSR to greater international competition through increased participation in international trade. Such an opening-up requires a more rapid expansion of the exports of the USSR, and should be implemented on the basis of an assessment of opportunities that is consistent with realistic extrapolation of the current structure of the country's international trade. Such an assessment has important implications for the types of financing and payments most likely to contribute to more rapid export growth, and thus for the liberalization of current arrangements.

60. As is shown in table 5, the exports of the USSR are dominated by energy and raw materials, the three categories, fuels, ores and metals, and agricultural raw materials accounting for more than 55 per cent of the total in the years specified. By contrast manufactured goods have accounted for about 20 per cent since 1980 after a decline from about 25 per cent in 1975. 11/ In the case of the USSR's exports to developed market-economy countries the preponderance of fuel, agricultural raw materials, and ores and metals has been more marked, the three categories typically amounting to at least three-quarters of the total and manufactured goods to less than 10 per cent during the 1980s. However, manufactures account for a much larger (though declining) share of the exports of the USSR to developing countries.

61. More rapid expansion of the total imports of the USSR will entail a shift in the direction of a greater share for manufactures. Attainment of such a shift, however, can be expected to take considerable time, and much of the initial increases in manufactured exports may be to markets in developing countries. As noted in section B above, a substantial part of the trade of the USSR with such countries is conducted under bilateral payments agreements, which make it possible to limit the use of convertible currencies. In view of the external financial stringency and shortages of such currencies at present being experienced by many of the developing countries whose trade with the USSR is covered by bilateral agreements, a significant part of the anticipated increase in the exports of the USSR during the next few years will necessarily have to be achieved within this framework, which is not compatible with full convertibility.

62. While there is thus likely to be a continuing important role for bilateral payments agreements in trade between the USSR and certain developing countries, a more general liberalization of the allocation of foreign exchange (that is, through increasing the convertibility of the rouble) is capable of making an important contribution to the restructuring process. Such liberalization is integral to initiatives giving enterprises in the USSR greater autonomy in their international trade with countries not covered by bilateral payments agreements. Moreover it can also enhance the incentives for joint ventures by reducing transaction costs and risks owing to the difficulties of obtaining the convertible currencies required for the repatriation of foreign partners' shares in profits.

Table 5. Exports and imports of USSR: Shares of selected commodity categories by major destinations/sources, 1975, 1980, 1986 and 1987

	Exports				Imports			
To/From:	1975	1980	1986	1987	1975	1980	1986	1987
World	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Food (SITC 0+1+22+4)	4.7	1.8	1.6	1.5	21.8	24.1	17.3	16.1
Agricultural raw materials (SITC 2 less (22+27+28))	8.1	5.5	4.3	4.7	3.0	3.1	2.7	2.9
Fuels (SITC 3)	31.3	47.0	47.5	46.7	3.7	2.3	2.3	2.3
Ores and metals (SITC 27+28+67+68)	16.5	7.8	7.3	6.8	10.6	9.1	8.1	8.2
Manufactured goods (SITC 5 to 8 less (67+68))	25.6	20.5	20.1	20.2	60.1	59.8	68.6	68.9
Developed market-economy countries	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Food (SITC 0+1+22+4)	3.4	0.6	1.8	1.6	16.9	22.3	15.7	13.9
Agricultural raw materials (SITC 2 less (22+27+28))	13.4	7.3	7.0	6.6	2.8	3.0	2.8	3.7
Fuels (SITC 3)	54.0	71.1	66.0	65.0	0.3	0.6	1.0	0.8
Ores and metals (SITC 27+28+67+68)	13.0	5.0	2.5	2.2	20.8	16.9	18.9	19.7
Manufactured goods (SITC 5 to 8 less (67+68))	12.5	6.0	8.4	7.1	58.6	56.4	60.2	60.0
Developing countries	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Food (SITC 0+1+22+4)	9.8	5.8	4.3	3.9	54.3	66.5	45.9	42.9
Agricultural raw materials (SITC 2 less (22+27+28))	3.7	5.0	3.7	6.7	8.0	7.4	5.9	7.1
Fuels (SITC 3)	13.4	20.1	20.8	23.9	10.3	9.0	8.9	9.6
Ores and metals (SITC 27+28+67+68)	4.1	9.9	9.0	7.5	5.1	5.6	4.7	5.2
Manufactured goods (SITC 5 to 8 less (67+68))	31.4	31.2	28.5	27.9	22.3	11.0	34.0	34.8
Socialist Europe	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Food (SITC 0+1+22+4)	3.4	0.5	0.4	0.4	11.3	10.1	8.3	8.1
Agricultural raw materials (SITC 2 less (22+27+28))	7.0	4.4	3.3	3.0	0.7	1.3	0.9	0.9
Fuels (SITC 3)	26.4	40.8	55.3	52.6	3.7	1.6	1.2	1.0
Ores and metals (SITC 27+28+67+68)	24.0	15.1	8.1	8.1	4.3	2.8	2.7	2.5
Manufactured goods (SITC 5 to 8 less (67+68))	28.3	25.4	18.3	20.0	78.8	81.4	86.0	85.5

