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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 92/42

10:00 a.m., April 2, 1992

M. Camdessus, Chairman

Executive Directors	Alternate Executive Directors
M. Al-Jasser	A. A. Al-Tuwaijri
	S. Gurumurthi, Temporary
	Deng H., Temporary
	G. C. Noonan
	Q. M. Krosby
J. de Groote	J. Prader
E. A. Evans	R. L. Knight
	J. Papadakis
	A. F. Mohammed
	J. A. Solheim
	M. Nakagawa, Temporary
B. Goos	
J. E. Ismael	
	J. C. Jaramillo
	P. Bonzom, Temporary
A. Mirakhor	
	T. Berrihun, Temporary
	P. Wright
	F. A. Sorokos, Temporary
C. V. Santos	N. Toé, Temporary
	R. Marino
	A. G. Zoccali

L. Van Houtven, Secretary and Counsellor
S. L. Yeager, Assistant

Also Present

Armenia: H. Bagratian, First Deputy Prime Minister and Minister of Economy; A. Egiazarian, Chief, Department of Economic Reforms. Kazakhstan: A. K. Aimanov, Deputy Minister of Foreign Economic Affairs; A. K. Arystanbekova, Envoy Extraordinary, and Minister Plenipotentiary to the United Nations; V. L. Bogatdev, Assistant Director, Institute of Economics; U. A. Dzandosov, Advisor, Supreme Economic Council; B. I. Izteleuov, Deputy President, Supreme Council of the President; G. A. Kaliev, President, Kazakh Agricultural Academy; D. Sembayev, First Deputy Prime Minister; V. Sobolev, Deputy Minister of Finance. IBRD: C. L. Hall, C. Michalopoulos, Y. T. Yurukoglu, Europe and Central Asia Regional Office. African Department: M. Touré, Counsellor and Director. Central Asia Department: Wong, C.-H. Central Banking Department: M. Quintyn. European I Department: F. M. Lakwijk. European II Department: J. Odling-Smee, Director; E. Brau, Deputy Director; A. Bisat, D. J. Donovan, S. Geadah, E. Gurgen, I. Kapur, A. Ouanes, G. C. Pastor, D. Ryan, T. Shikado, L. M. Valdivieso, K. S. Warwick. Exchange and Trade Relations Department: J. T. Boorman, Director; P. F. Allum, D. Burton, H. M. Flickenschild, A. C. A. R. Furtado, K. M. Meesook, H. J. G. Trines. External Relations Department: M. A. Seeger, J. M. Starrels. Fiscal Affairs Department: T. M. Ter-Minassian, Deputy Director; X. Maret, G. A. McKenzie, D. C. L. Nellor. IMF Institute: E. Croce. Legal Department: W. E. Holder, Deputy General Counsel; A. O. Liuksila. Research Department: P.-R. Agenor, N. U. Haque, K. H. Osband, D. Villanueva. Secretary's Department: J. W. Lang, Jr., Deputy Secretary; A. Jbili, A. Leipold, S. W. Tenney. Statistics Department: G. Khatchadourian. Treasurer's Department: A. J. Richards, C. J. Richardson. Personal Assistant to the Managing Director: B. P. A. Andrews. Advisors to Executive Directors: B. R. Fuleihan, M. Galán, A. Gronn, B. Szombati, S. von Stenglin. Assistants to Executive Directors: T. S. Allouba, S. B. Creane, N. A. Espenilla, Jr., H. Golriz, M. E. Hansen, O. A. Himani, K. Ishikura, J. Jamnik, J. Jonas, V. Kural, G. Lindsay-Nanton, L. J. Morelli, F. Moss, M. Mrakovcic, J. A. K. Munthali, E. H. Pedersen, R. K. W. Powell, E. Quattrociocche, P. L. Rubianes, N. Shimizu, R. Thorne.

1. ARMENIA - PRE-MEMBERSHIP ECONOMIC REVIEW

The Executive Directors considered the staff report for the pre-membership review for Armenia (SM/92/43, 3/4/92; Sup. 1, 3/18/92; and Sup. 2, 3/31/92). They also had before them background papers on the economy of the former U.S.S.R in 1991 (SM/92/68, 3/23/92; and Cor. 1, 3/31/92) and on common issues and interrepublic relations (SM/92/69, 3/23/92).

Mr. Hrant Bagratian, First Deputy Prime Minister of Armenia and Minister of Economy, and Mr. Armen Egiazarian, Chief of the Department of Economic Reforms, were also present.

Mr. Bagratian stated that he wished to express his deep appreciation to the Managing Director and to the staff for their quick response to Armenia's membership request and for their substantive assistance to Armenia over the past few months. Their efforts had made it possible for his delegation to be present to represent Armenia as a candidate for membership in the Fund. Moreover, their efforts had instilled a great deal of confidence in the people of Armenia and had helped develop market-based attitudes in the economy.

Armenia was going through a period of economic transformation from a totally planned system to a market-based system that would enable Armenia to open and integrate its economy into the world economy, Mr. Bagratian continued. Its economic transformation strategy in the near term would be based on fiscal reform, the creation of a robust private sector, continued privatization, trade liberalization, and the development of an effective, viable safety net to protect the most vulnerable groups during the current period of rapid change.

Despite a severe energy crisis and trade disruptions stemming from an economic blockade, Armenia had managed to design and implement the privatization of agricultural land, the liberalization of prices, and the privatization of several enterprises, Mr. Bagratian remarked. Armenia realized that the transition to a market economy could not be achieved along without international support and cooperation. It therefore looked forward to membership in the Fund and the cooperation of the international financial and economic community.

Mrs. Krosby made the following statement:

> In addition to the crises faced by the other former republics of the Soviet Union, including the collapse of the centrally planned economic system and the splintering of interrepublic relations, Armenia suffers from additional disasters that would cripple even an established and independently functioning economy: Armenia had not yet recovered from a disabling earthquake when a severe disruption of energy and other trade in 1991 brought the economy to almost a complete halt.

We strongly welcome and applaud the Armenian authorities' intention to move forward with economic stabilization and market reforms despite the current extremely difficult economic situation. The major reforms already taken--specifically, price liberalization and land reform--are highly commendable. The increase in productivity of the privatized agriculture sector illustrates graphically benefits of spreading privatization throughout the economy.

We urge Armenia to persevere in consistently following through on reforms and stabilization and to resist the temptation to fall back on government controls in the face of new and difficult problems in the future. The authorities should move as quickly as possible to pass the most strategic pieces of legislation currently under review in parliament. In particular, we have in mind legislation permitting a broad financial system and privatization reforms that would create the necessary structure for a market-oriented and stabilized economy.

Successful pursuit of tight financial policies is also critical, if difficult, in the current environment. Emergency policies need to be established that will maximize efforts to stabilize the economy now, but minimize the introduction of market rigidities and distortions that might be difficult to remove later.

On fiscal policy, Armenia appears to be making valiant efforts despite fierce constraints raised by the economic blockade and breakup of the Soviet Union. The aim for a balanced budget is appropriate, although considerably more needs to be done if it is to be achieved. In view of the loss of union transfers, the absence of other foreign aid, and the need to avoid domestic bank financing, the challenge is finding domestic fiscal resources to cover minimum expenditures at a time when the contraction in production has seriously eroded the tax base. In fact, revenue projections for 1992 appear to be highly optimistic. The value-added tax is expected to produce more than one half of total revenue, but was only recently introduced and with necessarily rapid preparations. This fragility in the revenue projections is another reason to move as quickly as possible on privatization as another source of public sector income.

As difficult as it might be to make additional cuts in expenditures in the current atmosphere, it is urgent that further prioritization of expenditures take place, with a safety net below only the most vulnerable segments of the population. Furthermore, the authorities are cautioned against taking decisions on increasing energy supplies that are likely to have a positive effect in the medium term at best, but will have a negative effect on the budget now. As an emergency measure, we would also support buffering tighter financial measures with an incomes policy, such as a tax on excess wage increases. Armenia is in need of assistance in creating a new budget institution and process, and we strongly support technical assistance in this area.

While for the time being monetary policy is effectively determined in Moscow, Armenia should not delay any longer in restructuring the financial system by removing the vestiges of the old Union-oriented framework and introducing one that fits its own domestic needs. In particular, there is an urgent need to pass legislation to create an independent central bank and to establish the framework for a competitive financial system. The entire interest rate structure is antiquated and rigid, with highly negative real interest rates. As a temporary measure, we support the staff suggestion of quarterly credit targets as a reasonable emergency solution. At the same time, we would urge Armenia to cooperate fully in reaching a conclusion on an interrepublican agreement on monetary policy within the ruble zone.

Armenia should avoid moving too hastily to introduce a national currency. It would be wise, first, to gauge the stability possibilities of the ruble zone over a short period before assuming that it would be inflationary. Furthermore, the time spent preparing for a new currency might be better spent on stabilizing the domestic economy. In the meantime, moving forward on the steps necessary to stabilize the economy is a prerequisite to either the successful introduction of a currency or membership in a common ruble zone.

In view of Armenia's small size, it is likely to be a very open trading economy. However, until less than one year ago, all trade decisions were conducted through Moscow. In the vacuum left by the breakdown of this system and the ongoing economic blockade, the Armenian authorities are considering falling back on controlled trade. We would urge them to resist this temptation as well. Legislation currently under consideration that would subject exporters to two types of quotas, one for interrepublic trade and one for domestic demand, or licenses that would have the same intent, should be discarded. In fact, the authorities should take steps to encourage export diversification and growth. One way to help export diversification would be to develop alternative trade routes, for example, through Turkey, to help break the current structure whereby most trade continues to be routed through Moscow.

In conclusion, one gets the sense of an economy so battered as to virtually be in shock. However, despite the chaotic situation, the Armenian authorities are choosing the right path in deciding to move forward with measures that will reform and stabilize the economy.

Mr. Al-Jasser made the following statement:

The Armenian authorities' commitment to a free market economy and structural adjustment is commendable. Nevertheless, the task of economic restructuring facing them is massive, and, as indicated in the staff report, the particular circumstances of Armenia are likely to make this undertaking even more difficult. As a result, the authorities will have to take thorny and courageous decisions in order to sustain the restructuring process while avoiding a severe drop in output and real income.

The environment in which the authorities must tackle the task of economic transformation and stabilization is complicated by four factors. First, the authorities must grapple with the problems associated with supply disruptions. Clearly, in conditions of sharply contracting output, the implementation of needed adjustment policies may be very onerous. Second, the relatively undiversified production structure of the Armenian economy may add to the transitional costs associated with the reallocation of resources to more productive uses in line with world prices. Third, the authorities can exert only a limited degree of control over domestic financial conditions. Finally, the authorities are constrained by the lack of technical capacity and institutional structures necessary to formulate and implement policies.

In these difficult circumstances, the authorities are to be commended for not hesitating in their efforts to establish financial restraint and to introduce structural reforms aimed at enhancing the supply potential of the economy. As a first step, the authorities undertook a comprehensive adjustment and liberalization of prices. This measure must now be buttressed by mechanisms to prevent the emergence of an inflationary price-wage spiral. Accordingly, in the absence of effective controls over monetary and credit aggregates, it will be important that wage and fiscal policy assume the role of nominal anchors. In this context, we share the authorities' concerns regarding the limitations inherent in the coordination of fiscal and monetary policies within the ruble zone, and every effort should be made to improve the consultation process. At present, the authorities' stabilization effort could be undermined if financial restraint in the ruble zone is not ensured.

In light of the important role of wage formation in price developments, the authorities should avoid introducing overly generous indexation pressures. Furthermore, there is a risk that the additional pressures on prices emanating from supply disruptions may result in an upward bias to the indexation of wages, which would hamper the process of real wage adjustment. Also, until effective control over credit to the enterprise sector has been established, fiscal mechanisms to influence wage settlements are unlikely to succeed. In these circumstances, a degree of direct wage control may be unavoidable in the short term. That being said, every effort should be made to ensure that an outdated structure of wages does not become solidified.

Wage policy measures must be underpinned by tight financial policies. In this regard, the authorities' objective of achieving a balanced budget is noteworthy. To this end, the authorities have introduced a number of changes in the tax system and have implemented sharp cutbacks in real expenditures. Nevertheless, I share the concerns of the staff as to whether this goal can be achieved under existing policies. In this regard, the additional action of the authorities, to limit expenditures to the current low level of fiscal revenues, is both commendable and courageous. However, the authorities should examine carefully expenditure priorities and the targeting of the social safety net, in order to minimize the short-term disruptions arising from this sharp fiscal adjustment. In the longer run, both the scope and level of government activity should be reviewed with the purpose of reducing those activities that could be best undertaken by the private sector.

