July 18, 2001
Approval: 7/25/01

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 01/13

2:30 p.m., February 7, 2001

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Decisions Taken Since Previous Board Meeting

Executive Board Attendance

E. Aninat, Acting Chairman
S. Sugisaki, Acting Chairman

Executive Directors	**Alternate Executive Directors**
S.M. Al-Turki	A.S. Al Azzaz, Temporary
	T.-M. Kudiwu, Temporary
	P. Charleton
	D. Guinigundo
R.F. Cippà	W. Szczuka
	D.H. Kranen, Temporary
	C.A.E. Sdralevich, Temporary
	H.E. Phang, Temporary
	V. Bhaskar, Temporary
W. Kiekens	
	I. Steinbuka, Temporary
	P.A. Brukoff, Temporary
	G. Bauche
	S. Le Gal, Temporary
A. Mirakhor	G. Nadali-Ataabadi, Temporary
	A. Lushin
	S. Alcaide, Temporary
	H. Hagan, Temporary
	V. Dhanpaul, Temporary
C.D.R. Rustomjee	
	A.F. Al-Faris
	Xu J., Temporary
	N. Yeritsyan, Temporary
Y. Yoshimura	
	R. Maino, Temporary

A.S. Linde, Acting Secretary
A. Mountford, Acting Secretary
Z.R. Ahmed, Assistant
S.T. Djumena, Assistant
T. Davidson, Assistant

Republic of Uzbekistan—2000 Article IV Consultation
Staff representatives: L. Hansen, EU2; Fetherston, PDR

Tunisia—2000 Article IV Consultation
Staff representatives: Gardner, MED; Lipschitz, PDR

Also Present
IBRD: R. Anand, K. Ogawa, and D. Pearce, Europe and Central Asia Regional Office; A.T. Kouame, Middle East and North Africa Regional Office; S. Urinbaev, Office of Executive Director. European II Department: J.R. Márquez-Ruarte, Deputy Director; R. Abdoun, L. Hansen, Y. Sun, G. van Selm, J.K. Wakeman-Linn, B.B. Zavoico. External Relations Department: K.L. White. Legal Department: N.Y. Rendak. Middle Eastern Department: D. Burton, Deputy Director; P. Dhonte, Deputy Director; D.G. Fanizza, E.H. Gardner, F. Jaumotte, A. Jbili, H.M. Joly, I. Karpowicz, N.L. Laframboise, M.M. Lazare, N. Ltaifa, E. Martin, K. Nashashibi. Policy Development and Review Department: L.J. Lipschitz, Deputy Director; M.J. Fetherston. Secretary's Department: L. Hubloue, P. Ramlogan, T. Turner-Huggins. Office of the Managing Director: A. Bauer, R. Teja. Advisors to Executive Directors: A.S.F. Atoloye, M.P. Bhatta, W.-D. Cho, A. Fidjestøl, O. Himani, A.D. Marinescu, S. Rouai, K. Sakr, J.N. Santos, R. Villavicencio, M. Yanase, F. Zurbrügg. Assistants to Executive Directors: J.G. Borpujari, N. Burnashev, M. di Maio, T. Hadded, F. Haupt, B. Kelmanson, S.K. Keshava, E. Kornitch, J.K. Kwakye, A. Maciá, R. Manivat, J.A.K. Munthali, J. Nelmes, Y. Saito, S. Sharipova, B. Siegenthaler, J. Sipko, T. Skurzewski, D. Vogel, S. Vtyurina, E.S. Weisman, A.Y.T. Wong.

1. REPUBLIC OF UZBEKISTAN—2000 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 2000 Article IV consultation with the Republic of Uzbekistan (SM/01/18, 1/22/01). They also had before them a background paper on recent economic developments in the Republic of Uzbekistan (SM/01/19, 1/23/01).

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

> The following information has become available since the staff report (SM/01/18, 1/22/01) was issued. This information does not change the substance of the staff appraisal, but adds urgency to its message that the authorities need to follow appropriately tight macroeconomic policies in the coming months.
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> According to the official index, consumer prices rose by 28 percent during the 12-month period to December 2000, i.e. somewhat less than assumed in the staff report. The alternative consumer price index calculated by the staff rose by 48 percent over the same period. According to official statistics, real GDP growth was 4 percent in 2000, i.e. somewhat higher than assumed in the staff report. Detailed information that would enable the staff to calculate an alternative estimate, consistent with its estimates for prior years described in the staff report, is not yet available.
>
> According to preliminary figures, reserve money and broad money increased by about 41 percent and 37 percent, respectively, during 2000, or much more than envisaged in the staff report. Monetary aggregates declined significantly during October–November and the first part of December as a result of substantial sales of foreign exchange by the Central Bank of Uzbekistan (CBU). However, in the last few days of the year, foreign exchange earned from cotton sales that had been kept abroad was repatriated and surrendered to the CBU. Moreover, the CBU purchased a large amount of foreign exchange from commercial banks. These foreign exchange inflows to the CBU (about US$175 million) were only partly sterilized and, consequently, resulted in a significant increase in monetary aggregates at the end of the year. For the year as a whole, net international reserves increased by US$166 million and gross international reserves by US$31 million.
>
> The monetary expansion in December was also fueled by government borrowing from the CBU, which in relation to the end-1999 reserve money stock increased almost 26 percent instead of the 23 percent assumed in the staff report. The increase in the borrowing requirement was due to the policy of repaying treasury bills and a significantly larger-than-expected budget deficit for 2000 because of a substantial increase in government spending in December. According to the official definition, the budget deficit recorded for 2000 was 1 percent of GDP compared with 0.4 percent of GDP forecast in

the staff report. Detailed information has not yet been made available to calculate the budget deficit according to the IMF definition.

The sharp increase in monetary aggregates, including in currency in circulation, in late 2000, has influenced developments in the foreign exchange market in the opening weeks of 2001. The exchange rate in the curb market, which had fluctuated in the range SUM 885–900/US$ in December 2000, depreciated to SUM 935–940/US$ in late January 2001, and the spread between this rate and the official exchange rate widened to about 185 percent at end-January 2001, from 172 percent at end-December 2000. In reaction to these developments, the CBU introduced some flexibility into the cash bureau exchange market in January. First, all commercial banks were permitted to sell cash foreign exchange. Second, the CBU has since mid-January depreciated the "recommended" cash exchange rate almost daily and now indicates a range for the buying and selling rates, respectively. The commercial banks are free to set the rates within this range, but with a maximum permitted spread of 5 percent between the buying and selling rates. This new procedure has introduced some competition into the market with some variation in the rates posted by the different banks. At end-January, the "recommended" cash exchange rates were SUM 708.75–731.4/US$ buying and SUM 744.2–767.97/US$ selling, respectively, compared with SUM 690/US$ buying and SUM 724.5/US$ selling at end-December 2000, i.e., a depreciation of 6 percent since the end of the year or equivalent to the depreciation of the curb market rate. The official exchange rate was depreciated by slightly more than 1 percent during this period. There has been no change in the access restrictions to the cash bureau market, and the commercial exchange rate applied to imports of consumer goods and for the non-surrendered part of non-centralized exports has not been adjusted.

