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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 93/107

2:30 p.m., July 28, 1993

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

Executive Directors	Alternate Executive Directors
	A. A. Al-Tuwaijri
T. C. Dawson	
J. de Groote	
I. Fridriksson	
	N. Tabata
	T. Oya, Temporary
	A. Raza, Temporary
	K.-T. Hetrakul
	K. Link
	R. F. Cippa, Temporary
A. Kafka	
	G. Y. Glazkov, Temporary
	E. V. Kotova, Temporary
	S. Vori, Temporary
	D. Desruelle, Temporary
	G. Torres
	J. M. Burdiel, Temporary
A. Mirakhor	
L. J. Mwananshiku	
D. Peretz	
G. A. Posthumus	
	J. K. Orleans-Lindsay, Temporary
S. Schoenberg	W. Laux, Temporary
A. S. Shaalan	Y. Y. Mohammed
D. E. Smee	G. Lindsay-Nanton, Temporary
	A. M. Tetangco, Jr.
	G. J. Matthews, Temporary
Zhang M.	Wei B.
A. G. Zoccali	

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

Also Present

IBRD: P. Garg, W. Grais, Central Asia Regional Office. European I Department: M. Russo, Director; J. R. Artus, Deputy Director; R. J. Corker, K. F. Habermeier, H. Vittas. European II Department: E. Brau, Deputy Director; E. Hernández-Catá, Deputy Director; D. A. Citrin, D. J. Donovan, K. Driessen, A. Gagales, P. C. Hole, M. A. Horton, H. R. Lorie, D. C. Ross, G. H. Spencer, L. M. Valdivieso, T. A. Wolf. External Relations Department: P.-M. Falcone, H. P. Puentes. Fiscal Affairs Department: S. Lugaresi. Legal Department: R. B. Leckow. Monetary and Exchange Affairs Department: M. Nieto, P. J. Quirk. Policy Development and Review Department: T. Leddy, Deputy Director; P. F. Allum, S. B. Brown, D. Burton, N. Kirmani, R. Moalla-Fetini, A. Singh. Research Department: M. Mussa, Economic Counsellor and Director; P. B. Clark. Treasurer's Department: H. Flinch. Western Hemisphere Department: S. T. Beza, Counsellor and Director. Office of the Managing Director: P. R. Narvekar, Special Advisor; G. R. Saunders, Personal Assistant to the Managing Director. Advisors to Executive Directors: J. M. Abbott, E. Breuer, A. Cserés, J. M. Jones, N. Mancebo, M. F. Melhem, R. Meron, A. Raza. Assistants to Executive Directors: S. Al-Huseini, R. N. A. Ally, M. Blome, J. A. Costa, M. Dzervite, R. Ferrillo, H. Golriz, N. P. Hahnemann, T.-M. Kudiwu, K. J. Langdon, S. C. McDougall, F. Moss, S. Narube, M. V. Nikitenko, C. F. Pillath, R. K. W. Powell, N. Prasad, F. A. Sorokos, Wu H.

1. GERMANY - 1993 ARTICLE IV CONSULTATION

The Executive Directors continued in restricted session, from EBM/93/106/R-1, their consideration of the staff report for the 1993 Article IV consultation with Germany (SM/93/136, 6/30/93; Sup. 1, 6/22/93; and Sup. 1, Cor. 1, 7/26/93). They also had before them a background paper on economic developments and selected issues in Germany (SM/93/151, 7/14/93).

The Chairman made the following summing up:

Executive Directors welcomed the staff's analysis and expressed their broad agreement with the thrust of the report. They noted with concern that Germany's economic and financial situation had deteriorated markedly since the last consultation, with adverse spillover effects on the economies of her trading partners, particularly in Europe. Output and business investment had fallen sharply, unemployment had risen, and the public sector borrowing requirement had reached a very high level. However, with the emergence of a significant degree of slack in the economy and the fall in import prices, underlying cost and price pressures had abated considerably. Although increases in consumer prices had remained high, in part because of changes in taxes and administered prices, many speakers felt that the conditions were now in place for inflation to fall significantly in the months ahead.

Directors observed that, notwithstanding recent more favorable data, the prospects for an early economic recovery were not good. They expressed concern that, with business and consumer confidence remaining depressed, the recession could be prolonged. This would have damaging longer-term effects on both the German and the international economy. They therefore urged the authorities to strengthen their macroeconomic and structural adjustment policies so as to help foster an early and robust recovery from the recession. In particular, most Directors supported the staff position that advocated the continuation of gradual but cumulatively important decreases in short-term interest rates and that this should be accompanied by further measures designed to reduce steadily over the next few years the sizable structural budget deficit and enhance the flexibility of labor and product markets.

In reviewing fiscal policy issues, Directors pointed out that the recession had exposed the full extent of the structural deficit in the fiscal accounts that had been created by the large intra-German transfers associated with unification. While the sheer size of these transfers had made it impossible in the short run to finance them mainly through tax increases or cuts in other spending, speakers, nevertheless, stressed that reliance on borrowing had been unsustainably high. Although the consolidation plan embodied in the Solidarity Pact had ameliorated the situation, the prospect was for sizable fiscal deficits to persist over the medium term, notwithstanding prospective further tax increases that would raise the tax burden to a high level by international standards.

It was emphasized that persistently high deficits and an enlarged public sector posed a threat to longer-term economic growth prospects and were inimical to a recovery of confidence in the private sector. In view of these concerns, Directors welcomed the measures that were recently announced in order to contain the size of the federal deficit in 1994 to its estimated 1993 level. These measures appropriately emphasized expenditure savings. However, Directors generally were of the view that the recent initiatives did not go far enough. In particular, the recent measures did not tackle in a decisive way the issues of subsidies to ailing sectors and, apart from unemployment compensation, excessive social expenditure. Moreover, little progress had been made so far in containing spending at the lower levels of government.

Directors emphasized that monetary policy had a crucial role to play in gearing the German economy to a noninflationary growth path and fostering an orderly functioning of foreign exchange markets, especially in the European Monetary System. In this regard, they welcomed the fact that monetary conditions had been significantly eased since last September and, in particular, the resumption of interest rate cuts on July 1 after a two-month pause. However, most Directors encouraged the authorities to continue monetary easing and emphasized that the room for further reduction in short-term interest rates should be fully utilized. In their view, such easing would be fully consistent with the authorities' medium-term inflation objectives given the progress already made in dampening cost pressures, the recent action to contain federal spending and the sizable degree of slack now existing in the economy. The views of some other Directors were closer to the German authorities, who remain more cautious than the staff about the prospect of an imminent further decline in inflation, and who emphasized that too aggressive a policy to lower interest rates would pose considerable risks in terms of loss of confidence in the deutsche mark. At the other end of the spectrum, the view was strongly held that interest rates were too high and that strong action should be taken without delay to ease monetary conditions.

A number of Directors raised doubts about the usefulness of M3 as a leading indicator of inflation because of distortions associated with the effects on monetary demand of German unification, the inverted yield curve and the instability in foreign exchange markets. It was emphasized by several speakers that the growing financial integration of exchange rate mechanism (ERM) countries, and the special role of Germany in the ERM system, made it desirable to assess the appropriateness of monetary conditions from an ERM perspective to a significantly greater extent than hitherto. Directors were of the view that a certain depreciation of the deutsche mark vis-à-vis non-ERM currencies was not a matter of concern, as it was to be expected after a substantial appreciation in real terms.

All speakers stressed that structural policies could make a major contribution to improving economic performance in the medium term. In the western states, structural reforms in the labor market, further deregulation, and the reduction of industrial subsidies were urgently called for. In the new eastern states it was important, among other things, to resolve property rights problems and complete the process of privatization. Above all, it was crucial to promote institutional changes in labor markets that would permit wage adjustments to reflect more closely productivity developments and the ability to pay of individual firms. Otherwise, Directors were of the view that there were grave risks that the region would not be able to attract sufficient private investment to attain self-sustaining growth and would thereby remain dependent on costly and inefficient subsidies. Directors urged the authorities to encourage greater flexibility in the implementation of collective agreements on wages and work practices.

Directors commended the German authorities for their support for an early conclusion of the Uruguay Round. Such a conclusion could do much to boost flagging business and consumer confidence. At the same time, many speakers urged the authorities to play a lead role within the EC in facilitating dismantling of barriers to imports from Eastern European countries and the states of the former Soviet Union. While trade liberalization may pose temporary adjustment problems in some sectors, it was ultimately beneficial to the German economy because of the gains from international specialization.

Executive Directors warmly commended the German authorities for their high level of external assistance, particularly to Eastern Europe and the countries of the former Soviet Union.

It was agreed that the next Article IV consultation with Germany should be held on the standard 12-month cycle.

2. RUSSIAN FEDERATION - STATEMENT BY DEPUTY MANAGING DIRECTOR

The Acting Chairman made the following statement:

Since the Central Bank of Russia issued its instruction on July 24, 1993 regarding the exchange of new ruble bank notes for old--pre-1993--notes, the modalities of the conversion have continued to evolve. President Yeltsin issued a decree on July 26 calling for an effective broadening of the definition of new rubles; an increase from Rub 35,000 to Rub 100,000 in the ceiling on the amount of old rubles that could be immediately exchanged; the maintenance as legal tender of the smaller denominations of old bank notes through end-August; and an extension of the period during which conversion into new rubles of old bank notes of all denominations could be made.

The Central Bank has already announced amendments to its initial instruction. The currency exchange issue is still being debated among the authorities, however, and it would obviously be premature to evaluate the effect of these measures.

The reaction of other states of the former Soviet Union (FSU) has been mixed. Officials in Azerbaijan, Georgia, and Moldova have used the occasion to reconfirm their earlier intentions to issue separate currencies--and to exchange them for the old rubles in circulation. Since these states already use coupons as a parallel currency--as does Belarus--they are in a relatively good position to respond rapidly to the Russian action. Other countries, such as Turkmenistan, which has already announced its intention to introduce a separate currency but does not have coupons in circulation, or Armenia, which has neither coupons nor a prospective national currency, are in a more difficult situation. These states face the possibility of an unwanted inflow of old rubles for some time to come. Another group of countries--Kazakhstan, Tajikistan, and Uzbekistan--have indicated their intention, at least for the time being to remain in the ruble area and to convert old ruble bank notes into new ones as soon as the latter become available. In the meantime, however, these countries would maintain the old ruble banknotes as legal tender. Therefore, they could also face an influx of old rubles from other states--including from Russia, given the present limits placed on immediate conversion by the Russian population.