Monetary policy is largely determined by developments in the rest of the ruble zone. In this situation, the authorities should be commended for recognizing that a prudent approach to credit and monetary policy is in the best interest of Armenia and the zone as a whole. However, the authorities are not yet well-equipped to conduct such policies, and this is an issue which must be addressed vigorously over time. For the present, I encourage the authorities to implement the staff's recommendations regarding simple mechanisms to contain credit expansion and increase financial savings.

With regard to introducing a national currency, I would caution the authorities against embarking prematurely on this endeavor. There are undoubtedly potential merits to such an approach in Armenia, including a greater role for the exchange rate to facilitate adjustment to world prices in an economy with a narrower production base than that in the rest of the ruble zone. In addition, it would provide the authorities independence in the conduct of monetary policy and the achievement of low inflation. However, a national currency now is not a practical alternative, because the preconditions to run a successful anti-inflation monetary policy are not yet in place. Indeed, at this early stage of the adjustment process, departure from the ruble zone would likely lead to greater instability, and, without an effective external payments system, would disrupt trade flows even further.

Although the serious deterioration in the immediate economic situation may, by necessity, dominate the policymaking process, the authorities should endeavor to continue their progress in the area of structural reform. Without such progress, the medium-term goal of improving the supply side of the economy will risk being delayed. In this regard, the advances achieved in privatizing agriculture are noteworthy, and I encourage the authorities to enact the legislation necessary for privatization in other sectors of the economy. I also welcome their intention to encourage foreign investment.

As regards external trade and payments, I urge the authorities not to introduce measures that could hamper the development of an export-based economy. Such measures will impede the process of structural adjustment. In this regard, I welcome the recent elimination of the tax on hard currency earnings.

The authorities have set forth on an ambitious process of reform in particularly difficult circumstances. Notwithstanding the considerable strains, which already have emerged, I encourage the authorities to persevere in their efforts, and not to lose sight of their ultimate goal: a sustainable improvement in the standard of living of their countrymen.

Mr. Zoccali made the following statement:

It gives us great satisfaction to welcome Armenia as a prospective and active member of the Fund. From the Board's discussions over the past few days, it is clear that all the republics of the former Soviet Union, from the largest to the smallest, are facing a very difficult economic situation. Armenia's is perhaps one of the most complicated because, in addition to the generalized difficulties associated with the disintegration of the Soviet Union and the transition from a socialist to a market economy, Armenia is also facing specific problems of regional security and the still enduring consequences of the terrible earthquake of 1988. The regional security situation has serious economic effects, attributable mainly to the consequences of an economic blockade, contrary to what seems to be happening in most of the republics of the former Soviet Union which are able to reduce the military component of expenditure and, therefore, generate some room for maneuver in terms of fiscal policy. There is no "peace dividend" for Armenia.

To paraphrase a comment by the Chairman on discussing the case of Argentina a few years ago, every crisis--and this is an exceptionally acute one--creates, at the same time, a challenge and an opportunity. The challenge is that the effort of adjustment and structural reform has to be more intense than would otherwise be the case. The opportunity is that, precisely because the situation is so serious and the nation is fighting for its survival, the Government is able to adopt more comprehensive measures than would be the case in more normal circumstances when their general acceptance tends to rest solely on considerations of economic efficiency and social welfare.

In that light, it is the opinion of this chair that, for Armenia, the conditions exist for designing a comprehensive front-loaded program of transformation and for resisting the tendency toward a more gradualist policy approach.

This being said, not all the elements of the current situation are negative. From the staff report one can see that progress in agricultural reform and in the privatization of land ownership is more advanced than in the other republics, and this is a very welcome development. It is hoped that the same approach will be extended to the manufacturing sector and other large-scale state enterprises. A critical sector is the energy sector, which is simultaneously affected by both pricing problems and supply constraints related to the security situation. The last paragraph of the staff appraisal states correctly that "given the urgency of the problem, the authorities' efforts to address the energy crisis--including policies to reduce Armenia's excessive consumption of energy--should also be a high priority, although major investment outlays to increase energy supply should only be undertaken if they are consistent with Armenia's comparative advantage." This is indeed sound advice.

I was therefore somewhat puzzled by the statements in pages 7 and 8 of Supplement 1 to the same report, that "the authorities feel that the scope for measures to reduce energy demand are constrained, at least in the short run, by very low demand elasticities resulting from Armenia's cold weather conditions and the highly energy-intensive technologies utilized in most state enterprises" and that "although the Government sharply raised energy prices in early January 1992, they remain far below the world price level. Since the demand for energy in Armenia appears to be quite inelastic, the price increases are expected to reduce some wastage, but not significantly decrease overall demand, at least not in the short run." I presume that the inconsistency is only apparent and could be explained by the distinction between short-run and long-run price elasticities of the demand for energy. Nevertheless, the authorities should be aware of the dangers of letting short-run considerations have an excessive influence on long-run investment decisions; for example, restoring the energy supply or devoting a significant portion of investment resources to the restoration of a Chernobyl-class nuclear plant would be unnecessary under the new demand conditions resulting from the alignment of domestic prices with world energy prices. An evaluation of supply and demand conditions in the energy sector under new pricing assumptions might increase the attractiveness of conventional thermal power plants, possibly using natural gas as fuel, with a much lower investment cost per unit of output.

On monetary and exchange rate policy, most of the concerns expressed by this chair and others on the occasion of the recent Board discussions on Russia and the Baltic republics are equally applicable in the case of Armenia. Clearly, this is one of the weakest elements of the program in light of Armenia's dependency on events in Russia and in the so-called ruble zone, which are by themselves highly uncertain. The alternative solution of going it alone and establishing a separate currency seems equally doubtful. Therefore imaginative policy design and decisive implementation is strongly needed in this area in order to avoid a protracted period of instability and output decline.

Mr. Mirakhor remarked that he welcomed the opportunity to discuss the pre-membership economic review for Armenia. The staff had produced a credible paper, and he was in general agreement with the staff appraisal. In particular, he viewed with sympathy the difficult circumstances that had resulted from the conflict with Azerbaijan. The staff correctly argued that the short-term outlook for Armenia was bleak unless a solution to the conflict was found soon. He hoped that such a solution would result in the near future as a consequence of the intense efforts of the Islamic Republic of Iran, whose mediation had already led to ceasefire among the parties.

He had no comments on the substance of the staff paper but wished to comment only on an issue lightly touched upon by the staff, namely, the question of whether Armenia should remain in the ruble zone, Mr. Mirakhor stated. The staff correctly pointed out that as long as Armenia remained in the zone, it would have to forego active use of monetary policy. It was also clear that the authorities were carefully studying the introduction of their own currency. They were, however, prudently seeking to stabilize the economy, introduce an effective and credible fiscal system, and organize the necessary infrastructure for a banking system supervised by a strong central bank before introducing the new currency. That was an admirable approach, but one which might prove costly, particularly if the current ruble zone displayed a greater degree of instability. An option available to the authorities was to consider setting up a currency board to promote hard currency convertibility and assist in achieving the goal of price stability. That would permit the authorities a transitional measure while they were in the process of establishing a central bank. He would appreciate staff comment on that issue.

He looked forward to the establishment of economic stability and the restoration of growth in Armenia as well as to expanded trade with all its neighbors, including the Islamic Republic of Iran, Mr. Mirakhor concluded.

Mr. de Groote remarked that it was a great pleasure for him, in particular on behalf of his Turkish authorities, to welcome Armenia to the

Fund and to wish it the very best in the current difficult circumstances. His Turkish authorities were firmly committed to helping in every possible way to stabilize the situation in Armenia and to ensure free trade transactions between the two countries.

He was particularly impressed by Armenia's extraordinary success in the privatization of agriculture, Mr. de Groote stated. In that respect, Armenia was an example for all other states of the former Soviet Union. He would be interested to hear from Mr. Bagratian or the staff whether that experience was unique to Armenia or whether it might be easily imitated by other republics. In particular, he wondered whether the kolkhozes had been transformed into cooperatives as a transitional measures, or whether the state enterprises had been immediately transformed into full private ownership. The issue of agricultural reform was indeed a challenging one, and the experience of Armenia could have important implications for increasing agricultural production in other republics.

The Chairman commented that Mr. de Groote had raised a most timely point. Indeed, Armenia had implemented a very bold and successful agricultural reform, and it would be helpful to hear what lessons could be drawn from that experience.

Mr. Toé remarked that he joined other speakers in welcoming Armenia and wishing it every success in its adjustment effort. He would also be interested to hear more about Armenia's privatization program, particularly in the agricultural sector, where the reform had been very successful.

Mr. Bagratian commented that Directors' remarks regarding Armenia's land reform were particularly gratifying. Prior to the land reform, about 500,000 hectares of arable land had been divided almost equally between thousands of kolkhozes and sovkhozes. Under the land reform, the land had been transferred from the kolkhozes and sovkhozes to the rural community councils. A special formula had been devised to calculate the minimum amount of land received by each community, and every person living in a rural area had the right to buy land. If an individual did not wish to purchase his allotment of land, his neighbors were given the opportunity to do so. Payment for the land had to be made within a two-year period, which would expire before the end of 1992. Following the transfer of land to individuals, agricultural equipment and buildings had been sold to anyone willing to buy them, with priority given to those living in a particular rural community. The sales were conducted through auctions. Thereafter, kolkhozes and sovkhozes had been officially disbanded as legal entities. As of March 1, 1992, 82 percent of kolkhozes and sovkhozes had been disbanded. The remaining 18 percent produced primarily seeds for planting and some types of livestock and were to be disbanded in the very near future.

The reform had, of course, given rise to some problems, Mr. Bagratian continued. For example, the quantity of livestock was declining. Nonetheless, it was recognized that Armenia had had larger numbers of livestock than its resources warranted. At the same time, the production of grapes, potatoes, and other crops had increased. In 1991, farmers had sold 57,000 tons of grain to the state authorities. That figure was small, but it was much higher than the previous level of 40,000-42,000 tons. Moreover, it showed that farmers were ready to sell grain to the state. However, there had been problems with the storage, transportation, and distribution of grain purchases.

One major problem was the lack of privatization in other sectors, Mr. Bagratian observed. Land reform needed to be accompanied by the privatization of the food processing industry and the entire food distribution chain. The banking system, however, was not ready to undertake those tasks. Interest rates were too low, and cities did not have the distribution network that was needed to move all of Armenia's agricultural output. Consequently, follow-up steps had been taken to privatize the food industry and trade in the cities. In 1991, 330 small enterprises had been sold, including 170 stores, primarily in Yerevan.

Currently, the pace of privatization had slowed because the Government was preoccupied with the preparation of necessary legislation for further reform, Mr. Bagratian stated. In the coming few months, he expected that Armenia would be able, with the technical assistance of the Fund and the World Bank, to move forward more boldly with privatization, which would permit it to use its resources more effectively.

It was difficult to say whether Armenia's approach to land reform might be successfully emulated by other republics, especially as most of the republics had very different characteristics and traditions, Mr. Bagratian commented. Certain aspects of the Armenian experience might, however, be applicable to Georgia, Azerbaijan, or Moldova, as well as the Baltic States and some parts of Central Asia, such as the Fergana Valley in Uzbekistan. Without technical preparation in supporting areas, such as the legal and distribution systems, or in instances where agricultural production traditionally involved large rural communities sharing limited quantities of equipment for cultivation--for instance, in most parts of Russia or Ukraine--it would be very difficult to follow the Armenian approach. Of course, there were many other factors to be considered as well, including the national mentality; for instance, in some republics, there was no historical tradition of private ownership. Thus, the lack of some important supporting elements suggested that Armenian-type agricultural reform could not be replicated on a large scale in other republics.

The staff representative from the European II Department observed that since the land reform had been introduced in December 1990 there had already been a sharp increase in agricultural production of about 30 percent in the 1991 crop year. That outcome suggested that the measures taken, which covered all aspects of land ownership, had had an immediate effect.

On energy policy, Mr. Zoccali had correctly suggested that the apparent inconsistency in the staff's statements regarding pricing policy was not really an inconsistency, but rather reflected that elasticities were greater in the long run than in the short run, the staff representative commented. For that reason, the staff had taken the view that energy prices should be raised sooner rather than later as it would take some time for price increases to have an effect on demand. The staff also recognized that in view of the energy-intensive nature of Armenia's industrial structure, which had been somewhat artificially imported into Armenia in the 1930s, it would be difficult to achieve major reduction on energy demand in the short run.

As to Armenia's participation in the ruble zone, the authorities appeared to be taking a very cautious approach, the staff representative remarked. They were developing contingency plans in the event that there were problems with the operation of the ruble zone, but they were very much aware of the considerable technical and institutional problems that surrounded the introduction of a national currency. Even more, they recognized that the lack of a stable economic situation would only hinder efforts toward monetary independence.