Mr. Cippà submitted the following statement:

The overall macroeconomic developments in Uzbekistan in the year 2000 have been quite favorable. Our Uzbek authorities are very encouraged by the sustained growth performance leading to a fifth consecutive year of GDP expansion. Achieving a real GDP growth rate of about 4 percent in 2000, i.e., only slightly lower than in 1999, notwithstanding the fact that domestic and external conditions were not very favorable (e.g. the drought that severely affected the cotton crops, the depressed world market price for gold, and the continuation of the threat of terrorist attacks in the southeastern part of the country) was not self-evident. This growth performance has allowed Uzbekistan to retain its top position among all FSU (Former Soviet Union) countries in terms of the ratio of the current GDP to the base level of GDP recorded in 1989.

Other macroeconomic indicators also show a relatively positive picture. Tight fiscal policy has allowed the deficit to shrink further to about one percent of GDP (based on the authorities' definition), the current account has moved into a small surplus, and foreign exchange reserves have been maintained at the level equivalent to almost six months of imports. As regards prices, the CPI-measured inflation stayed at a relatively modest level of 28.2 percent (only marginally higher than in the previous year). This is not a small achievement, given the strong steps taken by the authorities in 2000 to unify the official and commercial exchange rates, entailing a significant depreciation of the sum.

Our authorities have some difficulty in agreeing with the staff's assessment that the macroeconomic developments in Uzbekistan in 2000 can be described as "deteriorating performance" (para. 20). Even when using the staff's "alternative" data for the CPI (Consumer Price Index) and GDP, which show different levels but similar trends, this assessment seems to be too harsh. The diverging assessments of macroeconomic trends observed in 2000 have also been reflected in very different projections for the current year. The official projections provide for the continuation of strong GDP growth (4.5 percent) with inflation declining to 16 percent and with foreign exchange reserves remaining broadly unchanged. The fiscal deficit is projected not to exceed 1.5 percent of GDP and the current account should remain in surplus. Staff's projections are much more pessimistic and provide for a very significant deceleration of growth and for some increase in inflation. Our authorities hope that like quite often in the past the staff's projections will prove to be too pessimistic.

Monetary and Exchange Rate Policy

Monetary policy followed by the Central Bank of Uzbekistan (CBU) in 2000 was intended to be relatively tight. In November and in the beginning of December the monetary authorities successfully mopped up excess liquidity accumulated in the aftermath of the exchange rate measures introduced at the beginning of July. However, the large foreign exchange inflows in the last few days of the year pushed monetary aggregates higher, so that the preliminary figures suggest that reserve money growth was close to 40 percent. As regards CBU loans to finance the budget deficit, these were kept within the limit of 1 percent of GDP as stipulated in the "Law on State Budget for 2000."

In accordance with the "Law on the Central Bank," the CBU adopted the guidelines for monetary and credit policies for 2001 based on the macroeconomic projections mentioned earlier. Furthermore, the authorities assume that budget deficit financing by the CBU will be reduced further to 0.5 percent of GDP. The targets for reserve and broad money in 2001 are 19.3 percent and 21.8 percent respectively. Interest rate policy of the CBU will be implemented taking into account the levels of current and anticipated inflation rates.

As regards exchange rate policy, the unification of the exchange rate, liberalization of the foreign exchange market and acceptance of the obligations of Article VIII of the Fund's Articles of Agreement remain among the priorities of the Uzbek government. Last year the authorities introduced several important changes to the country's exchange rate system, which bring Uzbekistan much closer to its ultimate goal of full current account convertibility. All these changes have been described in detail in the staff report and in the helpful Appendix I to the background paper. These important reforms started on May 1 with the large step devaluation (by 55 percent) of the official exchange rate and with the unification of this rate with the commercial bank exchange rate. This was followed by the introduction of a new commercial bank rate and of a new rate for cash transactions at the exchange bureaus, which were initially set at the level very close to the illegal black market rate.

The market reaction to the introduction of these new rates was quite favorable as reflected in the very significant increase in sales of foreign exchange to the banking system and in the large increase in the turnover on the cash market. While initially only four banks were allowed to sell foreign currency on the exchange bureau market, this restriction has been gradually relaxed and by now all banks with a foreign exchange license are permitted to operate on this market. The number of foreign exchange bureaus increased from 320 at the beginning of last year to 980 at the end of December. The scale of the devaluation of the official and commercial bank exchange rate can justly be described as very large as the former was depreciated by 132 percent and the latter by 261 percent. At the same time the so-called curb market rate, for the first time in five years, has barely changed last year (depreciated by six percent in nominal terms but appreciated in real terms) and this resulted in a decline of the spread between the official and the informal exchange rates from over 450 percent at the start of the year to about 160 percent at the end of 2000.

In our authorities' view, the measures adopted in the course of last year, while admittedly still short of introducing the full unification and liberalization of the foreign exchange market, brought Uzbekistan much closer to this target and confirmed the government's determination to gradually move in this direction. The staff are trying to de-emphasize the economic importance of these measures by referring to them as "administrative" steps and indicating that they have mainly "psychological" impact. However, in the final appraisal the staff agree that the measures introduced in 2000 can be seen as steps in the right direction, so the main difference lies rather in assessing the length of these steps.

In our authorities' view, it would be rather difficult to prove that such a large depreciation of two most important exchange rates may have only a very limited impact on the real economy and that the very large narrowing of the spread between official and unofficial exchange rates does not signify a real progress towards unification of the exchange rate. This view has been indirectly confirmed by several references in the staff report that indicate that last year's devaluation has already resulted in reduced import demand and somewhat improved performance of nontraditional exports, in larger excise revenue, in pressures on the monetary policy due to net international reserves (NIR) expansion and in a marginal deterioration of banks' credit portfolios.

Fiscal Policy

In the fiscal area, a tight policy stance has allowed for a further decrease in the fiscal deficit in 2000. The restrictive policy in the past years has brought down the deficit from 7.3 percent of GDP in 1996 to under 3 percent in 1999. According to preliminary official data, the fiscal deficit in 2000 remained well below the 2.8 percent target included in the 2000 budget. It is important to note that this result stems mainly from better-than-expected revenue performance and increases in excise taxes as well as energy prices. On the expenditure side, some cuts in discretionary spending were made, however, without affecting social and investment expenditures. Furthermore, the government has remained current on all wage and other payments, thereby avoiding the serious negative impact of domestic arrears accumulation. Improved tax administration has also allowed a reduction of outstanding tax arrears to 0.3 percent of GDP.

As regards tax policy, the authorities reduced the maximum rate of personal income tax from 45 to 40 percent as of January 1, 2000. To stimulate private enterprise activity, the corporate profit tax rate was reduced from 33 to 31 percent in 2000, with a further reduction to 26 percent planned this year. To promote export activity, the government introduced a measure as of June 1, 2000 to partially or totally exempt enterprises from property taxes, depending on the share of exports in overall production. Overall, the authorities are firmly committed to continue the implementation of appropriately tight fiscal policies also in 2001.

