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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 92/102

3:00 p.m., August 5, 1992

M. Camdessus, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
M. Al-Jasser	
	L. E. N. Fernando
Che P.	Wei B.
C. S. Clark	
	Q. M. Krosby
	S. B. Creane, Temporary
J. de Groote	J. Prader
E. A. Evans	R. L. Knight
R. Filosa	J. Papadakis
M. Finaish	A. F. Mohammed
I. Fridriksson	
H. Fukui	S. Shimizu, Temporary
B. Goos	W. Laux, Temporary
	T. Sirivedhin
A. Kafka	J. C. Jaramillo
	P. Bonzom, Temporary
	S. Rouai, Temporary
L. B. Monyake	J. O. Aderibigbe, Temporary
D. Peretz	P. Wright
G. A. Posthumus	Z. Trbojevic
C. V. Santos	J. K. Orleans-Lindsay, Temporary
A. Torres	R. Marino
A. Végh	A. G. Zoccali

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

Also Present

Delegation from the Russian Federation: K. Kagalovskiy, Plenipotentiary Representative of the Russian Government for Interaction with International Financial Institutions; A. Vavilov, First Deputy Finance Minister; A. Potemkin, Director, International Operations Department, Central Bank of Russia; A. Mozhin, Director, Russian Government Department for Interaction with International Financial Institutions; G. Markosov, Counsellor, Russian Embassy. IBRD: P. Vieira Da Cunha, Y. Huang, Europe and Central Asia Regional Office. Staff Association Committee: J. M. Boyd, A. Doizé, H. Flinch. Administration Department: G. Rea, Director; H. J. O. Struckeyer, Deputy Director; D. S. Cutler, A. D. Goltz. European Department I: G. Bélanger. European Department II: J. Odling-Smee, Director; E. Hernández-Catá, Deputy Director; J. Berengaut, A. Cheasty, P. M. Keller, V. R. Koen, W. C. Middelkoop, P. M. Nagy, A. Ouanes, S. S. Phillips, P. S. Ross, L. M. Valdivieso, T. A. Wolf. External Relations Department: S. J. Anjaria, Director; S. W. Kane, H. P. Puentes, M. A. Seeger, J. S. Starrels. Fiscal Affairs Department: V. Tanzi, Director; K. Nashashibi. IMF Institute: C. J. R. Morris. Legal Department: F. P. Gianviti, General Counsel; P. L. Francotte, J. S. Powers. Monetary and Exchange Affairs Department: M. Guitián, Associate Director. Policy Development and Review Department: J. T. Boorman, Director; C. F. Adams, D. Burton, B. Christensen, M. E. Edo, R. E. Rennhack. Research Department: M. Mussa, Economic Counsellor and Director; B. Calvo, M. Knight. Secretary's Department: A. Jbili. Southeast Asia and Pacific Department: M. J. Fetherston. Bureau of Statistics: J. B. McLenaghan, Director. Treasurer's Department: D. Williams, Treasurer; K. Boese, S. M. Thakur. Office of the Managing Director: P. R. Narvekar, Special Advisor to the Managing Director; B. P. A. Andrews, Personal Assistant to the Managing Director. Office of the Deputy Managing Director: A. Wright, Special Advisor to the Deputy Managing Director. Advisors to Executive Directors: L. E. Breuer, L. Dicks-Mireaux, A. R. Ismael, F. A. Quirós, A. Raza, B. Szombati, A. Törnqvist, S. von Stenglin. Assistants to Executive Directors: S. E. Al-Huseini, D. A. Barr, J. H. Brits, B. Eggl, A. Giustiniani, H. Golriz, K. J. Langdon, G. J. Matthews, F. Moss, F. Ochoa, J.-M. Paul, E. H. Pedersen, D. Sparkes, N. Sulaiman.

1. RUSSIAN FEDERATION - STAND-BY ARRANGEMENT

The Executive Directors continued from the previous meeting (EBM/92/101, 8/5/92) their consideration of the staff report on the Russian Federation's request for a five-month first credit tranche stand-by arrangement in an amount equivalent to SDR 719 million (EBS/92/119, 7/10/92; Sup. 1, 7/13/92; Sup. 2, 7/16/92; Sup. 3, 7/24/92; Sup. 4, 7/31/92; Sup. 5, 8/4/92; and Sup. 3, Cor. 1, 7/27/92).

Mr. Konstantin Kagalovskiy, Plenipotentiary Representative of the Russian Government for Interaction with International Financial Institutions; Mr. Vavilov, First Deputy Finance Minister of Russia; Mr. Potemkin, Director of the International Operations Department of the Central Bank of Russia; Mr. Mozhin, Director of the Department for Interaction with International Financial Institutions; and Mr. Markosov, Counsellor at the Russian Embassy, were also present.

Mr. Filosa made the following statement:

When four months ago this Board discussed the pre-membership review for the Russian Federation, we commended the Russian authorities for having embarked on a bold and comprehensive program that would put to an end the previous series of unsuccessful reforming attempts. We were all aware of the highly demanding task that the Russian Government was facing, given the unprecedented scope of the transformation to be undertaken. The aim was, and remains, to bring about a radical change not only in the economic, but also in the social and political, structure of the country. Hoping for a smooth transition would have been unrealistic, particularly taking into account the lack of a broad domestic consensus for the reform process, as recent events have emphasized once again.

Therefore, it is certainly appropriate that the Fund and this Board be ready to apply an adequate dose of pragmatism in preparing and assessing macroeconomic programs. This attitude, of course, finds its limit in respect of the principle of uniformity of treatment that the Fund is called upon to apply to all of its members, especially when it comes to the implementation of strong adjustment programs.

It is my view that the agreement reached before the Group of Seven summit is fully consistent with our conditionality standards and that the program under discussion today, if fully implemented, would render successful the ongoing process of economic transformation.

I share the assessment that Russia has already accomplished the task of introducing far-reaching changes in its macroeconomic policy and in the area of structural reform. I warmly commend the authorities for their achievements. Therefore, I will limit my comments to the area of fiscal and monetary policy, where recent events have created doubts about the possibility of achieving both the fiscal and monetary targets.

The first source of concern is the recent delays and slippages in the implementation of the prior actions concerning the introduction of some envisaged revenue measures. In this regard, however, with the strong assurances given by the Government and the needed dose of pragmatism that I mentioned earlier, I can agree with the staff that such delays are not a fundamental threat to the overall objectives of the program. We should, however, bear in mind that experience shows that the actual revenue yield of such measures as import tariffs usually turns out to be less favorable than expected. Furthermore, the precise content of the package of fiscal measures expected to yield initially rub 440 billion and now rub 380 billion--the bulk of the agreed increase in revenues--is still not fully clear.

The second source of concern relates to the changes to the Budget Law approved by the Supreme Soviet in July subsequent to the agreement that was a condition underlying the agreement on the stand-by arrangement. Also, in this case, the Government has indicated new budgetary measures aimed at offsetting the effects of the Supreme Soviet's decision. However, the increase in the sequestering of budget expenditures from the already significant level of 20 percent to 25 percent as well as the reduction in the indexation of some other budget expenditure, such as those relating to wages, might turn out to be politically unfeasible. In a sense, the etymological meaning of "prior action" has been blurred: some measures have been delayed, others have yet to be defined, and the Supreme Soviet's decision has increased the potential level of the budget deficit.

In sum, the uncertainty surrounding some measures and the probable less-favorable-than-expected revenue yield of others might cast some doubts on the achievement of the targeted budget deficit. Therefore, I join the staff in strongly urging the authorities to monitor budget developments closely and to adopt additional measures, particularly aimed at strengthening government revenues, if those already proposed turn out to be inadequate.

In the stabilization program, monetary policy has to play a role that is by no means less crucial than control over budget developments. Indeed, monetary policy is assigned an even more pervasive role in the financial stabilization process if one considers that it has to play the role of nominal anchor, restore confidence in the ruble both domestically and beyond the borders of the Russian Federation, help establish the hard budget constraint for both enterprises and the Government, and ensure that credit flows are allocated efficiently. To this effect, indicative ceilings for the growth of net domestic assets of the Central Bank and for the growth of net credit of the banking sector to the Federal Government have been set, and interest rates are expected to become positive through both adjustments of nominal interest rates and the decline in inflation.

While I welcome the indications that both commercial bank lending rates and deposit rates increased significantly in recent months, they are still markedly negative in real terms and will continue to be negative throughout the second half of 1992. They cannot, therefore, play any relevant role in the allocation of scarce financial resources in the economy and in supporting the achievement of a sustainable level of the ruble exchange rate. While I welcome the intention, as stated by Mr. Kagalovskiy, of further increasing nominal interest rates "if and when it appears to be necessary," I would observe that the recent devaluation of the ruble and the envisaged introduction of a pegged exchange rate system require the achievement of positive real interest rates well in advance of the pegging of the currency if the exchange rate is to successfully pass the test of the market.

In addition, as the staff report makes explicit, movements toward positive real interest rates should help establish a hard budget constraint for enterprises and discourage the further growth of interenterprise arrears. While positive real interest rates alone cannot be the sole instrument for resolving the inter-enterprise arrears problem, I urge the authorities to consider that objective circumstances already exist to further increase nominal interest rates to achieve positive levels well before the end of the year. In such a situation, the respect of the credit ceilings remains the main pillar of the monetary strategy envisaged in the program.

The third cause of concern relates to the possibility that credit expansion could be significantly higher than the agreed indicative ceilings. According to recent reports, the Central Bank has decided to expand bank credit in order to allow a bailout of state enterprises. According to these reports, such a decision could imply an increase in domestic credit by an amount approximating the total growth of net domestic assets envisaged for the second half of 1992, while the limit on the budgetary expenditures related to the program of improving the working capital of the enterprise sector was set at rub 100-150 billion. Hence, the strategy of hardening enterprises' budget constraints would be completely reversed, and inflationary pressures would be dramatically boosted. Therefore, I would appreciate Mr. Kagalovskiy's or the staff's assessment of such recent developments and of whether we are already facing a major deviation from the accord on which the stand-by arrangement is based.

If the measures envisaged in this program are fully implemented, the risks of hyperinflation will be significantly reduced, and the first part of the phased cooperation between Russia and the Fund will bring significant benefits to the Russian people.

A successful macroeconomic stabilization and the much-needed structural transformation will, however, require in the future the adoption of a much wider range of measures than those envisaged in this first tranche arrangement. To mention a few: first and foremost, the conclusion of a satisfactory monetary agreement with those countries that decide to leave the ruble area as well as with those states that continue to remain in the ruble area; second, the introduction of an appropriate incomes policy; third, the introduction of an effective tax on excessive wages; fourth, the removal of ad hoc taxes; and fifth, the commitment to increase energy prices. If, therefore, the multistage approach to macroeconomic stabilization in Russia has to continue as planned, the authorities should seriously consider that, as the Chairman clearly emphasized at the annual meeting of the Bretton Woods Committee last June, a less than adequate program not only could not be supported by this institution but it would also be a disservice to Russia itself.

Mr. Al-Jasser made the following statement:

The Russian authorities have embarked on an historic and momentous adjustment effort that promises a transformed Russian economy based on market mechanisms. As the authorities recognize, the challenge that they have taken on is daunting, but offers great rewards in terms of improved standards of living. Moreover, success in this endeavor can only be achieved by an unwavering commitment to economic liberalization and to structural reform.

On this score, the authorities' achievements thus far are equally impressive and encouraging, and the economic program for the months ahead is a mark of their commitment to advance the transformation process. Key measures undertaken in 1992 include the comprehensive liberalization of prices, the abolition of restrictions on trading activities, and the recent introduction of a unified and market-determined exchange rate. These policies herald an unambiguous and, we hope, irreversible, change in the management of the Russian economy. Already, these actions have borne fruit, as witnessed by the improved availability of consumer goods, the growth of private sector production, and the reorientation of some state enterprise activities. Most recently, and as a precursor to a Fund-supported program, these beginnings have been buttressed by the several important measures set forth in Deputy Chairman Shokhin's letter of July 30.

At the same time, every effort must be made to contain the understandable uncertainties and risks that lie ahead for the economy. In this regard, it is important that the vacuum created by the removal of the old rules of central planning be replaced swiftly by a transparent market framework. Delays and half-measures will only make it harder and more unsettling for economic agents to adjust to the new environment. That being said, it should be recognized that the very breadth of the transformation effort being undertaken will tax heavily the implementation capacity of the authorities. In the circumstances, where immediate action is not feasible--for example, in the area of privatization--the early formulation of well-defined timetables will provide greater certainty in decisionmakers' planning horizons. This holds true also in the macroeconomic sphere: clear objectives matched by unambiguous policies can facilitate the adjustment process by their positive effect on expectations and external support.

At the outset of 1992, the authorities adopted a welcome and ambitious tightening of financial policies. Subsequently, however, domestic pressures have led to a weakening of this strong start: if not arrested, they could institutionalize hyper-inflation and dislocate the structural adjustment process. In this regard, the vacillations in policies that we have witnessed are a cause for concern because they risk compromising the very success of the transformation effort. For these reasons, the program before us is particularly welcome, as it represents a return to the original stabilization path, albeit after a sizable setback. At the same time, it will provide the authorities with essential breathing space in which to lay the groundwork for a far more intensive adjustment package.

Central to the program's objective of reducing inflation is the sizable and impressive fiscal consolidation effort amounting to 11.5 percentage points of GDP. Equally important for containing credit and monetary expansion is the adherence to the program's credit ceilings and the attainment of positive real interest rates. A key ingredient for monetary policy to be effective will be the establishment of a well-defined framework for monetary cooperation in the ruble area. In this regard, Russia has a special systemic responsibility to the other members of the ruble area.