The authorities had not yet considered the precise form of exchange arrangement that might be introduced with a national currency, the staff representative from the European II Department commented. As to Mr. Mirakhor's suggestion regarding the establishment of a currency board, that mechanism had both pluses and minuses, depending on the country's situation and its objectives in issuing its own currency. Currency boards were somewhat constraining in a financial sense, and they might not provide the degree of flexibility needed to use exchange rate policy to pursue structural objectives. The subject of currency boards was of broader interest and might be a matter for general discussion by the Board in due course.

The Chairman made the following summing up:

> Executive Directors welcomed the opportunity to review the economic and financial situation of Armenia. Speakers observed that the current very difficult circumstances prevailing in Armenia and in the region constitute formidable obstacles to efforts to improve economic performance. Nevertheless, they commended the authorities for proceeding with structural reforms aimed at creating a market economy as soon as possible while seeking to implement adjustment policies in key financial areas.
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> Directors welcomed the successful land reform enacted in 1991, as well as the comprehensive price liberalization measures introduced earlier this year. They urged that the privatization program and agricultural reform be continued and extended as rapidly as possible to other sectors, and that the price liberalization process be continued in the coming months in an environment that would be conducive to eliciting a strong supply response. Speakers stressed the need to develop mechanisms to avoid entering a wage-price spiral, including fiscal measures to

contain wage increases. In particular, Directors cautioned against overly generous wage indexation provisions.

Directors agreed that in addition to wage restraint, tight financial policies were essential. The authorities' intention, despite the difficult environment, to aim for a balanced budget in 1992 was most welcome. Speakers emphasized that achieving this objective would require difficult decisions to cut expenditures sharply as the revenue outlook appeared very weak. In this context, several Directors urged that care be taken to protect the most vulnerable sectors of the population while seeking to reduce the scope of government activities that could be better undertaken by the private sector.

Directors encouraged the authorities to make every effort to reach cooperative agreements with other states on an appropriate monetary policy for the ruble zone. The authorities were urged to move forward quickly to put basic institutional elements in place, including the enactment of necessary banking legislation, the formulation of practical and workable credit policy guidelines, including guidelines to pursue realistic interest rates, the establishment of a framework for banking supervision, and the development of markets for financial instruments.

Several speakers noted that the authorities were actively considering the introduction of a national currency, observing that the current arrangements for monetary policy coordination within the ruble zone left much to be desired. While the introduction of a national currency was a prerogative of sovereignty, Directors emphasized that in order to instill confidence in the new currency, it was essential that institutional arrangements and policy instruments would first be in place to implement tight monetary and fiscal policy.

Directors considered that, over the medium term, the key issue is how to address the existing constraints on growth stemming from the undiversified structure of production, the heavy reliance by industry on imported inputs, and the economy's high degree of vulnerability to exogenous shocks affecting energy and transportation. The need to reduce consumption of energy and to develop coherent energy and industrial policies for the medium and long term was emphasized.

While recognizing that the current climate affecting inter-republican trade is difficult, Directors urged the authorities to try to maintain a liberal exchange trade system, in close coordination with other members of the ruble zone.

Directors encouraged the authorities to persevere with their adjustment efforts and looked forward to Armenia becoming a member of the Fund in the near future. They wished the Government and people of Armenia success in their daunting task of restoring, and increasing, prosperity to their country.

Extending his remarks, the Chairman commented that the Fund was keenly aware of the tremendous shocks that Armenia had recently suffered, and it strongly wished to be as helpful as possible. In that connection, the Fund could best assist Armenia through its support of a strong economic adjustment program and through its mobilization of international financial support in that context. In view of Armenia's particular problems, the Fund would be in touch with other UN agencies, particularly those in charge of humanitarian assistance, to try to help catalyze timely support. He was certain that the Governments represented around the Board table would also do what they could to help Armenia in the current difficult period.

2. KAZAKHSTAN - PRE-MEMBERSHIP ECONOMIC REVIEW

The Executive Directors considered the staff report for the pre-membership review for Kazakhstan (SM/92/41, 2/28/92; and Sup. 1, 3/10/92). They also had before them background papers on the economy of the former U.S.S.R. in 1991 (SM/92/68, 3/23/92; and Cor. 1, 3/31/92), on common issues and interrepublic relations (SM/92/69, 3/23/92), and statistical profiles for six former Soviet republics (SM/92/72, 3/25/92).

Mr. D. Sembayev, First Deputy Prime Minister of Kazakhstan; Mr. B. I. Izteleuov, Deputy President of the Supreme Economic Council; Mr. U. A. Dzandosov, Advisor in the Supreme Economic Council; Mr. V. Sobolev, Deputy Minister of Finance; and Miss A. K. Arystanbekova, Representative of Kazakhstan, Envoy Extraordinary, and Minister Plenipotentiary to the United Nations, were also present.

The staff representative from the European II Department made the following statement:

Since the discussions with the Kazakh authorities in January, the staff has received additional information to update the staff report.

On inflation, in January the rate was around 140 percent; in February, it was approximately 120 percent, which would yield an inflation rate for the first quarter of 1992 of about 450 percent.

On the budget, in January and February revenues exceeded expenditures as the authorities implemented monthly cash management procedures and defense and investment spending was suspended. However, the authorities have informed us that pressures are mounting to increase expenditures, particularly in the area of investment. A significant development was that tax collections exceeded the authorities' projections for the first quarter, in particular for the value-added tax; in fact, collections from the value-added tax in the first two weeks of March exceeded those in the first two months of the year, largely owing to a much-reinforced collection effort.

The authorities are currently preparing a comprehensive program of macroeconomic and structural reforms for the remainder of this year. The Ministry of Finance is preparing a new budget, which is expected to be adopted by Parliament in May, and the authorities expect to be able to target a budget deficit of around 3 percent of GDP. Directors will recall that during the January discussions with the authorities, the staff had estimated the budget deficit for 1992 to be between 10 percent and 15 percent of GDP.

The staff has also been informed that the rollback in the retail prices of selected consumer goods in January, following certain civil disturbances, will be reversed. The rollback was undertaken by suspending the value-added tax on bread, milk, and meat. The authorities have informed us that the value-added tax will be reintroduced on milk and meat in May, together with an augmentation of the social safety net to target nominal income transfers to specific segments of the population.

On the exchange system, at the time of the discussions with the authorities in January, the new exchange system and exchange rate in force in Russia was not being applied in Kazakhstan. Since February, the Kazakh authorities have been applying the commercial rate--which is around ruble 55/US$1 in Kazakhstan--for all interbank transactions. However, as an emergency measure, the authorities have introduced a tax on export earnings in foreign exchange. The tax rate varies, depending on the industry and on the exporting enterprise, but the average rate is around 40 percent; the tax is collected in hard currency directly from the enterprises. This implies that there is no need for a domestic currency counterpart in the government budget since it is a straightforward tax rather than a surrender requirement. The staff has informed the authorities that it regrets that this tax has been imposed and has recommended that they consider removing it as soon as possible.

On the privatization front, the authorities have informed the staff that about 10 percent of the housing stock has now been privatized and that the privatization program as a whole has been accelerated. As indicated in the staff report, the President had proposed to Parliament that the program be accelerated; this proposal has been accepted. A large number of enterprises have already been privatized, and the authorities intend to continue speeding up the privatization program in the months ahead.

Mr. Sembayev made the following statement:

Allow me for the second time in the last 24 hours to use this historic opportunity to speak before such an authoritative international body. Yesterday, and again today at this review, one thing motivates us--myself and our Government: it is to give you our most objective assessment of one of the largest republics of the Commonwealth of Independent States. For this reason, the delegation was dispatched to Washington.

The staff papers on the former republics and on Kazakhstan have drawn a very objective picture. The economic problems of the republics of the former Soviet Union have the same roots, and arose from the same set of problems. But this is more true from a superficial viewpoint. Each republic is in fact quite different internally. They are different in terms of the scope of their economies; in terms of their priorities; and, to date, in terms of their level of economic development, owing to the very harsh policy of the Center, whereby individual republics were simply resource suppliers for the Center.

I therefore wish to highlight the specific features of our republic, of the position of President Nazarbayav, and of the steps that have been taken toward the stabilization of the economy, the establishment of various new forms of ownership, and the transition to a market economy. I would also like to report on the events of the past three months.

The relative stability of the situation today is linked with the peculiarities of the economic structure of Kazakhstan. Here, I would note, first, the self-sufficiency of our republic in basic food items. Historically, we fed not only ourselves but exported a large portion of grain, meat, and milk products to other regions of the U.S.S.R. In terms of foodstuffs, we are coping without any assistance from outside. However, because of the harsh drought we experienced last year, we were forced to purchase a small amount of feed grain to support livestock.

The second point that I would like to highlight is our self-sufficiency in fuel and energy resources. We are delivering coal and oil beyond the borders of our republic. We have approximate parity with Russia in terms of the exchange of oil and petroleum products. Only with Turkmenistan do we have a negative balance of trade in gas. On the whole, the republic is capable of exporting a significant quantity of oil--5 to 6 million tons--and we are the only republic within the Commonwealth of Independent States that has increased oil production in the last year--by 8 percent. While production in all other republics fell, we have experienced stable growth. Thanks to a wealth of mineral resources and an economy which is oriented toward these resources, we also have competitive products in ferrous and non-ferrous metallurgy and chemistry.

Third, we have a very stable political, social, and economic situation. As a result, the mood of separatism that has emerged in many regions or republics of the Commonwealth of Independent States is absent in Kazakhstan. Foreign and domestic observers alike have noted the support of the population for, and its belief in, the President and the policies of the Government.

These internal factors create for us favorable conditions in which to establish new institutions and new forms of ownership. Last year the Presidential Program for Privatization was adopted. The program consists of two parts. The first includes small enterprises and services. As the staff has indicated, we have denationalized more than 1,200 enterprises worth more than ruble 115 billion. We have a certain strategy for utilizing the funds obtained from privatization; we do not plan to use them for current expenditures. The second part involves the privatization of large enterprises. We are establishing holding companies as well as joint-stock companies. We will also be organizing a securities market, and, in this connection, we will need technical assistance.

At present, we are carrying out three major strategic tasks. The first is to establish a sovereign state based on the principles of international law and the establishment of new public institutions. The republic has to assume new functions that it has never before undertaken and that were usually the prerogative of Moscow. Appropriate organs and bodies for management have been established in connection with the transition to a market economy.

The second task is the achievement of economic stabilization. In the current situation, former administrative methods are no longer applicable: they will not solve our problems. Therefore, it is necessary to put into place market regulations within an adequate legal framework as quickly as possible. It is quite another matter that the legal framework we now have is insufficient, but our Parliament has the opportunity to change and correct this.

As to the third task, everyone knows the steps that Kazakhstan has taken to maintain a single ruble area, establish a common banking system, and control the imposition of tariffs. Certain republics oppose the establishment of such interrepublic organs, and on this point, the interests of republics are quite different. Ukraine and Moldova, for example, share one point of view, while other states in the Commonwealth of Independent States maintain that there should be a single body to deal with the problems connected with a single ruble area.

At present, the situation is still complicated owing to the customs barriers that have been established, including licensing requirements and quotas on exports between members of the Commonwealth of Independent States. Moreover, the very deeply integrated Soviet economy--a very complex system--is disintegrating, and a number of republics consider that they will be able, on their own, to escape these difficulties and to preserve their own frontiers, having in mind their overall deficit situation. They hope to resolve their problems by living, and building up their economies, in isolation. We believe that this is impossible, and our republic was the first to sign an agreement with Russia on opening trade borders and the free exchange of capital, services, labor, and goods between the two countries. Belarus reached a similar agreement with Ukraine, and six or seven republics now have bilateral agreements on these very issues.

Various difficult problems still exist in the area of price liberalization. In the first quarter of 1992, prices exceeded by twofold the level forecast by the Government. The reasons for that outcome lie in the monopolistic character of our economy--in the lack of competition--and, to a certain extent, in the tendencies toward isolation and the imposition of artificial barriers that I have already mentioned. In addition, we believe that countries in the ruble area have to implement a harsh and strictly disciplined monetary policy, and that the lack of coordination in this area worsens the overall situation. The lack of understanding and agreement on these issues as well as the lack of agreement on the consolidated budget deficits of the republics is, in our opinion, very dangerous, and at the March 20 meeting of the heads of states of the Commonwealth of Independent States in Kiev, seven republics signed an interbank agreement to coordinate actions with a view to the ruble's recovery.