I want to make it clear that the Fund management and staff were not consulted about the measures announced by the Central Bank of Russia. This is regrettable given the importance of monetary stability in Russia--as it implements its economic program with the support of the systemic transformation facility--as well as in other countries with which the Fund either has or is likely to have arrangements. Moreover, the apparent lack of full consultation and coordination with authorities in other FSU states and even among the Russian economic authorities on this matter is of concern. It has led to the announcement of less than thoroughly considered measures and an unnecessary degree of uncertainty both within Russia and in a number of other FSU states.

The Executive Directors took note of the Acting Chairman's statement.

3. REPUBLIC OF BELARUS - PURCHASE TRANSACTION - SYSTEMIC TRANSFORMATION FACILITY

The Executive Directors considered a staff paper on Belarus' request for an initial purchase under the systemic transformation facility (STF) in an amount equivalent to SDR 70.1 million (EBS/93/116, 7/14/93; and Sup. 1, 7/26/93).

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

> Belarus has implemented the three prior policy actions that had been set down for the program under the STF:
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> The National Bank of Belarus increased its general refinance rate to 140 percent on July 20 and plans to make further adjustments in line with the Central Bank of Russia's refinance rate.
>
> The National Bank and the Council of Ministers jointly resolved, on July 24, to unify the exchange rate for official foreign exchange transactions from August 1, with a temporary exemption for surrender proceeds from export contracts signed before end-July 1993.
>
> And the National Bank has made an official announcement that there will be no further generalized settlement of interenterprise arrears, nor generalized indexation of working capital through credit expansion.
>
> Since the issuance of the staff paper (EBS/93/116), a number of noteworthy events have affected Belarus' interstate economic relations. First, Russia's recent monetary measures appear to point to a further loosening of Belarus' link to the ruble area, particularly given the reluctance of Belarus to meet Russia's requirements for official use of the new (1993) Russian ruble bank notes. In the short term, the National Bank will convert the old Russian rubles in exchange for rubels at the fixed rate of 10 rubles to 1 rubel up to a limit of 50,000 rubles per Belarussian citizen. Rubles in excess of this amount may be placed in special deposits at the savings bank, for a minimum term of six months, at an interest rate of 60 percent a year. The time limit for conversion is currently set at August 7, but is likely to be altered in line with the time limit adopted by the Central

Bank of Russia. The new Russian rubles will continue to be legal tender on the territory of Belarus.

Second, on July 9, the prime ministers of Russia, Belarus, and Ukraine signed an agreement on economic union that is intended to lead to a customs union, a common market for goods, labor and capital, and unified policies in the areas of credit emission, taxation, and budgetary expenditure. A common currency, however, would not be required. A draft treaty and subagreements are intended to be ready for signing by September 1. The economic union agreement between members of the Commonwealth of Independent States, signed in May 1993, now seems to be moribund; however, there is provision for other states to participate in the new trilateral agreement.

Third, while yet to be ratified by the Russian Parliament, agreement has been reached between Belarus and Russia on a new intergovernment credit of rub 70 billion for the second half of 1993, and on the repayment terms for inter-central-bank credits accumulated up to mid-1993. On the former, once the agreement to shift from inter-central-bank to interstate credit is finalized, this will require adjustments to the quantitative targets for net international reserves and net domestic assets, as described in the Technical Memorandum to the Statement of Economic Policies (Attachment I, Annex I, EBS/93/116). On the latter agreement, Belarus received relatively favorable terms, with the existing debt to be converted to U.S. dollars at the end-1992 exchange rate, to be repaid over the years 2000-2007, and attracting zero interest. These terms will improve the balance of payments outlook compared with the projections contained in the staff paper; the debt service will be reduced by $20-40 million a year during 1993-95 and the estimated financing gap will decline in the out years, 1996 to 2000 by about $100 million a year.

Over the July 93-June 94 program period, however, the estimated financing gap remains large at about $700 million, or some 6 1/2 percent of GDP. Of this amount, some $300 million is expected to be filled by possible purchases under the STF and by a possible World Bank import rehabilitation loan. To reduce the remaining $400 million financing gap, it is necessary to marshall bilateral contributions as quickly as possible, as already conveyed to creditor representatives in a meeting with the staff on July 22, 1993. The staff urges Executive Directors and their authorities to consider urgently the Belarus case with a view to indicating early support for the STF program at a meeting to be chaired by the World Bank in Washington on September 27. Subsequently, a full Consultative Group meeting will be held on October 26.

Extending his remarks, the staff representative said that more recent data, covering June, indicated that output had continued to decline at a rate of 13-15 percent compared with a year earlier. Inflation appeared to have slowed somewhat, running at about 30 percent a month during January-April and 20-25 percent a month in May and June, less than assumed in the program despite a significant liberalization of food and utility prices in June. Wages, however, had jumped by 40 percent in June, following a 50 percent increase in the minimum wage, which was linked to the price of basic goods in the economy. Consequently, the wage increase had followed fairly directly the liberalization of food prices in June. However, the real wage increase was from a relatively low base, as shown in Chart 3 in the staff paper; with most of the food price liberalization out of the system, the staff did not expect a repeat occurrence.

In line with the recommendation and commitment in the Statement of Economic Policies, the Belarussian authorities had increased the price of energy charged to domestic users, the staff representative reported. The price of oil had been increased from Rub 27,500 a ton to Rub 45,000 a ton, which corresponded with the true cost of oil imported from Russia. On the financial side, the outcome for money and credit and for budget execution was essentially in line with the program assumptions in the staff paper.

Mr. de Groote made the following statement:

> Our Belarussian authorities take great satisfaction in presenting to the Board, less than a month after the Russian Federation's request, their own request for a purchase under the STF. Barely two months ago, at the time of Belarus' first Article IV consultation, this Board conveyed the clear message that Belarus should accelerate its reform efforts. At that time we cited on our authorities' behalf two major obstacles that prevented them from moving faster: lack of the technical and financial resources needed to accelerate the reform process, and uncertainty about the impact of ongoing reforms in large neighboring countries whose fortunes strongly affect the Belarussian economy.
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> Today, these obstacles are no more: the expected approval of Belarus' requests for an STF arrangement in the Fund and for an institution-building loan from the World Bank will greatly assist the implementation of reforms; and the reform process in Russia has gathered such momentum that further temporizing by Belarus is no longer justified. The Government of Belarus has always hoped to lay the groundwork for establishing a market system as soon as possible. The STF arrangement now allows them to translate this hope into well-focused and attainable goals and speedily pursue them. Its approval will ensure the irreversibility of the transition process in Belarus. By giving an unmistakable signal in the form of strong macroeconomic adjustment and structural reform under the STF, to be followed by a stand-by arrangement, our

authorities expect to gain access to much-needed capital inflows to help them meet the challenges ahead.

Belarus' double eligibility, based both on the sharp drop in its export receipts and a permanent increase in the net costs of its imports, underscores the magnitude of the adjustment the country must undergo to regain its balance of payments viability and at the same time move rapidly toward a market economy. The program will focus initially on keeping macroeconomic imbalances in check during the adjustment of the economy to world market prices. The general government deficit for the whole program year is therefore limited to 6 percent of GDP, rather than the 16 percent it would attain without policy changes. The unification of the exchange rate for official transactions and the tightening of monetary policy will be critical steps for reinforcing export earnings. Official interest rates, now aligned with those in Russia, will move in unison with them hereafter and will increasingly direct the credit allocation mechanism.

One advantage of the STF arrangement is its flexibility, which permits pragmatic policy adjustments to changing circumstances. For one thing, it will permit Belarus to adjust the timetable for moving its energy prices in the direction of world market levels. Flexibility may also be needed in responding to developments in the FSU, where a large degree of uncertainty about future trade and financial flows is compounded by the absence of well-defined economic relationships among countries still using the ruble. Such uncertainties could be dispelled by re-establishing stronger cooperation among the FSU states, and our authorities have a strong interest in doing so: the location of the Commonwealth of Independent States headquarters in Minsk is no accident, nor is Belarus' strong interest in establishing the Interstate Bank and promoting monetary cooperation in all or some of the FSU states. Nor should Belarus' active role in setting up a Slav Economic Union come as a surprise. But while our authorities have refrained from taking any concrete steps toward monetary independence that might jeopardize the prospects of cooperation in the region, they recognize that monetary autonomy will provide indispensable tools for adjustment and reform: they have therefore been carefully preparing the ground for it both domestically and in an international context.

Belarus is now firmly committed to introducing a national currency to replace the present hybrid system, which consists of a national unit of transaction for noncash operations, a local currency for consumer cash payments, and Russian banknotes. The conditions and timing for making the new currency the exclusive legal tender will be coordinated closely with Russia, and because Russia will continue as Belarus' main trading partner, the new currency exchange rate will at least initially be pegged to the

Russian ruble. In effect, the former currency union between Russia and Belarus, which has already evolved into a monetary union, will take on the form of a monetary association between two national currencies when Belarus' currency becomes the only legal tender. Belarus' principal motive in insisting on perfect clarity with Russia on the currency issue is that it will continue to depend importantly on trade with Russia and on Russia's contribution to the funding of its external financial needs. The unique nature of Belarus' approach, under which it will introduce an autonomous currency and implement fully independent economic policies while still maintaining a close economic relationship with Russia, was conveyed to the Fund by Belarus' President Shushkevich when he visited Washington last week.

Mrs. Kotova made the following statement:

We welcome the opportunity to discuss the economic reforms being implemented in Belarus at this turning point in the country's development. After a period of delays, the beginning today of a transition to a market-based economy is taking place in a rapidly evolving external environment that will undoubtedly require a lot of additional adjustment in the course of the program's implementation. This task cannot be carried out without international support. Belarus is doubly eligible for the STF program, and this chair fully supports the proposed decision. I also agree with the statement in the staff paper that the scope of the program to be supported under the STF already indicates the strong commitment of the authorities to accelerate reforms.

