

## A Multilateral Payments Union for Eastern Europe. A Reply

The comment of Jozef van Brabant shows how important it is to define explicitly the standard of reference in the discussion of a payments union in Central and Eastern Europe. The major part of van Brabant's comments concerns the advantages of such an arrangement over a *bilateral trading system*, above all the exploitation of static comparative advantages within Eastern Europe. As a consequence, he regards the scheme "as a contingent mechanism in the case the dash toward convertibility of Czechoslovakia and Poland (and near-convertibility in Hungary) falters" (p. 90). It would be a difficult analytical question to assess the allocative advantages and disadvantages of such an arrangement in Eastern Europe, above all because the traditional tools of integration theory were developed exclusively for market economies.

My paper does not deal with these issues, because it adopts a completely different perspective. Its central question is, whether a payments union is better or worse than a system with regionally unlimited current account convertibility. While it is evident that the static and dynamic advantages of a multilateral payments system increase with the number of participants, one has to ask whether the costs of being a member of a payments union are also an increasing function of its geographic size. The traditional case for restricting convertibility to a specific region is based on the assumption that this will protect a group of countries from unacceptable and exogenously determined balance of payments implications of unrestricted convertibility. This assumption is also of central importance for van Brabant's position.<sup>1</sup> He mentions three sources for balance of payments problems (p. 91):

1) "difficulties in introducing changes in domestic policies, instruments, and institutions on the way to a market economy". This very general argument

---

<sup>1</sup> VAN BRABANT (in this *Review*, March 1991, p. 91): "I am deeply convinced, and developments in 1990-91 have borne this out, that the reforming countries in Eastern Europe will face external-payment problems that they cannot weather on their own strength or for which full external balance-of-payments support in the requisite amounts and with the necessary supervisory mechanism is unlikely to be forthcoming".

says little about the possible balances of payments implications of half-hearted measures and leaves it open whether the constraints caused by unrestricted convertibility might not contribute to an overcoming of domestic rigidities.

2) "adverse terms-of-trade effects arising from abandoning the transferable-ruble regime in favor of current world prices and convertible-currency settlements". It is evident that this will lead to a deterioration of the balance of payments of East European countries in relation to the Soviet Union. However, as mentioned in the paper, if the Soviet Union is not willing to finance such deficits,<sup>2</sup> a payments union can do very little to solve this specific problem.

3) "the desire of reforming countries to extricate themselves from intragroup commerce as soon as possible by diverting earmarked trade flows to the west". It is difficult to see why this strategy, if successful, would lead to balance of payments problems. On the contrary, it would improve the balance in convertible currencies. What is even more important, the transition to unrestricted convertibility in all East European countries would largely reduce the incentive to divert trade to the west.

On the whole, van Brabant does not provide very convincing evidence to support his central hypothesis, which would be all the more important as, at least in 1990, no reforming country was confronted with a balance of payments problem. And even if such problems will arise in 1991 for the group of East European countries *as a whole*, a payments union cannot by itself provide them with the necessary financing in outside currencies, because it can only cope with *intra-group* imbalances.

On theoretical grounds the assumption of exogenously determined balance of payments problems is not very well founded, because the balance of payments is determined by the stance of macroeconomic policies and the exchange rate. In both fields internal adjustments or increased trade restrictions will be unavoidable, if the group of East European countries will move in a current account deficit and if the West is not willing to finance it. "Some cooperative strategy linked to reform" (van Brabant, p. 96) cannot provide an easy way out.

*Stuttgart*

PETER BOFINGER

---

<sup>2</sup> In contrast to van Brabant's comment (p. 94), my paper does make a case for a membership of the Soviet Union in a payments union.