As regards Uzbekistan's external debt, the authorities are cognizant of the risks associated with rapidly increasing debt levels. However, in their view, the various debt ratios at present should not be a cause of alarm. Although the prices for main exportable commodities were low and severe drought negatively affected growth prospects in agriculture, Uzbekistan has remained current in servicing its debt liabilities. The authorities intend to continue their conservative policy in external borrowing initiated last year. For example, according to the Investment Program for 2001, the external borrowing with state guarantee will not exceed the amortization payments associated with such borrowing.

Structural Reforms

Our authorities are committed to continuing their gradual approach in the area of structural reforms. They do not agree with staff's assessment that structural reform has "essentially stalled." During the last years the share of non-government sector in GDP has increased considerably to the level of around 70 percent and provides 76 percent of total employment. Further measures are contributing to increasing the relevance of market forces in several areas.

In the agricultural sector, reforms in ownership structures and pricing policies continue. As of January 1, 2001, 1754 entities out of 2235 agricultural enterprises were transformed into agricultural cooperatives (up from 774 in 2000). In 2000, the authorities committed to liberalize the state order system on a pilot basis within the framework of the World Bank Rural Enterprise Restructuring Project (RESP) in five provinces and under a project of the Asian Development Bank in another province.

Pursuing the objective of providing adequate incentives for agricultural producers and strengthening financial independence of entities, the procurement prices for cotton and grain were significantly increased for the 2001 crop. Prices for raw cotton were increased by 50 percent. This is significantly higher than expected inflation and signals the authorities' intention to increase economic incentives for agricultural producers and adjust income distribution among sectors.

On an administrative level, a special decree of the President adopted on August 2, 2000 expanded the authority of the "Committee on Demonopolization and Development of Competition" and changed its status by transforming it from an agency within the Ministry of Finance into an Independent State Committee. The authorities have also recently resolved to restructure the railway, energy, and cotton processing sectors.

Privatization efforts continue, as demonstrated by a 60 percent increase in privatization revenues in 2000 to around US$61 million. The government remains committed to privatization as shown by the inclusion of important enterprises such as Uztelecom, Uzbekneftegaz, TAPOICH (airplane production) among the hundreds of state enterprises listed to be privatized. For most of the important companies the privatization process has been initiated and commitments from foreign investors already exist.

In the banking sector, reforms are taking place in line with the medium-term program of the government to reform the banking system in 2000–2003. The objective of the program is to create a banking system that fulfills the requirements of a market economy, to intensify the intermediary role of banks on financial markets, and to achieve competitiveness of banks on domestic and international markets. The program includes the implementation of the following measures: a) institutional development of the banking system; b) improvement of payment systems; c) corporatization, privatization and increasing the role of shareholders in banks' management. It is important to note that at end-September 2000 all commercial banks complied with the minimum capital adequacy ratio of 10 percent. The capital adequacy ratios for the four major banks were between 18 and 53 percent.

Furthermore, the independence of banks was strengthened with legislation that prohibits the state and local authorities from intervening in banking activities. The elimination of restrictions on the number of accounts that can be held in various banks has led to considerable improvement in the competitive environment for commercial banks.

As mentioned by staff, measures aimed at strengthening banking supervision are being implemented by the CBU. In line with this objective, banking supervision activity was restructured significantly in close cooperation with USAID and the World Bank. Now, its functions are performed in compliance with standards of Basle Committee on Banking Supervision. Within the framework of a World Bank project 8 banks went through expanded external audits. The growing trend in the number of private banks, which increased to 17 banks in 2000, and the strong expansion of private deposits (200 percent) are some of the developments that reflect the increasing efficiency of the banking sector in Uzbekistan.

Data Issues

Since the question of the quality of official data has been give so much prominence in the staff report, I would like to stress that our authorities have very strong reservations about the use of staff's "alternative estimates" of CPI and GDP. Even the staff themselves admit in the background paper that the methods used by them to obtain such estimates are rather crude and suffer from a number of weaknesses. The sample used to calculate the changes in CPI is very small and very limited in geographical scope of its observations. The official data may not be perfect but they are being produced using very elaborate statistical methods recommended earlier by the Fund and on the basis of a very large number of individual data that are collected throughout the whole country from all economic agents. Uzbekistan has also been making constant efforts to improve the quality of its statistics and has already implemented several changes recommended by the IMF and World Bank experts. Our authorities also strongly object to staff's repeated but undocumented allegations of political interference with the process of compiling and disseminating statistical data.

Conclusion

Our Uzbek authorities remain fully committed to liberalizing the economy in a gradual fashion. The important steps taken so far have been implemented relying solely on Uzbekistan's own resources, without any foreign financial assistance. Achieving the unification of the exchange rate and current account liberalization is not a goal in itself, but an important element of the overall liberalization process. However, in line with their traditional approach of paying utmost attention to preserving social peace and protecting the most vulnerable parts of the society when introducing market-oriented reform, they prefer to move in a gradual way. The ultimate pace and sequence of further exchange rate liberalization measures will depend on two major factors: on the results of a thorough evaluation of all costs of exchange rate unification and on the availability of external financial assistance to cover part of such costs and to support the new currency regime. The authorities intend also to pay due attention to price developments on the international markets (mainly for cotton and gold) and to the general political situation in the region. To help with the calculation of the costs of the exchange rate unification the authorities have requested the assistance from both the Fund and the World Bank. The initial staff's calculations indicating only very modest cost of unifications are not entirely convincing as they exclude the impact of a devaluation on the enterprise and banking sectors. As admitted in paragraph 19 of the staff report, the further depreciation could lead to widespread difficulties for the corporate sector with associated ripple effects on the financial system. A World Bank mission is planned for March to assess the impact of foreign exchange liberalization on the banking and enterprise sectors.

The Uzbek authorities have also expressed a strong desire to receive firm assurances of sufficient external support before they proceed with decisive steps towards full exchange rate liberalization. This prudent approach is justified, among others, by the experience of other countries, for which large, externally-funded stabilization funds had been established to cushion the moves to currency convertibility. Until now the Uzbek authorities have not received any firm assurances that they would be provided with timely and sufficient financial support. Staff's unsubstantiated claim that quick-disbursing loans from official and bilateral sources would be forthcoming in the second half of 2001 is formulated in conditional terms and as such does not offer the degree of security that would be needed to proceed with the implementation of potentially very costly and painful economic decisions. Our authorities continue also to have strong reservations about the staff's approach according to which Fund financial support would be made available only after the implementation of a serious liberalization program. This can be compared to offering a patient undergoing an open-heart surgery access to a life-support system but only after the operation. The track record/monitoring period approach may be adequate for countries undertaking a medium-term program of structural reforms but much less so for a program providing for a change in the exchange rate regime and aiming at a relatively fast introduction of full current account convertibility. We continue to believe that one the Fund's main functions is to offer immediate financial assistance to countries facing balance of payments difficulties. The existence of a threat to the stability of Uzbekistan's external accounts is well established and this justifies, in our view, the provision of a front-loaded Fund's assistance immediately after reaching an agreement on a credible liberalization-cum-reform program with the authorities.