The staff has mentioned the difficulties in realizing the aim of budget policy. These are connected with the fact that we would not be a Soviet people if we did not attempt to solve all problems simultaneously. We have introduced a new tax policy and a new package of tax laws. At the same time, we liberalized prices. The enterprise personnel was not prepared for all of this, and as a result, in January there were a number of shortfalls in expected revenues to the budget. The situation is improving, and we have every reason to hope that we will be able to collect all monies that are due. A new organization has been established for tax inspection. Even though we are currently training specialists in this field, our personnel is still influenced by a Soviet institutional education. But life now demands new knowledge, new skills, and here, too, we hope for technical assistance from international organizations, including the International Monetary Fund.

As to balancing the budget, it is necessary to ensure that total expenditures for each month do not exceed the revenues of the previous month. The efforts to move away from subsidies in the social sphere should be tightened, and we should reduce investment programs. One of the difficulties that we have encountered in this area is public psychology. We can always sign a decree to liberalize prices and introduce new prices in the morning, but those imbued with a subsistence psychology often place great pressure on the Government to resist such measures. We must recognize that while pensions have increased threefold, prices have increased tenfold or more for a number of foodstuffs.

In the past 14 months, 290 joint ventures have been established. Not all of these enterprises are functioning; some have only been registered. But every condition exists to organize production in Kazakhstan.

What are our technical assistance concerns? Perhaps I am placing too much stress on this, but we believe that such assistance is needed in the areas of banking, taxation, and the budget. We virtually have to establish a new way of accounting and statistics, and to accomplish this we need to have qualified personnel. We ourselves are taking measures: we have established educational programs for this purpose. But we have to note that technical assistance is not well coordinated in this area, and it still lags behind demand.

As to the results of the first quarter, a new government program will be implemented that will reflect all of the positive and negative lessons that have been learned. We note that in mid-April, a Fund staff mission will visit our country, and we will be able to organize joint work. We are prepared to consider all of the comments that Executive Directors will make at this meeting, and we have every intention to act on some of them.

In conclusion, I wish to thank you for your attention, and I will be happy to answer any questions.

Mr. de Groote remarked that he would reserve his comments until the end of the discussion.

Mr. Wright made the following statement:

Macroeconomic stabilization is the immediate priority for the Kazakh authorities. This will require a significant degree of restraint in credit expansion and a substantial reduction in the fiscal deficit. Therefore, it will be of paramount importance that the authorities establish the institutional structures and skills to implement independent economic policies as soon as possible.

The staff is right to be concerned about the possibility of a collapse in trade flows. Although in the past there has been relatively little economic cooperation with other republics in the central Asian region, close coordination with Russia will help to minimize the falls in demand, output, and employment. The recent agreements on free trade, labor, and capital with Russia and Belarus are to be welcomed.

On monetary policy, it is a source of concern that real interest rates are strongly negative in real terms. This will need to be addressed if savings are to be stimulated and inflation kept under control during the liberalization process. If Kazakhstan is to remain part of the ruble area, it will be extremely important to cooperate closely in the formulation of monetary policy with the other states within that area. Events in Russia are likely to have an important bearing on policy elsewhere. In particular, if currency stabilization is achieved in Russia, this is likely to bring significant benefits to Kazakhstan. But this will not be possible unless there is adequate monetary control elsewhere in the ruble area. Kazakhstan will therefore need to establish its own institutional framework in order to begin to exert influence over its own money and credit growth policy. Of particular concern at the moment is the virtually unrestricted access of enterprises to credit from the banking system and the failure of the national bank to put in place adequate policies for effective monetary control.

Wide-ranging price liberalization is essential if market mechanisms are to be allowed to allocate resources in an efficient manner. An early supply-side response to the reform process will depend on producers being allowed to set their own output prices. Price liberalization will also be the key to identifying those public enterprises which are profitable, and those which are making losses, and thereby a burden on the public finances. Any temptation to reintroduce price controls or compensate for price liberalization through large wage increases should be resisted; this would simply increase the already serious pressures on the budget.

I have a number of concerns about fiscal policy, which deteriorated sharply last year. While this partly reflected the lower level of transfers from the Union budget, the unexplained disappearance "off budget" of social security revenues equivalent to about 3.5 percent of GDP, without any corresponding disappearance of social security payments, is a source of considerable concern. I hope that the staff and the authorities will be able to clarify this issue during the next mission. Clearly, a budget deficit projection of 3.2 percent of GDP this year is likely to be overoptimistic. The staff report describes recent reductions in income and corporate taxes. I am not wholly convinced of the wisdom of these reductions, especially as revenues from the increases in indirect taxation are typically uncertain and often take longer than expected to materialize. I am also uneasy about the prospect of introducing a temporary tax on exporters at a time when international trade should be encouraged. I urge the authorities to investigate--as a matter of some urgency--other potential sources of revenue.

Kazakhstan's privatization program to date has fallen well short of its original targets. Less than 2 percent of companies have been privatized so far, nearly all of them small. Furthermore, a number of important industries--for example, energy, telecommunications, and natural resources--are likely to be excluded from early privatization. The privatizations that have taken place so far were mainly at a discount from "book value," with facilities being made available for payment on credit. Establishing the real value of public enterprises should become easier as price liberalization gives a better indication of which enterprises are likely to be profitable in the future. Meanwhile, the fact that these privatizations have been associated with the extension of credit to the private sector makes me somewhat uneasy about its implications for monetary conditions. I would also encourage the authorities to adopt a more liberal stance on foreign participation in privatization; Kazakhstan, along with other republics, stands to gain enormously from foreign investment.

While I welcome the fact that Kazakhstan has committed itself to service its debt in full, and that it has benefitted from the recent agreement to defer some principal payments to external creditors, I was concerned to note that no interest payments have so far been made this year. I understand that this reflects uncertainties surrounding the legal and financial status of U.S.S.R. Vnesheconombank (VEB). However, the authorities should give serious consideration to making regular payments into an escrow account so that, when the legal issues relating to the VEB are sorted out, the arrears of interest payments will not then cause problems for the budget.

Mr. Al-Jasser made the following statement:

At the outset, I would like to welcome Mr. Sembayev to this Board meeting, and to thank him for his illuminating statement on the economic situation in Kazakhstan. I would also like to thank the staff for the impressive work it has have accomplished under very trying circumstances. Although one always expects the staff to produce high-quality work, the effort exerted to produce the pre-membership reviews for all the republics is indeed outstanding.

Kazakhstan's medium-term growth potential is very promising, given its large agricultural sector, substantial mineral resources, and its well-developed industrial base. These are clearly significant characteristics for a newly independent republic. Nevertheless, as in the case of other former Soviet republics, the authorities face the daunting task of restructuring and transforming their economic system to efficiently allocate resources and to allow the economy to perform near its full potential. As indicated in the staff report, this task will prove ever more difficult owing to the lack of the necessary technical capacity and institutional structures, as well as the intricate coordination requirements among members of the ruble area. The authorities deserve strong commendation for the important measures they have already implemented, which represent a first step toward a far more ambitious and comprehensive stabilization and transformation strategy.

The authorities have expressed their desire to remain within the ruble area and to retain many of the features of an economic union between the former republics. At least, in the short term, this is highly appropriate, because it is essential to preserve trade relations among the former republics if a dramatic and severe contraction in real output is to be avoided. Moreover, the objective conditions for the establishment of separate currencies are unlikely to exist in the short run. Thus, until these conditions develop, every effort should be made to utilize the ruble area and to improve the coordination and consultation process within that area. Here, one cannot but sympathize with the authorities' concerns about the lack of clear rules conducive to fiscal prudence and monetary restraint within the ruble area.

In light of the authorities' views on this issue, it is essential that their reform efforts move in tandem with other republics, particularly with Russia. Therefore, while the initial price liberalization measures are welcome, they must be supplemented in parallel with the Russian price reforms. At a minimum, the wedge between traded goods prices and world market price levels in the smaller republics should be equal to that prevailing in Russia. Moreover, it is inconceivable that members of a single currency area have different exchange rates and systems of surrender requirements. Therefore, I urge the authorities to simplify their system of surrender requirements and to reduce them to a level at least as low as that prevailing in the rest of the ruble area. Also, I am particularly encouraged by the staff's statement that the authorities have adjusted significantly their exchange rate.

The authorities' transformation effort must be underpinned by a strong and ambitious stabilization package. This is all the more relevant in view of Kazakhstan's membership in the ruble area, and the need for all ruble area members to adopt sufficiently tight financial policies. The price liberalization measures already implemented have contributed to a decline in government expenditures. This, coupled with significant changes in the tax system, should improve public finances. Nonetheless, if appropriate adjustments are made to the original budget estimates, the projected fiscal deficit could rise above 15 percent of GDP in 1992. In this regard, I am encouraged by the latest information provided by the staff and by the authorities' awareness of the need for additional fiscal measures. Hence, I urge them to expeditiously implement the staff's recommendations. Of particular significance is the need to exercise wage restraint in 1992, both as a means to reduce public expenditures and as a much-needed additional nominal anchor. Hence, I endorse the staff's view that financial assistance should not be provided to enterprises which grant wage increases above those granted to government employees, and that enterprise windfall profits should be geared toward investment rather than wage increases. Furthermore, I note that the Fund has correctly urged all the former republics to undertake substantial fiscal consolidation. However, for the smaller members of the ruble area, it may be too costly to undertake fiscal consolidation beyond that of Russia, particularly since the Russian anti-inflationary stance will more than likely determine inflation in the ruble area. Some elaboration from the staff on this point will be helpful.

Regarding monetary policy, the authorities commendably intend to limit the amount of currency needed by the National Bank of Kazakhstan from the central bank of Russia. However, while several significant steps have been taken to establish a legal and regulatory framework for the financial system, far more measures are needed to enable the National Bank of Kazakhstan to fulfill its envisaged roles. In addition, credit to public enterprises and the amount of refinancing made to banks need to be limited.

The authorities are aware that a strong stabilization package will inevitably lead to a dramatic contraction in real output. However, this contraction could be ameliorated if price liberalization and privatization measures lead to a timely supply response. Hence, while I welcome the authorities' decision to intensify their privatization efforts and the encouraging information given by Mr. Sembayev, I note the staff's concerns regarding the conventional and time-consuming procedures undertaken. The experience of East European countries may prove helpful in this regard. Moreover, I share the staff's view regarding the need to privatize retail and wholesale trade and distribution networks. In addition, I encourage the authorities to permit foreign participation in the privatization program and to reconsider their position on private land ownership.

In conclusion, the authorities are embarking on a highly ambitious transformation process that is bound to impose major economic and social strains, particularly in view of the uncertainties surrounding the approach and the time necessary for it to succeed. Nevertheless, I urge the authorities to persist in their efforts and to withstand the inevitable pressures to reverse their strategy, as the potential payoffs are very large.

Mr. Nakagawa made the following statement:

Let me join previous speakers in welcoming Mr. Sembayev to this meeting and expressing appreciation for his comprehensive and informative statement.

Clearly the challenges for the Kazakh authorities in the period ahead are not easy ones. They have to tackle the urgent problem of macroeconomic stabilization while substantially improving their institutional structures and skills needed to effectively design and implement independent economic policies. At the same time, if Kazakhstan is to remain within the ruble area, it must, as a matter of urgency, reach an agreement with other countries in the area, particularly Russia, on coordination in formulating monetary policy.

None of these tasks is easy. But Kazakhstan is a country of great potential. Among the republics of the former U.S.S.R., it has the second largest land area, and it is rich in mineral resources. Kazakhstan accounted for 19 percent of U.S.S.R. coal production and 7 percent of its oil production. It also has a developed industrial base in such sectors as metallurgy, heavy machinery, and petrochemicals. This chair strongly hopes that Kazakhstan will make its best effort to successfully transform its economy to a market-based system, utilizing its inherited high potential.

Kazakhstan's economic situation and the policy measures that are needed to meet the challenges facing it have been well described in the staff report, and I endorse most of them. I am also encouraged by the comprehensive explanation given by Mr. Sembayev at the meeting's outset. I will therefore limit myself to a few points.

I fully share the staff's concern over the fiscal prospects for 1992. In particular, slippage on the revenue side is highly likely in view of the still very weak tax administration. This is particularly true in the case of the newly introduced value-added tax. I would urge the authorities to keep a close watch on revenue development and to take any additional tax measures that might be necessary. The authorities should be ready to tax the profits of state enterprises, extend the scope of the value-added tax, and increase revenues from other taxes along the lines recommended by the Fund's technical assistance mission. In this regard, I am pleased to learn from the staff that revenue performance was successful and has improved substantially in the first quarter of the year.

I would also stress the importance of budget expenditure management. Expenditures should be kept strictly under the constraint of revenues. The authorities should maintain a very cautious stance on budget management for the time being, monitoring developments closely, on a monthly basis.

I would urge the authorities to substantially accelerate privatization. In particular, the privatization of key sectors of the economy, such as agriculture, trade, and transportation, should be encouraged now. In view of the great potential of the economy, measures to encourage the supply response should be carried out right away. This is the only way to maximize the economic effect of the liberalization of prices in early January.