Table 5 (continued)

To/From:	Exports 1975	1980	1986	1987	Imports 1975	1980	1986	1987
Socialist Asia	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Food (SITC 0+1+22+4)	7.3	8.6	1.3	1.8	31.4	30.0	27.8	30.6
Agricultural raw materials (SITC 2 less (22+27+28))	2.0	3.2	5.8	5.0	9.8	10.4	11.7	6.4
Fuels (SITC 3)	7.7	13.2	19.2	20.3	-	-	-	-
Ores and metals (SITC 27+28+67+68)	4.5	2.8	8.7	8.4	23.2	23.2	16.3	18.1
Manufactured goods (SITC 5 to 8 less (67+68))	67.0	59.1	42.5	38.5	32.7	36.1	44.2	45.0

Source: Data of the UNCTAD secretariat.

2. The concept of convertibility and the case of the rouble

63. The degree of convertibility of a currency depends on such characteristics as the identity of the economic agents with the right to hold it and to exchange it for another one, and the categories of transaction for which such exchanges are permitted. Historically the set of conditions generally agreed to constitute convertibility for a currency have varied with the overall system of trade and payments and with the prevailing norms of macro-economic policy. 12/ Since 1945, the main standard in that regard has been the set of obligations set out in article VIII of the articles of agreement of IMF.

64. A key distinction under the heading of convertibility is that between transactions on current and capital account. For the purpose of obligations under article VIII, convertibility refers only to "the making of payments and transfers for current international transactions". 13/ That restriction applies also to the discussion of rouble convertibility in the present study. The obligations of a member country of IMF that accepts article VIII include not imposing restrictions on the making of payments or transfers for current international transactions, converting currency balances presented for that purpose (so long as those balances are the proceeds of current transactions or their conversion is needed for payments for such transactions), and avoiding "discriminatory currency arrangements or multiple currency practices". The majority of the member countries of IMF have not yet accepted the obligations of article VIII, availing themselves instead of the transitional arrangements under article XIV, which permit a country to "maintain and adapt to changing circumstances the restrictions on payments and transfers for current international transactions that were in effect on the date on which it became a member".

65. The different objectives of currency convertibility are related but distinct. Steps taken by countries towards greater convertibility have generally been part of a drawn-out process, and have not involved attempts to attain all of those objectives simultaneously through the assumption of the whole gamut of obligations that would be entailed. Thus the ultimate, systemic objective of convertibility is the establishment and maintenance of a free multilateral system of payments for current international transactions. For individual countries, however, the main objectives of increased convertibility often have more to do with their particular historical situation and, in the case of the USSR, should be related to the process of reform.

66. That reform process will initially require measures of liberalization that fall well short of full convertibility for the rouble. For that purpose, a distinction may need to be made not only between the different obligations covered by article VIII, but also between such dimensions of convertibility as its applicability to residents, on the one hand, and to non-residents, on the other. Moreover, it is also necessary to give attention here to various instruments through which exchange control is exercised, for example, "surrender requirements" (under which residents are required to sell to the authorities the foreign exchange which they acquire) and "retention quotas" (under which exporters are permitted to retain specified portions of their foreign-exchange earnings). One possible feature of a new foreign-exchange régime for the USSR taken up in the discussion of measures of liberalization in section E below is that of multiple-currency practices. Those may actually constitute a step in the direction of increased convertibility if they replace the mechanisms for the allocation of foreign exchange under comprehensive central planning. A further point already made under section C.1 is that the objective of increasing the participation of the USSR in international trade may require the maintenance of a system of bilateral payments agreements with certain countries.