To conclude, our Uzbek authorities would like to thank the Fund for its valuable technical assistance and particularly the country team for their ongoing efforts to provide the authorities with guidance on how best to undertake the difficult task of liberalizing the Uzbek economy. In this context, our authorities feel very strongly that the resident representative of the Fund plays an important role in the policy dialog. They would like to thank management for temporarily extending the resident representative's stay and would consider it most unfortunate to eliminate this position at such a crucial stage of the reform process.

Mr. Djojosubroto submitted the following statement:

We thank staff for their candid assessment of the Uzbek economy. Many concerns were raised in the papers, and we are in general agreement with the main thrust of staff's appraisal. Mr. Cippà's preliminary statement also provides many convincing arguments. However, we would like to highlight a few salient issues.

According to staff, while the authorities are fully aware of the concerns highlighted, they have not been able to deliver on their promises to undertake several structural reforms. Central to the reforms is the unification of the exchange rates, and staff pointed out that based on the calculations shown in Box 5, the budgetary cost of this reform is "manageable provided that any assistance to enterprises and banks was limited and temporary." Staff's calculation of the budgetary cost of liberalization presented in Box 5 is useful but too simplistic, as the estimates do not include the cost of several important items, one of which is the cost of potential assistance to enterprises and banks. Given staff's assessment that the banking system is not strong at the present stage and a strong banking sector is vital for development, we believe it would be helpful to have an estimate of the total cost and look forward to the World Bank's assessment of the impact of foreign exchange liberalization on the banking and enterprise sectors.

In addition, we would like to highlight that the two major impact of exchange rate unification cited in Box 5 could have serious negative ramifications for a major section of the society. This alone would deter any government, let alone one that has to face the polls in the immediate future, to proceed with the reform measures without full assurance that there are sufficient means to mitigate the negative social implications. We should learn from the recent experience of the Asian crisis and not dismiss lightly the seriousness of a negative social impact from the elimination of explicit and implicit subsidies that affect a major proportion of the population. The second main risk highlighted in Box 5 is no less serious. In view of the Uzbek authorities' stated intention to build up the country's industrial and manufacturing sectors in general and local enterprises in particular, the negative impact of exchange rate unification on the competitiveness of the fledgling group of local enterprises would be an anathema to any government. The potential failure of the corporate sector could also have significant spillover effects on the already fragile banking sector. Hence staff's assessment that the cost of exchange rate unification would be "manageable" does not appear to have taken into account the full implications on the social and financial sectors. The experience of the Asian crisis has clearly demonstrated the importance of proper timing and sequencing of reforms. The necessary infrastructure must be in place prior to liberalization. We can therefore empathize with the Uzbek authorities for their hesitation to proceed with the implementation of staff's proposals without a fuller assessment of the risks and their "insistence on effective mitigation of the risks."

Having said that, we hasten to add that there are clear signs of macroeconomic imbalances that the authorities cannot afford to ignore. While the pressure on the balance of payments and inflation is currently not that serious, the high and rising external debt payments and the over-valued exchange rate strongly suggest that the current growth path is not sustainable. The "Uzbek model" of reliance on heavy borrowing to support an import-substitution policy to develop industrial and manufacturing capacity in a predominantly agricultural economy would only create a new set of problems. Country studies show that export-oriented strategies are more likely to succeed than inward-looking strategies especially as the size of the Uzbek economy is insufficient for reaping economies of scale while local technology and technical skills would benefit from foreign investment. At the same time, Uzbekistan is a predominantly agricultural economy that is subject to the vagaries of commodity prices, and the state order system creates another layer of distortion for the agriculture sector. Given that Uzbekistan has a low savings rate of below 10 percent, low foreign direct investment, and substantial capital outflow, we would urge the authorities to phase out ineffective or outdated strategies and to further accelerate reforms to bolster confidence, improve the business climate, and pave the way for constructive investment.

We are nevertheless encouraged that the authorities have demonstrated a strong commitment to banking sector reform to reduce government's interference and restrictions on banking operations and urge the authorities to press ahead with the measures to strengthen the soundness of the banking system. On the fiscal domain, we commend the authorities for maintaining the tight fiscal stance and would like to reiterate the necessity of establishing a treasury system. We are concerned about the quality of macroeconomic statistics, and the steady progress on this front would help improve the overall economic analysis and assessment.

A gradual and consistently implemented program of reform can be accepted if the momentum of progress is maintained, while tight fiscal and monetary policies will be needed to ensure economic stability. The authorities' reluctance to embrace a fully market-oriented strategy at this stage is understandable not only for the reasons mentioned above, but also because of the need to assist the development of the infant local industries. However, should the economy drift into serious difficulties, the authorities may be required to take far more painful remedies to restore growth. We therefore urge the authorities to review their policy options carefully so that the country can reap the full benefits of reforms and enjoy strong and sustainable growth.

Mr. Yoshimura made the following statement:

At the outset, I thank staff for the clear and concise report. I also appreciate Mr. Cippà's helpful statement. I was struck by the difference between the two. The former is a bit optimistic, and the latter is rather pessimistic. I would like to believe that the rosy picture provided by Mr. Cippà is true, but on balance, I am afraid that the staff's view is closer to the reality. Despite some encouraging moves in the foreign exchange system, very little progress has been made on the structural front. The macroeconomic prospects of Uzbekistan are fraught with risks. My basic message, therefore, is that it is essential for Uzbekistan to implement economic reform, including implementation of exchange rates liberalization and to remove distortions in the economy in order to achieve sustainable growth.

This is a way to attract foreign investment and promote exports. Up to now, the Uzbek economy has performed relatively well among transitional countries thanks to advantageous conditions and sound economic policy management. Before the favorable economic performance deteriorates, because of increased pressure on the external account and rising debt payment and the country finds itself faced with crisis, I strongly urge the authorities to act immediately to liberalize foreign exchange and current transactions, and to remove the various distortions hidden in the current economic structure.

The staff report highlights the differing views of the authorities and the staff on the future orientation of the Uzbek economy. While the authorities argue for import substitution strategies, the staff recommends export oriented policies. I see some sense in import substitution policies per se. However, the particular set of policies adopted by the authorities under the name of import substitution does not seem to be working well. Indeed, under the current world economic situation, sensible policy options are rather limited. Whether a country seeks import substitution or export led growth, the policies it needs to adopt do not differ significantly. This is because even if a country pursues import substitution, it must import equipment, technology and know how from abroad, and for this it needs to acquire hard currency, since the only practical way of acquiring foreign currencies is to export goods or attract foreign direct investment, it is essential for import substitution policies to aim at to build industries where there is comparative advantage. Such industries can export their products after import substitution is complete.