Until recently, Belarus was more successful than some other countries of the FSU in preserving stability in the areas of output and domestic finance. It is commendable that the authorities managed to retain the general government deficit within the limits of 3 percent of GDP in 1992, despite large increases in imports of energy and in pressures to raise subsidies to producers. Liberalization of prices gradually encompassed more commodity groups. The authorities continued to dismantle the system of state orders and adopted a number of important regulations, thus facilitating market development. Notable progress has been made in demonopolizing external trade and in streamlining regulations for international trade. What could be achieved within the framework of the chosen policies was achieved, but inevitably the events that overtook these policies called for new approaches. We welcome the authorities' attempts to regain the earlier momentum and to move forward.

The legacy of the past two years, however, seriously complicates the program's implementation. The Government's reluctance to relinquish direct responsibility for the performance of the enterprise sector has created a lot of inconsistency in macroeconomic management. Despite all the earnest efforts to tighten budgetary policies, general government expenditures are still equal to about 55 percent of GDP, a level that is incompatible with a market approach. The same inconsistency is observed in the authorities' financial policies. The National Bank began raising its refinance rate, currently at 100 percent. For the latest auctions, held in June, the rate was 165 percent. At the same time, up to 90 percent of the National Bank's resources are still being allocated not through the developing market mechanism but through direct credit, which devalues the increases in the refinance rate.

Contradictory exchange rate regulations and the present hybrid system of currencies and exchange rates add to the misallocation of resources and send confusing signals to the economic agents. When the authorities finally moved in early 1993 to a truly unified exchange rate and toward allocation of foreign exchange through the interbank market, the effect of the coexistence of the former "unified" rate, the "investment" rate, and interim national coupons--designed to facilitate cash transactions--had already created distortions of unmanageable scope in the thin exchange market. In particular, maintenance of the artificially low investment rate not only led to the rapid depreciation of the Belarussian ruble to Brub 1,900 = $1, but also constituted another form of subsidized investment financing of public enterprises. Mandatory usage of the Belarussian ruble in state retail stores is actually a hidden form of rationing of consumer goods, since there is a fixed proportion of Belarussian rubles in an average salary. The ultimate result of the attempts to stabilize production and prices at the same time, through these and other contradictory measures, was the highest rate of inflation in the FSU states--of about 30 percent a month--and overall increases of monetary and credit aggregates by 18-19 percent a month between January and May of 1993.

Unlike the case of many other countries, this level of inflation in the main provided a shock but very little therapy to the economy. It was triggered not by full liberalization of the price mechanism but by the acute shortages of capital and consumer goods available under the remaining administrative system. The total shock to the society was actually no less than that in other transitional economies, although the yields were marginal since economic potential remained locked. This is well illustrated by the staff representative's description of the latest events in Belarus: the liberalization of prices for some additional commodity groups and utility tariffs caused not aggravation but a slight decline of inflation, evidently because inflows of goods and services started to saturate the consumer market.

In these circumstances, it was not an easy task to formulate the initial clear and elaborate framework of a stabilization strategy. I congratulate the staff for doing an excellent job, which enabled the Government to emphasize the key areas for their efforts. However, the program's targets are not ambitious enough to provide visible rehabilitation of the economy at this stage of the implementation period. Several points should be highlighted in this regard.

Price liberalization and abolition of all remnants of the state order system must be completed without delay. Also, the limits on manufacturers' profit margins, as well as fixed wholesale and retail trade margins that are inconsistent with the program's objectives, should be removed. The use of indirect financial instruments in the implementation of the program would not be possible without the full phasing out of the subsidized credits of the National Bank. The present target of reducing direct credits to 30 percent of total lending is not sufficient to reduce the excessive liquidity in the economy and to curb inflation.

The current level of state intervention in the economy is detrimental to public finance. The first priority in this area must be the streamlining of the taxation system and the elimination of tax exemptions on a case-by-case basis. This measure, as well as a further phasing out of the subsidies and direct credit of the National Bank to enterprises, is important not only from a fiscal standpoint but also because it would push the enterprises toward privatization, which has not yet begun on a large-scale basis. The still incomplete regulatory framework for privatization, together with the institutional weaknesses of privatization agencies and a lack of commitment by the regional authorities, allows the least efficient privatization technique to dominate--leases of enterprises to the workers' collectives. The fact that "a significant part of the Belarussian economy is no longer directly run by the State"--as reported by the staff--is more worrisome than commendable. After several waves of leases of enterprises, revisions of the terms of leaseholds, and re-registrations for leaseholders, legally clear property rights for companies and corporate governance of firms have gradually disappeared, and currently it is even more difficult for an enterprise to plan its development strategy than it was under the former state ownership. However, it is clear from the staff report that simple and efficient privatization procedures have not been yet agreed upon.

As for the external outlook, Belarus again proves that the overall challenges of transition are formidable enough to justify searching for the most simple and realistic policy options. No matter how apparently attractive it might seem to try to maintain a common monetary area through coordinated financial policies in the ruble area, the associated costs might simply not justify these efforts. So far, cooperation between Russia and Belarus in financing the balance of payments of Belarus has been fruitful and has permitted the Russian authorities to commit themselves to providing Belarus over $70 million in 1993. This cooperation will undoubtedly continue, but I disagree with Mr. de Groote on one point, namely, that steps toward monetary independence could jeopardize the prospects for regional cooperation. Rather, they can be jeopardized by the unclear status of the Belarussian ruble as legal tender, or by the fact that monetary, fiscal, and credit adjustments in Belarus lag in time and scope behind those of Russia. Actual depreciation of the Belarussian ruble against the Russian ruble reflects not only the large current account deficit with Russia but also "somewhat easier monetary conditions in Belarus compared to Russia," according to the staff report.

The rationale for moving toward a national currency is strong, and I was pleasantly surprised to learn only from Mr. de Groote that this is exactly the present commitment of the authorities; I would appreciate the staff's comments. My authorities view this as an important precondition for the effective utilization of the assistance provided to Belarus not only by Russia but also by the entire international donor community.

The current lack of independent monetary tools considerably raises the risks associated with the program's implementation. The staff's balance of payments scenario assumes, for instance, the buildup of Belarus' international reserves to an amount equivalent to one week of total imports. But even this modest target may not be achieved if the national currency is not introduced promptly, as was revealed in a similar discussion on Kazakhstan recently (EBM/93/103, 7/23/93). The scenario also assumes an aggressive export strategy. I share the staff's concern that this might not happen. But even if it does, export revenues might not be fully channeled into the country, since, so far, the balance of payments demonstrates large uncontrolled outflows of capital and an unsustainable level of $305 million of errors and omissions in 1992. This is a clear reflection of the lack of tools for balance of payments management.

This chair, therefore, fully shares the cautious approach of the staff report as regards the second purchase under the STF. I would be twice as cautious as far as a possible follow-up stand-by arrangement is concerned. We hope that by the time a stand-by arrangement is requested, Belarus will have introduced a national currency and obtained the tools to maintain its exchange rate.

Belarus today is passing through an extremely difficult phase of its development. The two years that have been somewhat lost for reforms have raised the costs of transition. Now the authorities are about to break the vicious circle of recession and inflation. The achievement of this objective will depend largely on the translation of the authorities' commitments into actions and on the international financial, intellectual, and moral support available.

Mr. Fridriksson made the following statement:

When the Article IV consultation report on Belarus was discussed in the Board in May (EBM/93/75, 5/21/93) we were struck by the gradualism that seemed to have prevailed and guided the authorities, and by the very grim medium-term prospects on the external side.

The paper before us today confirms the very serious balance of payments outlook, even on the basis of what the staff describes as optimistic assumptions. The message from the Board to the authorities in May was clear, and the importance of that message is very much underpinned by the external prospects.

The gradualistic approach has not served Belarus well, and policy weaknesses are clearly reflected in the significant outflow of capital. While the authorities in May attributed the fact that output fell by only 10 percent in 1992 to good economic policies, I view it more as an unfortunate consequence of inadequate adjustment and reform efforts. A significant further output fall was clearly unavoidable and there was little advantage in unnecessarily delaying it. Moreover, the staff is characteristically careful in its description of developments, particularly when inflation is said to have been relatively high at 30 percent a month. It is also a serious source of concern that monetary policy appears to have been even more lax in Belarus than in Russia. This has to change, and I want to strongly emphasize the need to raise interest rates sharply and to eliminate preferential interest rates. Otherwise, capital flight will not be stemmed and the allocation of resources will continue to be distorted.

While developments in Belarus have in many respects been discouraging, and in May the authorities seemed reluctant to embrace a comprehensive reform program, I am pleased to note that the paper before us today reflects an important change in their approach. In this respect, I welcome the confirmation from the staff that all prior actions have been implemented. I also wish to commend the staff for having obviously convinced the authorities to alter their thinking, and I note Mr. de Groote's statement that the approval of the STF drawing will ensure the irreversibility of the transition process in Belarus. Once again, the medium-term prospects underscore the need for a radical change, of which the measures agreed in connection with the STF drawing are but a first step, and clearly, the efforts of the authorities need to be considerably strengthened in the months ahead.

Among those areas requiring attention is the fiscal sector, which needs to be strengthened thoroughly, through administrative improvements and policy changes, on both the expenditure and revenue sides. I share the views expressed by the staff and I fully support its recommendations. I merely wish to emphasize that further substantial savings will be required to achieve the fiscal objectives of the STF-supported program. Needless to say, the remaining subsidies should be reduced and the growth of the budgetary wage bill should be restrained.

Skeletons from the past must be removed, such as the commission to review enterprise taxation, and privatization must be stepped up rapidly.