D. Some aspects of the reform process and its future agenda

1. Enterprise autonomy and steps to open up the Soviet economy

67. Since 1986, the process of economic reform in the USSR has centred on the attempt to give increased autonomy to enterprises. Under the new régime, enterprises are to have much greater leeway in selecting inputs, outputs and business partners. To that end, the share in their production of compulsory state orders is to be reduced. While major investments and new ventures will continue to be financed from the central budget in the absence of an effective capital market, the intention is that the resulting government-enterprise relationships should take place on the basis of stable, clearly defined norms and guidelines. 14/

68. As already mentioned, efforts to improve micro-economic performance as part of the reform process are closely linked to the opening-up of the economy of the USSR to greater participation in international trade. That link is reflected in a number of recent measures bearing on such trade. Thus, for example, a decree of August 1986 permitted 20 industrial ministries and 70 enterprises to engage in trade on their own account; that right was later extended to all enterprises and

organizations, including co-operatives. Regulations governing joint ventures between Soviet and foreign enterprises have been substantially liberalized (for example, by the repeal of the stipulation that a majority share had to be held by the Soviet participant), and the administrative machinery for approvals in that area is being reformed.

69. In 1986, retention quotas for foreign currency were introduced as an encouragement to enterprises to increase their exports. That measure suggests that the allocation of foreign exchange is to have an important role in the improvement of the system of incentives in the Soviet economy. A further step in that direction is the recent announcement that farmers are to be paid in foreign currency for above-average production.

2. Aspects of the reform agenda to accompany liberalization of external payments arrangements

70. The steps described in section C.1 above are part of reform which is expected eventually to cover many other aspects of the foreign trade of the USSR. Thus, new tariff and non-tariff regulations are being developed, and a new law on foreign trade will eventually be introduced. Moreover the decree of December 1988 covers such topics as trade financing and insurance, and the development of free trade zones to attract foreign capital. Furthermore, simplification of the system of DCCs described above is under way as part of a move towards a new exchange rate. Those plans will not be analysed here, since many of the relevant details concerning their modalities are not yet available. Instead a number of problems that must be tackled in conjunction with the measures to liberalize foreign-exchange allocation taken up in section E will be raised in this section, and some suggestions made with regard to the general nature of appropriate policy responses.

71. One important issue in the connection which the liberalization of Soviet external payments arrangements can be expected to introduce between macro-economic balance, on the one hand, and foreign-exchange management, on the other. A particularly pressing manifestation of this connection is the large overhang of unspent money, accumulated as a result of past and present shortages of goods, which represents a pent-up source of potential demand for convertible currencies. But, even after the overhang has been absorbed by measures of the kind discussed in a moment, under a liberalized régime of foreign-exchange allocation, the continuing relation between the overall balance of demand and supply in the Soviet economy and the demand for foreign exchange is likely to become a major element in decisions concerning fiscal policy, and to constitute a constraint on the magnitude of future government deficits.

72. The opening-up of the economy of the USSR to greater participation in international trade requires a realignment of internal relative prices in the direction of those in international markets. Such a realignment is capable of having substantial effects on income distribution and the financial position of enterprises. Some of the former effects may be judged socially undesirable. Moreover, if they were to prove a source of unrest by undermining confidence, they

could have a counterproductive impact on the process of reform. Potential difficulties involving the financial position of enterprises can be exemplified by two cases. The first is that of enterprises forced into insolvency, and the second that of enterprises whose increased profits during the early part of the transition reflect the irrationality of the old system of relative prices rather than efficiency. Owing to the lack of relevant information, it is impossible to know how extensive are the cases in those two categories. Enterprises in the first category, however, might include many capable of eventually making a positive contribution to national welfare once the realignment of prices has been completed. On the other hand, among enterprises in the second category might be some that would need to be restructured or even closed after the final achievement of the price reform. Yet, during the initial stages of the transition, their higher profits might generate pressures for the expansion of their operations (and increase their capacity to bid for convertible currencies in the auction markets discussed in section E).