In the case of Uzbekistan, the authorities' priority should be to facilitate the production of cotton and wheat and to establish the industries that use cotton and wheat as raw materials. Table three in the recent economic development paper, however, presents a completely different picture. There is no growth in these light industries. Instead, we see car manufacturing and audio-visual equipment production starting to grow rapidly for several years and then to stagnate. The table shows that what the authorities are trying to do as import substitution is just to introduce heavy industry regardless of the country's competitive position. It is not surprising that they have been less than successful. In this context, I would like to refer to the history of industrialization in other countries. Almost all developing countries that successfully industrialized began with light industries based on competitive advantage. This was the case for the United States in the 19th century, and for Japan in the 20th century. We hope the authorities will apply this lesson to Uzbekistan in the 21st century.

To facilitate production, it is essential for the authorities to utilize foreign exchange in current transactions. Once these are liberalized, the production of internationally competitive goods will accelerate. Moreover, once production of these goods starts to grow, it will be possible for the authorities to support noncompetitive industries from competitive industries. By contrast, the method currently adopted by the authorities of using foreign exchange regulation as a tool to support certain industries has serious side effects. It could lead to economy wide distortions, thereby inviting widespread insidious rent seeking behavior and corruption.

By what government officials have been saying, it seemed that the authorities had understood the points I have mentioned with regard to the issue of liberalizing foreign exchange in the current account transactions. I suspect it is their fear of unchartered waters that is making progress slow and hesitant. As I note, however, the later they embark on the process of liberalization, the rougher it will be.

While I welcome the unification of the offshore exchange rate and the commercial bank rate and the creation of the new commercial bank's rate as explained in Mr. Cippà's statement, these measures are not enough. I am disappointed that complete liberalization did not take place last year as promised. I hope that it will be done in the immediate future. To this end, the authorities are encouraged to quickly prepare a schedule for full liberalization and to begin implementation.

For the Fund's part, involvement of the Fund in the discussion of Uzbek reform is crucially important. I urge the staff to continue the cooperative and constructive dialogue with the authorities. It is essential for the Fund to provide advice on the effect of foreign exchange liberalization and the sequence of Fund support and reform measures. The Fund's recommendation needs to be practical and politically feasible. In order to provide such advice, I strongly urge management to maintain the resident representative position in Uzbekistan. My authorities dispatched a mission to Uzbekistan to carry out a study on the implementation of foreign exchange liberalization. The conclusion of this study was similar to that of the staff report, that liberalization is necessary for economic stability and its early implementation will make a significant contribution to the economy. I hope the authorities and the staff will use the report for their reference.

On the amount of financial assistance necessary for the liberalization, I share the staff's view that the limited amount will be sufficient and that it should be made available through quick disbursing international assistance. While I note the authorities' argument that the significant amount of assistance will be needed for intervention to correct the overshooting of the exchange rate, and to support those hurt by liberalization, I do not believe that a larger amount of support is necessary, since some sectors will benefit from liberalization. In addition, since liberalization needs to correct industrial structures in Uzbekistan, support should not be so great as to allow nonviable sectors to survive. Moreover, we should note that Uzbekistan has the advantage of being self-sufficient in energy, and does not need to worry about the impact of exchange rate depreciation on energy imports.

As staff points out, liberalization of foreign exchange must be accompanied by other structural reform measures to maximize their benefit. In particular, given the importance of promoting agricultural production, it is essential to either abolish or improve the state ordered system in order to make the market mechanism work. I welcome the process described in Mr. Cippà's statement, but more needs to be done. It is important to create a regulatory environment conducive to economic activity. While I understand it is technically and politically difficult to implement these reform measures over the short run, I encourage the authorities to implement them steadily.

I share staff's view that in the run-up to liberalization, it is imperative to tighten fiscal and monetary policy. The recent economic data presented in the staff's statement adds urgency to this issue. Moreover, for policymaking in less regulated environment, there must be accurate data. Therefore, an improvement in the statistic system is in order.

Furthermore, as a result of liberalization, I expect there will be strong pressure on the balance sheets of banks, resulting from changes in the economy. Close monitoring of the quality of assets of banks will be required.

In conclusion, I hope that the authorities will proceed along the path of reform, so that I will not need to repeat my remarks at the next Article IV Board discussion. I hope we will have an opportunity to discuss a Fund arrangement with Uzbekistan before that discussion.

With these remarks, I wish the authorities the best in their endeavors.

Mr. Kiekens made the following statement:

The staff paper on Uzbekistan is candid but balanced. Mr. Cippà has circulated an informative introductory statement.

Since the beginning of transition, Uzbekistan has chosen a gradual approach to economic reformation with an emphasis on sustaining social stability, securing employment, and achieving self-sufficiency. The country has adopted what may be broadly called "import substitution strategy" in order to achieve economic diversification through development of domestically oriented industries. In turn, these industries can employ the rural population and foster transition from agricultural to industrial based society.

For that, central planning bodies developed plans what and how much to produce, and pass them to commercial and state-owned enterprises. Country's financial authorities, and state-owned banks are expected to secure sufficient domestic and foreign financing for the projects.

Today's Board meeting presents the chance to evaluate the interim outcomes of this development model after ten years of transition.

The model has worked in the sense that Uzbekistan has used initial comparative advantages: cheap and well educated labor force, political stability, and potentially attractive domestic and regional markets. The cumulative output decline has been one of the smallest among the countries of the former USSR. Over these years, the Uzbek authorities have broadly achieved their declared goals, as it has been documented in Mr. Cippà's preliminary statements.

However, the model has yet to demonstrate it is capable of achieving its main goals. In the course of time the policies have created powerful vested interests whose very survival depends on a continuous state support and subsidization. Policies encouraged—as a side effect—rent seeking behavior from a large and generally inefficient domestic bureaucracy. The alliance of these actors can effectively block any progressive reform agenda, including economic liberalization. And without such liberalization it will be difficult for the authorities to unlock the access to financial assistance from the international financial community.

Balance of payments position

Over the last years, due to the imposed foreign exchange and trade restrictions the country has been largely cut off from multilateral and concessional lending. As a result, it had to finance its development needs by borrowing abroad at commercial terms, and by maintaining the old Soviet system of separated cash and non-cash financial flows. The total cumulative foreign direct investments (FDIs) compared to other transition countries, and economy's potential have been meager. Meanwhile, increased foreign exchange market segmentation, illegal imports, and capital flight put an increasing pressure on the country's balance of payments. In response, the authorities intensified administrative compression of official imports, which together with a sharply depreciating exchange rate led to large compression of official imports. The strategy seems to have worked for a while but it may not be sustainable in the future. For one reason, it leads to compressing imports of necessary machinery and equipment for the domestic industries impeding the realization of the authorities' own strategy. For another reason, it encourages shuttle imports and contraband of foodstuffs and consumer goods in the country further exacerbating balance of payments problems. The authorities therefore need to work out and successfully implement a credible strategy of current account liberalization. If this strategy is supported by adequate measures to improve the business climate, then it will increase FDI inflows in the export-oriented industries and help alleviate capital account pressures.