The staff mentions the importance of reversing recent trends in interrepublic trade through cooperation with other republics. This is no doubt an important systemic issue for the authorities. Nevertheless, I would like to welcome the recent development in trade relations between Kazakhstan and China. The two countries signed a trade agreement as early as last December. Moreover, a railway has been reinstalled between Wulmuchi in Outer Mongolia, China, and the Kazakh town of Dulujiba, whose name means "friendship." According to a recent newspaper article, markets outside Alma Ata are full of products from China, Hong Kong, Korea, and Japan. Products imported from Turkey were also on sale in those markets. The article noted that the wide variety of goods from all over the world seen in the markets of Alma Alta is rare in the markets of Moscow. I also heard that the President of Kazakhstan has agreed with the presidents of other central Asian republics to build railways between their countries and that, in the near future, Beijing and Istanbul will be directly connected by a railway which will pass through Kazakhstan. This is the revival of the so-called silk road of ancient times, by which silk was traded among countries in the Eurasian continent from China to the Roman Empire. I strongly welcome the renaissance of this international trade route in the central part of the Eurasian continent. Obviously Kazakhstan, as well as other central Asian countries, will play an important role as a key section of the trade route. The silk road in this century and the next should play the same role as it did many centuries ago when central Asia was at the center of a dynamic international trade.

Mr. Mohammed made the following statement:

Kazakhstan is rich in natural resources, has a well-developed industrial base and infrastructure, and is a significant producer and exporter of agricultural and energy products--elements that should help it become a viable economic entity under normal circumstances. But circumstances are far from normal, and the transformation from being an integral part of a centrally planned economy to an independent market-based economy presents massive intellectual and institutional challenges to Kazakhstan, as it does to the other republics of the former Union. While a rapid move to a market system is the desired objective, economic policies during this initial period cannot ignore the immediate need to contain further declines in output and limit the adverse impact on vulnerable segments of the population during the transition.

Kazakhstan's economy will remain closely linked to those of other former republics, especially Russia, in view of its highly specialized productive base. Kazakhstan's decision to adhere to maintaining a common economic space with other republics indicates a welcome recognition of this reality--a recognition that appears to elude several of the other republics.

Kazakhstan is a major energy producer and exporter. Table 14 of the supplementary paper shows that exports of oil, gas, and petroleum products account for 35 percent of projected convertible currency exports in 1992, to which coal adds another 4.2 percent. Petroleum products are presumably exported to other republics at below international market prices, and Kazakhstan may therefore be expected to reap the benefit of improved terms of trade as it moves these exports to international prices. It would be interesting if the staff could provide some information as to the expected timing and impact of this on the fiscal accounts, and how it is reflected in the 1992 budget. Kazakhstan's decision to remain part of the ruble area creates an overriding need for effective coordination of financial policies with Russia as well as other republics, if its macroeconomic objectives are to be achieved. Even though the needed level of coordination has been lacking to date, the Kazakh authorities must nevertheless proceed to develop and implement fiscal and monetary policies aimed at controlling inflation. Kazakhstan's 1992 budget targets an overall deficit equivalent to about 3 percent of GDP, but the staff points out that the deficit could rise to the equivalent of 10-15 percent of GDP if elements that were not considered at the time of the budget's preparation were taken into account.

We were told by Mr. Sembayev that the budget being prepared for the remainder of 1992 allows for a deficit of 3 percent. It is not clear whether the staff still maintains its earlier estimate of 10-15 percent or would revise it downwards in light of the budget measures planned by the authorities. I would be grateful for any clarification on this point.

The scope for increasing revenue is constrained by falling output levels and diminished real incomes. Effective revenue-enhancing measures must therefore rely on strengthened tax collection efforts, particularly since several taxes are being introduced for the first time. Most of the fiscal adjustment effort will most likely have to be made through expenditure reductions. There should be scope for reducing transfers to state enterprises as prices are liberalized and enterprises begin to operate on a commercial basis. Containing the wage bill will be another important element of the needed expenditure control, and measures to limit salary increases and freeze hiring by the public sector are therefore well taken.

While still on the fiscal accounts, I note that net transfers from the Union amounted to 10 percent of GDP in 1990, less than 5 percent in 1991, and will all but cease in 1992. Some of these funds presumably went to cover the expenses of the Baikonur space center and the Semiplatinsk nuclear weapons testing facility, which previously were all-Union responsibilities. Does the staff have any information on the implications of the cessation of Union transfers for the future of these facilities, and on whether Kazakhstan will now incur the expenses associated with these facilities on its own?

Another unknown in the budgetary picture is the cost of the social safety net that is being put in place to protect certain vulnerable groups of the population. The reforms undertaken in 1991 represent a significant effort, but the demands on the system in 1992 and beyond raise concerns. Mr. Sembayev has pointed out that while pensions have gone up threefold, the price of the basket of essential consumer goods has gone up as much as tenfold. The structural and financial reform of the social security system that is due to be completed in 1992 will have to address the issue of funding in ways that do not intensify an already difficult fiscal situation.

Monetary and credit policies will be governed to a large extent by Kazakhstan's membership in the ruble area. Harmonization regarding credit policies, reserve requirements, and interest rate policies--especially for refinancing credits--are of the utmost importance. The central bank refinance rate in Kazakhstan was significantly lower than the inflation rate and below the refinance rates in Russia in January and February 1992.

The rate will need to be raised to align it with that of Russia and with the inflation rate. The central bank will have to limit credit to the Government in line with a reduction in the fiscal deficit, and the virtually automatic access of enterprises to the banking system will have to be curtailed.

Kazakhstan's membership in the ruble area requires maintaining a common exchange rate policy with other members of the area. The absence of effective centralized control over monetary and exchange rate policies has given rise to different exchange rates for the ruble, with the rates in Kazakhstan appearing to be more appreciated than those prevailing in Russia. The financial and trade dislocations emerging from such an anomalous situation will undermine the ruble area, and I would be interested in recent developments in this regard. It is not clear what the combination of a commercial rate of ruble 55/US$1, together with a 40 percent tax payable in hard currency, implies for the effective exchange rate that will apply to Kazakh exports, and I would be grateful for any clarification on that point.

We tend to agree with the staff's view that the likely benefits of Kazakhstan's membership in the ruble area outweigh, on balance, the potential costs of issuing its own currency and pursuing an independent monetary policy. The benefits of ruble area participation, however, hinge to a large measure on the success of effective centralized control of monetary and exchange rate policies in lowering inflation and then maintaining a degree of price stability in the ruble area. It would be unfortunate if the failure of these efforts leads Kazakhstan to reappraise the cost/benefit calculus and to proceed with issuing its own currency before its institutional and policy capabilities can ensure a successful independent monetary policy.

My final point relates to the reform of the public enterprise sector. Restructuring the pervasive public enterprise sector in Kazakhstan is an essential element in the transition to a market-based economy. The absence of capital markets and a viable private sector does limit, however, the extent and speed of privatization that can be successfully implemented, and I was very interested in Mr. Sembayev's remarks on that subject. I wonder whether it would not be preferable for divestment of public assets at this stage to focus on the small business, agricultural, and housing sectors, and possibly direct sales of medium-sized enterprises to workers, while the focus on large enterprises could well be on restructuring their operations with the aim of putting them on a commercial footing; this would perhaps be a better way to proceed over the next year or two. The reform of the public enterprise sector will require significant technical assistance, and there is an obvious role for the World Bank, the European Bank for Reconstruction and Development, and other regional institutions in helping Kazakhstan with the design and implementation stages of this process.

Mr. Goos remarked that the Kazakh authorities were to be congratulated on their decision to transform the economy into a market-based system and to seek its induction into the international financial system, as evidenced by their application for Fund membership. He was impressed by the commitment to those objectives expressed by Mr. Sembayev in the meeting of the Membership Committee for Kazakhstan and at the outset of the current discussion.

The economic challenges facing Kazakhstan were daunting, and their resolution would put the authorities' skills and stamina, as well as the population's endurance, to a severe test, but if pursued with vigor and in a sustained manner, well-designed adjustment and reform efforts could be expected to yield unprecedented economic benefits resulting from improved utilization of Kazakhstan's vast natural resources, Mr. Goos observed. There was little doubt that the international financial community, including the Fund, stood ready to complement such efforts with significant technical and financial assistance.

The specific requirements of a successful stabilization and reform strategy were well detailed in the staff report, Mr. Goos commented. The report conveyed in particular two critical messages, namely, that there was no realistic alternative to swift and resolute action, and that efforts must be embedded in a comprehensive and consistent adjustment strategy in order to minimize the inevitable costs of the transition process. Against that background, the authorities undoubtedly deserved to be commended on the measures already implemented, but those were only first, even though important, steps in the right direction.

From Mr. Sembayev's opening statement he had gained the impression that the authorities agreed with that assessment, particularly the indication that the Government was working on a more ambitious effort for the rest of the year, Mr. Goos continued. Moreover, he had noted that the Kazakh Government had publicly endorsed Russia's Memorandum of Economic Policies, which he took as an encouraging indication of Kazakhstan's intention to embark on a comparable comprehensive program of adjustment and reform. He would certainly welcome such a move, particularly if it were taken in close cooperation with the Fund.

In that context, he wished to also commend the authorities on their efforts to maintain the free movement of goods, capital, and labor between the republics of the former Soviet Union, which attested to their commitment to market-oriented principles, Mr. Goos remarked. There were, however, a number of areas where that commitment appeared to be still somewhat obscured, notably the areas of enterprise financing and monetary control, including the setting of positive real interest rates, as well as the areas of privatization and land reform.

On the latter two aspects, he found the authorities' restrictive stance on privatization--explicitly excluding western capital--somewhat surprising considering the urgent need for investment capital, modern technology, and management skills, Mr. Goos stated. Moreover, the unsatisfactory experience with Yugoslavia's model, where workers jointly owned and managed their enterprises, would advise against undue emphasis in the privatization strategy on the sale of enterprises to their staff.

Concerning land reform, he would stress that private ownership was an integral part of any functioning market economy, particularly inasmuch as land served as a collateral for bank lending, which was a driving force of private sector investment and production activities, Mr. Goos commented. Long-term leases on land, even with inheritance rights, could not serve that purpose.

As to other policy issues, he would merely endorse the staff appraisal and associate himself with the concerns expressed by previous speakers, notably Mr. Wright, Mr. Goos remarked. As he had done in earlier pre-membership review discussions, he would urge the Kazakh authorities to carefully study the staff paper on common issues and interrepublic relations, which amplified in a more detailed fashion the recommendations of the staff report on Kazakhstan.

Mr. Noonan made the following statement:

> I would like to join other speakers in welcoming Mr. Sembayev and his contribution to our discussion. My contribution will not be able to reflect the importance of this historic occasion, in part because the excellent staff report has left us with so little to say, but will instead emphasize some selected aspects of the staff appraisal. Like other former Soviet republics, Kazakhstan has embarked on the metamorphosis from a command economy, insulated from the world community, to a market economy, integrated into that community. This would be an enormous challenge in its own right, but when that challenge is set in the context of associated political upheaval and the birth of new countries, it might best be described as awesome. Success will require not only enlightened leadership but also generous and constructive external assistance.
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> The staff has encouraged the authorities to seek technical assistance from the World Bank and other international and bilateral sources. In our view, it is right in doing so, and I was pleased to note Mr. Sembayev's concurrence on the importance of technical assistance for Kazakhstan. This chair sees the provision of technical expertise as particularly important in the case of Kazakhstan because the reform measures being undertaken there appear to fall short of what would be required of a credible stabilization and adjustment program. We can, of course, appreciate the authorities' hesitancy to undertake major policy

changes without being certain of a successful outcome. However, the alternative offers an even less attractive prospect. Indeed, given planned developments in Russia, the Kazakh authorities have little alternative but to keep pace. Otherwise, arbitrage will ensure a leveling out of price and other discrepancies, and the process could prove to be a costly one for Kazakhstan. We believe that the sensible use of technical assistance would help Kazakhstan to quickly develop and implement a credible program, which in turn would warrant support by the Fund. In this context, I am particularly pleased to see that the Fund has been able to provide some technical assistance and plans to provide significantly more.

In general, this chair supports the staff's critique of the authorities' current efforts, particularly in the area of macroeconomic stabilization. We concur with the staff on the need for a substantial reduction in the fiscal deficit and for restraint on credit expansion, much of which is currently directed to finance the fiscal deficit. The staff makes specific recommendations to achieve these objectives. We cannot claim any particular expertise in assessing those specific recommendations in Kazakhstan's circumstances, but either these, or equally effective alternative measures, must be taken by the authorities to achieve the fiscal and credit restraint necessary to stabilize prices. Unless inflation is brought under control, many of the structural and other measures already taken and planned, including price liberalization, will be built on sand. The staff's statement that the authorities are now targeting a deficit of no more than 3 percent of GDP this year is welcome, and I trust that effective measures consistent with that target have been put in place.