Also, Belarus should move immediately to prepare for the adoption of a national currency, and I welcome the confirmation provided by Mr. de Groote of the authorities' intention in this area, as well as his information on how the Belarussians see their monetary relations with Russia being arranged. However, despite the further elaboration in the staff representative's statement, it is still not clear to me what the Belarussians intend or wish as far as their monetary arrangements are concerned. Perhaps the staff can provide further clarification. Following the discussion on Kazakhstan (EBM/93/103) and the statement of Mrs. Kotova today, Belarus seems to have little choice but to adopt its own currency, and this has become even more urgent in my view after the monetary measures introduced by the Central Bank of Russia on July 24. With reference to the Acting Chairman's statement at the beginning of the Board meeting, I could add that an expert on Russian affairs in a recent interview said that he thought that the Central Bank of Russia had introduced the measures to impress the Fund; I hope no one else thinks that way.

In moving toward the adoption of a national currency, the Belarussian authorities must fully realize the importance of adopting appropriate financial policies to support the currency. These policies are clearly not in place yet but should be developed as quickly as possible. In that respect, I am confident that the neighbors of Belarus in the Baltic countries would be willing to share with the Belarussians the experience they have gained from the initial adjustment phase and from the introduction of national currencies. As a starting point though, I wish to emphasize that full implementation of this program is of paramount importance to set the stage for agreement on a Fund-supported program in the upper credit tranches that could help move Belarus toward medium-term viability. I am quite sure that I speak for my

Baltic authorities in expressing the hope that Belarus may enjoy early success in its stabilization efforts.

State involvement in the economy is still considerable. While I welcome the recent progress made in demonopolizing Belarus' external trade, I urge the authorities to expedite the liberalization of domestic business activity and the removal of restrictions on external trade. Developing market structures, improving competition, and allowing the private sector to enter into the economy would help to reduce unemployment pressures and would improve the revenue base for the Government.

I agree with the staff that the risks to the STF-supported program are substantial. They arise from the high degree of uncertainty over future trade and financing flows, which in turn depend on the success of policies pursued by Russia and other transitional trading partners, and from the risks of adverse domestic political pressures.

The external outlook is fraught with uncertainty. The capital account is much worse than projected. In addition to the large outflows of capital, the downward revision of medium- and long-term loan disbursements is disappointing.

The financing gap in the second half of this year is large, and it is difficult to see how it can be closed given the experience, for example, of Kazakhstan as well as the fact that the next Consultative Group meeting will not be held until late-September. I would therefore welcome further comment from the staff on what we may realistically expect in terms of external financing as well as an assessment of the readiness of the authorities to tailor policies to the availability of external financing. While on this topic, I note the information presented by the staff representative on the favorable terms that have been negotiated on Belarus debt to Russia. However, the balance of payments outlook continues to be very difficult despite these terms.

In my view, the Fund is taking a risk in Belarus, but on balance, it is a risk worth taking. The authorities now appear to be bent on following the example of the early reformers and in moving aggressively toward a stand-by arrangement. Their efforts merit support under the STF. Support is also needed from the staff in mobilizing external financial assistance. I support the proposed decision.

Mr. Peretz made the following statement:

I generally agree with the comments made by the previous two speakers, but I will perhaps emphasize even more the need not only to implement the measures set out in the staff paper but indeed for Belarus to go further and faster, if successful progress is to be made toward a stand-by program and a restoration of economic stability and growth.

Indeed, as time has gone by, the strategy of postponing fundamental adjustment measures in Belarus has proved--as most of us around this table predicted it would--to be more and more unsustainable. GDP has fallen substantially since 1991; this decline and the expected further balance of payments deterioration ahead show clearly that a cautious "gradualist" approach to market reforms has not been successful and is certainly no longer appropriate for Belarus, if it ever was.

I therefore welcome the decision of the authorities to request an STF purchase as a positive indication of their commitment to accelerate the reform process. But I am disappointed that the program's objectives are not more ambitious. Given the modest evidence of the authorities' reform commitment, as recently as at the time of the May 21 Article IV discussion--and given the Board's message at the time--I regret that the Belarussian authorities were not ready to implement more measures before the first STF drawing. Belarus has much catching up to do, even compared with the other states of the FSU that have already qualified for STF drawings. In particular, despite the welcome price and tariff increases in early June, administered prices in Belarus are still pervasive; the National Bank's refinancing rate is only moved to match that of the Central Bank of Russia with a time lag, and the National Bank finances a greater proportion of subsidized credit than does the Central Bank of Russia.

I note the stated intention of the Government to consider the issue of a national currency at the time of a possible stand-by arrangement. I recognize that this issue raises political as well as economic sensitivities. We discussed the issue at length in the context of the Russian program and last week's discussion on Kazakhstan, and I do not intend to go over the arguments again. But I would add that whatever one thinks of the recent decision in Moscow to withdraw old ruble notes--and I welcome the Acting Chairman's statement at the beginning of the meeting--it surely reinforces the desirability of an early move to an independent currency in Belarus, and I hope that the Belarussian authorities will draw that conclusion themselves. The policy framework would certainly need to be strengthened, however, if a new currency is to be introduced successfully.

For the purposes of the STF, comparisons with Russia's and Kazakhstan's programs are appropriate given, for the time being, the linked monetary policy, and, therefore, shared inflation objective for the three countries. Given that inflation in the first half of the year has averaged around 22 percent a month in

Russia compared with 30 percent in Belarus, I doubt whether simply increasing the refinance rate to match the Central Bank of Russia's rate to be implemented by mid-August will be sufficient to achieve the inflation objective of 5 percent a month by December. Credit policy will probably need to be tighter than in Russia to achieve this target. In fact, with a considerable part of the National Bank's credit continuing to be extended in the form of directed subsidized credits, the average interest rates in Belarus are less than one third of the refinancing rate, so that Belarus' monetary policy is inherently weaker than that of Russia. I would strongly urge the authorities to move more quickly than planned to eliminate directed credit operations in favor of market-based methods, and in particular to reduce the proportion of directed credit to a figure much below the figure of 30 percent of total credit by the halfway stage of the program.

Given the extent of subsidized credits, fiscal policy is a poor indicator of the tightness of overall public finances. Even so, fiscal adjustment of over 8 1/2 percent of GDP is required to keep the general government deficit to the required 6 percent for the program year. It is questionable how achievable all these measures are, particularly given that the brunt of adjustment falls on changes in the national pension scheme. At the same time, I fully share the staff's concerns that future tax revenues could be reduced by the commission recently set up to review enterprise taxation. I agree that the commission's discretionary powers should be eliminated as quickly as possible. Given the uncertain outlook for the whole program year, I agree that it may well be necessary to reconsider the need for further fiscal measures later in 1993.

On the structural side, privatization has also proceeded slowly in Belarus. Particularly disappointing is the fact that no more than 10-15 percent of agricultural land will be in private hands, especially given the importance of agriculture in the economy. I was pleased, however, to see IFC involvement in the privatization process. IFC has done good work in this area in Russia and Ukraine, and the Brest city project is an encouraging development.

On external policy, the prior condition of unifying the exchange rate is a step of major significance, despite the temporary retention of a percentage of export proceeds to be converted at a discount. It will be essential to increase the role of market forces in the allocation of foreign exchange, in view of the balance of payments outlook. It is vital, given the precarious and weak financial position, that the stabilization program succeed in halting capital flight in the second half of 1993. This can only be achieved if the measures undertaken already and taken during the second half of 1993 are sufficient to convince economic operators that the economy is being put firmly on the track to recovery. This means that international creditors will require convincing that their assistance will not be used to finance capital flight. The figures for short-term capital outflows and negative errors and omissions for 1992 and the first half of 1993 are in many ways very disturbing and are perhaps the strongest demonstration in the whole report of the need for the Belarus authorities to adopt a fully committed approach to economic reform and stabilization.

Mr. Oya made the following statement:

I would first like to commend the authorities on reaching agreement with the Fund on an STF program. I hope that they will proceed smoothly to a full-fledged stand-by arrangement as soon as possible.

The STF program contains the necessary measures for successful economic reform and includes some quantitative objectives. I believe that the observance of the conditions of this program will lead to an early agreement on a stand-by arrangement.

However, in order to make a successful transition to a stand-by arrangement, it is not sufficient only to implement policies included in the STF program. In light of the fact that Belarus is still in the ruble area and its relationship with Russia as regards its relative share of monetary authority is unclear, clarification of the monetary relations with Russia needs to be regarded as an essential prerequisite for moving to a stand-by arrangement.

Also, since the recent announcement by the Russian authorities on the withdrawal of pre-1993 ruble bank notes, monetary conditions in the FSU states as a whole have become more unstable and the prospects are quite unpredictable. Under these circumstances, it is advisable that the authorities seek to attain monetary stability through their own initiatives. In other words, I urge them to make a decision as soon as possible on the introduction of their own currency. The authorities have indicated that they intend to make a decision on monetary arrangements during the second half of 1993; and according to Mr. de Groote's statement, Belarus is now firmly committed to introducing a national currency. In this connection, I would like to ask the staff for details on the authorities' recent indication, especially as to the timing of the decision and the progress of preparations.

In addition, I have some concerns about Belarus' economic management. First, on the recent announcement by the Central Bank of Russia on the withdrawal of pre-1993 ruble notes, although the modalities are still uncertain, the decision will undoubtedly accelerate the FSU states' move toward the introduction of their own currencies and will have a large influence on their economies.

In this respect, I would like to ask the staff about the influence on decision making of the monetary arrangement in Belarus. More fundamentally, I would appreciate staff comment on whether the viability of the STF program might be undermined even if the Central Bank of Russia's announcement has changed some of the important assumptions of the program.

Second, I am not certain whether the authorities have sufficient knowledge and experience to implement independent monetary policies and issue their own currency. In this connection, I believe that the Fund could play a major role in providing technical assistance.

Heretofore Belarus has displayed a cautious approach to economic reform; however, now that the authorities have agreed on an STF-supported program, they have only a limited time in which to implement the policies. I hope that they will make every effort to do so within the time allowed. Although there may be many difficulties in implementing economic reform, I hope that they will tackle them with determination, strengthening their consultation with the Fund. I support the proposed decision.

Mr. Dawson made the following statement:

To date, Belarus has pursued only the most gradual of economic reforms, attempting to shield its economy from the instability of the FSU with a high degree of direct government control. Much of the country's output was still produced and allocated by government directive in 1992.