Debt service

Most of the capital expenditures over the last years has been financed by the expansion of foreign and domestic debt. As a result, from 1998 to 2000 only, the external debt, related to GDP estimated at the indicative exchange rate—which is an average of the official and market rates—the staff at the market foreign exchange rates, has risen to 63 percent of GDP. Correspondingly, for the same period, debt service as a percentage of gross international reserves increased from 44 percent to 93 percent. Under the circumstances, the authorities deserve praise for timely external debt servicing.

According to the staff projections, debt service is expected to rise further over the medium term, while the exports stay roughly at the current level. The staff cites several reasons for that. The country now exports mainly cotton fiber, gold, and energy. Cotton exports depend on natural conditions, and vary widely from year to year. Gold exports in the last two years have remained roughly unchanged both in terms of price and output. Energy exports, having increased markedly in the recent year, are constrained by existing production and transport capacity, as well as the ability of the Uzbek main customers to pay fully in time and in cash. The rest of the Uzbek exports, particularly coming from the newly born or modernized domestic enterprises will face tough competition from the regional and even global producers due to economies of scale and lower transport and marketing costs.

Therefore there is a serious risk that in the years to come existing debts can no longer be rolled over at reasonable costs. It is also far from certain that continuing the present policies of the financing deficits by monetary expansion and import compression will be possible at all. Eventually, the authorities will have to abandon the distorted foreign exchange regime, embark on liberalization and enhance a business climate conducive for investment.. The sooner they do it, the less costly and painful it will be.

Fiscal position

To their credit, the authorities have managed to run relatively tight fiscal policies in the past and they are committed to do so in the future. This, however, excludes quasi-fiscal operations, which the staff has difficulties to estimate. These activities include directed lending and the implicit taxation of exports and subsidization of imports, and other payments abroad, mainly debt service through the existing foreign exchange regime. The government is also able to collect necessary taxes and keep expenditures under control reflecting predominantly state controlled character of economy.

Monetary policy and financial system

Monetary policy and financial system have firmly remained subordinated to the state directives. I note Mr. Cippà's explanation in the preliminary statement on authorities' monetary policy conduct. In fact, this may be the maximum of what the Central Bank of Uzbekistan can achieve in the present situation. The staff in their report note increased depreciation, accelerating inflation, and widening spread between various exchange rates. I agree with the staff that one of the main reasons why second tier banks are able to meet their prudential standards is because of the zero risk evaluation of direct and government guaranteed loans and other financial transactions. Further depreciation of the official exchange rate, if it is not followed by other necessary measures and stepped up banking supervision, may lead to deteriorating portfolio of the banking system. Given the prevalence of government guaranteed loans, this may result in additional and severe burden on state public finances. In absence of meaningful reforms, this burden will only increase over time.

In sum, this year's staff report presents widening macroeconomic imbalances and diverging views between the staff and the authorities. This is worrying. The external security situation in Central Asia continues to deteriorate, poverty is on rise, and economic development is, at the best, stagnant. This may not be sustainable for the longer period, and the political and economic consequences may affect the whole region of Central Asia and even beyond.

I believe the authorities have not yet lost the possibility to turn the situation for better, and initiate long waited and much needed reforms. The Fund and all international financial institutions (IFIs) should do what they can to assist the country.

An important measure would be the establishment of an independent statistical body, largely free from political interference, capable of processing, producing, and disseminating statistics, and monitoring the economy on a regular basis. If the country's leadership does not have a full and inherently coherent picture of the economic situation in the country, it cannot design and implement any meaningful economic and financial reforms. In the absence of an independent evaluation and monitoring body, it will be difficult for the authorities to negotiate with the multilateral institutions and other lenders about financial assistance and support.

If the authorities take the necessary measures, the international community including the Fund and the Bank should be ready to provide the required technical assistance and after a staff-monitored program financial assistance. I ask the staff to stay involved even if this requires to combine patience and firmness.

With these remarks, I wish the authorities all the best in their policies.

Mr. Yeritsyan made the following statement:

Uzbekistan continues to puzzle observers with its conflicting macroeconomic outcomes. Despite the authorities' persistence with their import substitution strategy, which distorts different sectors of the economy, the Uzbek economy is growing in real terms. Moreover, the positive growth is accompanied by a reasonably sustainable and improving fiscal stance and a moderate current account balance (it turned positive in the year 2000, albeit mainly because of imports compression), unless statistics like CPI or GDP growth are wrong.

I agree with the staff that the distortionary policies of the authorities, via restrictions and heavy interventions, are counterproductive. Indeed, comprehensive liberalization and reform of the economy could improve the Uzbek medium term growth and macroeconomic prospects. However, the authorities deserve to be complimented for their tight fiscal policies and openness to foreign investment. Finally we must respect their desire to press for ownership of the economic program.

In general I agree with staff's conclusions and the policy measures that they suggest, although staff has to address the consequences of some policy decisions. Mr. Cippà and Mr. Djojosubroto are rightly challenging these issues in their statements. In this respect, staff has to continue discussions with the authorities, on the understanding that we expect the authorities to be open in this process.

The main challenge in reforming the Uzbek economy remains the number of exchange restrictions and multiple currency practices. I agree with the staff that the Uzbek authorities do not need international financial resources up-front or large amounts of money to introduce current account convertibility, but, as other directors, I fully support the authorities request for technical assistance to identify the costs of exchange rate unification. Staff tries to answer this question in the report, but I believe there is a need for deeper analysis than the impact of exchange rate depreciation on different sectors of the economy. Alternative flow of funds analyses or different types of stress tests could be one of the approaches. These kinds of exercises and BOP manipulations could help to convince the authorities that a well-designed export-oriented liberalization program that relied on a market based allocation of resources would not cost them much. This is why I would urge the Uzbek authorities to discuss foreign exchange liberalization measures in the context of program with the IMF.

Although I understand why the Uzbek authorities feel they need to impose import restrictions, I question whether they actually gain anything from having different exchange rate regimes and surrender requirements. Uzbekistan's foreign exchange market will become much more liquid and sophisticated after unification of exchange rates and elimination of non-market conversion mechanisms (such as surrender requirements). In the report staff provides very good evidence in favor of this issue as well, which is the appreciation of the curb market rates in the year 2000, because of the government announcement to liberalize foreign exchange transactions and unify exchange rates.

I share staff's methodology of estimating Consumer prices, which shows that CPI is twice as high as the published official statistics. The CPI is very high (according to staff estimates it is more than 50 percent, authorities are reporting 25 percent) and cannot be considered as viable for Uzbekistan. I agree with staff that the continuation of current tight fiscal policies and further tightening of the monetary policy will guarantee less costly exchange rate unification and external sector liberalization. At the same time I see a rationale for a further tightening of monetary policy than the staff is projecting, under the liberalized scenario. Sources of the monetary contraction will be the government's commitment to reduce the CBU loans to the budget by one half, reduce the high level of reserves, and the urgent need to keep the real interest rates at least at a positive level. This will guard the exchange rate against fluctuations and will prevent from refusing to implement reforms in the middle of the process, because of some future political difficulties, too.