With respect to monetary policy, the authorities are not planning, at least for the present, to introduce a new currency. However, as the staff points out, they cannot at the same time delay implementation of the new exchange rate system for the ruble that has been introduced by Russia. Kazakhstan's membership in a currency union requires the immediate rectification of this situation. Of course, we also agree with staff on the urgent need for closer coordination of monetary policy by all members within the ruble area.

We note the staff's identification of virtually automatic and unlimited access by enterprises to credit from the banking system as a key immediate problem. That degree of access has to be limited. While recognizing that some action has already been taken, the staff report nevertheless notes many other weaknesses in the operation of monetary policy as well as in banking supervision. It lists recommendations to improve the capacity for monetary management and to strengthen the legal and regulatory framework of the National Bank. We support the thrust of those recommendations and share the staff's concern about the capacity of the authorities to monitor the proliferation of new banks.

We also share the staff's concerns about the existence of various extrabudgetary funds and agree on the importance that must be given to the transparency and integrity of the public finances. Indeed, this is a concern that extends well beyond Kazakhstan.

Kazakhstan's plans for privatization, land reform, and the provision of employment subsidies to state enterprises all raise questions for us, but these issues probably fall more within the competence of the World Bank. Nevertheless, I would like to hear more about the objectives of the privatization program. Those objectives appear to have a social dimension in that the authorities seem to have particular ownership patterns in mind. These may, or may not, be consistent with the efficient use of resources. In general, we would suggest that social objectives are most efficiently served through a redistribution process rather than by direct involvement either in the functioning of the market or in its mechanisms. Some comment on the authorities' perception of the purpose of privatization would be appreciated.

Mr. Solheim observed that Kazakhstan was a country richly endowed with natural resources and an ample supply of arable land, and possessed a relatively diversified industrial sector. Even though it was currently unclear how much investment and restructuring would be needed to make the industrial sector viable in a free market system, the growth potential over the medium term appeared to be considerable. However, to ensure a positive development of the economy, a wide-ranging and difficult transformation from a command system to a market-based economic system was required. He welcomed the authorities' commitment, as stated by Mr. Sembayev, to engage in such a transformation process.

He appreciated the authorities' perception that it was essential to minimize the immediate disruptions owing to the breakup of the former trade arrangements and the payments and settlements system of the ruble area, Mr. Solheim remarked. Although currency reform was a possible option, without the necessary institutional arrangements, an appropriate macroeconomic stabilization policy, and the needed external support, the adoption of a national currency would at the current stage entail serious risks for economic stability.

To get inflation under control and help stabilize the ruble, price liberalization should be given high priority in the immediate future, Mr. Solheim considered. Moreover, prompt actions were needed in the monetary field. The current situation, where enterprises had unimpeded access to credit from the banks, and the banks and the Government had virtually automatic access to refinancing with the central bank, was not sustainable. Consequently, measures to bring monetary expansion under control were urgently needed. Furthermore, central bank interest rates should be set at a level that would establish positive real rates. An effective monetary policy would, however, also require a substantial strengthening of the legal and regulatory framework for the financial system, including a strong central bank with the necessary autonomy.

In light of the staff's estimate of a budget deficit for 1992 of about 15 percent of GDP, an immediate tightening of the budget along the lines recommended was needed, Mr. Solheim continued. In that connection, the current practice whereby local authorities made major expenditure decisions relatively independent of the central authorities was posing a problem. Also, extrabudgetary funds and the Social Security Fund should be brought under the control of the budgetary authorities.

Along with tight monetary and fiscal policies, incomes policies should play a role in combatting inflation at the current stage, Mr. Solheim commented. A variety of the tax-based incomes policy applied with success in several East European countries seemed applicable to Kazakhstan.

Although privatization had barely begun, some elements of the privatization program seemed questionable, Mr. Solheim observed. Handing off enterprises to employees at written-down book values did not provide sufficient capital or attract the necessary technology and knowhow for transforming the state enterprises into viable market-based entities. Foreign direct investment and participation through joint ventures should also be encouraged. He urged that rapid measures be taken to allow for the creation of private ownership and competitive markets.

In closing, he wished to convey to Mr. Sembayev that the members of his constituency looked forward to Kazakhstan's membership of the Fund, Mr. Solheim remarked.

Mrs. Krosby made the following statement:

> The staff report on Kazakhstan presents a mixed picture of the country's situation and prospects. Kazakhstan reportedly has considerable natural resources and a reasonably well-developed infrastructure. The basic principles underlying the authorities' strategy appear sound, and many of the authorities' first steps, including the price liberalization, privatization, and the interest they have shown in private foreign investment, seem promising. We are also encouraged by the fact that Kazakhstan has adopted Russia's "Memorandum on Economic Policy," and look forward to hearing more about the practical significance of this announcement.
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> Notwithstanding these positive elements, however, key economic institutions are weak, and economic management expertise is thin. Despite the authorities' good intentions, efforts to stabilize and reform the economy have so far been fragmented,

often ineffective, and in some cases, even counterproductive. Clearly, a much more coherent and comprehensive economic program is needed. Much of the required action will need to be taken within Kazakhstan; nevertheless, the situation is complicated by the fact that a number of important issues also need to be addressed in consultation with other republics, especially Russia.

Let me enumerate the central tasks ahead, as we see them.

First, there is an immediate need to improve, and in some cases establish, useful statistics and data bases suited to a market economy so that policymakers can reach informed decisions. Likewise, the central bank and Finance Ministry need to be organized effectively and given the necessary authority to conduct economic policy.

Second, while considerable headway has already been made on price liberalization, further movement toward market-determined prices is needed in order to allow the price mechanism to allocate resources efficiently and to reduce the cost of subsidies on the budget. Privatization and demonopolization should also go hand-in-hand with freeing prices in such key areas as transportation, since competition will help moderate price increases.

Third, Kazakhstan needs an effective incomes policy to avoid a dangerous wage-price spiral and hyperinflation. At a minimum, the Government needs to set an appropriate example for the rest of the economy by limiting wage increases for government employees and penalizing state enterprises which exceed those increases by eliminating their subsidies. In our view, the authorities should adopt a uniform wage policy for the state sector that is simple and transparent and contains effective sanctions for increases above the announced norm.

Fourth, firm fiscal restraint will be required to ensure an adequate supply of credit to the rest of the economy and avoid further disruptions in output and trade. We applaud efforts to date to keep the deficit under control, but the staff's estimate of a 1992 deficit on the order of 15 percent of GDP is alarming. To gain better control over the budgetary situation, extra-budgetary accounts need to be integrated into the regular budget; cash flow should be monitored monthly so that expenditure can be adjusted quickly if budget targets are not being met. At the same time, social spending needs to be better targeted so that there will be an effective social safety net for groups that need assistance most, while limiting overall expenditure. Meanwhile, the tax base needs to be broadened and tax administration improved in order to raise revenue.

Fifth, with regard to monetary and credit policy, we agree with the staff on the need to strengthen the legal and regulatory framework of the National Bank of Kazakhstan and to endow it with an effective means of controlling domestic credit expansion. Over the longer term, Kazakhstan should aim for more sophisticated monetary policy instruments; for the immediate future, however, we support the staff's recommendation of imposing credit ceilings on National Bank refinancing to the rest of the banking system. At the same time, interest rates should be positive in relation to the expected level of inflation in 1992 so as to check the demand for credit and raise domestic savings, and credit subsidies should be removed.

Sixth, we agree that, at Kazakhstan's current stage of policy and institutional development, the republic would be well advised to remain within the ruble area, at least for the time being. That being said, we recognize that consultation and policy coordination within the ruble area will have to improve. We were concerned that Kazakhstan was not applying the same exchange rate and surrender requirements as those in effect in Russia; we understand, however, that this has now been corrected.

On the issue of structural reform, I would like to underscore a lesson we have seen repeated in all of the formerly centrally planned economies--namely, that the complicated process of structural reform, including, in particular, privatization, demonopolization, liquidation of unviable state enterprises, and financial sector reform, must keep pace with the more straightforward process of economic stabilization. This is a very difficult task, especially for a country with as little previous experience in economic policymaking as Kazakhstan. Yet without rapid progress on these fronts, the economy will languish and the appetite for continued adjustment and reform will surely wane. Thus, we fully support the authorities' plan to accelerate the privatization process in 1992 and urge them to streamline procedures so that their ambitious targets can be met. At the same time, we, along with other Directors, urge them to open the privatization process to foreign investors, so that Kazakhstan can benefit from the infusion of capital, technology, and managerial expertise that foreign investment would bring.

In closing, we believe that Kazakhstan has considerable economic potential, and we see some promise in the authorities' policy intentions. They will, however, need to work hard to define and implement more consistent policies for this potential to be achieved. We encourage them to draw on foreign technical assistance and hope that they will be ready to agree with the Fund on the elements of a strong adjustment program in the not-too-distant future.

Mr. Evans made the following statement:

I join previous speakers in welcoming Mr. Sembayev and his colleagues and in thanking him for his comprehensive introductory remarks. I do so not only on behalf of the ten countries which I represent in the Asia/Pacific region but also on behalf of one of Kazakhstan's near neighbors, Mongolia, which shares most of the economic problems of the former U.S.S.R. republics.

Among those republics, Kazakhstan is blessed with one of the richest natural and human resource potentials. It also possesses a well-developed industrial base and adequate physical and social infrastructure. All of these assets should provide a solid starting point for Kazakhstan's full transformation into a modern, economically competitive, and independent state. Kazakhstan appears less well endowed with economic statistics, and an early priority must be to develop the data bases necessary to monitor the economy and to conduct macroeconomic policy.

The most important tasks ahead, as in most of the republics, will be to quickly stabilize the economy and build the institutions essential to the efficient functioning of markets. The authorities have already made a useful start through the large-scale liberalization of prices in January and the preparation of a revised fiscal budget for 1992 that could significantly scale down the size of the deficit. They have also initiated new legal and institutional arrangements more consistent with a modern market-based economy.

Notwithstanding this progress, however, we would strongly agree with the staff on the need to further deepen and broaden reforms. The costs of transition, as other recent experiences have confirmed, are likely to be less with bolder strokes than with piecemeal efforts.

The authorities have expressed a preference for staying within the ruble area. That is probably a wise economic course of action in the light of current institutional capabilities, notwithstanding the temptation to assert national identity through the issuance of its own currency, and the doubts that naturally persist regarding the potential stability of the ruble or its suitability for Kazakhstan's industrial structure. In any event, the decision to stay in the ruble area carries with it a responsibility to harmonize exchange rate and monetary policy in common with other participants in the area. One might add that taking the alternative course of introducing an independent national currency would in no way lessen those responsibilities or the political pain that appears inevitably attached to the conduct of an independent monetary policy.

Bearing this in mind, we would attach priority to strengthening the powers of the National Bank of Kazakhstan to discharge the normal responsibilities of a central bank, especially as these pertain to credit control, bank supervision, and reserve management. Enterprises will quickly need to learn to live with hard budget constraints if credit policy is to remain manageable and also to ensure the most efficient allocation of resources.

The risk arising from bank failures, heightened by the proliferation of new financial institutions, at a time when supervisory capacity is limited, should not be underestimated. A loss of confidence in the financial system is one of the surest recipes for the unraveling of stabilization efforts and the fomenting of political instability. Therefore, there is a place for more stringent bank licensing requirements.

The staff's recommended response to currency depreciation causes me some concern. The staff appears to be concerned that depreciation has led, or will lead, to excessive or windfall profits and that those profits need to be confiscated or sterilized. In particular, it recommends that export profits might be taxed through a temporary excess profits tax and, further, that the authorities should ensure that the increased profits do not lead to wage increases. Both of those recommendations appear to contradict the purpose of the depreciation, which is to ensure that relative prices play their role in attracting resources to the traded goods sector. They cannot play that role if they are interfered with in the manner suggested by the staff. I note the staff's concern, mentioned at the outset of today's meeting, with the proposed foreign exchange tax on export industries. But I do not see that tax is different, in economic substance, from the one that the staff has supported. I would appreciate staff comment on those aspects. I also wonder whether its concern reflects a suspicion that the ruble is not necessarily the appropriate currency for Kazakhstan in the long run.

Privatization should rightly be accorded a very high priority. This is especially desirable in the key agricultural, distribution, and transportation sectors to quickly alleviate shortages and to curb the abuses of monopolies in the face of rapid price liberalization. There should also be sufficient room for foreign participation in the privatization program, particularly in the industrial and manufacturing sectors, so as to obtain not only additional capital but, more important, access to modern technology in products and processes.