The fiscal consolidation effort is substantial, and I am concerned about the authorities' ability to realize it fully, in view of the considerable domestic pressures for continued expansionary policies. In this regard, I welcome the package of fiscal measures outlined in Deputy Chairman Shokhin's letter. In particular, I am encouraged by the fact that additional expenditure cuts have been formulated, which will offset the revenue reductions introduced in the budget by the Supreme Soviet. That being said, I would have preferred to see more precision and no delays in the timing of the fiscal measures--uncertainty in this area can only cast doubt on the amount of savings that could be achieved. Also, pressures for additional revenues may arise from the Supreme Soviet's supplementary spending package. These points underscore the importance of monitoring closely the fiscal situation and introducing rapidly compensatory measures as needed to preserve the programmed budget deficit.

As to specific measures, on the tax side, I welcome the authorities' firm resistance to a reduction in the value-added tax rate. Also, I note that the main source of new revenues is the oil sector. While I agree that energy prices, as distinct from taxes, should be raised gradually toward world market levels, the pace of change should strike a prudent balance between improving efficiency in energy use and minimizing the dislocation and contraction of output resulting from sharp increases in the price of such an important input to production. With respect to expenditure measures, I welcome the authorities' intention to reduce nonprotected expenditures by 25 percent, which is greater than initially programmed. Nevertheless, this temporary cash management measure may eventually create unsustainable strains unless replaced by more fundamental budget reform. As regards financing the deficit, it is essential that the counterpart funds of external assistance be accurately monitored for the limit on domestic bank credit to be meaningful. More significantly, if net foreign financing exceeds expectations, I urge the authorities to reduce government recourse to bank credit by an equivalent amount, and thereby release more resources for the enterprise sector.

Success on the stabilization front will rely critically on timely progress in institutional and structural reform. While I am impressed by the authorities' comprehensive and ambitious privatization plan, the pace of implementation should be accelerated. Privatization, commercialization, and increased competition lie at the heart of the transformation effort and a lasting resolution to the financial strains emerging in the enterprises and commercial banks. An immediate priority should be the introduction of hard budget constraints, which, among other things, will help assure wage restraint and adherence to overall bank credit limits, as well as preserve the quality of banks' balance sheets. At the same time, it is important that an effective and timely financial payments system be established to facilitate the reorientation of production by enterprises. In light of these pressing needs, I hope that the growing participation of the

World Bank and the European Bank for Reconstruction and Development will help pick up the pace of reform.

In conclusion, I support the proposed first credit program as an initial first step toward a more comprehensive stabilization package. Indeed, as I have noted before, a liberal first credit tranche is a useful intermediary phase between the unconditional use of the reserve tranche and more demanding upper credit tranche programs. In this case, it can play an important catalytic rôle in attracting external assistance. However, as other speakers emphasized, this role has to be supported by a commitment to service all external debts. Of course, it remains absolutely critical that the authorities meet their commitments under this program, in order to maintain their credibility and support domestically and internationally.

I cannot end my statement without greatly commending the staff and management for their tireless efforts to give the Russian authorities the best possible advice.

Mr. de Groote made the following statement:

I agree with the decision to grant Russia a first credit tranche drawing of about $1 billion. Obtaining such credit is, indeed, the privilege of any member of this institution. Today's decision should be interpreted as a demonstration of the readiness of the Fund to cooperate with Russia in its daunting task of metamorphosing its command economy. It also has to be seen as reflecting the expectation of the international community that Russia is serious about its intentions in the area of stabilization and systemic reforms.

The hidden but real purpose of today's meeting is not to decide on this first credit tranche: the objective of this discussion is to determine whether the proposed first credit from the Fund will help the Russian Government convince its public opinion of the validity and necessity of the reforms to be embodied in a regular Fund-supported program, or whether we have to consider the risk that the quasiautomatic quality of today's decision could be misconstrued as implying that we will go along with any type of program.

Let me first emphasize that I understand how difficult it must be, given the magnitude of the needed reforms, for the Russian authorities to agree, among themselves and with the Fund, on the type of program to be designed and on the modalities of its implementation. This difficulty is aggravated by the impracticability of some of the advice Russia has received from other quarters, which has to some extent been followed despite the experience gained by other European countries in transition.

A first lesson of this experience is that when a country needs a strong macroeconomic stabilization program, as Russia does today, it is dangerous, maybe even counterproductive, to try to implement such a program simultaneously with a full-fledged shock program of systemic change. Macroeconomic stabilization and systemic change both lead to short-term income losses that are bound to compound each other. The resulting overall income losses can easily reach a level that prevents the expected supply effects from materializing. It would be an egregious error to suppose that macroeconomic stabilization is less urgent in Russia's case because the country is still in the early stages of systemic change, or that the program of systemic change alone is capable, through its supply effects, of stabilizing the economy. Thus, if a priority must be established favoring either the systemic or the stabilization program, it remains my view that in Russia's case the priority must be given to stabilization: without the prior stabilization of prices and the balance of payments, the improved allocation of resources--which is the very objective of any systemic program--has little chance of being realized. This means that further demand-management measures have to be taken immediately, both by reducing the budget deficit to manageable proportions and by controlling the expansion of money flows. The recent increase in defense spending is hard to reconcile with the prerequisites of such a stabilization program. Also, the country must not be diverted from the pursuit of these macroeconomic priorities by the pressure of longer-term objectives, such as the full convertibility of the ruble, which are to be achieved at a later stage.

A second lesson from the experience of other transition countries is that price and import liberalization cannot produce their expected results until the country possesses the basic institutional elements of a market economy, which in Russia's case should have been put in place during the Perestroika era. Russia thus must commence this task immediately, by pressing forward with privatization, adopting positive real interest rates, providing real independence to its Central Bank, and establishing real competition between its state enterprises. In sum, besides credible demand-management policies, Russia's program should include specific components of institutional reform so that the country can envisage, at a later stage, a genuine liberalization of price and imports on the double basis of stable price levels and a critical mass of market-friendly institutions.

It would be a disservice to our Russian friends for us to conceal from them that we are deeply concerned, both for our institution and for their country, about their readiness to implement a program extending to higher credit tranches. We are worried because we detect serious misunderstandings about what Russia should do. For example, what does Deputy Prime Minister Shokhin mean when he says that "the government is placing the demands of domestic...politics before the requirements of the IMF"? Does he mean to suggest, as I hope, that the program supported by the Fund is, first and foremost, in the national interest of Russia? Or, is he implying that the Fund's views about what must be done in Russia's long-term interest are not accepted as valid? If it is true that the President of the Central Bank has written to several major enterprises informing them that they will continue to receive financial support, does he mean that such support will be forthcoming irrespective of the rehabilitation of their financial situation? Why are fiscal reforms to be postponed while the budget deficit for the first six months of 1992 has reached 18 percent of GDP? We know that domestic savings will only cover up to 1 percent of GDP of this deficit, leaving the other 17 percent of GDP to be financed by external sources. Even with up to 7 percent of GDP being covered by official external support, as is now envisaged, the current deficit might lead, given the difficulties of obtaining additional financial assistance, to a clearly excessive reliance on foreign commercial banks, particularly in light of the problematical debt situation. It should be made clear to the authorities that they cannot count on unconditional international support, and that they will accordingly have to implement additional measures that are indispensable for the rehabilitation of the economy.

The program that I hope will come soon before this Board should, in the interest of Russia itself, not be limited to Russia alone, but should also extend to relations between Russia and the other republics of the former Soviet Union. A first problem in this connection concerns the status of the former Soviet Union's external debt. For the moment, every former Soviet republic is responsible for the whole of this debt. This means in practice that none is responsible. The result is a lack of access to foreign financial markets for Russia at a time when such access is particularly needed. We therefore urge the Russian authorities to achieve a clearer sharing of the debt responsibility with the former Soviet republics. One interesting modality would be for the former Soviet republics to buy, on the secondary market, their share of the debt and refinance it, eventually with international aid. Dealing with this problem would also involve dealing with the division of some assets and liabilities of the former Soviet Union. We can take advantage of today's discussion to indicate to the Russian authorities the readiness of the Fund staff to assist them in their debt negotiation, and to inform them about what resources the Fund could make available for these purposes.

A second problem requiring immediate attention concerns the payment relationships among the republics of the former Soviet Union. The decrease in trade of Russia and its neighbors could very soon lead to dramatic consequences. This will mean, because of the disappearance of trade specialization, mutual losses. A related problem is the present inflationary pressure resulting from the bilateral accounts between Russia and the other republics, a point well documented by the staff. It appears to us that a system similar to the European Payments Union after World War II could be extremely helpful in resolving these important issues. It appears every day more likely that several of the former Soviet republics might wish to have a currency of their own. A payments union would allow for such a move and, at the same time, would permit members' currencies to remain inconvertible outside the union and accommodate those members who decide to use a common currency. In order to promote the multilateralization of trade, an increasing share of payments union members' net deficit position should be settled in convertible currencies. In my view, it is not premature to consider whether Fund resources could be made available to such a payments union, in the same way as was done under the Marshall Plan to support the European Payments Union. Still another point of immediate concern is the taxation of exports that has begun to be implemented. I have always understood that there are few propositions in economic theory more generally recognized than that global welfare and the balance of payments cannot be durably promoted by these kinds of measures.

Having had the privilege of actually being present when both cases were considered, I would like to conclude by recalling the precedents set by the stand-by arrangements for Italy in April 1974 and April 1977 and by the stand-by arrangement for the United Kingdom in January 1977. Both countries had quotas larger than Russia's. Despite domestic inflation and deteriorating current accounts, both countries had pursued expansionary policies after the first oil shock of 1973. In both cases, agreement was extremely difficult to reach. The phraseology used by the political leaders of both countries, some of which is recounted in the Fund's history in quotations from Mr. Andreotti's diary, displays many similarities to some statements being made in Russia today, where the patient is likewise forced to be his own surgeon while hoping to remain in power. In both cases, the authorities engaged in the usual lobbying to obtain a softening of the Fund's conditions on account of special circumstances, including size, the danger of political instability in the case of Italy, the special relationship with the United States in the case of the United Kingdom, and the risk of strikes. It was to the great benefit of both countries that due consideration of the particularities of their respective political situations did not lead to any relaxation of the measures that the Fund regarded at the time as necessary for their recovery. And both countries did well under their Fund-supported programs. The Russian delegation should know that just as the Board supported the courageous and effective Fund negotiator, Sir Alan Whittome, in the cases of Italy and the United Kingdom, we will stand behind Mr. Odling-Smee in his difficult task. Taking Russia's special circumstances into account should indeed lead to the consideration of stricter--not more accommodating--conditions, given the challenge of the task. I have taken the liberty of speaking frankly because Mr. Kagalovskiy knows how greatly I admire the determination his Government has shown up to now. To my own wishes for Russia's success are added those of four countries in my constituency: Belarus and Kazakhstan have a close and friendly association with Russia, continue to use the ruble, and will benefit greatly from the preservation of a high level of regional trade. Hungary and Czechoslovakia are two countries which, having enjoyed a special relationship with Russia of long duration in the past, have greatly suffered from the disruption of CMEA trade, and hope to restore their exchanges with Russia to a satisfactory level. In ending, I would observe that Mr. Kagalovskiy's title of Director for Interchange with International Financial Institutions is most appropriate, indeed. Positive and constructive interchanges between Russia and the Fund is what we all desire and expect.

Mr. Jaramillo remarked that the Memorandum of Economic Policies that had been presented to the Board by the Russian authorities in March had spelled out their plans to move from an inefficient command economy to a market-based economy. At the time, his chair had expressed hope, but also great doubts, regarding that program, based on its view that the task would be made particularly difficult by the virtual disappearance of the institutional framework under which the economy had been organized. Events of the past few months had proved that those difficulties were even greater than most had envisaged.

The request for a first credit tranche arrangement was based on a medium-term commitment to the policies outlined in the original Memorandum of Economic Policies, although, in the shorter run, policies would not be as tight as had been planned in March, Mr. Jaramillo observed. The authorities were adopting a more gradual approach to reform than had been originally envisaged, but their efforts had by no means been minor. Prices had been largely decontrolled, basic reforms to the tax system had begun to be implemented, interest rates had been raised and should become positive in real terms by year-end, the ruble exchange rate had been essentially unified and floated, foreign trade had been largely liberalized, and efforts were being made to more closely target subsidies through a basic social safety net.

The initial thrust of the stabilization effort had been concentrated, and would continue to be so for some time, on the fiscal, rather than the monetary, side, partly owing to the difficulties posed by enterprise arrears, Mr. Jaramillo continued. The authorities had committed themselves to adopt certain prior actions in the fiscal area previous to the Board's discussion of the revised program. Some delays were, however, to be expected in that area. When implemented, those measures should help avoid loss of control over budgetary expenditure and would be instrumental in containing the general government deficit at around 5 percent of GDP.

Credit expansion would continue to be pressed by existing inter-enterprise arrears and by additional credit demands arising from public firms forced to accommodate their operations to a drastically changed environment, Mr. Jaramillo commented. Consequently, monetary policy could not be expected to contribute initially to the stabilization effort, and would not do so until hard budget constraints could be effectively established. It should, however, at least avoid aggravating the inflationary environment. Recent developments regarding price trends were not encouraging in that respect, as credit to the Government had been loosened recently and prices had continued to rise rapidly. Those were worrisome developments, as a rapid reduction of the inflation trend was a critical element for the success of Russia's transformation into a market-oriented economy.

The need to relax policies in the short run highlighted the enormous difficulties that governments could face when attempting to implement drastic adjustment and reform measures, despite their best wishes to carry them out in their entirety, Mr. Jaramillo stated. The question was whether the authorities would be able to fulfill their commitments even within the new diluted package. On that issue, he strongly felt that the authorities should be given the benefit of the doubt. That was basically the principle behind the low level of conditionality associated with first credit tranche purchases. Although that stance might pose both credibility and financial risks to the Fund, his chair had repeatedly emphasized its view that the Fund should take risks, and that it would fail to carry out its duties if it did not. In the case of Russia, the degree of access to Fund resources was reduced and, furthermore, support for the program in its current form might prove instrumental in the transition toward a more ambitious adjustment effort in the coming months. He thus supported the proposed decision.