Hence, the country's agreement on an STF-supported program represents an important departure from past economic policies, and, if implemented, would be a significant acceleration of Belarus' market reforms. The program would also improve Belarus' ability to adjust to Russia's changing trade policies and begin to form the basis for stabilization and economic recovery.

While this STF-supported program represents an intention to significantly improve Belarus' economic reforms, many of its components, however, are still modest and limited in scope. The program would need to be substantially strengthened and expanded in order to develop the sort of comprehensive set of reforms necessary for a full stand-by arrangement.

Nonetheless, fully implementing this STF-supported program would be an important step in Belarus' market reforms. Expanding price liberalization and structural reforms, and making a final decision on a currency system, will be critical next steps in constructing a comprehensive reform program and moving to a full stand-by arrangement, an essential goal for Belarus.

Turning to key policy issues, price reform is the first and one of the most crucial components of Belarus' reform effort that must be improved. Recent actions to liberalize consumer goods prices are helpful and the STF-supported program calls for further liberalization of food and utility prices, fully passing through increases in energy costs, and removing half of all profit margin restrictions. While these are important steps, Belarus should move to further increase the percentage of costs covered by prices and more significantly reduce subsidies. As the staff paper notes, profit margins give perverse incentives to competition and increase economic distortions. Removing all but, at most, a handful of these markup restrictions should be a priority.

Fiscal policy is one area where Belarus has performed relatively well in relation to the other FSU states. Major Russian subsidies and credits, however, have played an indispensable role in Belarus' budget and are now fast disappearing. Belarus must take active measures to preserve its fiscal balance. The STF commits Belarus to a budget deficit no higher than 7 percent of GDP for 1993, only 5 percent of which may be financed by the National Bank. The program's prescriptions of limiting wage increases, broadening the tax base, and better targeting social expenditures will be important steps to follow. I agree with the staff that more fiscal action will be needed in the second half; and I commend the staff's recommendation to abolish the commission granting tax exemptions. I also concur with Mrs. Kotova's comment that having 55 percent of GDP still in government hands seems to be inconsistent with a market economy, although I would be careful about specifying the level of GDP that makes it inconsistent in light of a recent Board discussion of another member with government spending hovering around 50 percent. Resisting pressures to increase wages and subsidies will be a significant challenge to the Government. Maintaining strict fiscal discipline is a critical step to stabilization.

As regards monetary policy, Belarus has opted to remain in the ruble area during at least the initial part of this program. While this decision does not preclude improvement in macroeconomic stability, since Russia and Kazakhstan are also implementing stabilization policies, full stabilization will only be possible with a final decision on a currency system. A definitive decision to either fully coordinate or attempt to coordinate monetary policy with other ruble area members or introduce a national currency will be necessary before a full Fund-supported program is possible.

The Fund has required key prior actions for the STF-supported program, including raising the National Bank's refinance rate to that in Russia and unifying its exchange rate. Other important commitments include tracking the Central Bank of Russia's refinance rate, limiting net domestic asset growth, increasing the proportion of credit allocated by auction, and reducing subsidized credits. Belarus should fully eliminate subsidized credit and nonmarket interest rates as the next step in liberalizing its monetary policy and preparing for a final resolution to its currency question.

On external policy, government control in the trade sector has been pervasive and is a key area requiring liberalization. Reducing state-to-state contracts and increasing market mechanisms in Belarus are urgently required. The STF-supported program calls for removing export restrictions for goods without price controls, removing all quantitative export limits, and removing all export taxes. These policies, in addition to unifying the exchange rate, tightening monetary policy, and increasing price liberalization, are, appropriately, key preconditions for increasing exports and raising the rate of hard currency repatriation. More generally, the country must begin to restructure its trade policy and create new incentives in order to help become more externally self-supporting and better prepared to tolerate further external shocks.

Structural reform is another critical area. State orders have already been significantly reduced from 1992, falling from 45 percent of GDP in 1992 to 20 percent so far in 1993. The STF agreement commits Belarus to eliminating all state orders not related to the Government's own procurement needs or state-to-state trade agreements. The program further commits Belarus to privatize 10 percent of all state firms by the end of the year, accelerate small and medium-sized firm privatization, and implement the bankruptcy law in a few cases by the end of the year. These would be constructive steps. However, the recently passed privatization law only requires that vouchers, key to a broad-based privatization effort, be distributed before July 1994. This represents a potential year-long delay in a key component of Belarus' privatization program. Steps should be taken to expedite this distribution and accelerate the entire privatization process.

The staff is right to be concerned about the financial requirement. A Belarussian agreement with the World Bank and a successful Consultative Group meeting in the fall are critical to the success of the program as now envisioned. The alternative of further adjustment would be very difficult, but, for better or worse, the risk is going to be there; the STF was created as a "paving" facility and risk to the Fund is what was envisioned when the STF was established. But the staff is correct to remind us, and our authorities, of this.

Regarding the ruble area, this chair, during the discussion on Kazakhstan, said that the balance of factors was tilting in favor of Kazakhstan establishing its own currency. More recent events may well remove any question of tilt. It is a question that the Belarussian authorities must decide, but I join others in noting that recent developments make life for the authorities more difficult even if it makes some decisions easier.

The staff representative from the European II Department said that, on monetary arrangements, Belarus would remain in the ruble area for the time being. The authorities had agreed that it would be appropriate to adopt a separate currency at some future date, but they were concerned that the decision should not be taken until certain conditions had been met: first, that the technical aspects of preparing for a new currency were manageable, which did not seem to present a problem as a new currency had been printed and large numbers of notes were stored in the National Bank; second, that appropriate macroeconomic policies and stable financial policies were in place; and third, that good relations with the other FSU states--and Russia in particular in the context of the new tripartite (Belarus, Russia, Ukraine) agreement--would be maintained. Those last two conditions were somewhat more problematic, and the authorities would look closely at the implications, notably of the tripartite agreement, before moving completely out of the ruble area. But he was sure that in due course a new currency would be introduced, which he hoped would be part of the next step toward a stand-by arrangement and a further strengthening of the reform effort.

He would not wish to hazard a guess as to the extent to which the financing gap would be filled, the staff representative commented. The situation was difficult and obviously had been discussed with the authorities. While there were no formal contingencies, in terms of mechanisms for adjusting the quantitative targets, the authorities' Statement of Economic Policies noted: "In particular, the Government stands ready to strengthen its adjustment efforts should external circumstances significantly deteriorate relative to expectations, including the possibility of a shortfall in available financing." Thus, the authorities were ready to reduce and tighten credit, if a situation arose where foreign financing and, consequently, imports were reduced and output was less favorable than assumed in the program.

A picture of Belarus as somewhat of a laggard in the reform process had been painted by Mr. Peretz, and there was not much doubt that the pace had been somewhat slow; nevertheless, the member deserved credit for measures that had been taken recently and those that had been agreed in the program, the staff representative remarked. For example, very few administered prices remained in Belarus. On the overall stabilization effort, as reflected in the strength of the program, he believed that monetary and fiscal policy was as tight as that under the Russian and Kazakh

STF-supported programs. He agreed that a tight monetary policy could not be achieved through interest rates alone. Interest rates under the FSU state programs were still negative in real terms; therefore, quantitative credit targets were used to achieve the objectives. For Belarus, those targets were consistent with achieving the same inflationary objectives as those under the Russian and Kazakh programs.

Monetary arrangements in Belarus had not been changed as a result of the recent moves by Russia, the staff representative stated. Belarus would be able to cope reasonably well with the conversion of old Russian rubles to Belarussian rubels--those coupons already accounted for about 80 percent of total cash in circulation and substantial stocks of notes were on hand at the National Bank. While the amount of rubels in the system would probably rise to close to 100 percent, new Russian rubles would continue to be legal tender in the system. Therefore Belarus effectively remained in the ruble area: it was still affected by Russian monetary policy, because rubles could come over the border and be spent within Belarus.

It had been mentioned by Mr. Dawson that the objectives for privatization under the program might not be achieved, given that vouchers might not be issued until July 1994, the staff representative from the European II Department recalled. In fact, the Privatization Program had been passed in June and the vouchers were being printed. While there had been some confusion concerning the process, he believed that the allocation of vouchers would be completed in the second half of 1993.

Mr. Wei made the following statement:

> This chair believes that the authorities' cautious approach in Belarus has meant that the economic reform shocks have been more moderate than in other FSU countries, in terms of the severity of output decline.
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> In theory, the argument in the staff report that "while a faster approach to reform could increase the costs of adjustment in the short term, it would achieve a substantial net benefit in the longer term" may be true. In practice, however, given the relatively short period of reform experience in most economies in transition, adverse effects are evident in the short run while the longer-term benefits are still elusive. Without political and social stability, radical reform programs cannot proceed as desired and achieve the targeted objectives.
>
> It is easier to break down the old house than to build a new one. Some economic fundamentals can be adjusted to reasonable levels in the short term, but at a very high cost. To achieve a smooth-working market mechanism in the transition economies requires changes in the institutional and legal framework as well as in the attitude of the general public. Changes in these non-economic factors will take time and require a stable political and

social environment. In addition, entrepreneurship, which is essential for a market-based economy, also takes time to evolve after the breakdown of a command economy where it barely existed.

On monetary policy, it is encouraging to note that the authorities are taking reform measures with the aim of reducing subsidies in the form of interest rates. The authorities are encouraged to continue to move in this direction. As the enterprise reform deepens, such subsidies should be reduced concomitantly. The authorities are also encouraged to take further measures to promote more active competition between the banks. On whether to introduce a separate national currency, of course it is up to the authorities to make that decision. In our view, the earlier they have their own national currency the better. I associate myself with the comments made by Mr. Oya; the Fund has a major role to play in the process of establishing a new central bank with its own currency, and the staff should participate actively in providing technical assistance. Recalling the discussion of Kazakhstan, it was clear that the authorities should make the technical preparations so that when the time is appropriate, the conditions are in place for the introduction of their own currency.