73. Many of the problems likely to arise during the transitional phase of price reform are owing to the coexistence of economic activities governed by the "command" system described in the first section of the present study and others subject to market processes. Under the reform process, there is to be a progressive increase in the importance of the latter. For example, reference was made above to the reduction envisaged in the share of state orders in the output of enterprises. The implications of such a shift can be illustrated in the case of the wholesale trade in means of production which, according to current plans, is to account for 60 per cent of total turnover by 1990 and about 90 per cent by 1992. 15/ Nevertheless, there remains a challenge to policy-makers to manage the transition in such a way as to minimize disruptions due to interrelations of the "command" system and market processes. In the case of the "command" system, for example, large shifts in the prices or availability of intermediate goods are capable of having unfavourable "domino" effects on several branches of production owing to planning which prescribes tightly balanced supply and demand and the absence of excess capacity. Activities governed by the market mechanism, on the other hand, can be stifled if certain goods prove difficult or impossible to obtain owing to the dependence of those activities on the "command" system.

74. The immediate overhang of unspent money will require one-off measures to absorb it. Some proposals that have been put forward for this purpose seem unlikely to be politically acceptable owing to the likelihood that they would be regarded as unfair and would thus be a possible source of social unrest. Those proposals include (a) freeing prices and letting a sharp increase in inflation reduce the real value of the monetary overhang; and (b) currency reforms, which would replace the rouble with a new money on a basis that would reduce the real value of part of existing holdings of roubles. 16/ Measures more likely to be politically acceptable include short-term increases in imports of consumer goods and steps to make available assets capable of mopping up the purchasing power represented by the overhang. There is still a shortage of attractive financial assets for that purpose. One of the eventual by-products of the reform process itself is likely to be the increased availability of such assets. For example, the development of autonomous capital markets 17/ to meet the financial needs of enterprises is one potential source of investment instruments capable of absorbing

the liquid balances of enterprises and households. But, to meet the immediate problem of the current monetary overhang, a useful role could be played by sales of real durable assets. Government bond sales could also be helpful here, provided that the public had confidence that the interest income and repayment of principal could be used to purchase goods and services, such as housing, land and equipment.

75. As already noted, even after the overhang has been absorbed, the relation between overall macro-economic balance and the demand for foreign exchange will continue to be a problem for macro-economic policy. Although details of a reformed framework for such policy cannot be discussed here, it should be mentioned that greater reliance on direct and indirect taxation and the availability of a broader spectrum of borrowing instruments would give the Government increased flexibility not only in macro-economic policy, but also in implementing price reform.

76. Successful management of the coexistence of activities still governed by the "command" system and those subject to market processes will entail, *inter alia*, the achievement of the appropriate balance between different methods of pricing and the use of taxes and subsidies as the movement takes place away from dual or multiple pricing systems towards uniform prices. Thus, for example, reliance on market processes is most clearly indicated for sectors where the typical size of enterprises and the absence of entry barriers can be expected to promote genuine competition. Elsewhere price liberalization needs to be accompanied by the availability of techniques (including price controls) capable of preventing large enterprises from exploiting their market power. Moreover taxes and subsidies 18/ are capable of serving as instruments for handling the unfavourable shifts in income distribution and the unwanted pattern of profits and losses among enterprises which, it was noted earlier, may characterize the initial stages of price reform. Thus, for example, the structure of indirect taxation (including tariffs) can be used as a method of influencing relative prices which avoids the detailed price fixing of comprehensive central planning. The problem of excess profits can be met through the direct taxation of enterprises. Direct income support can be introduced for segments of the population whose living standards are in danger of being driven below socially acceptable levels by price increases for certain consumer goods.