Mrs. Sirivedhin said that she generally agreed with the staff appraisal and had little to add to the extensive comments by previous speakers. Since most speakers had emphasized fiscal and monetary policy, she would limit herself to a few brief comments on the external sector.

The authorities were having some difficulty in implementing their export tax system because of the complicated procedure and the proliferation of exemptions, Mrs. Sirivedhin observed. Moreover, export taxes had the potential to reduce export competitiveness and went against the thrust of the authorities' trade liberation policy. Therefore, it would be preferable to eliminate them entirely, except in the case of products in serious shortage.

At the time of the pre-membership economic review with Russia, she had voiced skepticism at the suspension of import tariffs and the proposed use of a 15 percent flat rate, Mrs. Sirivedhin recalled. It appeared that currently, the intention was to apply an import customs rate of 15 percent on average. While not advocating an excessive proliferation of rates, she agreed with the rate differentiation that that new policy would allow, and could even see the case for higher average tariffs at the initial stage of external adjustment followed by a lowering later on. Any further postponement of their implementation should be avoided.

The policy regarding the foreign exchange surrender requirement had been vastly improved with the use of the market exchange rate, Mrs. Sirivedhin remarked. Nonetheless, there seemed to be a slight discrepancy between the surrender method described on page 25 of the staff report and the method described on page 55; she would appreciate clarification on whether the 30 percent that ultimately went to the Central Bank of Russia went directly to the Central Bank or through commercial banks. The latter would be preferable. Like Mr. Fukui, she considered that a surrender requirement could be useful in the current situation, although in the long run, the requirement should be phased out as intended. While the requirement was in effect, exemptions should be minimized.

The exchange rate applied to foreign exchange surrendered to the banking system was that prevailing on the date of repatriation, which the staff indicated might result in a multiple currency practice, Mrs. Sirivedhin stated. She wondered whether it might instead be viewed as a forward transaction.

In wishing the authorities well in their endeavors, she wished to stress that their track record under the stand-by arrangement would be an important determinant of future Fund cooperation with the Russian Federation, Mrs. Sirivedhin concluded.

Mr. Aderibigbe made the following statement:

> I commend the Russian authorities for taking the initial steps toward reversing the rapidly deteriorating economic and financial conditions following the collapse of the central planning system. The transformation process to a market economy will certainly be arduous and demanding, and only sustained commitment to a comprehensive adjustment program, supported by adequate and timely external financial and technical assistance, will ensure ultimate success. For this reason, we welcome and support Russia's request for a first credit tranche arrangement with the Fund and hope that this will catalyze additional resource flows from other sources.
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> The phased approach to reform in Russia is the appropriate strategy, taking into account the considerable efforts and time that will be required to eliminate existing structural rigidities

in the system and build up necessary institutional structures and managerial capacity for a market economy. The swift action taken early this year to decontrol most domestic prices and liberalize the trade and exchange rate system is noteworthy. We also note that further progress has been made in other areas, particularly the unification of exchange rates. However, the current high rate of inflation, output decline, and the pressure on exchange rates are matters for concern, as their persistence could undermine other reform efforts and erode public support for adjustment. The need for tightening financial policies, as outlined in the Memorandum of Economic Policies, is of utmost importance in reducing the monthly inflation rate to single digits and stabilizing the ruble. Progress in restoring macroeconomic stability will be determined largely by the pace of structural reform, particularly in the areas of tax policy, state enterprises, and the financial sector.

To overcome the likely obstacles to achieving stipulated fiscal targets for 1992 will require exceptional efforts on the part of the Russian Government. Additional tax measures are needed to strengthen revenue performance, while the current slippages on expenditure control should be reversed. Restoration of financial discipline in state enterprises and acceleration of the privatization process should help mitigate expenditure growth through a reduction in budgetary subsidies. It should also facilitate the achievement of monetary and credit targets.

The institutional structure for effective implementation of monetary policy is lacking, and may take some time to establish. Meanwhile, the Central Bank should exercise greater restraint in providing liquidity to the economy through its soft lending to the banking system and the so-called priority sectors. Commercial bank credit to state enterprises should also be more effectively controlled. Consistent with this stance, a more active interest rate policy should be pursued to ensure efficiency in the use of resources and to stimulate increased financial savings. There is also an urgent need to overhaul the banking operations and payment system to facilitate efficiency in debt settlement through the clearing mechanism. An early restoration of confidence in the payment system should help reduce the sizable demand for currency holding and the accumulation of interenterprise arrears.

We recognize that the problem of monetary management is further compounded by the difficulty of determining the ruble area and standardizing and coordinating monetary policies. We hope that the anticipated conclusion of monetary arrangements within the ruble area by October 1992 will facilitate a more orderly behavior and movement toward the convergence of monetary policies.

We note that the external sector position is extremely weak and is likely to remain so for some time. During this period, adequate and timely foreign resource inflows, including direct private foreign investment, will be the major source of strength. The authorities should, therefore, provide the necessary enabling environment to facilitate such flows. Factors that impede improved export sector performance should also be eliminated. In this regard, increased access of Russia's export commodities to the industrial countries' markets is crucial.

We support the proposed decision and wish the authorities of the Russian Federation success in the onerous task ahead.

Mr. Santos made the following statement:

When Mr. Kagalovskiy addressed this Board in March, he stated that in reforming their economy, the Russian authorities did not want to find unique ways, but that they wanted "to use the traditional economic approach of stabilization and liberalization of the economy." The authorities' present request for a first credit tranche arrangement reflects this view, and is another clear indication of their commitment to the path of radical reform that they embarked upon some months ago, which aims at creating a fully functioning market economy.

As noted by previous speakers and by the staff, this program is a challenging one. The objectives are ambitious, and the measures to be taken are far from easy, especially in view of the sociopolitical context in which they are being implemented. In spite of these constraints, the authorities have already taken bold actions in some areas, especially tax reform, price and foreign trade liberalization, and the exchange market. We commend them for these actions and encourage them to persevere in their efforts.

Under the current program, the authorities are appropriately emphasizing macroeconomic stabilization, and in this context, tight demand-management policies will be essential preconditions to any further reform because of the real danger that the economy might slide into hyperinflation. The implementation of demand-management measures might prove difficult, however, because they have to be accompanied by institutional and structural reforms. In this respect, the proper coordination and sequencing of policies become crucial. Previous speakers have elaborated on this issue, and I share most of their views. I am also in general agreement with the staff appraisal, and I will therefore concentrate my remarks on some financial policy issues on which I would appreciate the staff's comments.

In the fiscal sector, I note that the significant progress achieved in the first quarter of the year was not sustained, especially because of lack of control, and has necessitated the introduction of a wide range of measures both on the revenue and the expenditure side. We would note, however, that the impact of these measures on the deficit will depend to a large extent on their full and timely implementation. The report that there have already been delays in the introduction of several fiscal measures is troubling. While we are somewhat reassured by the staff's view that short delays "would not fundamentally threaten the overall objective of the program," we would emphasize that the achievement of the fiscal objective remains essential to the success of the program, and we encourage the authorities to increase their efforts to that effect. Their decision to increase the ratio of sequestered unprotected budgetary expenditure as well as to take compensatory fiscal measures as needed is therefore welcome. We would also add that the achievement of the targets will not only require strict implementation of the envisaged measures, but will also depend to a large extent on the administrative capacity of the Government to ensure the proper collection of revenues and to monitor expenditure. In this respect, I wonder what administrative measures the authorities are taking to ensure that the fiscal targets are achieved.

As regards monetary policy, a tight credit stance remains vital. I welcome the authorities' intention to limit the amount of lending to the commercial banks and to stand ready to adjust the central bank finance rate as needed. However, a major cause of credit expansion has been borrowing by public enterprises and accommodating the credit needs of other republics in the ruble area. Previous speakers have commented extensively on the issue of credit to the other republics and on the ruble area, and I broadly share their views. I would, however, appreciate staff comment on whether any further progress has been made between the Russian Central Bank and the central banks of the other republics on rules for coordinating monetary and credit policies among the republics and especially on ways to control credit in the republics until a clearly defined ruble area is created.

The credit needs of the public enterprises is one area where the possibility of slippages will be the greatest. While welcoming the measures that have been introduced to address the problem of interenterprise arrears, we would note that the authorities will have to continue to exert strong discipline to withstand pressures to bail out failing, inefficient enterprises. Moreover, we are concerned about the conflicting news report in yesterday's Morning Press regarding the order to cancel the debt of state enterprises. Does the staff have additional information on this order and its possible effects on the program's objectives? In the light of these developments, designing a comprehensive program to restructure the public enterprise sector should be given the highest priority. In this context, I welcome the broad lines of the privatization process as outlined in the letters of intent, and I encourage the authorities to pursue their plans steadfastly.

More generally, I would note that the implementation of the envisaged measures will result in higher prices and the closure of many state enterprises, which will increase unemployment. Therefore, I welcome the provision of safety nets to protect those who will suffer from these measures and support the staff's recommendation that the authorities should accelerate their efforts to establish a simplified, work-incentive-oriented unemployment compensation scheme. The authorities' consideration of labor-intensive public works schemes with appropriate financing is also welcome as this will help to maintain domestic support for the reform process. I would note also that the continued financial assistance of external creditors along the lines recommended by the staff will be of vital importance to the authorities' efforts. Another important step that industrial countries could take to assist Russia's reform efforts is to open fully their markets to Russian goods so as to help stimulate Russian exports and accelerate the economy's integration into the world economy.

This chair fully supports the proposed decision.

Mr. Fernando made the following statement:

A first credit tranche program is usually viewed as a mix of substantive actions and expectations, with somewhat greater weight on expectations. In the case of Russia, the balance shifts toward substantive actions because, with the breakdown of the central planning system, there is no system to fall back upon. Policy actions and institution building should be credible in a fundamental sense so as to promote confidence that the authorities can effectively articulate and oversee the course of reform. The core of this concern is the large gap that currently exists between monetary conditions and monetary objectives. Putting in place a viable system rests on the speed at which money gains currency; in Russia's case, its acceptance as the medium of exchange is yet to be fully accomplished.

We conducted the pre-membership economic review in March against a background of dramatic actions. This chair commended the authorities for their resolute actions. Expectations were high, although concerns were registered as to the sustainability of policy actions. The second quarter reflected these concerns as slippages on both the expenditure and revenue fronts, coupled with loose credit, eroded the budgetary position. Now that the program and policies have been suitably modified to take into account domestic reactions to the original policy package, we expect a very high degree of performance.

The staff papers highlight the many downside risks to program performance. The latest staff update again draws attention to variations and delays so soon after the delivery of the letter of intent of July 10. For us to consider a stand-by arrangement in the upper credit tranches, a good track record of economic policy implementation should already have been established. The policies on liberalization cannot be sustained without accompanying policies on financial discipline. This is what we would like to see the authorities demonstrate over the next six months.

We recognize the burden placed on fiscal policy owing to the urgency of stabilization and inflation control. At this stage, we are of the view that a credible fiscal policy requires a strong revenue effort. The downside risks to a strategy that emphasizes more efficient collection are very high. Even if such a strategy can yield results, the time scale required would likely outstrip the urgency of short-term stabilization. Thus, we welcome the recent measures that relate higher revenues to higher tax rates. A self-evident case exists for use of taxation to capture windfall profits arising from price deregulation and exchange depreciation. Given pervasive state involvement in commercial activity, the scope for monopoly rents arising from price deregulation is large. There is much potential for output losses in this instance. Such tendencies can undermine the reform exercise and argue for taxes to offset such monopoly rents. An overall improvement in the budget from these expedients could give the authorities greater latitude for targeted income transfers so as to support the supply response of the economy.

It is hoped that budgetary control can be re-established under present policies and that the need to use sequestering procedures will not arise. We fear that output losses could worsen and, coming on top of lower import volumes, could poison the atmosphere for reform.

More generally, in evaluating performance under the stand-by arrangement, we would like to see strong progress in achieving a better balance in macroeconomic policies. In particular, monetary policies should achieve inflation control and hasten the attainment of positive real interest rates. A successor stand-by arrangement in the upper credit tranches requires a strong confidence that policies will be sustained. The best insurance for this would be a growth orientation. In this sense, a better balance in macroeconomic policies would provide the basis for self-sustaining growth both through incentives for investment and through structural reforms that optimize returns.

Even as we are encouraged by the authorities' assurance on implementation, we cannot dismiss lightly the risk of contrary actions by other government organs and executing agencies within Russia. These are real, as alluded to in the staff update. The envisaged compensating actions on the fiscal side in the event that the legislature is not fully cooperative is a demonstration of commitment, but it is not without undesirable side effects, especially on the supply side. Another example is a reported energy policy paper recently approved by the Ministry of Fuel and Energy which advocates tight control over energy prices and exports, and runs against basic market principles. Of course, any government should have the benefit of differing viewpoints. But in Russia, it can have unfortunate practical consequences in terms of dissipating administrative and managerial capability at a time when greater efficiency in administration is called for.

The analysis of the external position and its prospects should be taken much further in any successor arrangement. Presently, gaps in the financing scenario are filled through arrears financing. The Fund has strengthened the authorities' hand in calling for untied external assistance and for a lengthening of external debt maturities. We support this approach as we continue to believe that Russia's problem is a lack of liquidity and not one of solvency. Yet solvency alone, as may be reflected in Russia's untapped potential of natural and human resources, will not be adequate to safeguard the Fund's resources in a timely manner. Consequently, we look forward to clearer assessments of capacity to repay in future staff papers.

We support the proposed decision.

Mr. Che said that he welcomed the Russian Federation's request for a first credit tranche stand-by arrangement. The authorities' letter of intent was comprehensive and indicative of their strong determination to transform their ailing economy. It therefore should constitute a good basis for the negotiations with the Fund. In the meantime, the Fund management and the staff deserved special thanks for undertaking consecutive and difficult discussions with the authorities.