Uzbekistan's macroeconomic statistics suffer from a number of weaknesses to the extent that, according to the staff, hampers the analysis of macroeconomic developments. I would urge the authorities to pay more attention to produce reliable data and try to absorb more effectively the technical assistance provided by international organizations.

As a conclusion I would like to agree with the staff appraisal. Uzbekistan remains the one of the Former Soviet republics, where non-market oriented (supply side) policies are still prevailing. The positive part of the story is that demand management institutions are in place as well. That's the reason that I would urge the authorities, even if they do not want to have a program with the fund, to effectively use the Fund's assistance role to strengthen their institutional capacities. The authorities have to recognize that eventually they will need more market oriented institutions and to facilitate an environment where private enterprise can function. The current favorable macro environment is a good chance for them to transform their economy (which was not the case in many of other transitional economies).

Ms. Brukoff made the following statement:

I will be very brief, since we have repeated our key themes on Uzbekistan over a span of several years and have little new to add today. Uzbekistan is a country with great potential, but unfortunately due to its current policy orientation, much of this potential has been and will remain unrealized. Economic conditions in Uzbekistan have continued to deteriorate over the past year, and despite promises from Uzbekistan's leadership, the prospects for reform now seem further off than ever. We wholeheartedly concur with staff's conclusions and recommended approach.

I will focus my statement on key recent developments, the issue of data quality, and the role the IMF should play in an environment such as the one we are confronted with in Uzbekistan.

The authorities' efforts in May and July 2000 to reduce the overvaluation of the exchange rate undoubtedly entailed political costs. These measures did reduce somewhat the distorting effects of the country's multiple exchange rate system. But they are unlikely to lead to lasting or fundamental change in the efficiency of foreign exchange allocation in the economy because they were not matched with any further liberalization of access to foreign exchange, and because exchange rate movements remain heavily managed by the authorities. The political difficulty of imposing a large step depreciation, combined with the minimal positive impact the devaluation can be expected to have on the economy, will make it even more difficult in the future to build constituencies in favor of a broader reform agenda.

Although the authorities' exchange rate policies did not go far enough, they went in the right direction. The same cannot be said for the recent government resolution outlining a detailed import substitution strategy through 2005. By choosing this policy direction, the authorities demonstrate their continued preference for maintaining self-sufficiency and protecting employment at the expense of realizing the county's enormous growth potential.

Recent statements by President Karimov that convertibility is three to five years away represent a significant step backwards and are the clearest indication yet that the Uzbek leadership remains committed to its present policy course. Under these circumstances, I fully endorse staff's conclusion that providing an up-front stabilization fund, as requested by the Uzbek authorities, would be inappropriate. Fund resources should not be deployed until the authorities develop a credible program with a specific timetable for implementation, and after a track record of performance has been established.

Turning to data issues, we note with concern the discrepancies between growth and inflation outcomes reported by the authorities and those estimated by staff. If the authorities genuinely hope to make use of Fund resources at some point, they should make every effort to address the data weaknesses identified by staff to avoid a possible misreporting situation.

Finally, I would also like to comment on the role of the IMF's Resident Representative in Tashkent, who has done an excellent job under very trying circumstances. However, given the continued lack of interest in reform exhibited by the Uzbek authorities, his ability to engage them in constructive policy dialogue appears quite limited. Having reached the point where he is being asked to duplicate work he has already done at the authorities' request, it would seem that his continued presence in Tashkent provides little marginal benefit. He should be withdrawn as planned this spring, as further delay in doing so would only signal to the Uzbek authorities a willingness to continue the current non-dialogue in the future.

Mr. Al-Azzaz made the following statement:

Mr. Cippà's helpful preliminary statement presents an encouraging picture of economic developments in Uzbekistan over the past year. Growth has been sustained and inflation stayed at a relatively modest level. The external current account also strengthened and the foreign exchange reserves have been maintained at a level equivalent to almost six months of imports.

These developments notwithstanding, the economic situation remains difficult and the reform measures taken so far are only steps in the process to address the challenges ahead. Here, I will make a few brief remarks for emphasis.

The authorities' continued priority for unification of exchange rate is reassuring. Last year changes to the exchange rate system are steps in the right direction. However, the authorities are encouraged to step up efforts to move toward a full unification and liberalization of the foreign exchange market. In this connection, the Fund's financial support for a strong program would play a major role in catalyzing the necessary financing. Here, I urge authorities and staff to show flexibility in finding a solution agreeable to all.

It is encouraging that the fiscal deficit was lower than expected in the 2000 budget. While the authorities are to be commended for this achievement, further progress is needed given the high debt burden. In this regard, I welcome the authorities' firm commitment to continue the implementation of appropriately tight fiscal policies in 2001.

On structural reforms in other areas, speedy establishment of a business-friendly legal and regulatory environment is essential for a successful completion of the privatization program. In the banking sector, I endorse the objective of the medium-term program to reform the banking system.

Also in the agricultural sector, I note the continued efforts in both ownership structures and pricing policies. This process, however, needs to be accelerated so as to improve the living standards in rural areas and create a constituency for the broader economic reforms. In this regard, I welcome the authorities commitment to liberalize the state order system on a pilot basis as pointed out by Mr. Cippà's preliminary statement.

On conclusion, Uzbekistan made some progress last year, but it still has a long way to go. In this regard, a comprehensive and well sequenced program would be essential. Further delays will only complicate the economic situation and increase the costs of adjustment.

With these remarks, I wish the authorities success.

Mr. Lushin made the following statement:

As in the previous year, staff papers are critical of economic policies in Uzbekistan, although they admit that some progress has been achieved in fiscal consolidation and the unification of exchange rates. I broadly agree with most of the staff's analysis and policy measures that are recommended to the authorities. I want to emphasize, however, that the staff evaluates the Uzbek economy through the lenses of market mentality, implicitly assuming that this economy, although not a market one at the moment, is at least moving in that direction. But this assumption may be doubtful.

Despite lip-service to liberalization and market reforms, the Uzbek authorities seem to remain firmly committed to running the economy by administrative means. It is widely accepted now that an old dispute on whether a market economy is superior to a centrally planned one is over both in the intellectual and practical sense. Every country, however, is free to select its own ways and I am not going to judge the choice made by the Uzbek authorities. But this choice is important to bear in mind when we talk about economics, because what is good for a market economy is not necessarily so for an administered economy and vice versa.

For example, if we were sure that Uzbekistan is seriously moving towards a market economy, then current account convertibility and elimination of a multiple exchange rate system would be a must. Conversely, in a command economy the multiplicity of exchange rates is an important mechanism in the hands of the authorities to reallocate resources according to their general economic strategy. Dismantling it without changing other mechanisms of the administrative economy may well make the things worse rather than better. An example of such type of inconsistency could be an ill-conceived foreign trade liberalization in the USSR in the late 1980s. Undertaken in the context of a still centrally planned economy, it resulted only in an upsurge of capital flight and a massive loss of fiscal revenues.