E. Concrete steps to liberalize Soviet external payments arrangements 19/

77. While liberalized external payments arrangements were incompatible with the old régime of comprehensive economic planning in the USSR, the reforms described in section D above do not require, for a successful outcome, the introduction of full rouble convertibility for current transactions. Nevertheless the intention of the Soviet Government is clearly that the reforms should be accompanied by progressive liberalization of external payments. This section discusses certain issues that need to be considered in that context, and the potential contribution of various proposed measures to the reform process.

1. Exchange rates

78. Closely connected to the liberalization of external payments arrangements is the question of the future exchange-rate system for the rouble. The intention of the Government is that there should be a phased shift towards a new rate for the rouble (including a devaluation of 100 per cent at the beginning of 1990). The system of DCCs is to be dismantled, and the new exchange rate (unlike the old one) is to have importance both for external payments and for resource allocation. That process is to be complete by the beginning of 1991. Many details concerning future arrangements in this area, however, have apparently yet to be worked out.

79. One aspect of those arrangements bearing on their relation to convertibility concerns the possibility of more than one exchange rate for the rouble. The eventual outcome here will depend on the way in which the coexistence of activities still governed by the "command" system and those subject to market processes is managed, and on the precise modalities of the new external payments arrangements. For example, one possibility would be a multiple exchange-rate system consisting of an official rate for certain categories of transaction alongside of another rate or rates determined in the internal market for currencies described below. The number of rates under that system would depend on the way in which it was decided to compartmentalize different categories of transaction and economic agent for that purpose.

80. Two points in particular concerning such a system of multiple exchange rates seem worthy of emphasis in the light of remarks made earlier in the present study. Firstly, although article VIII of the articles of agreement of IMF proscribes "multiple currency practices", in the case of the USSR, the substitution of a limited number of exchange rates for the complex system of DCCs is likely to contribute substantially to progress towards the basic economic objectives that are the rationale of convertibility. 20/ Secondly, the initial impact of ending DCCs and moving to a more uniform system may diverge substantially among activities and sectors, for example, having the effect of a rouble devaluation in some cases, but a revaluation in others. 21/ As explained in section D.2 above, in so far as this impact is judged undesirable, the reformed system of prices, taxes and subsidies provides means for offsetting them. Moreover, reducing "surrender requirements" for foreign exchange might help to counteract the reduced incentives to export for enterprises faced with revaluation.

2. An internal market for convertible currencies

81. Various possible ways of facilitating buying, selling and financing operations in convertible currencies can be envisaged as part of reform in this area. Under a decree of December 1988, there are to be officially organized periodic auctions for foreign exchange. The number of enterprises participating in those auctions is apparently to be limited, the selection being made on the basis of the authorities' evaluation of the way in which enterprises will use the currencies purchased. At the same time there has been a liberalization of regulations governing the right of Soviet enterprises to hold and exchange foreign currencies.

82. The institution of auctions for convertible currencies and their accompaniment of increased direct transactions between enterprises in such currencies are capable of making an important contribution to economic reform, in particular its objective of giving enterprises greater autonomy (so long as effective measures are taken to eliminate the large potential excess demand associated with the monetary overhang). Inter alia, such developments would facilitate greater use of market processes and enterprise-to-enterprise relations in the trade of the USSR, educate officials and managers in the USSR concerning foreign-exchange operations, and provide information about the rouble's value in terms of foreign exchange (which would be a useful guide in setting a fixed official exchange rate of the kind mentioned in section E.1 above). Moreover, as is discussed below, analogous steps in the case of non-convertible currencies might also serve as a useful instrument for the liberalization of the modalities of the bilateral payments agreements of the USSR. Eventually the system of periodic officially organized auctions and of transactions between enterprises in convertible currencies could be expected to evolve into a genuine foreign-exchange market, where government intervention would take the form of buying and selling operations as part of its exchange-rate policy.