Although the program was ambitious, he found merit in its phased implementation, Mr. Che continued. Moreover, while he could not say that the transformation program was typical of a gradual approach, it certainly contained elements of such an approach in many areas.

He supported the phased approach toward possible financial support from the Fund, Mr. Che remarked. That approach was consistent with the judgment that there still existed a number of important uncertainties with respect to the prospect for full implementation of the program. The Fund should decide the extent of the next phase of financial support on the basis of performance criteria alone. Although the design of a sound program was important, its implementation was even more important. In that regard, he remained concerned about the authorities' capacity to fully implement the program in the face of the deteriorating economic situation and unsettled institutional framework. He could go along with the proposed decision.

Mr. Rouai made the following statement:

We welcome the opportunity to discus Russia's economic program with the Fund, and we commend the authorities for the courageous measures already implemented. We support the phased strategy of Fund financial support to Russia, as well as the thrust of the staff appraisal. What is ultimately important for the Fund and for Russia is not only the design of a comprehensive program addressed to the pressing problems of the Russian economy but, more important, the agreement on a course of action under a medium-term strategy that is both sustainable and meets Fund standards of conditionality.

Experience suggests that when adjustment programs are designed in the context of a medium-term framework, there are clear advantages for the authorities, the Fund, and for other creditors as well. For the Russian program, the Memorandum of Economic Policies of March 1992 is a useful framework, and we welcome the authorities' assurances that they remain committed to the objectives and policies outlined in this document. However, as agreed during the Board discussions on Bank-Fund collaboration on the states of the former Soviet Union, we see merit in the preparation of a tripartite document that reflects Bank-Fund collaboration with Russia and details in a more comprehensive way the authorities' program of macroeconomic stabilization and structural reform over the medium term. We are interested in knowing whether such a document is envisaged for Russia. In this context, while experience suggests that both stabilization policies and structural reforms are required to move the economy to a full market system, the lack of institutional and legal framework warrants particular emphasis in structural and sectoral reforms.

With regard to the sustainability of the reform process, two important factors should be kept in mind. One is the fragile political and social consensus with regard to the need, depth, and speed of the reform process. The other is the lack of administrative capacity to design, implement, and monitor policy reforms. The authorities' administrative capacity is being developed through the wide-ranging expertise provided by the Fund and other institutions. Technical assistance cannot, however, remove the deep-seated mentality of state dependency, which could prove to be highly resistant to change. The success of this important task depends largely on the political strength and the will of the authorities to implement the required structural reforms. The ultimate success of the program over the medium term rests on maintaining an appropriate balance between the strength and speed of reforms on the one hand and safeguarding the necessary political support on the other. While the objectives of the program should remain ambitious, the course of actions should be realistic and closely monitored in view of the magnitude of the task at hand and the existence of nonquantifiable political, regional, and ethnic issues. In addition to these risks, the lack of mutual experience between the Fund and Russia and the absence of adequate information raise the broader risk stemming from what the staff calls the "partial understanding of the likely reaction of the rapidly changing economic system to different policy measures." In light of these considerations, a cautious strategy of incremental progress along the lines of the proposed phased approach appears to be suitable.

Having said this, we must recognize some elements of fragility in the Russian program. Our main concern relates to the still-existing state of uncertainty in the economy stemming from the fact that the culmination of financial and economic difficulties coincided with the collapse of an ideological and political system that tended for decades to guarantee individuals' employment and stable price levels on the one hand, and guarantee enterprises assured markets for their output and access to financing on the other. The strategy of moving the economy toward a market system requires replacing this mentality of state dependency and the certainty provided by state intervention with the uncertainties and vagaries of market forces. The success of this strategy depends, therefore, on an early clarification of the various roles of the state, in particular its relations with state enterprises. The lack of cognitive clarity is demonstrated by the accumulation of interenterprise arrears with the expectation of a traditional bailout. This could also lead to a serious slippage in the wage bill, which, under the current as well as the proposed policy based on taxing excess wage awards, has no effect on those enterprises that earn low taxable income or are in deficit. The state of uncertainty also affects the work force, since the reform process will certainly be accompanied by a sharp rise in unemployment. Moreover, it is also evident in Russia's relations with the other former Soviet republics and the lack of defined rules of coordination governing the functioning of the ruble area.

The phased strategy for Fund financial support to Russia attaches two objectives to the first stage, namely, agreement on monetary coordination between Russia and the other states of the former Soviet Union and the satisfactory implementation of the program during the first stage.

Regarding the implementation of the program during the remainder of 1992, although there is a clear need for rapid action in a wide range of policy reform areas, priority should be given to the introduction of financial discipline in the state enterprise sector. The program of restructuring and privatization is ambitious, and the contribution of the World Bank to this process will certainly be helpful. What is now important is for the authorities to decide rapidly on those enterprises to be privatized, liquidated, or maintained in the public sector. Early and decisive attention to state enterprises would help the authorities to react to the trend of "spontaneous" privatization and to the establishment of monopolistic positions; more important, it would allow the authorities to integrate state enterprises into a national industrial policy. To be successful, however, the clarification of relations with state enterprises should be accompanied by the resolution of interenterprise arrears and by the enforcement of a hard budget constraint on those enterprises that remain in the public sector.

Wage policy is another important element of the enterprise reform; and here, we have some concerns with regard to the policy of taxing excess wage awards. If hard budget constraints and tight credit policies are applied, public enterprises could be tempted to grant large wage awards to compensate for the social costs of the stabilization policies. The taxation of excess wage awards will not have any dissuasive effect on those state enterprises in deficit. It could also lead state enterprises to accept, under social or political pressures, the use of their profits to finance the taxation of large wage awards instead of financing their investment needs. In our view, the authorities could benefit from negotiating with the unions a medium-term forward-looking wage policy that incorporates not only wage incentives but also agreement on productivity gains. In any event, the introduction of, and adherence to, financial discipline by state enterprises is the cornerstone of the reform process in Russia. Without firm financial discipline, it is difficult to exert any control on monetary aggregates or to reduce the budget deficit.

We agree that preferential interest rates and the earmarking of credit for particular sectors could have distortionary effects on the allocation of resources. It is not certain, however, that financial markets are equipped or prepared to support those viable enterprises in need of restructuring, particularly those undergoing a radical reorientation of activity or the replacement of physical capital stock. These considerations may warrant acceptance of a temporary support for those viable public enterprises having a sizable impact on economic output and willing to embark on restructuring programs. In this context, we endorse Mr. Fukui's call for the establishment of a specialized bank to handle the financial needs of small to medium-sized private enterprises.

With respect to monetary policy, we associate ourselves with the comments of Mr. Végh and Mr. Peretz on the need for the authorities to focus with greater intensity on a stronger monetary stance. On the status of cooperation in the ruble area, we see an urgent need for a quick decision by the states of the former Soviet Union on whether to remain in the monetary zone. We agree with the staff that there is an urgent need for a clear definition of the functioning of the ruble area. We recognize, however, the difficulties arising from the objective of maintaining close monetary cooperation without infringing on national sovereignty, which was, after all, at the root of the dissolution of the former Soviet Union. Various issues and interests are involved in designing a framework of cooperation, but they all revolve around the stabilization of the ruble itself and the problems associated with the introduction of national currencies. In this connection, a recent working paper prepared by the staff on independent currency authorities highlights the usefulness of currency boards in a process of macroeconomic stabilization involving monetary and fiscal discipline. The paper suggests that such institutions could promote price stability and foreign trade. In view of Argentina's recent experience with a currency board, we wonder whether the staff is working on a similar scheme for Russia or other states of the former Soviet Union.

With these comments, we can support the proposed decision and wish the authorities every success in the difficult and lengthy reform process.

Mr. Finaish made the following statement:

The staff papers in support of the request for a first credit stand-by arrangement are candid about the risks that attend this program. While naturally concerned about the many uncertainties, one must at the same time recognize the truly gigantic task of transformation of political, social, legal, and economic institutions upon which the authorities are embarked and the importance to the global economy of their success. The data bases are fragmentary and unreliable, and most judgments on program design and content must be based on anecdotal evidence, garnered from a small number of contacts in a vast country. While commending the staff on its valiant efforts to extract meaning and purpose from a welter of confusions, one must recognize that it was set an almost impossible task and has discharged it ably.

Among the risks to the program, perhaps the most immediate one is that of social explosion. The staff is evidently at a loss to explain the fact that "there has thus far been little unrest over the decline in real wages," which have been halved since the beginning of the year. It is puzzling that the saving rate remains above 20 percent in the first half of 1992, although down from around 30 percent in the second half of 1991, compared to only 5 percent in 1985. A situation of "excess demand for real balances" in which households have suddenly found themselves is offered as an explanation; another one could be that this is "forced saving" resulting from the crediting of wages into individuals' saving accounts which then could not be withdrawn because of the pervasive shortage of currency. Yet another riddle: why the price "burst" in January 1992 was so unexpectedly stronger than in the case of Poland. With food prices continuing to rise--the food price index is reported to have risen by 32 percent from May 19 to June 16, 1992--the possibility of a social breakdown must be regarded as real. As we understand it, a minimum subsistence basket probably requires one and a half times the minimum pension, and it is not clear whether more than 5 percent of the pensioners' population could be receiving that much. Especially troubling for the general populace must be the many reports of actions to protect entrenched positions through "spontaneous privatization" of state enterprises by their managers and workers, the formation of powerful cartels by former Party nomenklatura, and the growing evidence of "mafia activities" in local markets, as noted in the staff report.

The second blade of this particular pair of scissors is the specter of growing unemployment. To date, the reported numbers are less than one percent of total employment, although an International Labor Organization survey in April indicated a possibly substantial undercount. However, as and when stabilization measures begin to take hold, the establishment of a hard budget constraint on enterprises will lead to widespread layoffs, and the characterization in the staff appraisal that there would be "some bankruptcies and closures" must surely be a serious understatement. Whether reforms of the unemployment compensation arrangements can be rapidly instituted to provide an adequate, or even a minimal, social safety net for the four million people expected to be laid off by the end of the year must remain in doubt, considering the highly archaic operating procedures that prevail in most local offices of the employment bureau. There remains, in any case, great uncertainty about the magnitude of the unemployment "bulge" that parallels the earlier misjudgment on the intensity of the price "surge." To the extent that such a bulge emerges, the actual expenditures for the social safety net would be much higher than budgeted, adding another indeterminate element to the many others on the size of the budget deficit.

Previous speakers have rightly emphasized the importance of the authorities fully implementing their commitments under this stand-by arrangement. However, given our incomplete understanding of the transition process in Russia and the poor quality of the data base, it will be especially difficult to monitor progress by comparing performance with the indicative targets for intermediate variables. The real test of effectiveness for macroeconomic policy should be its success in decelerating the inflationary process; similarly, the real test of structural policy is whether it brings about a supply response in such critical areas of the economy as agriculture. Indeed, it is this apparent lack of response so far that seems to pose the greatest risk to the future of the program. Evidence of tangible progress in respect of such fundamentals will be essential for reaching a judgment on whether to proceed beyond today's first credit tranche transaction to extending additional Fund resources under an upper credit tranche arrangement.

Mr. Torres made the following statement:

I wish to commend the Russian authorities for the reaffirmation of their commitment to the basic objectives and policies initially stated in the Memorandum of Economic Policies of March 1992. Indeed, these are ambitious objectives, which in our view represent the best and least costly way to effect the difficult transition from a centrally planned economy to a market economy.

During the discussion on the pre-membership economic review last March, our chair pointed out the importance of placing the main emphasis during the initial stages of the reform process on stabilizing the economy. We argued that the magnitude of the fiscal deficit determines the margin of maneuver in the stabilization effort as well as the space available to conduct the needed structural changes in an orderly fashion. By now, it is clear that the ambitious budget target for 1992 set forth in March will not be attained. After the remarkable improvement in the fiscal position in the first quarter of 1992, monetary and fiscal slippages, mainly on the expenditure side, started to emerge, jeopardizing the prospect of a rapid stabilization, and reached such a magnitude that they placed the economy on the verge of hyperinflation. Fortunately, the authorities are willing to undertake compensatory actions to get back on track and have recognized that budgetary discipline must continue to be the centerpiece of the stabilization effort. Slippages in this field will only lead to costly delays in the attainment of the objectives set forth and might contribute to stopping the momentum that the reform effort has gained.

In this context, we welcome the authorities' recent actions to put the fiscal accounts back on track. It seems that the specific measures to increase revenues, improve tax administration, and cut expenditures will contribute to achieve the objectives set forth in the letter of intent. However, we are concerned about possible delays in implementing these measures. The longer the delays, the less effective and the less impact these policies will have. In this regard, it is regrettable that delays have already materialized in the implementation of some of the revenue measures envisaged to be in place by August 1. We note the efforts being made to minimize and offset the impact of such delays, and we urge the authorities to take any additional measures necessary to ensure that the fiscal targets will be attained.

The fiscal consolidation has to be supported by a tight monetary policy in order to achieve the inflation and external objectives of the program. In this regard, I share the concerns expressed by most Directors about the weakness of the monetary program in the present arrangement and the need to move toward a tighter monetary stance in the near future. In our view, the success of the stabilization effort during the second half of 1992 will hinge to a great extent on the strict observance of the ceilings on the central bank lending to commercial banks and the Government. With monthly rates of inflation of about 10 percent, the dispersion of relative prices and the volatility of inflation and expectations is very high. Any acceleration of inflation will easily throw the program off track and will de facto tighten the credit ceilings. In such an inflationary environment, uncertainty, social unrest, and political frictions flourish. We hope that the authorities recognize the dangers involved in following this route.

As to the institution-building process, we urge the authorities to make every effort to reach agreement on the rules and institutions that will facilitate the coordination of monetary policy in the ruble area. In the meantime, it will be essential to establish firm commitments with the other central banks in the ruble area on restricting credit expansion, harmonizing interest rates and reserve requirements, and liberalizing interest rates. The conduct of monetary policy in the absence of these minimum conditions of coordination would be plagued by uncertainty and by a greatly reduced effectiveness of the available policy instruments.