Mr. Deng remarked that he wished to join previous speakers in welcoming Mr. Sembayev and thanking him for his comprehensive statement. He agreed with the staff's appraisal of the economic situation in Kazakhstan and commended the authorities for their bold efforts, particularly the various liberalization measures aimed at restructuring the country toward a market economy.

In spite of the important reform measures undertaken by the authorities, the transition from a centrally planned system to a market-based economy would be long and painful, Mr. Deng observed. Economic reconstruction required tremendous efforts by the authorities to correct distortions, particularly the dislocation of production and trade, and to adopt as quickly as possible strong policy and structural measures to put economic developments on a sound track. He was pleased with the progress made in price liberalization, as that was a major step toward the fundamental restructuring of the economy. He was also encouraged by the implementation of a number of important structural measures, particularly fiscal reforms and the program for the privatization of state enterprises.

In view of the severity of the economic situation facing Kazakhstan, particularly the economic dislocation owing to the breakdown of the centrally planned system, liberalization measures could not be sustained without the support of macroeconomic stabilization policies, namely, fiscal and monetary policies, Mr. Deng commented. As the staff had correctly pointed out, the implementation of rigorous financial policies was an immediate priority in order to address the severe macroeconomic imbalances facing the economy.

He wished to endorse the staff's policy recommendations and to encourage the authorities to put them into practice without delay, Mr. Deng stated. At the same time, he understood that efforts to establish an institutional framework to enable the authorities to formulate and implement policies independently were to be accelerated.

The staff had noted that Kazakhstan's economy had considerable growth potential over the medium term, Mr. Deng remarked. He fully agreed with that assessment and therefore endorsed the staff's view that substantial savings and investment must be generated and that sustained implementation of strong financial policies and wide-ranging structural reforms were needed for the development of the economy. In that regard, it was important to put into place a comprehensive and well-designed reform policy package. He looked forward to seeing more technical assistance from the Fund to speed up that process.

Mr. Mirakhor stated that he was in general agreement with the thrust of the staff appraisal on the pre-membership economic review for Kazakhstan. He had a number of questions, which had already been raised by other Directors, including Mr. Mohammed, Mr. Wright and Mr. Goos, and he looked forward to the staff's and Mr. Sembayev's responses.

He agreed with the staff that Kazakhstan was endowed with a strong natural resource base in agriculture and mining, which provided it with a substantial capacity for development and growth, Mr. Mirakhor commented.

But to realize that potential, it would be necessary for Kazakhstan to stabilize the economy, based on firm and sound financial policies as well as the provision of an efficient incentive system to mobilize national resources so as to permit the restoration of economic growth. The process of privatization was important to such an incentive system, and in that respect--and in addition to comments made by Mr. Goos and Mr. Wright--he was surprised to see that private land ownership was not under consideration. In view of the importance of agriculture in Kazakhstan, land reform should be made the centerpiece of the privatization process.

He welcomed the authorities' intention to reform the social security fund and to introduce an employment fund to help reduce the adverse impact of the transition to a market economy, Mr. Mirakhor remarked. He, however, endorsed the staff's view that those programs should be reflected in the government budget for the sake of transparency. With those remarks, he wished the authorities every success in their efforts to stabilize the economy and move toward a market-oriented system.

The staff representative from the European II Department, commenting on the possibility for foreign participation in the privatization effort, stated that he understood that, at the moment, foreign investment was permitted under joint ventures but not in the form of wholly foreign-owned enterprises. The staff was discussing with the authorities the possibility of enlarging the privatization program to include direct foreign investment by nationals outside the Commonwealth of Independent States. Nationals of other countries within the Commonwealth were allowed to participate in the privatization program.

As to the fiscal deficit target for 1992 and the kind of fiscal consolidation the staff would wish to see in Kazakhstan, compared to Russia, the staff representative observed that projecting the fiscal deficit in 1992 was especially difficult because there were two areas in which agreement had to be reached between Kazakhstan and Russia in particular, and Kazakhstan and the other major republics in general. The first was the space program and the Baikonur space center, which had been an important feature of Kazakhstan's relations with the Union as a whole. Discussions were ongoing between Kazakhstan, the Russian Federation, and other members of the Commonwealth to find a way to finance the Baikonur space center on a common basis. The Kazakh authorities had also looked into the possibility of privatizing part of the Baikonur space center, or at least encouraging private participation, including foreign private participation. Discussions were still under way, and it was not possible to forecast the outcome in that particularly sensitive area. Whatever the outcome, it would have an impact on the budget deficit for 1992.

The second area in which agreement had to be reached concerned the Semiplatinsk nuclear weapons testing facility, the staff representative continued. He understood that the facility was no longer operational. At issue were the substantial environmental problems resulting from the facility's operation, and Kazakhstan had committed itself to doing something about the environmental damage. It was impossible at present to assess the costs of such an effort, which would stretch over several years. It was partly in that connection that the staff had urged the authorities to seek technical assistance from other institutions, including the World Bank.

Thus, at the current stage, it was difficult for the staff to judge the realism of the authorities' deficit target of 3 percent of GDP, the staff representative commented. The authorities had assured the staff that they would put together a package of measures, to be discussed with the staff in the coming six weeks, in support of a deficit target of 3 percent of GDP. A judgment on the achievability of that target would be made on the basis of that package.

Whether the staff should be recommending a faster, slower, or similar fiscal adjustment for the republics vis-à-vis Russia was also a difficult question, the staff representative observed. It was safe to say that Kazakhstan was still very far from the commitments undertaken by Russia in its memorandum, particularly with respect to the fiscal deficit target for the first quarter of 1992 and for the whole of 1992. Moreover, there were delicate and difficult questions related to the terms of trade impact of the increase in energy prices in Russia as well as a range of issues related to whether Russia should assist other republics in coping with that terms-of-trade shock. The differential speed of fiscal adjustment was one implicit way of dealing with that issue. However, the staff had so far encouraged the Kazakh authorities to target a fiscal deficit as close as possible to, if not smaller than, that being targeted by Russia.

The social security contributions "hole" that Mr. Wright had noticed in 1991 had been the subject of discussions between the staff and the authorities, the staff representative commented. He understood that the social security fund had been made independent and outlays therefore were not reflected in the budget. That was not entirely clear in the deficit estimates, and the staff would continue to work with the authorities to clarify that point.

The staff was not particularly concerned about the reduction in tax rates in 1991 in view of the extensive tax reforms introduced in 1992, the staff representative stated. The important issue was the implementation of the value-added tax as envisaged, and in particular, that its coverage should be appropriate and extended to services and imports. The staff had counseled the authorities to concentrate on tax collection efforts in that area, and as Mr. Sembayev had noted, they were doing exactly that.

As to a possible terms of trade gain arising from the energy sector and its impact on the fiscal accounts, Kazakhstan was, in fact, unlikely to experience a gain or loss of any significance in the short run on the energy balance because it had a virtual balance with Russia, the staff representative observed. Kazakhstan exported crude oil to Russia and imported refined products, and even at international prices, that exchange was roughly in balance in value terms. There were also imports from

Turkmenistan, and Turkmenistan had been moving increasingly to world market prices for its gas and petroleum exports. If the energy balance was separated out, Kazakhstan would have neither a terms of trade loss nor a significant gain. However, if there was a rapid move to world prices for Kazakhstan's mineral exports, there would be a terms of trade gain. At the current stage, the staff was not in a position to quantify the gain or loss, partly because the bilateral agreements between republics on the trade of important minerals consisted of either a simple barter arrangement--and therefore there was no price, not even an implicit one--or specified prices that ranged from the previous very low prices to world market prices, depending on the commodity. The staff would be assessing the impact of the terms of trade on the fiscal accounts in the context of its first consultation report on Kazakhstan.

As to Mr. Mohammed's question on the effective exchange rate implied by a commercial exchange rate of ruble 55/US$1 and a 40 percent export tax, the staff would make the calculation and convey it to him bilaterally, the staff representative remarked. The staff had only learned about the 40 percent export tax the previous day.

On whether the staff's recommendation regarding the excess profits tax was going in the wrong direction in terms of achieving appropriate relative prices, he would simply note Mr. Evans's own observation that the abuses of monopolies should be curbed and rapid price liberalization would be one way of doing that, the staff representative continued. In fact, one reason for the staff's recommendation was its concern about monopolies, particularly in the mineral exports sector, where one or two enterprises enjoyed a monopoly position. In that situation, a move from an exchange rate of ruble 1.8/US$1 to ruble 55/US$1 was not considered advisable, because it would result in excess profits for those enterprises, which would then be plowed into various substantial wage increases. If the system was working as it should, if the enterprises were private enterprises, and if the system was free of government control, including the absence of state orders and direct government intervention, he would agree with Mr. Evans that the staff should not be recommending the imposition of an excess profit tax. In current circumstances, where exporting enterprises were intimately linked to the Government, if not de jure, certainly de facto, the staff considered that it would be a misallocation of resources to give those enterprises large funds which might be used for wage increases or for investments that were not based on market-oriented decisions.

On the privatization program, he would simply add two points, the staff representative from the European II Department stated. The first was that the authorities had indicated general concern that neither the modalities nor the speed of privatization should create a situation where outsiders--namely, other republics--bought up Kazakh assets. That was a delicate political and social question, even more so in view of the emphasis that the Kazakh Government had placed on the multiethnic nature of the country and the delicate balance between different ethnic groups. Those ethnic groups were also represented in other republics, which made the situation extremely complicated as the social dimension assumed a political dimension. The second point was that the authorities had underlined that Kazakhstan's population was poor while the amount of state assets was extremely large--roughly ruble 200 billion even at the old prices. It would therefore be difficult for a privatization program to succeed in a short period of time simply because there were few prospective buyers and no credit facilities. The staff would be discussing those difficult issues with the authorities as it encouraged them to move rapidly in their privatization program.

Mr. Sembayev remarked that he had attempted to convey to Directors the internal and external problems facing Kazakhstan, including those arising from membership of the Commonwealth of Independent States and the legacy of being a former republic of the U.S.S.R. He had taken note of the points that Directors had raised, and they would be taken into consideration as Kazakhstan formulated an economic program. He wished to express his gratitude for Directors' comments and for their sincere desire to share their experiences with economic reform and building a market economy.

In view of the republic's leadership in taking steps to preserve a single ruble area, it was clear that the Government had not set itself the task of introducing a national currency in the short term, Mr. Sembayev observed. Indeed, in the light of the critical situation of the economy, the issue of a national currency could not be considered until there was first a recovery of the economy. Moreover, the former republics had already achieved the sovereignty that was usually associated with the concept of a national currency, and participation in the ruble area was expected to secure mutual benefits for all members.

There appeared to be some misunderstanding regarding the participation of foreign investment in the privatization process, Mr. Sembayev commented. He wished to assure Directors that foreign investors who desired to actively participate were allowed to do so. The lack of participation to date perhaps showed that they lacked the necessary confidence or that state assets were not attractive to them. In any event, domestic legislation allowed for foreign investors to participate in the privatization process. Moreover, Kazakhstan was currently undertaking every effort to attract foreign investors of all sorts, particularly to provide know-how and newer technology to existing enterprises as well as those under construction.

As to the budget and expenses previously covered by the Union budget, there still was no agreement on expenses relating to a unified army, Mr. Sembayev remarked. A number of republics were considering the establishment of independent armies, but Kazakhstan did not believe that that was the best course. Moreover, the four republics that possessed nuclear weapons, including Kazakhstan, desired to unite their strategic forces. Several republics, including Russia and Kazakhstan, also believed that both strategic and tactical forces should have a unified command, which would allow a reduction in military expenditure and guarantee a certain degree of security.

There had been several rounds of negotiations on the Baikonur space center, and the site had been declared to be in the ownership of Kazakhstan, Mr. Sembayev stated. On March 20, 1992 Kazakhstan had signed an agreement with other interested republics on the financing of space programs. Measures were also being taken to attract foreign investors for that purpose.

Kazakhstan had declared a moratorium on nuclear testing, and there had been not testing on the Semiplatinsk site for some time, Mr. Sembayev continued. The Government was currently concerned with the conversion of nuclear materials on the site, including the security and safety of nuclear power stations. The scientific center would be maintained through contributions from the republics of the Commonwealth of Independent States. Although the question of the armed forces was not a simple one, the republics were taking practical measures to ensure a certain level of security as well as leadership, to be carried out from a single center. He believed that the creation of national armies in current conditions could destabilize the situation within the Commonwealth.

The value-added tax introduced in Kazakhstan was the same as that in force in the Russian Federation, Mr. Sembayev stated. As it was a new tax, time was needed for every firm, kolkhoze, sovkhoze, and enterprise to become familiar with the methodology for its calculation. Consequently, revenues had fallen short of expectations in February. Currently, the situation was significantly improved, and in the first 15 days of March, revenues from the value-added tax had surpassed those received through the first two months of the year. Control over tax collection had increased to ensure more efficient administration at every level.