83. If auctions for convertible currencies are to fulfil their potential, however, the number of participants and the frequency will need to be increased beyond that currently envisaged. The introduction of such auctions can be a progressive process, but it is important that the number of economic agents initially admitted on the supply and demand sides should be large enough for the existence of a genuine market, and that there should be avoidance of official intervention to prevent currencies going to the highest bidders. Such a characterization still leaves open the question of the categories of enterprise that would be admitted to the auction market in its initial stage. On the supply side, those might include all enterprises permitted to retain a portion of their earnings of convertible currencies. Another criterion for admission to both the demand and the supply side of the market could be based on whether or not an enterprise was engaged in categories of production likely to contribute to the expansion of the hard-currency exports of the USSR in fields other than energy and raw materials, or to import substitution. Admission could subsequently be extended to other categories of enterprise. As admission is extended and experience of foreign-exchange operations is acquired, it would be natural for the mechanism of auctions to be gradually superseded by an autonomous foreign-exchange market in which the primary role was played by banks. Once the right to engage in foreign-exchange transactions has been extended to households, convertibility for residents would have been achieved.

84. During this progressive enlargement of the scope of the auction market, decisions will also need to be taken concerning the possibility of admitting particular categories of economic agent not mentioned in the brief outline above. One such category would be farmers receiving foreign currency in return for above-average production under the recently announced measures. Another such category would be the foreign partners in joint ventures. When the sales of such joint ventures consist primarily of hard-currency exports, the enhancement of incentives can be achieved through appropriate measures concerning their right to retention of convertible currencies. But for foreign partners in joint ventures oriented towards markets in the USSR itself and other CMEA countries, admission to the auction market for convertible currencies would be likely to reduce risks associated with the difficulties of repatriating their shares in profits. 22/

85. A note of warning should be sounded concerning liberalizing the use of convertible currencies by economic agents in the USSR. In the absence of an improved supply of goods, there is a danger that it might lead to the progressive replacement of national money by convertible currencies internally ("dollarization"), a phenomenon recently observed in several countries (including some in Latin America and Poland) experiencing high inflation and financial instability.

3. Payments arrangements vis-à-vis partners in CMEA

86. Payments in trade between the USSR and its partners in CMEA are in some cases made in convertible currencies, but an attempt to impose the use of such currencies in this trade would cause it to contract. Nevertheless, there would appear to be scope for liberalizing payments arrangements between the USSR and CMEA not involving convertible currencies.

87. In the past, attempts to place payments arrangements within CMEA on a more rational and uniform basis and to multilateralize them have failed to overcome problems (analogous to those discussed above in the case of the internal economy of the USSR) owing to the subjection of intra-CMEA trade to decisions of comprehensive central planning relating to real quantities, and to the use of the principal money in such trade (the transferable rouble) solely as a unit of account. One consequence of current arrangements is that prices in transferable roubles and the exchange rates for their conversion into domestic currencies are, to some extent, independent of international prices and bear little relation to national prices and production costs. Another consequence is that holders of balances resulting from payments in intra-CMEA trade do not have an automatic right to purchase goods or national currencies.

88. There are various ways in which the processes of reform under way in the USSR and certain other socialist countries of Eastern Europe are capable of facilitating the solution of those problems. Firstly, the realignment of internal relative prices in the direction of those in international trade in countries undertaking such reform can provide the basis for a more rational system of prices in intra-CMEA trade. Secondly, the new exchange rates associated with this reform between the national currencies of these countries and convertible currencies can serve as guidelines for the calculation of new relative exchange rates for use in their mutual trade. Thirdly, improvements in the convertibility of money into goods internally ("commodity convertibility") in those countries might naturally be accompanied by giving to the holders of balances in transferable roubles the right to spend them on goods. In a longer-term perspective, the results of those changes might facilitate multilateral usability within CMEA of balances resulting from payments in intra-CMEA trade. However, only partial multilateralization will be possible within CMEA so long as the process of reform is limited to only some member countries.

4. Bilateral payments agreements

89. As noted above, many of the most promising markets for increased exports by the USSR in the near term are in developing countries. Payments arrangements with a number of major trading partners of the USSR among such countries are governed by bilateral agreements and, as in the case of payments arrangements with CMEA countries, an attempt to impose under present conditions the use of convertible currencies would lead to a contraction of that part of Soviet trade. But consideration should none the less be given to changes in the modalities of those agreements that would be in accord with the thrust of economic reform in the USSR.