I am concerned about the widening gap between saving and investment from 1992 to 1993, as it not only exerts more pressure on external financing, which has already been difficult to realize, but it also harms sustained economic growth in the longer run. Interpreting the available data in Table 1 in the staff paper, I suppose that the projected poorer government finance position for 1993, compared with that in 1992, is attributable to this adverse development. In this connection, it will be a formidable task for the authorities to improve substantially the fiscal position in the program year so as to facilitate the attainment of the stabilization objectives under the STF-supported program.

As production costs have been pushed up tremendously by increased import prices of energy and essential raw materials, I encourage the authorities to implement firmly restrictions on budgetary wage growth. In this respect, the authorities' decision to support low-income earners by offering close to full indexation for the lowest pay levels is welcome.

On prices, we note that the authorities are continuing their reforms in a prudent way in order to mitigate their negative impact, which, in our view, is practical. In some areas, the authorities are actually taking bold measures, such as their intention to raise oil prices for priority sectors to at least balance the barter contract with Russia over the second semester of 1993.

With improvement in the external current account still out of sight, short-term capital outflows as well as a high level of unreported capital outflows and delays in the repatriation of foreign exchange earnings might aggravate the already fragile situation of the balance of payments. Against this background, the reform initiatives in exchange and trade arrangements envisaged by the authorities for the program period are encouraging. If successfully executed, they will be conducive to the improvement of Belarus' external position.

In concluding, I hope the authorities will successfully implement the STF-supported program which, I believe, will lead to a full-fledged program supported by a stand-by arrangement. I support the proposed decision.

Mr. Matthews made the following statement:

The STF-supported program is a welcome step forward on the still rather rough road to a stand-by arrangement. The prospective fiscal situation remains worrying, and it will be essential that all of the measures that have been agreed be implemented fully. Reforms to the Pension Fund will be particularly important, and here the authorities may wish to consider linking pension payments to expected wage growth rather than past wage growth. This could be beneficial in terms of not simply reducing outlays faster as inflation falls but also reinforcing expectations of lower inflation.

The authorities' commitment to restrict growth in the wage bill to no more than 70 percent of the rise in the retail price index is welcome, but I am unsure about the advisability of trying to achieve this by effectively compressing wage relativities in the public sector. A better approach could perhaps be to apply wage restraint to the whole public sector and to meet social objectives through a limited and targeted safety net.

Even with the full implementation of the authorities' program of economic reform, a substantial financing gap will remain. This gap will need to be filled before the authorities can successfully move to a second purchase under the STF or to a stand-by arrangement. External concessional assistance has an important role to play in filling this gap. The current program represents a marked improvement in the plans for economic reform in Belarus. The coming six months will present the opportunity not just for the authorities to prove to the international community their ability to implement reform, but also for the international community to prove their willingness to support Belarussia's reform effort.

When we last discussed the situation in Belarus just over two months ago (EBM/93/75), most Directors encouraged the authorities to abandon their strategy of gradual change and to embark upon a wide-ranging program of macroeconomic stabilization and decisive structural change. At that time, there were some who suggested that the authorities' gradual approach had helped them avoid the large fall in production so common to other FSU countries. We now know that that was not the case. Industrial production had, by that stage, fallen to less than 70 percent of its 1990 level and all indications are that production continues to fall rapidly.

With this fall in production and a rapid outflow of capital, the authorities were left with little choice but to hasten their reform efforts. Nevertheless, it is no less pleasing to see that they have indeed begun to do so; the measures that have already been taken which are outlined in the staff statement are particularly welcome.

The current implicit oil price subsidy, which resulted in unmet contractual export requirements and hence increased government outlays, is clearly unsustainable and will become increasingly so as Russia's energy export prices rise to world levels. The authorities' intention to raise domestic prices and to pass on all of the anticipated increase in import costs to consumers is encouraging, but an implicit subsidy component will nevertheless remain.

The recent establishment of a commission to review enterprise taxation on a case-by-case basis appears to be a backward step. With a difficult budgetary situation, it will be necessary for revenue from the existing tax base to be maximized. The new commission appears to be inconsistent with this objective and with the authorities' program of privatization and liberalization. I agree with the staff that it should be abolished as a matter of priority.

The operation of monetary policy in Belarus has been complicated by the authorities' attempts to continue their monetary union with other ruble-using countries. This situation has become even more complicated following the recent decision by Russia to cancel old ruble notes. In this regard, it is pleasing to learn from Mr. de Groote that his authorities are now committed to introducing a national currency.

But regardless of the timing of the replacement of the current hybrid system, the authorities must regain control over monetary policy. The program's aim of reducing inflation to 5 percent a month by the end of 1993 is ambitious and, if achieved, would lay a solid foundation for a further reduction in inflation under a stand-by arrangement. A fundamental component of the current program is reduced reliance on subsidized directed credits, and this is welcome. But directed credits will still represent some 30 percent of outstanding central bank credit. Even though the authorities intend to channel the subsidy component through the budget, the allocation of credit will still be distorted. Hence, all directed credits should be eliminated and a market-based system of credit allocation initiated.

The authorities have taken some first steps toward price liberalization and privatization, and further progress is to be made under the STF. The continued liberalization of prices will be an essential element in the overall program of structural reform, particularly in the area of energy prices where a substantial drain on the budget could eventuate in the absence of full liberalization.

It is encouraging that the program of privatization has now been approved, but this program will need to be backed by effective bankruptcy procedures and, for those enterprises that are not to be privatized, by hard budget constraints. The authorities appear to be somewhat indecisive on the method by which privatization should proceed, although a voucher system has been used with success elsewhere.

Mr. Desruelle made the following statement:

At the time of the Article IV discussions, it was noted that some results had been achieved, for instance on the fiscal front, by the cautious approach of the authorities. At the same time, the Board encouraged the authorities to move more forcefully in the structural reform effort. Therefore, the request for a purchase under the STF supported by the authorities' Statement of Economic Policies is most welcome.

The program presented by the authorities in support of the STF contains both structural measures--the main ones are price liberalization measures, the removal of profit margins, and the other steps taken to develop the legal framework for a market-oriented economy--and macroeconomic stabilization efforts aimed at achieving fiscal restraint and a tightening of monetary policy. It will be important, of course, to fully implement all measures included in the program. Some of the previous speakers have argued that the program should be stronger. This desire to see a stronger program is understandable. Nevertheless, it must be recognized that, as the program stands, the task of the authorities will not be easy. It will therefore be essential that the authorities do not waiver and implement forcefully all the program's measures.

Previous speakers have addressed the issues of national currency and the financing gap. On the currency, I note the intentions of the authorities, as stated by Mr. de Groote, and also the information provided by the staff representative today. On the financing gap, like Mr. Dawson I hope that the authorities will reach agreement with the World Bank and benefit from a successful Consultative Group. I would simply add that, clearly, the best way to stem capital outflows and to attract external financing is to move forcefully with the program of reforms.

After these general remarks, let me comment on fiscal policy and on public enterprise reform. First, on fiscal policy, like Mr. Peretz and Mr. Matthews, I note the importance of measures to diminish the cost of pensions in the envisaged reforms to consolidate the fiscal situation. As the information given in the staff report regarding pension reform is sketchy, I would appreciate any additional comments on what is intended in this regard. On other social expenditures, an increase is included for expenses of the unemployment fund, but I wonder whether, given the expected large increase in unemployment, the cost of unemployment compensation may nevertheless be underestimated. I would appreciate the staff's views on this as well. In any case, in view of the uncertainties, strict control of expenditures so as to keep them in line with revenues is essential.

On structural aspects of the fiscal situation, it is certainly very important that the authorities enlarge the tax base. This is especially so since the restructuring of public enterprises will, as in other FSU countries, negatively affect the existing tax base.

Encouraging steps are being taken to strengthen management of state enterprises and harden their budget constraints. Notable among these steps is the limitation of the provision of directed credit by the central bank. Other steps include the commitment not to grant a general settlement of arrears and the commitment not to have a general indexation of working capital. These measures are essential since restructuring and privatizing state enterprises is a major element of the authorities' program. In this respect, the establishment of a commission to review enterprise taxation appears to be a step in the wrong direction. Indeed, granting ad hoc exemptions to state enterprises can only lead to confusion about the rules of operation of these enterprises and weaken budget constraints. I therefore agree with previous speakers that the commission should be abolished.

With these comments, I can support the proposed decision, and I hope that forceful implementation of the program will allow Belarus to take decisive steps toward an upper credit tranche stand-by agreement.

Mr. Burdiel made the following statement:

We are pleased to consider the Belarussian authorities' request for a purchase under the STF just two months after Belarus' first Article IV consultation. On that occasion, this chair, like many other speakers, recommended a stronger commitment to the reform process and further progress in defining economic policies, especially with regard to the full introduction of a national currency. We view the agreement of the authorities to pursue an economic program under the STF as a signal of their commitment to a more comprehensive adjustment strategy. We welcome this and hope that we can also support a request for a stand-by arrangement later this year.

The staff has made it clear that a precondition for moving to a stand-by arrangement will be a clarification of interstate economic relations and, in particular, a final decision on Belarus' monetary arrangements and its status within the ruble area. As others speakers have mentioned, the Board had a most interesting discussion on this issue at the time of Kazakhstan's request for an STF purchase (EBM/93/103), and I will not repeat the same arguments. In this regard, it is encouraging to see the firm commitment of the authorities to the introduction of a national currency and full implementation of independent economic policies while maintaining a close economic relationship with Russia, as indicated by Mr. de Groote.

Economic activity has continued to decline, and inflation remains at the high levels of past months--higher than in Russia. The authorities have implemented prudent fiscal policies, but the future evolution of the Pension Fund is of some concern. Real interest rates remain highly negative. From the perspective of monetary policy, the special situation of Belarus has not been ideal for proper monetary management. Also of concern is the evolution of trade, as well as the high level of capital outflows. Because of the trend of imported energy prices toward world market levels, the external shock will continue until 1995, and the balance of payments outlook remains difficult over the medium term.