The growth of interenterprise arrears has also complicated the conduct of monetary policy. These have grown at such a fast pace and have reached such a dimension as to create a systemic problem and the danger that the monetary authority might be pressured into a dramatic loosening of monetary policy to address the arrears problem. This action would inevitably lead to hyperinflation. The monetary authorities should move expeditiously to assure that interest rates are positive in real terms.

Only through this action will the right incentives be put in place and will monetary conditions reflect the realities of a profound stabilization effort. It is also encouraging that the Presidential decree on bankruptcy was at last issued in June 1992, thereby paving the way for the process of transformation and restructuring of the enterprise sector.

Regarding exchange rate policy, the freely floating market-determined exchange rate in the interbank market will undoubtedly be the thermometer by which to measure the stance of financial policies. Under highly inflationary conditions, there is a risk of the exchange rate becoming part and parcel of the inflationary process, since it is the most visible price on which to index all other prices. However, until Russia can reach a strong financial position, a flexible exchange rate policy seems to be the only feasible option.

I support the proposed decision.

The Director of the European II Department observed that Executive Directors had generally supported the authorities' program. Speakers had emphasized the major achievements that had already been made and had stressed the importance of a comprehensive, determined implementation of the program. They had also pointed to the ambitious fiscal targets for the remainder of 1992 and had expressed some doubts about the ability of the authorities to achieve those targets. He would therefore first address points that had been raised with respect to the budget and fiscal policy.

A number of questions had been raised concerning the impact of the delays in the implementation of envisaged measures, the Director recalled. As Minister Shokhin's letter made clear, the loss of revenue from the delay in increasing the import tariff was estimated to be rub 50 billion. In addition, the Government currently planned to go ahead with a package of fiscal measures that would produce rub 380 billion, rather than the originally envisaged rub 440 billion, because the Supreme Soviet had not agreed to one component of the original proposal. Moreover, the Supreme Soviet had reduced revenues in a number of ways by rub 270-300 billion. The Government intended to cover those reductions in revenue through the introduction of offsetting measures. The sequestering rate on unprotected expenditures, for example, would be increased from 20 percent to 25 percent, which would yield an estimated additional rub 50 billion. The Government also hoped to save an additional rub 400 billion through the lower indexation of wages and other expenditures.

Sequestering was a key instrument for cutting excessive expenditure commitments, the Director continued. Although it could not be used forever, in the past sequestering had been effective over the short term. Nevertheless, the staff had some concerns about whether the envisaged amounts could be realized through sequestering and lower indexation, and for that reason, its recent update had noted the need to keep the matter under close review. In the longer term, the staff would prefer to see a reduction of expenditure commitments.

As to possible additional budgetary measures in the event that such monitoring revealed that budget developments were not on track, further expenditure reduction would be difficult in current circumstances, the Director remarked. In fact, the Government's proposed expenditure cuts were the absolute maximum that could be achieved within a short period of time. On the revenue side, however, a number of measures could be contemplated in principle. For instance, as Mrs. Sirivedhin had suggested, the import tariff could be increased further. Moreover, although import subsidies had already been reduced, there still remained considerable scope for further cuts in that area. The main remaining subsidies were on foodstuff and medicine. There were also large exemptions to export taxes, but while action in that area was, in principle, possible, it would be politically difficult. The energy sector might also yield additional revenue. In any event, the staff expected that all of the proposed rub 380 billion in additional revenues would be raised. Although the Government had asked the staff not to reveal at the current stage the exact measures to be taken, the staff had strong assurances that the measures would be implemented within the coming few weeks.

On the cost of rising unemployment, the estimates set out in the staff report were based on the assumption that unemployment might rise to 4 million people--about 5 percent of the labor force--by the end of the year, the Director explained. That assumption was also being used by the Government in its planning. The experience in Eastern Europe suggested, however, that unemployment was unlikely to rise to that level so early in the process. The staff's assumption was therefore somewhat pessimistic. In the event that it was realized, the budget figures in the staff paper, which included the effects on unemployment of the budget measures that had been taken, would be adequate. Unemployment might, in fact, be less and the budget deficit would be less if the general macroeconomic situation was more stable.

The issue of the unification of the exchange rate had been unsettled at the time when the letter of intent was prepared, the Director stated. At that time, some special budgetary exchange rates were still being used for imports that had been contracted before the date of the letter. The staff had been assured that those rates had been abolished, as planned, by August 1, 1992.

As Mr. Végh had pointed out, the general government deficit as measured in the current program was not as broad as might be desirable, and should, perhaps, include loss-making state enterprises, which would yield a larger figure, the Director commented. While he agreed with that proposition, that was a difficult exercise in view of the current state of Russian statistics. It should, however, be pointed out that many subsidies to loss-making enterprises were more explicit in the Russian budget than in those of many other countries. For example, most interest rate subsidies were explicit, so that those losses were, in a sense, already taken into account in the general government deficit.

With regard to the sharp rise in defense expenditure after the first quarter of 1992, it should be noted that the level in the first quarter had been unsustainably low as the Government had attempted to squeeze defense spending more than was tolerable, the Director explained. Moreover, the Russian Federation had subsequently accepted responsibility for essentially all of the Commonwealth of Independent States' (CIS) defense forces, and that had been costly. In that way, Russia had transferred some resources to other republics. In addition, defense conversion was costly, and some of those costs were reflected in the rise in the defense budget.

The staff would agree with Mr. de Groote that in financing the budget, it would be unwise to rely on a high level of foreign commercial bank financing, the Director stated. So far, however, the external financing received by Russia in 1992--some $10 billion out of the approximately $24 billion that was being sought--was almost entirely from official sources.

Concern had been expressed about a recent statement by a deputy chairman of the Central Bank that interest rates might be lowered, the Director recalled. The staff had been assured that the reported statement did not reflect the policy of the Central Bank. Indeed, the authorities' commitment in their letter of intent was not consistent with a reduction in interest rates in current circumstances, and Mr. Gerashchenko had assured the staff directly that it was not his policy to reduce interest rates.

He recalled that Mr. Clark had observed that the increase in rates on household deposits of the savings bank was not very great, the Director remarked. In his view, the increase--to 60 percent--was substantial. In many countries, the rates on household deposits were somewhat lower than other rates. One good reason for that approach in Russia's case was that the deposits had a government guarantee. Moreover, the high cost of the savings bank network was reflected in the spread between the deposit rate and the lending rate. More generally, in view of the expectation that inflation would decline under the program, interest rates should be viewed in terms of a forward-looking inflation projection rather than a backward-looking one.

The staff had considered the possibility of a currency board for Russia, and while it had no general policy objection to that approach, it was not viewed as appropriate for Russia at the current stage, for a number of reasons, the Director commented. First, a currency board would impose a very strong discipline on financial policies. Second, it would require much larger initial foreign exchange reserves than Russia currently possessed. Third, it would require Russia to give up an independent monetary policy, which was asking a great deal of a major country at the current stage in its history and evolution. In general, the staff had concluded that the time was not yet ripe in Russia for the currency board approach.

The proposal to issue treasury bills was not intended to provide a major source of budget financing in 1992, the Director remarked. Its purpose was, instead, to develop a new instrument that would be available for monetary management in due course. The authorities and the staff believed that there would be a small market for such bills among commercial banks, if the interest rate was right. Again, with a falling inflation rate, it should be possible to find an appropriate interest rate at which a small amount of treasury bills would be taken up.

In the external sector, Mr. Fukui had asked why the authorities proposed to phase out the surrender requirement, the Director recalled. He wished to clarify that it was not the authorities' intention to phase out the requirement that exporters should surrender 50 percent of their export earnings to commercial banks, but rather, that the second part of the policy--that 30 percent of the amount surrendered to commercial banks should be surrendered to the Central Bank--was to be phased out. Currently, amounts surrendered by commercial banks to the Central Bank did not enter the foreign exchange market. Thus, by abolishing the second part of the surrender requirement, the foreign exchange market would be broadened, which was an important objective. It was also important to remove any automatic mechanism whereby, as under the old system, foreign exchange was channeled through the Government for allocation. As to Mrs. Sirivedhin's concern that surrender to the Central Bank through the commercial banks gave rise to a multilateral currency practice, the staff would be pleased to provide an explanation, which was quite technical, on a bilateral basis following the meeting.

With respect to the tax system, it should be noted that export taxes on natural resources or raw materials were not unusual, the Director stated. Indeed, such taxes were used in a number of countries and were an effective way of bridging the gap between domestic and world prices. In most instances, the intention was to raise the domestic price to the world price, and during that process, the export tax would be reduced and eventually eliminated. While the export tax did not reduce competitiveness, because the price was determined at the world level, it did affect the profits of the producer. In Russia, the authorities kept an eye on producers' returns on raw materials, and an ongoing debate in recent months was whether oil producers were being allowed a sufficient return or whether the export tax had been too high and the local price too low. The staff would agree that in that sense, competitiveness--or at least the supply response--was affected by the export tax.

The staff would fully agree with the great importance many Directors had attached to structural issues, the Director commented. In that connection, the World Bank was fully aware of the Fund's activities in that area, and the Fund was well apprised of the World Bank's activities. In fact, the work of the two institutions in Russia had been closely synchronized. Staff missions had visited Moscow at the same time and the authorities' memoranda on policies had been forwarded to the two institutions at the same time. Of course, on structural issues, many other organizations were involved, such as the EBRD and the OECD, as well as private organizations, such as the Russia-America Banking Forum. The staff had kept in touch with, and had supported, the activities of those organizations. As to whether there were plans to prepare a tripartite document with the World Bank and the authorities, in view of the close collaboration among all parties to date, there did not appear to be an immediate need to formalize arrangements in a document. The staff would certainly continue to work closely with the World Bank on structural issues and on the program in general.

A number of Directors had emphasized the importance of reforms in the agriculture and energy sectors, the Director continued. There was no doubt that those two sectors were extremely important for the immediate success of the Russian economy. By immediate, he meant the coming three to five years. Moreover, it was important that they be reformed quickly and efficiently. The World Bank was proposing sectoral loans for 1992 in those two areas, which it was giving top priority.

He agreed with Mr. Goos that it was important that human capital capable of running a market economy should be developed as quickly as possible, that that could not be done overnight, and that there had to be room in any program for the gradual development of human resources, the Director remarked. Nonetheless, every effort should be made to try and speed up the process. To that end, the Fund had been most active in providing technical assistance to assist the development of institutions and training in monetary and fiscal policy as well as in statistics. Moreover, the Vienna Institute would be taking on an increasing burden of training officials in Russia.

As to recent press reports regarding the Government's policies on cancelling the debts of enterprises and providing credit to pay off interenterprise arrears, the staff understood that Mr. Gerashchenko had sent a telegram to central bank branches the previous week describing the new arrangements that he was proposing for dealing with arrears, the Director of the European II Department stated. Moreover, he understood that there had subsequently been discussions between the Government and the Central Bank during the week that would probably lead to a change in the proposed new arrangements. It should be noted that Mr. Gerashchenko's proposal did not relate to any specific amount of credit: the figure of rub 1,000 billion that had been reported in the press had been mentioned informally by a deputy chairman of the Central Bank, but it was not the Central Bank's policy to make available such a large amount of credit for the settlement of arrears. Furthermore, Mr. Gerashchenko had not only committed himself in his letter to the Managing Director to staying within the terms of reference of the program and the letter of intent, but he had also publicly stated the previous day that the Central Bank would always take into account its current agreements with the Fund on credit policy. Thus, the Fund had assurances that credit policy in the area of interenterprise arrears and the new arrangements were consistent with the program.

The staff representative from the European II Department remarked that the various sources of the interenterprise arrears were detailed in Annex II of the staff report. In that connection, it was important to distinguish between what had happened in the first month or so of 1992 as a result of the rapid increase in prices, and what had happened in subsequent months. The special circumstances that had applied in January were covered in some detail in the Annex. In more recent months, several important factors had contributed to the phenomenal growth of interenterprise arrears. One major factor was sharply negative real interest rates, which had reduced the opportunity costs for enterprises of holding claims on other enterprises and had given them an incentive to accumulate stocks. Although statistics were not available, the fact that the fall in final expenditure and in export volumes had been much greater than the fall in production suggested a substantial buildup in stocks in that period. Another major factor was the lack of enterprise reform--particularly, the persistence of old attitudes and a great deal of unwanted production--as well as the slowness to realize that the market situation was changing, which was related to the willingness to accumulate stocks without fully realizing the implications of massive stockbuilding. Moreover, the rigid and inefficient payment system had contributed to the arrears problem. The expectation of many enterprises that there would be a bailout was yet another factor. In the staff's view, such expectations should be dissipated as quickly as possible.

As to solutions, Mr. Landau had made the interesting distinction between the stock aspect--the existing arrears--and the flow of future arrears, the staff representative continued. That observation underlined the importance of positive real interest rates. A move toward positive rates could be expected to affect both the stock and the flow problem, thereby providing an additional impetus for enterprises to trade, and extinguish, their claims. Positive interest rates should certainly discourage a further buildup in arrears. A major consideration, of course, was the need to ensure a hard budget constraint for the state enterprises. That could be done in a number of ways--through reducing budgetary subsidies, limiting credit growth, accelerating privatization, and enforcing the bankruptcy decree that had been issued and following it up with a bankruptcy law. Improvements in the payments and settlement system should also help to resolve the problem. As explained in Annex II, from July 1 the enterprises had to worry more about the creditworthiness of their customers in that unpaid payment orders would no longer be allowed to pile up in commercial banks but would be sent back to the enterprises. As to the stock of arrears, it was important to avoid a bailout and the moral hazard problem that had been raised by several Directors. Enterprise expectations in that regard had to be changed or the whole process of structural reform would be strongly inhibited. It was somewhat reassuring in that connection that the authorities had set up an Agency for the Management of Enterprise Debts, which was intended to facilitate the clearing of the arrears in conjunction with the process of privatization. That was also discussed in Annex II, and more detailed reports on the agency were currently being prepared by the World Bank. The Fund staff had been asked to participate in a working group on interenterprise arrears, and in that context, it would be looking at the issue in the light of the stabilization objectives as well as the need for restructuring state enterprises.