90. The main objective of those changes should be the encouragement of trade on an enterprise-to-enterprise basis. Movement in this direction in the USSR and its partners under these agreements might well be helped by giving consideration to new procedures. One such procedure might be the institution of currency auctions as a source of means of payment. Such auctions would involve the rouble and the non-convertible currencies of each of the partners of the USSR and would be open to enterprises on both sides wishing to participate in that trade. However, the financing arrangements for much trade in capital goods are complex, and do not involve simple cash payment. Even after a greater role in the conduct of the foreign trade of the USSR generally has devolved upon enterprises, official promotion and financing is likely to continue to play an important part in its exports of capital goods (as it does in such exports from OECD countries). Nevertheless, as the Soviet enterprises producing capital goods acquire greater autonomy as a result of economic reform, their export efforts will benefit from the provision of flexible financing arrangements and their accommodation, where necessary, within bilateral payments agreements.

Notes

1/ See Nomura Research Institute, Quarterly Economic Review, vol. 19, No. 3 (August 1989), pp. 13-14.

2/ For more details, see Bank for International Settlements, 59th Annual Report (Basle, June 1989), p. 191.

3/ See, for example, OECD Economic Outlook, No. 45 (June 1989), pp. 13-18; and Bank for International Settlements, op. cit., p. 150.

4/ The issues discussed in this section have been dealt with in more detail in chapter IV of the Trade and Development Report, 1989 (United Nations publication, Sales No. E.89.II.D.14), pp. 73-118.

5/ The term "highly indebted countries" in this section refers to a group selected on the basis of the availability of data relevant to the analysis. This group consists of Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Côte d'Ivoire, Ecuador, Jamaica, Mexico, Morocco, Nigeria, Peru, the Philippines, Uruguay and Venezuela.

Notes (continued)

6/ See Trade and Development Report, 1989, op. cit., pp. 97-98.

7/ See Trade and Development Report, 1988 (United Nations publication, Sales No. E.88.II.D.8), pp. 113, 118.

8/ See Trade and Development Report, 1989, op. cit., pp. 102-104.

9/ See M. Pastor, "The effects of IMF programmes in the third world: Debate and evidence from Latin America", World Development (February 1987).

10/ DCCs currently range between 0.2 and 6.6. Geonomics Institute and Institute of the USA and Canada, "A phased plan for making the rouble convertible", n.d., mimeo, p. 24. On the basis of a hypothetical rouble/dollar exchange rate of 0.65, enterprises may receive as little as 0.13 roubles or as much as 4.29 roubles for each dollar of exports.

11/ For both exports and imports there are residuals which cannot be allocated among the commodity groups shown in table 5.

12/ Concerning the evolving nature of the concept of convertibility, see Robert Triffin, Europe and the Money Muddle. From Bilateralism to Near-Convertibility, 1947-1956 (New Haven: Yale University Press, 1957), pp. 234-245.

13/ Article VIII, sect. 2 (a). Article XXX (d) of the IMF articles of agreement defines current international transactions as follows:

> "Payments for current transactions means payments which are not for the purpose of transferring capital, and includes, without limitation:
>
> (1) all payments due in connection with foreign trade, other current business, including services, and normal short-term banking and credit facilities;
>
> (2) payments due as interest on loans and as net income from other investments;
>
> (3) payments of moderate amount for amortization of loans or for depreciation of direct investments; and
>
> (4) moderate remittances for family living expenses.
>
> The Fund may, after consultation with the members concerned, determine whether certain specific transactions are to be considered current transactions or capital transactions."

Notes (continued)

14/ For a fuller account of the recent progress of economic reform in the USSR (including the specific measures mentioned in the text) see World Economic Survey, 1988 (United Nations publication, Sales No. E.88.II.C.1), chap. VI; World Economic Survey, 1989 (United Nations publication, Sales No. E.89.II.C.1), pp. 18-25; L. Abalkin, "The framework for the radical reform of the economic mechanism in the Soviet Union", chap. 1.7 of Economic Reforms in the European Centrally Planned Economies, United Nations Economic Commission for Europe Studies No. 1 (United Nations publication, Sales No. GV.E.89.03 (paperback) or GV.E.89.04 (hardcover)); and "USSR: new management mechanism in foreign economic relations", a consultant study prepared at the request of the UNCTAD secretariat (United Nations publication, Sales No. E.88.II.D.5), chaps. I and II.