In this context, we commend the authorities for the progress made in liberalizing Belarus' external trade and the introduction of a single unified exchange rate for all official foreign exchange transactions, as well as the other prior policy actions. And we welcome the program's aim to reduce inflation substantially and to accelerate market reforms in order to alleviate the increasing balance of payments constraints and to provide a basis for sustained growth.

We understand the high degree of uncertainty about the second half of the program period--perhaps also the first half--and the implications for the shaping of future fiscal and, above all, monetary policies. Luckily, there is no doubt about the need for systemic reforms, or their path and timing, especially concerning price and trade liberalization, deregulation, and privatization. In this regard, we especially recommend the rapid removal of all impediments that diminish the role of market prices in the allocation of resources and, consequently, jeopardizes the growth of a vigorous private sector.

Mr. Posthumus said that he agreed with the statements of previous speakers, particularly with the conclusions of Mr. Fridriksson and Mr. Peretz. He agreed with Mr. de Groote that to some extent the program supported by the STF was being formulated while the resources were being spent. He had some hesitation about the program, and although he approved it, he did so with the same concerns expressed by his colleagues.

He was somewhat amazed that, according to the staff's explanation, the turmoil surrounding the Russian ruble was not expected to affect the Belarussian rubel, Mr. Posthumus commented. Of course, no one knew what would happen to the ruble in Russia in coming weeks, but it seemed that inevitably the monetary situation in Belarus would be affected. That issue was linked to a question that usually did not arise, concerning what would happen to the Fund's SDRs once the program was approved. In the present situation, that question was appropriate because the program was not strong and there were two currencies--one, not really a currency and the other, the ruble, which was having problems.

Mr. Laux stated that he supported the program under the STF. Since the so-called cautious transformation process chosen by the Belarussian authorities to reduce the short-term costs of adjustment had already proved to be unsuccessful, it was absolutely necessary to accelerate the transition process to a market economy, and he hoped that the STF would foster that process to a large extent. Compared with other countries' programs, that of Belarus could have been more ambitious. He concurred with Mr. Dawson that many of the program's components were modest and limited in scope, and with Mr. Peretz on the catching-up process that had to be undertaken in Belarus. The Fund was taking a great risk in the present case, but, with the same hesitations as those mentioned by Mr. Posthumus, he could support the decision.

He agreed with most of the previous speakers' comments, but he wished to make three points, Mr. Laux continued. On currency, the situation was confusing; he understood from the staff that, for all practical purposes, Belarus had not only its own currency but in fact two currencies: a ruble that was pegged to the Russian ruble at one to one, and a noncash ruble that was basically floating freely. The discussion about the ruble area seemed somewhat academic, but he asked the staff to comment.

Some speakers had said that interest rates had to be raised and credit tightened to fight inflation, Mr. Laux recalled. Yet a large amount of credit had been extended at preferential terms to enterprises, and he understood from the staff report that a substantial amount would remain over the program period. He wondered why those interest subsidies were not included in the budget, as had been done in Russia, and he would like to know the amounts involved. Clarification of that aspect was particularly important since the figures for the budget deficit presented in the staff paper could be misleading if a substantial part of quasi-fiscal expenditure was outside the budget. Related to that issue, he wondered whether there was a mechanism in place that decided how those directed credits were allocated, say, whether there was cooperation between the Government and the central bank to avoid waste and whether Parliament had any influence over allocations.

The financing gap was huge and would remain so over the next years, Mr. Laux commented. Because it was not clear how the gap would be closed, it was difficult for him to approve the STF request, but he did so aware of the risk involved. He hoped that the Consultative Group meeting in October would lead to positive results.

Ms. Lindsay-Nanton made the following statement:

> The paper before us today represents a start by the Belarussian authorities toward laying the basis for transformation of its economy to a market system. The purchase under the STF should assist the authorities in pursuing this goal, and this chair can support the request.
>
> At the time of the 1993 Article IV consultation discussion, some two months ago (EBM/93/75), it was noted that the slow progress in implementing reforms enabled the Belarussian authorities to contain the decline in output in 1992 at lower levels than that experienced by other transforming economies. The staff's projection of a larger output decline in 1993 seems to confirm that the contraction was merely delayed.
>
> The authorities aim to reduce the monthly rate of inflation to 5 percent by end-1993 and to contain the external current account deficit in the face of larger terms of trade shocks. Indeed, firm control over monetary and credit policy will be crucial in stabilizing the Belarussian economy and enabling the authorities to meet their objectives.
>
> The authorities now seem committed to the introduction of a national currency, as stated by Mr. de Groote. Such a move would permit the pursuit of an independent monetary policy while maintaining a close economic relationship with Russia and other FSU states. I note the recent signing of an agreement on economic union between Belarus, Russia, and the Ukraine. This should help

to foster closer relations between these countries, which would be mutually beneficial.

I agree with the authorities' decision to introduce their own national currency, but as Mr. Peretz noted, this is a sensitive issue. I too wondered about the timing of its introduction, particularly in view of the staff's assumption of ruble area participation throughout the program period. Would this imply additional adjustment? Perhaps the staff could comment on this particular issue.

I welcome the authorities' intention to increase competition and efficiency in credit allocation. The proposed increase of National Bank credit to banks through auctions and the reduction in the limit of directed National Bank credit to banks are steps in the right direction. So too is the planned elimination before year-end of the regulations prohibiting commercial banks from on-lending any nondirected and other resources into the interbank market.

On fiscal policy, the authorities' intention to limit the general government deficit to 6 percent over the program period is appropriate. However, this would imply strict adherence to the measures detailed in the staff paper. As other Directors have noted, further fiscal adjustment may be required in order to achieve the stated targets. Like the staff and other Directors, I am uneasy about the newly established commission set up to assist "distressed" enterprises. The authorities should take care not to undermine the revenue targets through deferment of enterprise tax obligations and the granting of new exemptions. I agree that the commission should be eliminated as soon as possible.

In the external sector, the removal of obstacles to the growth of exports and the encouragement of repatriation of foreign exchange must be a priority. In this regard, the unification of the exchange rate for official transactions, for the most part is an important accomplishment. Also, the planned phaseout of all export taxes and quantitative restrictions on goods not subject to price controls by end-1993 are to be welcomed.

Finally, while the staff update reveals that the balance of payments outlook will be better than initially projected, on account of relatively favorable repayment terms on debt owed to Russia, a financing gap of some $700 million over the program period remains. This will be covered in part by Fund resources as well as a World Bank rehabilitation loan. I agree that failure to arrive at full financing assurances could well jeopardize Belarus' STF-supported program and that if this were to be the case, the STF might well fail to fulfill its role as a bridge by which Belarus could progress to a stand-by arrangement. Strict adherence to implementation of the reform program and possibly additional adjustment efforts, which will in turn engender the necessary confidence in the economy, might well be the surest way for the authorities to garner the necessary international support.

The staff representative from the European II Department observed that financing the social safety net and the pension scheme presented a problem for which the staff did not have a specific solution. Moreover, the situation would worsen in coming years owing, in part, to demographics as well as to the assumed fall in inflation as a result of application of the financial program--elements that could cause the Pension Fund to grow dramatically relative to its resources. The staff, including a Fiscal Affairs Department mission on social safety nets, had discussed various options with the authorities, including a reduction in the overall level of pensions relative to wages, similar to the forward-looking approach suggested by Mr. Matthews of linking pensions to expected wages rather than to wages of the previous two months as at present. Another possibility was a cap on overall pensions or implementation of a flat pension, compared with present pensions which were related to an individual's wages at retirement, indexed by the overall wage system. The staff had not made specific recommendations in that complex area, except the requirement that pensions be contained within the resources of the Pension Fund and not lead to an increase in the turnover tax that financed the Pension Fund--a tax that was already at a very high level.

The staff would agree in principle with Mr. Matthews' view that a targeted social safety net would be preferable to the approach that the authorities had been taking, which was to increase lower wage levels more than high wage levels by compressing the relativities so as to protect low-income earners, the staff representative remarked. Unfortunately, there were problems in implementing a targeted safety net because of the lack of a personal income tax system; thus, the lack of a mechanism to assess the income of households. A crude mechanism was used at present to distribute child benefits, but there was a risk that a targeted system could create a huge bureaucracy that would tend to favor an approach whereby the authorities could be intrusive in attempting to identify needs or wealth. The staff, therefore, wished to be cautious with regard to its recommendations.

Admittedly, as Mr. Posthumus had suggested, he might have overstated the ease with which the Belarussians would handle the conversion to a national currency, the staff representative said. Technically, it would be disruptive, particularly outside Minsk where the distribution of rubels and the conversion process would entail a slow, time-consuming process for the people. But, in principle, once that turmoil had passed, the underlying situation in terms of Belarus' monetary arrangements and its relationship to the ruble area would be no different; it simply meant that there would be fewer old Russian rubles and more Belarussian rubels in the system. Those currencies were linked at a fixed exchange rate of Rub 1 = Brub 10, and that rate would continue.

It had been suggested by Mr. Laux that being a part of the ruble area might be academic, because Belarus had its own currency, the staff representative continued. But even if rubels represented 100 percent of the notes in circulation in Belarus, it would still not be possible to implement an independent monetary policy in that situation unless Russian rubles were no longer legal tender in the territory of Belarus and rubels were, as a separate currency, the sole legal tender. Otherwise, if Russia's monetary policy collapsed while Belarus maintained a restrictive monetary policy, Belarus would be flooded with rubles that would bid up prices in Belarus in line with prices in Russia. Under the present arrangement, Belarus could not implement an independent monetary policy, and therefore the program had to be linked with the Russian program.

Interest subsidies on directed credit would be included in the 1994 budget as part of the program set out in the Statement of Economic Policies, the staff representative remarked. Also, it was envisaged that those subsidies would be phased out. The staff's estimate of interest rate subsidies in Belarus for the second half of 1993 was about 1.5 percent of GDP, compared with subsidies amounting to about 1 percent of GDP included at present in the Russian budget.