One Director had expressed concern that the rate of inflation was expected to come down in the second part of 1992 and at the same time, credit and money were expected to grow in real terms, the staff representative recalled. The growth in credit had to be viewed in light of the tremendous fall--by roughly three quarters in real terms--in credit extended by the banking system to enterprises in the first half of 1992. Of course, that had been largely accommodated by the growth of interenterprise arrears. With the various measures being taken in the second half of 1992 to reduce, and eliminate, the problem of interenterprise arrears, it would be reasonable to expect some growth in real credit from the banking system to enterprises, especially if the authorities hoped to accelerate the process of privatization and restructuring, for which credit would be necessary. The demand for real balances was also expected to increase as inflation declined. The projected increase was not large--about 10 percent, compared with a fall of about 80 percent in real terms in the first half of the year.

As Mr. Fukui had observed, there had been a great deal of earmarking of credit, the staff representative commented. The staff had expressed substantial concern in that regard in its report. It would, however, be unrealistic to expect that in the early stages of the transition process, directed credit, which had been very much the rule under the centrally planned system, could be completely replaced overnight by market allocation of credit. Moreover, much of the direction of credit that had taken place in the early months of 1992 in agriculture, in energy, and into the so-called northern territories could be seen as a crisis-management approach to keeping those sectors afloat. In the staff's view, while that approach might be expedient in the short run, it was difficult to judge which sectors should survive in a more market-oriented environment. The best approach was to foster increased market allocation of credit over time. The realignment of relative prices, particularly the further realignment of energy prices, would help give better signals in that respect. Moreover, the authorities had committed themselves to a majaor realignment of energy prices over the coming few years.

As to whether small and medium-sized enterprises in an economy dominated by enormous state enterprises should receive some sort of special assistance with respect to obtaining credit--a point raised by Mr. Fukui--it would be noted that in Russia, many of the smaller banks--which represented perhaps well over 1,000 of existing banks--were very much involved in lending mainly to small and medium-sized enterprises, the staff representative from the European II Department remarked. That situation was very different from the one prevailing in many East European countries at a similar stage of transition. In the circumstances, the staff would prefer to see efforts to ensure that the banks, subject to the usual prudential regulations, survived and thrived so as to help small and medium-sized enterprises to thrive. In fact, that was one reason to avoid direct credit controls on commercial banks: it would be extremely difficult to design a system of credit ceilings that would ensure that smaller new banks would be able to extend credit to the more dynamic parts of the economy in the short run. Even where the staff was persuaded that direct controls on commercial bank lending were the appropriate approach in the short run--and one important difference between its approach to the net domestic assets ceiling in the case of Russia compared with that taken in programs in Eastern Europe was that the indicative ceiling applied to the Central Bank and not to the banking system--it would be very difficult for the Russian authorities to implement controls because the banking system was much more wide open. Moreover, the Central Bank of Russia had indicated that it did not have the legal status to impose such controls.

Mr. Fukui said that he appreciated that the Government might not have sufficient hard data to determine those sectors where development might be encouraged through directed credit. From a practical point of view, however, it was not difficult to identify the most important sectors in the economy. In his view, and based on experience, an approach to directing scarce credit resources to such sectors should be given more consideration. More generally, he would be interested to know more about the structure of the banking system, which he understood to be a two-tier banking system. Depending on the stage of development of the system, the continuation of some sort of direct controls on credit was inevitable, at least for the short term.

The staff representative from the European II Department said that it would perhaps be useful if the staff prepared a short, detailed memorandum on the banking system and credit controls in Russia. Briefly, the banking system was a two-tier system: there was a Central Bank and over 1,500 banks. While the latter were dominated by a few enormous specialized banks that had grown out of the old system, most banks were small and operated very much like banks in the American Wild West in the 1840s. The Central Bank had certain instruments at its disposal, including reserve requirements, which had been raised substantially in early 1992, and a central bank finance rate. While the Bank could not fine-tune its use of those instruments in the same way as the central banks of many other countries, that was certainly the objective over time.

On incomes policy, the excess wage tax was viewed as a transitional instrument, and experience in Eastern Europe had shown that especially in the early months of a macroeconomic adjustment program, progressive excess wage tax systems had an important role to play, the staff representative remarked. The key was to implement them without exemptions, which had proved to be a problem in the 1980s in some East European countries that had attempted to use such a tax and, more recently, in the former Soviet Union. The system currently in place, which was detailed in the staff report, could be improved. If Russia was to have an excess wage tax system--and the staff considered that it should have one as some sort of nominal anchor in the shorter run--then it should be streamlined and operate more along the lines of those currently in use in Eastern Europe.

The staff proposed to follow up Mr. Végh's question on energy developments with a short memorandum on the issue, if that was acceptable to Directors, the staff representative commented.

On privatization, it was true that efforts had lagged significantly behind the various ambitious goals that had been laid out by the authorities at the end of 1991, for reasons that were well understood, the staff representative from the European II Department stated. There had, however, been some small-scale privatization and some experiments in certain cities with the help of the World Bank. The Supreme Soviet had recently approved a privatization program for 1992, and the State Property Committee was expected to issue soon guidelines for privatization. State enterprises were expected to present their own privatization plans by the end of September. Moreover, the process of corporatization was under way: all large enterprises were to be transformed into joint stock companies by November 1. In sum, there was so far a great deal of activity but few concrete examples of privatization.

Mr. Kagalovskiy said that he was grateful for Directors' useful comments on Russia's economic reform policy, which he would convey to Prime Minister Gaidar. He also wished to state, on behalf of his Government, that in respect of recent press reports criticizing the Fund's role in Russia, the authorities were fully satisfied with the cooperation between Russia and the Fund. In that connection, he wished to thank the Fund staff for the considerable time and assistance given to work on Russia's current economic policy framework. In general, he would observe that recent press reports, including those on the situation in Russia, even in respectable newspapers such as The Financial Times, were far from reality.

As to concerns that had been expressed about the ability of the Government to fulfill its commitments, it should be noted that the Government supported the reform movement in Russia, as evidenced by the nomination of Mr. Gaidar as Acting Prime Minister a month and a half earlier, Mr. Kagalovskiy continued. Moreover, the Government had the full support of President Yeltsin in its reform policy. As in any democratic country, there were differences of view between the Government and Parliament. But even in the Parliament, a large group had shown its support of the Government's economic policy as well as its relations and cooperation with the Fund. That support had also been reflected in a letter from parliamentarians to the Managing Director.

On the issue of interenterprise arrears and central bank policy, the announcement that had recently received so much attention in the press had been superseded following a discussion of the matter between the Prime Minister and the Central Bank Governor, Mr. Kagalovskiy commented. The general approach to be taken to interenterprise arrears was to provide technical credits to enterprises in arrears. Those credits would then be transferred into securities to be issued by a special agency to be organized under the auspices of the State Privatization Committee. The objective was to avoid financing arrears through the current account. In that connection, he wished to stress that the authorities' priority was to achieve the monetary targets set out in their policy memorandum.

The phased approach being taken to Fund support of Russia's program was useful, and it was hoped that negotiations on a full stand-by arrangement could be completed in October, Mr. Kagalovskiy concluded.

The Chairman made the following concluding remarks:

> Executive Directors have given their support to this first credit tranche arrangement, and in doing so, they have rightly concentrated their remarks on the future, and in particular, on the preparation of the program in support of an upper credit tranche stand-by arrangement. Possibly, I should capture in a few concluding remarks some of the views offered by members of the Board, so as to help guide the staff in the preparation of these future negotiations.
>
> All Directors observed that this is indeed a remarkable and historic occasion. They were also unanimous in noting that the program in support of this arrangement clearly demonstrates the Russian authorities' continued commitment to economic reform; for this, the authorities deserve to be commended highly. The unification of the exchange rate and the recent initiatives to speed up privatization continue the bold reforms that started at the beginning of the year with comprehensive price liberalization.
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> Nonetheless, as all speakers pointed out, there are clear and tangible risks regarding the achievement of the authorities' objectives. Directors expressed particular concern about delays in the implementation of some agreed measures, which add to the concern about the risks. To minimize these risks, Directors invited the authorities to be attentive and rigorous in monitoring and implementing their policies and to take every opportunity to strengthen policies and reforms. We have today heard from Mr. Kagalovskiy that these are their intentions, and I received similar assurances from President Yeltsin only a month ago. Here, we should, as was noted in the discussion, give the authorities the benefit of the doubt.
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> Special care will, however, be needed on the budget to ensure that the program's fiscal targets are met and that any needed additional measures are implemented in a timely fashion. The public enterprises, in particular, should be subject to a hard budget constraint and should avoid a further accumulation of

arrears; and the earmarking of central bank credit should be eliminated.

Directors viewed the monetary side of the program as its Achilles' heel, its primary weakness. I am certain that Mr. Kagalovskiy would agree with us that the program's minimal elements of monetary discipline should be applied with the most determined, strongest commitment. In addition, many Directors have insisted that positive real interest rates should be achieved in the Russian Federation, at the latest by the end of the year; delay here, they stressed, might complicate, or even have an adverse impact on, the authorities' reform and adjustment efforts.

Macroeconomic stabilization should go hand in hand with structural reform, Directors stressed. They welcomed the steps that have been taken, as well as the assistance of the World Bank and other institutions in support of the authorities' structural reform efforts. Directors have urged the authorities to move forward resolutely with privatization so as to encourage the rapid growth of a vibrant private sector. They have also urged that high priority be given to the agriculture and energy sectors, which could be expected to yield quickly a significant supply-side response.

Directors viewed their endorsement of the first credit tranche arrangement not only as a recognition of the far-reaching changes that are already under way in Russia, and of the authorities' commitment to reform and adjustment, but also as underlining the firm belief of the Executive Board that the pace of reform should not be allowed to slow down. Experience in other member countries has shown again and again that it would be erroneous to postpone reforms in the hope of easing the pain of adjustment. That path leads instead to hyperinflation, which in turn would call for even more drastic measures to eliminate the disequilibria and achieve the transition to a market economy. It is therefore critical that the measures set out in the Memorandum of Economic Policies be implemented, and that any slippages be addressed immediately.

Of course, I can assure the members of the Board, and Mr. Kagalovskiy and his delegation, that Fund management and the staff intend to provide all possible assistance to the authorities to ensure that the program is implemented successfully and that its targets are achieved. The next phase in our collaboration has already begun with in-depth discussions on policy measures and reforms aimed at accelerating the development of markets and progress toward price and exchange stability. These discussions should evolve quickly into developing the basis for a program to be supported by an upper credit tranche arrangement.

In addition to a successful implementation of the program that Directors have just approved, an upper credit tranche arrangement will require substantive additional actions in a number of areas. Here, I would like to highlight a few crucial areas.

First, a further and significant tightening of financial policies for 1993 is indispensable to build on progress made under the current program, reducing inflation further so as to approach price stability, or, as stated in the program, very low single-digit monthly inflation.

Second, it will be necessary to resolve and normalize monetary and trade relations with all states of the former Soviet Union, and to finalize workable and sustainable arrangements for relations with those states that choose to remain in the ruble area, as well as for the orderly withdrawal of those states that prefer to leave. That, of course, is now expected to be accomplished before October 1.

Third, there needs to be a marked acceleration in the pace of implementation of structural reforms so as to support the transition process, to minimize the fall in output in the near term, and to pave the way for a high and sustainable rate of growth in the medium term.

Directors have also emphasized that the vigorous implementation of comprehensive adjustment and reform policies is the surest way to strengthen the Government's financial credibility abroad. The maintenance of a positive relationship with Russia's foreign creditors is critical, and Directors have also encouraged the authorities to create a favorable environment for investment from abroad.

No doubt our future work in this area will present a number of challenges for both the authorities and the Fund. We can be proud to have already met a few of them. While this work is likely to require considerable efforts, I would like to assure all of you, both Executive Directors and the Russian representatives, that we are committed to making our very best efforts toward a speedy and successful conclusion of the next phase in our collaboration. Of course, there is no artificial timetable here; the timing will be determined by the evolution of our negotiations. In that regard, it might be useful, as some Directors have suggested, to review developments in Russia's program in any event before the end of the year. I will, of course, continue to provide the Board with periodic reports on our work with the Russian Federation and other states of the former Soviet Union.

Last, but not least, I would like to pay tribute to the work of the staff. I am particularly grateful to those of you--Mr. Kagalovskiy and Executive Directors--who have expressed their commendation to the staff. It has indeed involved a unique, exceptional effort to bring this request for use of Fund resources to the Board for consideration within only a few weeks of Russia's accession to membership. This has been done. Congratulations to all of you.

The Board took the following decision:

1. The authorities of the Russian Federation have requested a first credit tranche stand-by arrangement in an amount of SDR 719 million for a period of five months.

2. The Fund approves the stand-by arrangement set forth in EBS/92/119, Supplement 6.

Decision No. 10108-(92/102), adopted
August 5, 1992

2. ADMINISTRATIVE TRIBUNAL - REVIEW OF DRAFT STATUTE

The Executive Directors considered a staff paper for the review of the draft statute on the establishment of an administrative tribunal for the Fund (EBAP/92/126, 7/20/92).

The Vice-Chairman of the Staff Association Committee (SAC) made the following statement:

It has been somewhat more than a year since the Executive Board considered the issue of an administrative tribunal for the Fund. We are grateful to management and to the Legal and Administration Departments for the thoughtfulness with which they have considered the staff's concerns, and we in the Staff Association Committee stand ready to give our support to the draft statute. We informed the staff of our opinion in an open meeting that was held on Friday, July 31. We have also indicated to the staff the few remaining areas of concern that we intended to bring to the attention of the Executive Board. While the draft statute is not ideal from our point of view, we believe that the end product will have the potential to serve the institution and the staff well.