15/ World Economic Survey, 1988, op. cit., p. 115. Variation among sectors can be expected in the pace at which the shift in the direction of greater reliance on market processes takes place. Concerning alternative views on this topic, see, for example, J. M. van Brabant and P. Havlik, chap. 3.9 (pp. 222-223) of Economic Reforms in the European Centrally Planned Economies, op. cit.

16/ There is a more detailed account of the mechanics of possible currency reforms in Geonomics Institute and Institute of the USA and Canada, op. cit., pp. 19-21.

17/ Under the "command" system, credit is extended to enterprises and organizations by banks. Such lending, however, is governed by the process of central planning, and is designed to implement decisions under this process concerning production and trade. The lending is not determined by the autonomous decisions of borrowers and financial institutions.

18/ Any price subsidies used as part of a reformed fiscal policy should be designed to meet carefully specified objectives. One of the aims of reform is to move away from a system of supply of goods and services characterized by widespread use of blanket subsidies and the huge resulting drain on the government budget.

19/ External payments arrangements refers not only to currencies used for international payments, but to the structure of modalities and institutions required for foreign-exchange transactions.

20/ Concerning the acceptance by the International Monetary Fund of multiple exchange rates in the context of the liberalization of exchange-control régimes in certain Latin American countries, see Triffin, op. cit., pp. 125-126.

21/ The effect depends on the relative magnitudes of the old rate at which an enterprise exchanged its earnings of foreign exchange into roubles (that is, the old official exchange rate times the relevant DCC), on the one hand, and of the new exchange rate, on the other. Thus, for example, if the new exchange rate involves devaluation of 100 per cent in comparison with the old, enterprises with a DCC less than 2 will experience a devaluation, while those with a DCC greater than 2 will experience a revaluation.

<u>Notes</u> (continued)

<u>22</u>/ This proposal for enhancing the incentives to joint ventures is consistent with the thrust of that for the establishment of special economic zones in certain border regions of the USSR. Among the measures from which enterprises in such zones would benefit would be liberal currency régimes, for whose modalities a number of different alternatives are possible.

ANNEX

Recent proposals for convening an international conference on international monetary and financial issues

1. As noted in a report a/ prepared for the forty-third session of the General Assembly, interest in the convening of an international conference on monetary and financial issues has intensified since 1982. A survey of proposals under this heading was provided in a report b/ prepared for the forty-second session of the General Assembly. The present annex updates that information.

2. At the 40th and 41st meetings of the Ministers of the Intergovernmental Group of Twenty-Four c/ on International Monetary Affairs, the Ministers "reiterated that an effective reform of the international monetary and financial system requires the convening of an international conference". They also reiterated their call for the creation of a representative Committee of Ministers from developing and industrial countries to consider reform of the international monetary system as an effective step in preparing for such a conference, the suggested form for the Committee being a joint sub-committee of the Interim and Development Committees.

3. At the Ninth Conference of Heads of State or Government of the Movement of Non-Aligned Countries, held at Belgrade from 4 to 7 September 1989, the Heads of State or Government called upon the developed countries:

> "To respond positively to the initiatives of non-aligned and other developing countries in relation to the reform of the international monetary system, including the proposal of the Group of 24 on the setting up of a Representative Committee of Ministers of developing and developed countries to jointly consider further steps towards a reform of the international monetary system". d/

Notes

a/ "Current international monetary issues", report of the Secretary-General (A/43/749 and Corr.1), annex III.

b/ "The current international monetary situation", report of the Secretary-General (A/42/555), annex.

c/ Intergovernmental Group of Twenty-Four on International Monetary Affairs, "Communiqué of the fortieth meeting of ministers" (Washington, D.C., April 1989), paras. 73-74, and "Communiqué of the forty-first meeting of ministers" (Washington, D.C., September 1989), paras. 90-91.

d/ Final documents of the Ninth Conference of Heads of State or Government of the Movement of Non-Aligned Countries (A/44/551-S/20870, annex), "Debt, development, finance and monetary issues", p. 92.