In looking at the fiscal deficit, even though the amount was relatively small, it was important to note that the Russian deficit showed interest rate subsidies as an expense and central bank profits as a revenue item, the staff representative continued. Those items tended to offset each other. The National Bank of Belarus was taxing the country through the seigniorage tax, then shifting that money to enterprises through interest rate subsidies. Both sides of that equation would have to be brought into the budget, which would actually reduce the deficit, reflecting the National Bank's large profit that was contributing to the accumulation of the Bank's capital reserves.

The process of directed credit was complex and, although it was difficult to assign specific roles, essentially it involved the National Bank, the Government's Gosplan, and Parliament, the staff representative from the European II Department explained. The National Bank and Gosplan worked out and formulated a monetary program for the following year that contained a component of directed credit, which in turn was broken down into credit for sectors such as agriculture and certain industries. The plan was then presented to Parliament for approval. Subsequently, the National Bank allocated the money tagged for particular sectors through banks usually associated with those sectors.

Mr. de Groote made the following concluding remarks:

> We are here today to examine and support a program of stabilization and systemic change whose implementation has begun in the transition country that had shown the strongest adherence to the centralized model. The Government and the staff both deserve praise for this achievement. I can think of no case that

better demonstrates the usefulness of the STF: the compensation of a part of the trade losses stemming from the adjustment of its import and input prices to world levels will enable Belarus to launch a radical process of stabilization and systemic mutation. The Statement of Economic Policies and list of performance benchmarks form an impressive body of preliminary but essential steps in the direction of change. In this ensemble, the distribution between stabilization and systemic measures is in my view the correct one.

During this first phase of laying the groundwork for an economy directed by market mechanisms, Belarus has given priority to macroeconomic stabilization through firm actions on the budget and on the management of credit, and to setting into place the budgetary, monetary, and banking institutions and mechanisms. This will allow for the effective stabilization of price levels and external payments, for now, in unison with similar stabilization in Russia, and later, under conditions of full monetary autonomy.

I do not mean that the systemic part of the program could not by now have been stronger. My colleagues are right to observe that too small a share of GDP, about 5-7 percent, is produced by the private sector. My authorities are firmly committed to rapid progress in this area. My point, however, is that the chances of durably expanding the market-directed segment of the economy will be much greater if the expansion takes place in a sound fiscal and monetary environment that is conducive to household savings and to confidence in the currency.

My authorities' concern to make macroeconomic stabilization their first priority is strongly demonstrated today. Mr. Bogdankevich, the President of the National Bank of Belarus, announced to the media a series of decisions that will immediately take effect in the context of the agreement with the Fund. Interest subsidies to enterprises will be terminated; commercial banks will henceforth gain access to refinancing through an auction mechanism; credit will no longer be granted for settling enterprise arrears or for financing price adjustments in the working capital of enterprises. In the area of external adjustment, Mr. Bogdankevich committed the Government to taking prompt measures if the resources do not materialize to cover the balance of payments deficit assumed at present in the program. The measures announced today complement the interest rate measures already taken to bring Belarus' refinance rate closer to the Russian rate, and the measures taken on the unification of exchange rates.

Colleagues who addressed the stabilization aspects of the program dealt with issues related to the internal sector and the external accounts. Concerning internal stabilization, Directors were generally of the view that the fight against inflation has to be more vigorously pursued. Mr. Peretz was especially outspoken on this point, suggesting that the desired results are unlikely to be achieved simply by aligning the refinance rate of the National Bank of Belarus with the same rate in Russia. Monetary policy in Belarus, according to him, should be stronger than in Russia. I agree with this recommendation, but for a somewhat different reason. Belarus is committed to pursuing a more restrictive monetary policy than Russia because, as a transforming economy, it is particularly vulnerable to the effect of increases in its production costs on its external position. It would, however, be an oversimplification to say that monetary policy in Belarus has to be more restrictive overall than in Russia because Belarus' inflation rate is higher now than that in Russia. Here we must distinguish between inflation resulting from excessive money creation, and deliberate price adjustments. If prices have recently increased faster in Belarus than in Russia, it is largely because, in Belarus, energy prices are already aligned with world levels, while in Russia they are not, and because some price adjustments made some while ago in Russia were only recently implemented in Belarus.

On external stabilization and balance of payments financing needs, I would like to enlarge on a point already mentioned by the staff representative from the European II Department, by stressing the importance of Russia's contribution. Based on a preliminary agreement with Russia, Rub 250 billion has already been granted, Rub 70 billion has been decided on, and disbursement of a further Rub 100-150 billion before the end of 1993 is under consideration. My Belarussian authorities are confident of a favorable outcome. It is especially important to note that the Rub 250 billion already disbursed was under the same favorable terms that were agreed for settling the inter-central- bank arrears of 1992: the repayment maturity extends from the year 2000 to the year 2007 at a zero interest rate, which clearly shows that the Russian authorities regard these amounts as related to monetary movements inside the ruble area.

My Belarussian authorities are grateful to their Russian counterparts for this contribution, which will substantially reduce their country's debt-service obligations. Still on the same point, since we have deducted, from the $700 million representing the deficit to be financed over the coming 12 months, $400 million that will be contributed by the Fund and the World Bank, should we not likewise deduct the Rub 70 billion to be disbursed during the second half of 1993 and about $25-30 million planned for institution building? These two amounts, representing roughly $100 million, would then reduce the deficit to be financed to $300 million, instead of $400 million.

On systemic transformation, all Directors recommended going "further and faster," if I may use the words of Mr. Peretz. Mrs. Kotova and Mr. Fridriksson particularly stressed the excessive role of government in the economy, which remains blocked by administrative regulations and other remnants of the command economy model. The need to accelerate the process of privatization is recognized by my authorities. I am certain that it will be the cornerstone of the stand-by arrangement with the Fund, which we hope will be concluded before the end of the year. The staff representative has carefully dispelled some misunderstanding about the precise nature of the obstacles surviving from the previous system. It is not so much that prices have not been liberalized, but that the rules and practices under which the economy functions are still different from those of a market economy, as was so appropriately pointed out by Mr. Desruelle and illustrated by Mrs. Kotova when she cited the contradictory exchange rate regulations that reinforce the misallocation of resources. Only a few prices remain under administrative control, such as energy at the intermediary stages of production; housing rents, household heating, and electricity; and milk and bread. But it is definitely more complicated and time-consuming to change attitudes, rules, and practices than to introduce price liberalization, which can be accomplished by decree.

Monetary relations with Russia and the need for Belarus to have its own currency were understandably at the center of all interventions, as they were at the center of the staff paper. Given the importance of this subject, I would like to repeat the position of my authorities, on which the staff has already given some useful clarification. For the time being, Belarus considers itself as fully belonging to the ruble area. I use the latter concept deliberately because I wish to avoid confusion with the notion of monetary union, which Mr. Kagalovsky rightly advised abandoning on the occasion of our recent discussion of the case of Kazakhstan. Belonging fully to the ruble area, Belarus is therefore bound to implement, in unison with Russia, all measures Russia takes in the monetary sphere, and in particular all measures pertaining to the conversion of rubles issued before 1993. The latter measure will be enacted, exactly as it is in Russia, except that those rubles will be converted into rubels. The conversion has the mechanical effect of increasing the share of rubels in the money stock, thereby making it easier to adopt, in due time, the rubel as a national currency. The staff is right: what is needed to this end is to declare the rubel the exclusive legal tender in Belarus. The difficulty of doing so, from a purely technical standpoint, is not as important as some of my colleagues seem to imply.

There are three major components to Belarus' present hybrid monetary system. First, the rubel is already used for all consumer cash payments. Second, the denomination of the national unit of transaction for noncash operations has deliberately been left vague, so that there will be no special difficulty in deciding to denominate all operations effected in this unit in rubels. The third component is the Russian ruble: as long as it remains legal tender, Belarus will have no control over its monetary base and cannot be regarded as possessing autonomy of monetary policy.

But if there are no major technical difficulties in adopting the rubel as legal tender, why are the Belarussian authorities procrastinating? First, as noted by the staff, my authorities do not wish to take the decision before all necessary supportive mechanisms, techniques, and policies are firmly in place, in order to avoid the predicament Ukraine encountered when it introduced the national currency prematurely. Additional steps have to be taken in Belarus to develop the banking system further and to make sure that the transmission mechanisms needed for monetary policy to exert its full effects are already operating. A second and more important consideration is that Belarus enjoys particularly close relations with Russia which it intends to maintain and develop further. My authorities have therefore decided to establish the currency only when it has become certain that they can simultaneously sign an agreement with Russia on a monetary association governing the relationships between the two national currencies. Such an association must, in their view, complement and reinforce the advantages provided to both countries by a common trade zone. Ideally, this cooperation should evolve, at a later stage, into what the EC is now attempting to achieve: the creation of a common market with a common currency.

Meanwhile, Belarus wishes to continue to play the role it traditionally played in the Soviet Union, namely, that of provider of transformed products to the Russian market and to the markets of the other republics, on the basis of imports from them. The excellent relations existing between the leadership of Russia and Belarus, and the closeness of their cultural and political contacts, bode well for the success of this design.

It is symbolically interesting that we are considering Belarus' access to the STF at the moment when the country is celebrating its independence holiday. Implementing the program under the STF on the way to a stand-by arrangement will help Belarus to consolidate its full economic independence. We could find no more suitable present for this country today.

The Executive Board took the following decision:

1. The Fund has received a request by the Government of Belarus for a purchase equivalent to SDR 70.1 million under the Decision on the Systemic Transformation Facility (Decision No. 10348-(93/61) STF, adopted April 23, 1993).

2. The Fund approves the purchase in accordance with the request.

Decision No. 10431-(93/107), adopted
July 28, 1993

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/93/106 (7/28/93) and EBM/93/107 (7/28/93).

4. REPUBLIC OF LATVIA - REPRESENTATIVE RATE FOR LATVIAN LATS

The Fund finds, after consultation with the authorities of Latvia, that the representative rate for the lats, under Rule O-2(b)(i), is the midpoint between spot buying and selling rates for the U.S. dollar in the exchange market as ascertained by the Bank of Latvia. (EBD/93/127, 7/23/93)

Decision No. 10432-(93/107) G/S, adopted
July 28, 1993

APPROVED: February 11, 1994

LEO VAN HOUTVEN
Secretary