I would like to address the three issues that are proposed for resolution by the Executive Board. We believe that our concerns could be addressed without changing the balance that the proposed statute strives to strike between the legitimate interests of the institution and those of its staff.

One of our foremost concerns has always been the chilling effect of the provision on the award of costs to unsuccessful applicants. We could, at this point, go along with either of the alternatives presented in the paper, provided some wording was found to set a limit to the costs that could be awarded against an unsuccessful applicant. We want to discourage frivolous cases from being brought before the tribunal, as such cases would do a disservice to the staff, as well as entail some costs for the institution. In Alternative 1, it is specified that a successful applicant could only be awarded "reasonable costs," but no such limit is set to the costs that could be awarded to the Fund. In addition, the commentary on Article XV, both under Alternative 1 and under Alternative 2, indicates that frivolous cases could be prolonged and costly to defend. The absence of a limit together with the commentary gives the impression that an unsuccessful applicant might have to pay large sums of money to the Fund. We are not convinced that a frivolous case--namely, one that is manifestly without foundation or clearly intended to harass the Fund--would survive summary dismissal by the administrative tribunal. The cost to the Fund of defending such a case should be minimal. Thus the effect of the above-mentioned commentary would not be rightfully to deter frivolous applicants, but rather to discourage some applicants with a bona fide case, who would probably be among those most in need of protection, from availing themselves of recourse to the tribunal. We would propose that the commentary make clearer that the Fund could only be awarded costs incurred after the case is filed with the tribunal and only up to a reasonable limit, perhaps expressed in terms of weeks or months of salary.

With regard to the standing of the Staff Association, we took note of Mr. Conable's opinion and his reference to parallelism, which we would have liked to be used in other aspects of the tribunal's statute. We strongly advocate standing for the Staff Association. We can assure you that the Staff Association will not be less inclined to pursue vigorously the reasonable interests of the staff if it has to act in the roundabout way that befalls our World Bank colleagues. Whether it has standing or not, the Staff Association will act in a responsible way, taking into account the legitimate interests of the staff and the institution. However, we strongly believe that the process will be less acrimonious, less costly to the Fund, less damaging to the Fund's relations with its staff, and altogether more effective if the Staff Association is granted standing.

Concerning access to the tribunal by other than current and former staff, we have consistently expressed our support for providing recourse to the tribunal to all the Fund's employees, regardless of their status. Since the last discussion of the tribunal in June 1991 (EBM/91/87, 6/28/91), contractual employees and technical assistance experts have been provided access to arbitration. This has been a welcome development, and at this point we can go along with the rationale for arbitration as a way of settling disputes arising out of their contracts with the Fund.

With regard to the tribunal's jurisdiction, we were, of course, disappointed that Executive Directors felt it necessary to include the provision that would preclude the tribunal from considering regulatory decisions that Executive Directors passed on to the Board of Governors and the provision on the binding effect of the Executive Board's interpretation of the Fund's Articles of Agreement. The statute of the World Bank's tribunal does not have such provisions, and we did not think this was needed. We are sure that this Board would not wish to take decisions on conditions of employment that a tribunal could find illegal, and to ask the Board of Governors to take such a decision would seem to suggest that the Executive Board itself lacked confidence in whether it was acting legally. We trust, therefore, that it will never be found necessary for the Fund to curtail the competence of its tribunal in this way. I hope that you will give a sympathetic ear to our remaining concerns.

In conclusion, I would like to reiterate the Staff Association's conviction that the establishment of the administrative tribunal will strengthen the organization by providing a system of judicial review that is consistent with the Fund's legal structure and will safeguard the legitimate interests of the staff.

Mr. Wright said that he would appreciate staff comment on amending Article XV to provide that "the Tribunal may order that reasonable compensation be made by the applicant to the Fund for all or part of the cost of defending the case." Such an amendment would take account of one of the SAC's concerns.

The General Counsel said that the staff would have no difficulty with adding the word "reasonable" before "compensation" in Article XV. That amendment would thereby make explicit what was already implicit in the text.

Mr. Kafka, commenting on the SAC's request to be permitted to remain for the Board's discussion of the matter, remarked that he would prefer to maintain the tradition of a restricted deliberation.

Mr. Fridriksson and Mr. Wright stated that they supported Mr. Kafka's view.

The Staff Association Committee representatives then left the Board Room.

The General Counsel observed that the number of issues had narrowed considerably since the previous Board discussion on an administrative tribunal, particularly in view of discussions between management, the staff, and members of the Staff Association. Therefore, if the Executive Board could reach a consensus at the present meeting on the remaining issues, it would be possible to circulate a final version of the draft statute for approval on a lapse of time basis and transmittal to the Board of Governors in the near future.

The Chairman remarked that to facilitate the conclusion of the Board's work on the tribunal, he would suggest that Directors focus their comments on the few issues remaining for consideration, particularly the matter of the award of costs, the standing of the Staff Association, and access by contractual employees.

Mr. Végh said that he welcomed the opportunity to return to the issue of the administrative tribunal and was hopeful that the Board could complete its discussion of the matter and move toward a final decision.

With regard to the awarding of costs, he supported the first alternative whereby a successful applicant would be awarded costs, while the Fund would be awarded costs only in exceptional circumstances in the event that a case was devoid of merit, Mr. Végh continued. He believed that that approach would not discourage applicants with valid cases from resorting to the tribunal.

He did not favor giving the Staff Association access to the tribunal, Mr. Végh stated. As to the access of persons other than current and former staff, while he was inclined to favor the current system of arbitration for that category of individuals, he would not like to create an incentive for long-time consultants to join the staff on that account. In that connection, he would appreciate some elaboration from the staff on how arbitration had worked.

Mr. Wright observed that on costs, under the first alternative, if an applicant was unsuccessful, there would normally be no award of costs to the Fund--except in cases where the claim was "manifestly unfounded"--and he hoped that that situation would not arise. He would have thought that that alternative would give much clearer guidance to the tribunal and much greater protection to unsuccessful applicants. It could therefore have the effect of encouraging staff to bring well-founded cases to the tribunal without fear of having costs awarded against them, which was a considerable benefit. Alternative 2, by contrast, seemed to be much more open ended and created significantly more risk for the potential applicant. He preferred Alternative 1, which gave greater certainty to both the Fund and the staff.

As to access to the tribunal, he could support the definition of staff that excluded contractual employees, who had other arrangements, but that included assistants to Executive Directors, Mr. Wright commented. On whether the Staff Association should have access to the tribunal, he recalled that the President of the World Bank had specifically asked the Fund not to allow its Staff Association to challenge directly its administrative decisions because in his view, SAC access could easily lead to a more adversarial relationship between the staff and management, which could spill over into the Bank, where it would have considerable implications. He himself shared that assessment. The SAC played an extremely important advisory role in personnel and administrative matters, but the Board should avoid the possibility of the tribunal becoming a forum for the routine resolution of conflicts between the SAC and management. The tribunal should instead be reserved for individual staff members with specific grievances. Of course, there was nothing to stop the SAC from supporting an individual in his or her claim.

On other issues raised in the staff paper, he could accept the general approach to interlocutory relief and the production of documents that had been set out in the paper, Mr. Wright stated.

In his statement at the June 1991 discussion on the draft statute, Mr. Peretz had made a number of suggestions, Mr. Wright recalled. The most important was that the commentary on the statute should make it clear that the Board intended the administrative tribunal to act in a restrained way with respect to decisions regarding the terms and conditions of Fund employment. He therefore welcomed the fact that the latest draft commentary had been expanded considerably to take those considerations into account.

Ms. Creane remarked that on the awarding of costs, she could go along with Alternative 1. She would prefer that the SAC not be able to bring cases in its own name to the tribunal. As to access by contractual employees, the current arbitration method appeared to be satisfactory, and she could therefore go along with limiting access to assistants to Executive Directors.

Mr. Knight recalled that when the idea of creating an administrative tribunal for the Fund was first discussed by the Executive Board in January 1987, his chair had been among those that questioned the need for such a body in the Fund. Once it became clear that there was majority support for an administrative tribunal, however, his chair's approach was to seek to make the statute governing the tribunal as open and fair as possible from the viewpoint of the staff. That approach, which still colored his chair's views on the matters yet to be resolved, derived from the simple proposition that the only real purpose of the tribunal was to deliver fair treatment on administrative decisions.

With that background, on the award of costs by the tribunal, he favored Alternative 1, which skewed the balance in favor of applicants and against the Fund, allowing costs against an applicant only if the application was manifestly unfounded, Mr. Knight continued. He would expect the latter outcome to be extremely rare, since any such case should be expected to be dismissed quickly and with minimal cost. He would be happy to accept the addition of the word "reasonable" in Article XV as proposed.

He considered it desirable to allow the Staff Association to be a direct party in challenging the legality of a regulatory decision, Mr. Knight commented. Since the purpose of the tribunal was to ensure just decisions, the Board should be wary about narrowing the doorway through which justice was to be sought. Equally, it should not allow its perception of logic and justice to be clouded by its knowledge of shortcomings in any other tribunal, even one in a sister institution.

As to access by contractual employees, he found it somewhat curious that two different judicial mechanisms were needed for contractual employees and for other staff, Mr. Knight stated. In the Reserve Bank of New Zealand, where he was formerly employed, all staff above very basic grades were employed on individual contracts. A move in that direction within the Fund would make nonsense of the proposal to differentiate the means of settling disputes. Even without that prospect, the proposal appeared to make little sense. He therefore urged that contractual employees should have access to the tribunal.

The issue of interlocutory relief posed potential problems either for the Fund as an organization or for the individuals affected by particular decisions, Mr. Knight observed. However, the problems for individuals were capable of being compensated financially, once there had been a decision as to where justice lay. It was important that the level of financial compensation should take full account of all of the problems created for the applicant where he or she was shown to have been the victim of an unjust decision. With that proviso, he could agree with the proposal to let administrative decisions stand while they were being argued before the tribunal.

He accepted the right of the Managing Director to withhold documents on confidentiality grounds as long as the applicant in all such cases received the benefit of the rule regarding "adverse inferences," Mr. Knight remarked.

His chair remained ambivalent about the need for the tribunal, Mr. Knight commented. But if the Fund was to have one, the Board should at least ensure that, to the maximum extent possible, the tribunal fulfilled the purpose for which it had been designed, namely, to ensure the delivery of fair administrative decisions.

Mr. Aderibigbe made the following statement:

> Although slow and delayed, the process of establishing an administrative tribunal for the Fund seems to be approaching the final stage. Our position on the few unresolved issues in the draft statute remains largely unchanged. Before dealing with the specifics, I will speak on the general issues raised by the staff. First, I see no reason why the tribunal should not be explicitly empowered to grant temporary relief to an applicant, pending the determination of a case in which he would, otherwise, suffer irreparable harm. The fact that such circumstances are unlikely

to occur should not be used as an argument to omit this important provision, since unlikely events have been known to occur. Second, I accept the proposed modification to Article X of the draft statute that spells out the legal consequences for the applicant's evidence where the Managing Director decides to withhold documents of a sensitive or confidential nature from the tribunal.

On the other three specific issues, with respect to the authority of the tribunal to award costs, I agree with the staff on this issue and prefer Alternative 1. However, I remain concerned that an unsuccessful applicant could still be made to pay costs to the Fund, on the ground that his case is "manifestly without foundation." I would like to reiterate our earlier position that this provision could have the unintended effect of intimidating aggrieved staff members from seeking legal redress. While I recognize the need to check frivolous recourse to the tribunal, I believe that the chances of such reckless behavior are greatly reduced by the fact that an unsuccessful applicant would, in addition to losing his claim, suffer other losses arising from unrecoupable legal and personal expenses. More important, a reasonable safeguard would be provided by vesting the tribunal with the power to summarily dismiss spurious applications. In my opinion, the elimination of Article XV of the draft statute would not do any damage.

As to access by contractual employees, I go along with the staff view that contractual employees should not have access to the tribunal. There is no doubt that their grievances could be effectively and more expeditiously resolved by an arbitration panel as provided in their employment contracts. In this regard, the expression "member of staff" in Article II Section 2(c)(i) and (ii) should exclude contractual employees, as in Alternative 1 of the staff's proposals.

Regarding the standing of the Staff Association, I endorse the inclusion of a provision that grants the SAC access to the tribunal to directly challenge the legality of a regulatory decision that adversely affects the universal interest of its members. This approach appears to be more realistic and at the same time more time and cost effective than the traditional principle espoused by other international organizations, including the World Bank. I, therefore, support the retention of Article II Section 1(c) of the draft statute.

Mr. Bonzom made the following statement:

I strongly support the establishment of an administrative tribunal, and I have no difficulty in endorsing the proposed draft statute. In our view, the establishment of such a body will constitute a major improvement by reinforcing the legal framework of our institution. Moreover, such a body exists in most other international institutions. The creation of the Administrative Tribunal will add to the existing procedures a new welcomed way to settle disputes.

After four years of reflection and clarification, the time has come to conclude this matter. In our view, the proposal made by the staff is a balanced one.

On the three specific issues before the Board, with respect to the award of costs by the Tribunal, I am convinced by the staff's arguments: Alternative I is preferable to Alternative II as it provides more certainty to the Fund and the staff. I would add that Alternative I includes defined boundaries, which appear to be protective of both the applicant's and the Fund's rights. Indeed, by delineating the circumstances and the factors in the framework of which the tribunal would be authorized to award costs, greater assurances would be given to the different parties.