As to Russia's policy on energy prices, it should be noted that any such economic decision would have certain political consequences, Mr. Sembayev observed. In the event, Kazakhstan would have sufficient energy resources of its own to carry out the necessary spring plowing. But Russia would have a problem in acquiring sufficient amounts of grain in the coming year if its peasants and farmers were unable to afford fuel at the new prices. In fact, there had already been a 10 million hectare decrease in the area under cultivation in Russia. Kazakhstan had urged Russia to delay the price increase until after the planting season, as the success of the entire movement toward a market economy depended heavily on a successful harvest. His own republic was attempting to postpone the liberalization of prices on oil products until early June.

Kazakhstan would realize an economic gain from the energy price liberalization because it supplied 40,000 million tons of coal to both Russia and Ukraine, Mr. Sembayev continued. Certain losses would be offset by an excess in exports to Russia, of up to 5 million tons.

At the start of the year, credit policy had continued as in the past, Mr. Sembayev remarked. Subsequently, the interest rate had been raised to 25 percent and credit emission had been limited to the agriculture sector.

His Government did not agree that, in the current economic situation, interest rates should be maintained at low levels as had been proposed in Russia and Belarus.

The issue of land reform was a difficult one for the people of Kazakhstan, who until recent times had been nomadic, Mr. Sembayev explained. The concept of private ownership was not acceptable to them, and therefore he believed that the Government was correct in deciding instead to initiate the leasing of lands with inheritance rights. Over time, the population would become accustomed to that new ownership pattern, and therefore, it might be possible to gain acceptance for the idea of private land ownership.

For that reason the Government had not adopted a law on privatizing agriculture, Mr. Sembayev continued. The Government had instead developed a special law suited to the unique situation of Kazakh agriculture. In particular, agricultural production in Kazakhstan was notable for its large scale. Moreover, the land was very arid land, and conditions were similar to those in Canada, although Kazakhstan's harvests were much smaller. In moving away from kolkhozes and sovkhozes, the Government was establishing cooperatives, on a voluntary basis, made up of renters. As a result, a growing amount of agricultural land was being held by renters.

Kazakhstan was making efforts, on a bilateral basis, to attract foreign investment capital, Mr. Sembayev stated. An agreement had been signed with Pakistan to provide credits for building cement plants and textile plants. Pakistan had considerable experience in those areas. An agreement had also been reached with Austria to finance the building of food processing enterprises. In that sense, Kazakhstan's markets were open to foreign investment, and it guaranteed that the enterprises to be built thanks to those credits would be highly efficient.

The Government had rejected the idea of cost-free transfers of land to achieve privatization, Mr. Sembayev explained. Instead, and as the population did not have the means to purchase directly stores or the facilities necessary for services, everything was being sold on credit. Approximately ruble 1.5 billion had been collected through that approach, of which ruble 700 million had been allotted to the solution of social problems. A special account had also been established to pay off the internal domestic debt that had been accumulated when the republic was part of the Soviet Union.

He wished to assure Directors that enterprises' unlimited access to credit was a thing of the past, Mr. Sembayev remarked. The Government intended to use the currently available credit resources of the National Bank to resolve the most urgent and pressing issues facing the economy.

He agreed with Directors' comments on the condition of financial statistics in Kazakhstan, Mr. Sembayev stated. The art of statistics in his country was, however, no better or worse than that in any other republic of the former Soviet Union. The methodology of the past was totally unsuitable for a market economy, and a great task lay ahead to establish an accurate statistical database. The entire system had to be adapted.

He also agreed with Directors' comments on the National Bank, Mr. Sembayev remarked. The Bank, which previously had been a regional branch of the Gosbank, had operated as a central bank for only four or five months. A new management had been entrusted with the authority necessary to carry out the functions of a central bank. Bank directors were no longer subject to the Government, and the Government no longer had unlimited access to bank credit. Indeed, the objective was to operate the National Bank in accordance with international practice. But there were problems with respect to administrative capacity. The Government had therefore asked the Fund, if possible, to provide some qualified experts to help set up a financial system. The supervision of commercial banks, in particular, was cause for concern, because of their rapid proliferation. Measures had been taken to make the licensing of new banks more difficult, and the process of merging smaller banks was currently under way, which should make their supervision easier.

Mr. de Groote stated that the discussion had left him with three impressions. The first related to the relation between policies and Kazakhstan's endowment of natural resources. As Board discussions over the years had revealed, a generous natural resource endowment was at the same time the best and the worst possible situation from the viewpoint of economic policies because it could lead to euphoria and laxity. That did not, however, appear to be the case in Kazakhstan, where a wealth of natural resources was seen as an advantage that had to be systematically exploited so as to maintain its competitive position in the area and accelerate its progress.

The second impression arose from Kazakhstan's multi-ethnicity, Mr. de Groote continued. There, the richness of ethnic diversity was seen to be an element of social dynamism, rather than a potential source of unrest.

The third aspect that had impressed him was the authorities' pragmatism in choosing policy options, Mr. de Groote commented. Many examples of that pragmatism had emerged during the Board's discussion. First, the clear decision--and Kazakhstan was the first country to speak out clearly in that regard--to maintain a common monetary area, with all the advantages attending that course, especially the fact that the discipline imposed on all members of the ruble area was also beneficial for its largest member, namely, Russia. In that respect, he was not certain that he could agree with Mr. Al-Jassar's view that there might be some possibility for a more flexible fiscal policy in Kazakhstan if Russia followed a strict fiscal policy. Certainly Belgium's experience with pegging to the deutsche mark had led the Belgian people to believe that they were subject to even more rigorous constraints than Germany if Belgium was to maintain its competitive position and the credibility of the peg.

Another example of pragmatism was the decision to proceed with privatization in a way that could be easily accepted by the population while at the same time seeking fast progress in establishing the institutional framework necessary for privatization to be effective and trying to commercialize state economic enterprises, Mr. de Groote observed. The decisions that had been taken to correct slippages in the budget were also impressive examples of policy pragmatism. Moreover, even before unemployment started to increase, a modern incomes policy had been set in place that allowed for retraining and limited unemployment benefits in an efficient way.

In closing, he wished to express his confidence that Kazakhstan would be one of the first republics to present to the Board a comprehensive stabilization and reform program, Mr. de Groote commented. The authorities were fully aware that the adoption of such a program in Russia implied that they had to follow suit very rapidly in view of Kazakhstan's close contacts with that country. It was also great cause for satisfaction for his chair to see that the "silk route," which started in Istanbul, passed through Kazakhstan, which underlined its unique position between the Far East and the Near East. The Kazakh authorities were fully aware of the role the country could play as a bridge to understanding between East and West and could be expected to continue to develop that role in an extremely active way.

Mr. Al-Jassar remarked that he wished to clarify that he had not suggested that there was room for lax fiscal policies in Kazakhstan. He had indicated instead that it was necessary to make sure that the fiscal policies of the anchor of the ruble area were not laxer than those in the smaller republics, because the cost would be too high for them, and the arrangement would fall apart. That was, in his view, an important point.

Mr. de Groote stated that he was grateful for that clarification, which put the problem in its correct perspective.

Mr. Mirakhor observed that, in fact, the silk road had not started or ended in Istanbul but had originated even farther westward.

The Chairman made the following summing up:

> Executive Directors welcomed this first opportunity to discuss recent economic developments in Kazakhstan and the main features of the authorities' stabilization and economic reform programs in 1992. Directors commended the initial steps taken by the authorities since independence to transform the economy toward a market-based system, notably in the fields of price liberalization and tax reform, and in adopting new legal and institutional structures for the banking system, private property rights, and the privatization of state enterprises. The tasks ahead were daunting, but Directors were impressed with Kazakhstan's potential, including its rich agricultural, mineral, and industrial bases, and they were confident that with the right economic and

financial policies, there would be a strong basis to restore rapid growth.

Directors underscored the need to assign a high priority to the immediate implementation of strong macroeconomic stabilization policies in coordination with other former U.S.S.R. republics, mainly through a substantial reduction in the fiscal deficit and restraint over credit expansion. They also urged the authorities to take concrete actions, in conjunction with other former republics, to reduce the substantial disruptions in interrepublican trade and payments so as to minimize the decline in output. In this respect, they welcomed the authorities' expressed adherence to the principle of maintaining a common economic space with other republics, and they praised Kazakhstan for the steps taken in this direction. Directors pointed out the benefits of moving rapidly toward world market prices and accelerating the privatization in key sectors of the economy, such as trade and agriculture, if an appropriate supply response is to be forthcoming soon.

While commending the authorities for the fiscal policy steps they had already taken, Directors stressed the importance of further tightening the fiscal position so as to limit the overall expansion of domestic bank credit. Directors endorsed the authorities' intentions to adopt a revised budget in the second quarter of 1992 and to strictly limit this year's fiscal deficit. In this context, Directors called on the authorities to adopt promptly revenue-increasing and expenditure-reducing measures along the lines recommended by the staff and to take the necessary steps to strengthen tax administration, especially with regard to the value-added tax--whose early collection results had been encouraging--as well as to reinforce expenditure control, as recommended by recent technical assistance missions. Directors supported the creation of a social safety net, while advocating a close monitoring of its budgetary implications, and urged the authorities to seek new measures to improve the cost effectiveness of, and better target, the protection that is to be provided. Directors supported the authorities' commitment to consolidate recent reforms of the Social Security Funds and the creation of an employment fund.

Directors welcomed the authorities' intention to restrain wage increases at the level of the central administration and to freeze public sector employment. Directors urged the authorities to eliminate transfers and subsidies to state enterprises which have awarded wage increases in excess of those granted to the civil service.

Directors noted Kazakhstan's decision not to issue its own currency for the time being, and commended the authorities for their constant efforts at closer coordination of monetary, and other economic, policies with member countries of the ruble area. However, Directors expressed serious concern about the virtually automatic credit granted by the banking sector to enterprises, and they advised the authorities to enforce limits and to impose a hard budget constraint on public enterprises. Particular emphasis was placed on tightening the use of the rediscount mechanism, on a realistic interest rate structure in consultation with the other member countries of the ruble area, and on the critical role to be played by the introduction of market-based monetary control instruments.

While recognizing the appropriate recent steps taken by the authorities to establish the legal and regulatory environment for the banking system, Directors stated that high priority needed to be given to the strengthening of the National Bank and to encouraging competition in--and appropriate supervision over--the financial system. In this context, the requests for technical assistance from the Fund were noted in a positive spirit.

Directors welcomed the authorities' recent decision to adopt an exchange rate and exchange system common to Russia and other member countries in the ruble area. The efficiency of such a system would be enhanced if accompanied by further liberalization of trade. Directors expressed regret at the recent introduction of a foreign exchange tax on export earnings.

Directors acknowledged the complexity of the task of simultaneously stabilizing the economy and instituting fundamental structural reforms, particularly when appropriate institutional structures, skills, and well-established coordinating mechanisms among the members of the ruble area were either weak or absent; however, Directors urged the authorities to proceed rapidly with the reduction of the network of state controls in the economy. They encouraged the authorities to be more ambitious and to move faster with privatization. Large enterprises that could not be privatized soon should be put on a rigorous commercial footing. The authorities should also review the important role that foreign investment could play in increasing efficiency and modern know-how. Directors urged the authorities to work closely with the World Bank in the area of structural reform.

Finally, Directors looked forward to Kazakhstan becoming a member of the Fund and to a close and productive relationship between the Fund and Kazakhstan in the future. Directors emphasized that the economic and financial reform efforts should be appropriately drawn together in a comprehensive program of stabilization and reform, and they expressed the hope that Kazakhstan's efforts at building a modern market-based economic system would succeed in efficiently utilizing the country's enormous natural resource endowment to bring growth and prosperity.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/92/41 (3/31/92) and EBM/92/42 (4/2/92).

3. TENTH GENERAL REVIEW OF QUOTAS - ESTABLISHMENT OF COMMITTEE OF THE WHOLE

In accordance with Rule D-3 of the Fund's Rules and Regulations, a Committee of the Whole for the Tenth General Review of Quotas with the Managing Director as Chairman is hereby established. Committee action shall not be binding on the Executive Board. Minutes of meetings shall be prepared and circulated for approval of Committee members. (EBD/92/55, 3/24/92)

Adopted March 31, 1992

4. EXECUTIVE BOARD - INFORMAL RECESS

The proposed period for the Executive Board's informal recess, as set forth in EBAP/92/67 (3/25/92), is approved.

Adopted March 31, 1992

5. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 91/132 through 91/136 are approved.

APPROVED: December 1, 1992

LEO VAN HOUTVEN
Secretary