I understand that some fear the deterrent effect that the possibility of an award to the Fund might have in cases where the application "is manifestly without foundation" or where "the applicant intended to delay the resolution of the case or to harass the Fund." As the staff report clearly shows, under Alternative II, the tribunal could award costs in favor of the Fund, as a prevailing party, without pre-established precise boundaries. Assuming the tribunal would follow the practice of other international tribunals, it would have to make a decision regarding the "frivolousness" of the applicant's case. I have some doubts as to whether this is more protective for both parties. For these reasons, I favor Alternative I.

On the standing of the Staff Association to challenge regulatory decisions on its own name, we are in favor of granting the SAC access to the tribunal. Indeed, as the participation of the SAC in the process of challenging regulatory decisions is de facto the case, it is better to make such an access official. In addition, I am not sure that denying the SAC access would lead to "a more adversarial relationship between Management and the staff and to an increase in the quantity and acrimony of litigation before the tribunal," as has been suggested by the former President of the World Bank. On the contrary, transparent procedures would be an asset in relations between the staff and management and would probably result in fewer conflicts.

Regarding the access to the tribunal by persons other than current and former staff, including retirees, I have no difficulty with the staff proposal to proceed with Alternative I on the grounds that contractual employees and experts have been provided with the right of recourse to arbitration.

For the reasons expressed above, I can endorse the staff's proposals. Indeed, beyond some misunderstandings owing to the fact that Directors are not expert on legal matters, the Board should now rapidly find a way through the procedural questions and finalize the decision to create the administrative tribunal.

Mr. Shimizu said that before addressing the specific topics for discussion, he wished to stress two general points. First, while his authorities generally supported the establishment of an administrative tribunal, they attached importance to safeguarding the discretionary powers of the Executive Board and the Board of Governors mandated by the internal laws of the Fund, including the Articles of Agreement. Second, the establishment of a tribunal should not lead to a significant increase in administrative expenses. Also, it should not make the process of resolving legal disputes on employment issues too complicated.

On the award of costs by the tribunal, he supported Alternative 1, as amended by Mr. Wright, Mr. Shimizu continued. It was reasonable, in light of the Fund's advantageous position, not to award the Fund costs against the nonsuccessful applicant, except in certain circumstances. It was important to make that point clear in the statute. In that connection, in the event that the SAC was given standing before the tribunal, the SAC would be treated the same as an individual staff member in terms of the limitation on costs awarded, even though the SAC was in a more advantageous position vis-à-vis the Fund than an individual staff member. He would welcome staff comment on that point.

He did not believe that the SAC should have the ability to challenge the legality of regulatory decisions on behalf of staff members, Mr. Shimizu stated. Since the employment relationship between staff and the Fund was on an individual basis, employment disputes should also be settled on an individual basis. He believed that in each case that was brought to the tribunal, there should be a concrete benefit for an individual that could be awarded by the tribunal. He further believed that the Fund should follow the practice of other international institutions in that respect.

On access by contractual employees, he supported the staff proposal, Mr. Shimizu commented. He supported access for assistants to Executive Directors. As to the remaining issues raised in the staff paper, his chair agreed with the staff's proposals.

The General Counsel remarked that if the SAC was given access to the administrative tribunal, and if the SAC was successful in its application against the Fund, then the SAC would be entitled to an award of costs on the same basis as an individual staff member. If, however, the SAC was not successful, and if the action was found to be manifestly frivolous or unfounded, costs could be awarded against the SAC on the same basis as an individual staff member. In both instances, the SAC would receive the same treatment as individuals, assuming the Board agrees to give it direct access to the tribunal as a party.

Mr. Al-Jasser said that he wished to emphasize at the outset that it was in the interest of the Fund to provide staff members with a forum to voice and resolve their grievances. Also, he did not believe that the Executive Board had adopted, or would adopt, any decision that would not be upheld by such a tribunal. For those reasons, he did not object to the establishment of an administrative tribunal.

Nevertheless, he remained unconvinced of the need to establish an administrative tribunal, particularly as the Fund had a good record in protecting the legal rights and compensation of its staff, Mr. Al-Jasser continued. Moreover, the Grievance Committee had worked reasonably well, and management had heeded its recommendations. Any shortcomings could have been addressed without the creation of a new mechanism. By contrast, a tribunal might merely discourage the early settlement of disputes through the creation of a complex, time-consuming, and expensive process. In that respect, a tribunal might not be the most efficient, or appropriate, way to address legitimate staff complaints. Indeed, most staff/managerial problems revolved around issues of implementation rather than around questions of policy, and a tribunal might not provide a solution to that less tangible, but real cause of staff problems. In fact, he feared that the tribunal might raise false expectations that could not be fulfilled, and thereby further frustrate the staff and lower its morale. Another major concern was that the tribunal would create, and possibly institutionalize, an adversarial relationship between the staff and management, the lack of which had been a noteworthy hallmark of the Fund. Indeed, every effort should be exerted to preserve the existing collegial attitude among the staff, management, and the Executive Board.

He would not, however, oppose the emerging consensus in support of the establishment of an administrative tribunal, Mr. Al-Jasser stated. Therefore, as regards the proposed draft statutes, while he did not have strong feelings about the proposed alternatives for the award of costs by the tribunal, he was persuaded by the staff paper that Alternative 1 was preferable to Alternative 2, as it provided greater certainty in the process to both the Fund and the staff. He did not believe that it was advisable to allow the SAC access to the tribunal as that could aggravate and further institutionalize tensions between the SAC and management. Moreover, he was persuaded by Mr. Conable that SAC access to the tribunal could increase the quantity and acrimony of litigation before the tribunal. He continued to support the view that disputes concerning contractual employees should be submitted to arbitration rather than to the jurisdiction of the tribunal. Hence, he supported Alternative 1 of Article II, Section 2(c). Finally, he was persuaded by the arguments in the staff paper concerning interlocutory relief and the production of documents.

Mr. Clark remarked that the Board had had many opportunities to discuss the tribunal and its functions and roles, and he was pleased to see that the matter was about to reach a successful conclusion. At one point it appeared that the approach being taken was, in fact, driving a wedge between management and staff. Looking at developments over the past year and the process that had been followed, the Administration and Legal Departments and management deserved to be congratulated for their efforts. In fact, it was notable that the statement by the Vice Chairman of the SAC provided full support for the proposed statute. He therefore thought that the tribunal would help improve staff morale.

As to the various issues to be addressed, on the award of costs, he supported Alternative 1, as amended, Mr. Clark stated. With respect to access, he supported the definition that excluded contractual employees. As to the standing of the SAC, like Mr. Knight, he supported the right of the SAC to bring actions to the tribunal.

Mr. Fridriksson said that like previous speakers, he was pleased that the process of establishing an administrative tribunal was finally drawing to a close. Like Mr. Clark, he wanted to acknowledge, and express his appreciation for, the effort that had been undertaken over the past year to clear the air in relations between management and the Board on the one hand, and between management and the staff on the other.

On the authority of the tribunal to award costs, he supported Alternative 1, Mr. Fridriksson remarked. As to access, he was satisfied that the interests of contractual staff were taken care of within the existing arrangements. Moreover, he would oppose the SAC being able to bring cases to the tribunal in its own name.

Mr. Kafka said that he wished to compliment management and the staff, as well as members of the SAC, for having been able to clear the air and for putting forth proposals that had been endorsed not only by the management that had proposed them, but also by the SAC.

On the award of costs by the tribunal, the draft statute presented two alternatives, Mr. Kafka observed. Under Alternative 1, different rules would apply to the applicant and the Fund: if the applicant was successful, in whole or in part, the tribunal would be authorized to award costs against the Fund. The decision would be discretionary, taking into account several factors, namely, the nature and complexity of the case. Under Article XIV, Section 4, "If the Tribunal concludes that an application is well-founded in whole or in part, it may order that the reasonable costs incurred by the applicant in the case, including the cost of applicant's counsel, be totally or partially borne by Fund...." Thus, if the applicant lost his case, there would normally be no award of costs to the Fund unless the applicant's claim was manifestly unfounded--namely, frivolous. In that event, or if the applicant intended to delay the resolution of the case or to harass the Fund or any of its officers or employees, the tribunal might order that compensation be made by the applicant.

Under Alternative 2, there would be only one provision: "The Tribunal may award costs in whole or in part to the prevailing party in a case," Mr. Kafka continued. He favored Alternative 1 because it delineated the circumstances under which the authorization was given to the tribunal while providing assurances to the applicant that if he acted in good faith, he would not be penalized.

On access to the tribunal by persons other than current and former staff, including retirees, he agreed with the proposal--Alternative 1--for a new wording of Article II, Section 2(c) i and ii, referring to the meaning of "member of the staff," Mr. Kafka stated. The new definition included "any person whose current or former letter of appointment, whether regular or fixed-term, provides that he shall be a member of the staff," and it also included "any current or former assistant to an Executive Director." It did not include contractual employees because the Board was providing for contractual employees to resort to arbitration regarding disputes arising out of their contracts with the Fund.

Alternative 2 included any current or former officer or employee of the Fund or any current or former technical assistant expert, Mr. Kafka added.

As to the standing of the SAC, he favored giving the SAC the right to challenge the legality of decisions affecting any or all of its members, Mr. Kafka remarked. He therefore favored the new text of Article II, Section 1.

With respect to interlocutory relief, Article VI, Section 4 stated that "the filing of an application shall not have the effect of suspending the implementation of the decision contested" and the explanation provided established that similar provisions were found in the statutes of the major administrative tribunals, Mr. Kafka commented. The purpose of allowing interim or interlocutory relief was to avoid irreparable harm. For example, an applicant could be exposed to losing his visa status while challenging a termination decision, but even in that case it was proposed that the situation be handled as an administrative matter and not through an interlocutory order. It was of extreme importance, in order to protect applicants in the future, that the Board maintain the clear understanding that "the statute would not preclude the Tribunal from ordering such measures--interlocutory relief--if warranted by the circumstances of a particular case."

Regarding the production of documents and the withholding of evidence, it was essential to allow the Managing Director to withhold evidence from the tribunal, Mr. Kafka stated. There was a question whether he should, in principle, do so only if authorized by the Executive Board, as he assumed that withholding of evidence would entitle the tribunal, at its discretion, to give a judgment against the Fund.

Mr. Prader observed that there seemed to be unanimity on every issue except on the standing of the SAC, and he could join the consensus, except with respect to the SAC, where he would support the views of Mr. Bonzom, Mr. Knight, and others to give the SAC standing.

Mr. Laux recalled that the previous Board discussion on the administrative tribunal had been characterized by a certain degree of tension, and like Mr. Clark, Mr. Fridriksson, and Mr. Kafka, he wished to thank management and all involved for helping to ensure that those tensions had ceased to exist.

On the right to award costs, he could go along with the staff proposal under Alternative 1, Mr. Laux stated. On the access of contractual workers, he continued to consider that their grievances should be left to arbitration; he therefore supported Alternative 1. On the access of the SAC, he continued to believe that the SAC should not be given access to the tribunal.

Mr. Marino said that he agreed with those Directors who did not favor giving the SAC the right to challenge regulatory decisions in its own name.

Mrs. Sirivedhin remarked that she shared the views of Mr. Marino.

Mr. Wei said that regarding the authority of the tribunal to award costs, he preferred Alternative 1. On the SAC's access to the tribunal, since there was no precedent in international administrative tribunals and taking into consideration the parallelism between the two Bretton Woods institutions, as earlier expressed in the letter from the World Bank President to the Managing Director, he did not support allowing the SAC to challenge regulatory decisions in its own name. As to the access of contractual employees, since the Administration Department had already arranged for them to have resort to arbitration, he agreed that they should not have access to the tribunal. Meanwhile, he was convinced that Assistants to Executive Directors should have access to the tribunal.

Mr. Mohammed said that on the awarding of costs, he would go along with Alternative 1. On the issue of SAC access, he would not be agreeable to giving the SAC standing in its own right. Regarding the question of contractual employees, he would favor continuing the existing arbitration procedures.

Mr. Filosa said that he wanted to join the consensus on the award of costs and therefore supported Alternative 1. He could go along with having contractual staff resort to arbitration, although he would prefer giving them the same channel of justice. As to the standing of the SAC, he would prefer to avoid setting a precedent by formally allowing the SAC to have standing in the tribunal.

The Chairman observed that on the award of costs, there was unanimous support for Alternative 1. He invited the Acting Secretary to review the positions on the standing of the SAC.

The Acting Secretary remarked that there was a clear preference in favor of not allowing the SAC to enter a dispute in its own right.

Mr. Orleans-Lindsay and Mr. Trbojevic said that they supported the view that the SAC should be given access to the tribunal.

The Chairman observed that a consensus had not been achieved allowing the SAC to enter a dispute in its own right. As to access by contractuals, most Directors had supported the continuation of the existing practice of arbitration.

The General Counsel remarked that a dispute between contractuals and the Fund was not of the same nature as a dispute between the Fund and regular staff members. A dispute between the Fund and a contractual bore on the interpretation of the individual contract, rather than on staff regulations, which were of a general nature. Moreover, a dispute between a contractual and the Fund would not go through the first stage of the grievance procedure for a dispute between the Fund and a regular staff member--namely, the Grievance Committee. Thus, the structure for the settlement of disputes between the Fund and regular staff members was fundamentally different. Moreover, the use of arbitration for settling disputes involving contractuals reduced the cost of the proceedings.

The Chairman remarked that in the light of the discussion, he proposed to circulate a final text of the draft statute in the near future, for approval by the Executive Board, on a lapse of time basis, for submission to the Board of Governors. In concluding, he wished to thank Directors for their words of appreciation to the staff for trying to re-establish a positive climate for discussion of a difficult issue.

Executive Directors accepted the Chairman's proposal to circulate the revised draft statute for approval, on a lapse of time basis, for submission to the Board of Governors.

3. EXECUTIVE BOARD TRAVEL

Travel by an Assistant to Executive Director as set forth in EBAM/92/56 (8/4/92) is approved.

APPROVED: March 23, 1993

LEO VAN HOUTVEN
Secretary