In other words, attempts to combine plan and market within one economy may well be a recipe for disaster. When drafting the economic strategy, the authorities of a country should first firmly decide on what side of the river they are. It seems to me that an obvious reluctance of the Uzbek authorities to dismantle the system of multiple exchange rates is a good indication of their true stance. Moreover, current account liberalization is not compatible with the strategy of import substitution, which is actively pursued by the authorities and which, in my view, is not very prudent even in the framework of a centralized economy.

The staff mentions on several occasions (for example, in para 18) that the reform agenda should be comprehensive and that current account convertibility alone is not enough. Still, the aforementioned distinction between the appropriate economic policies in the context of a market or an administrative economy is muted in the staff paper, if at all present. Therefore, the reader may decide that current account liberalization is an issue #1 in the Uzbek economy and that this is a single most important measure to implement, which, in my view, is not entirely correct. The elimination of the state order system for cotton and wheat, that is mentioned only briefly in paragraph 18, would be of no less significance for the dismantling of the foundations of the administrative economy.

Let me say a few words about official statistics and the way it reflects the economic situation. I agree with the staff that it is difficult to make a reasonable judgment about the Uzbek economy on this basis. The problem is not only with data quality or political interference, even though these two are legitimate concerns. Macro statistical indicators in an administrative economy may often have a meaning which is very different from what we have gotten used to. For example, when key prices are regulated, the CPI does not reflect true inflation pressures and, hence, the degree of imbalances in the economy. The rate of growth can also be a misleading indicator. This is because some of the goods and services produced and accounted for may have no market value and, therefore, may not reflect wealth creation or changes in consumption. As a result, there may be an indirect linkage at best between such growth rates and the living standards of population.

Finally, a few remarks on the external debt. First, its rapid growth over the last several years is really alarming. I have strong doubts that borrowing undertaken to develop import substituting industries will eventually pay off. It is suffice to say that the attempts to do something similar by the Soviet authorities in the mid-1980s (the so called "acceleration" policy) failed completely. Second, it is highly regrettable that the issue of the Uzbekistan's debt to Russia related to technical credits of 1992–94 remains unresolved. All attempts made by my authorities to start negotiations on this matter had no outcome but one—the appearance of Uzbek counter claims of roughly the same amount, dating back to the Soviet times. My authorities find this approach highly regrettable and urge the Uzbek authorities to revise their position.

With these remarks I wish the Uzbek authorities well.

Mr. Xu made the following statement:

We thank staff for the well-written report and Mr. Cippà for his very comprehensive preliminary statement. The Uzbek economy performed well last year: real GDP growth turned out 4 percent according to official data; and foreign exchange reserves were maintained at a comfortable level, equivalent to almost six months of imports. This has not been an easy task, given the strong impact of the exchange rate unification measures on prices last year. We clearly see the merits of the staff report and would like to make following remarks.

Exchange rate policy

First, we are pleased that the authorities' priorities continue to include unification of the exchange rate, liberalization of the foreign exchange market, and acceptance of the Article VIII obligations. We share the view that their actions to reform the exchange rate system last year have brought Uzbekistan closer to its ultimate goal of full current account convertibility. With an increasing number of authorized participants on the exchange bureau market and an increased number of operating foreign exchange bureaus, the exchange rate now represents more market forces. As a result, as indicated by Mr. Cippà, the spread between the official and curb market rates declined from over 450 percent at the beginning of the year to about 160 percent at the end of 2000. That being said, much needs to be done toward unification of the exchange rate and we encourage the authorities to continue to spearhead decisively and rigorously in a timely manner.

Statistical issues

With the increasing importance of accurate and reliable statistics for macroeconomic performance evaluation and policy-making, especially for transition and emerging economies, we are encouraged by the authorities' steady efforts to improve the quality of statistics, including the introduction of new measures recommended by the Fund. Since 1997 there have been clear signs of convergence between the official and staff data for real GDP and CPI as listed in Box 2 of the staff report, particularly for real GDP numbers, although there were still wide margins. While we commend the authorities for their achievements in improving statistics, we encourage them to redouble their efforts, particularly with national accounts, the CPI, and fiscal data.

Resident representative

Finally, we turn to the resident representative position. Uzbekistan is at a critical juncture in its liberalization and reform process toward a market economy. There are many tough challenges ahead—the unfinished agenda to maintain full convertibility for current account transactions, sustain low inflationary growth, and, above all, alleviate poverty and raise living standards. Against this background, we note the authorities' strong and continuing desire to benefit from the Fund's policy advisor on a daily basis, given the need for enhanced mutual understanding between the authorities and staff for a agreement on the important economic issues. Like the authorities, we believe the resident representative plays an important role in policy dialogue as well as in narrowing any differences between the authorities and the Fund. Therefore, we support the authorities' request that the resident representative post be continued.

With these remarks we wish the authorities continuing success.

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

> We take the statements that the authorities wish to move to a market economy at face value. The only disagreement we had is on the speed with which they are moving. Their actions may show a different picture, but we have analyzed those on the basis of the authorities wishing to move to a market economy. We know that current account convertibility is not the main issue, but given the emphasis on the Fund's core business we have focused on that aspect of economic reform in Uzbekistan.
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> On the issue of the costs of the exchange rate unification, it was mentioned that the staff's approach in box five is simplistic. We agree with that assessment. However, we have been limited in our ability to carry out a proper analysis by the lack of information provided by the authorities, except as regards the social costs.
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> On the impact on enterprises and banks, we have been asked by the Uzbek authorities to pull a number out of the hat because the information that we have requested in terms of enterprise balance sheets and bank balance sheets has been considered state secrets, and therefore we have not been able to make more detailed calculations. We have as an upper bound, the increase in the costs of the debt service on government guaranteed debt. We know that not all enterprises would get into difficulties because of exchange rate liberalization. Some enterprises would benefit from the depreciation and would be able to pay this increased debt service. As Mr. Yoshimura mentioned, they should not be fully compensated. The authorities would have to make a clear decision on which enterprises would be viable, and which banks would be viable in this environment. There may be confusion concerning the estimates of the social costs of unification, but that is related to the way that the current exchange system works. A number of prices have already adjusted to the black market rate, influence prices, or the curb market rate as we call it, and therefore the impact on prices of the depreciation that is expected of the official exchange rate would be fairly limited. For example, the agricultural sector would benefit significantly from this depreciation, and that would reduce poverty in the rural areas.
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> On enterprises, it is difficult for to us to understand the authorities' concern about the impact of the further depreciation of the official exchange rate. In our view, to unify the exchange rate this year, the depreciation of the foreign exchange rate would be much less than last year. And last year the authorities tell us that there has not been one single bad loan and no enterprise has gotten into trouble due to the depreciation. However, we agree that the longer the depreciation continues, the more difficult it will be to cope with it.

> On the resident representative, this is an issue for management to decide. We have recommended, taking into account resource constraints, that once the current term is up at end March, we do not replace him with a full-time staff member. We will only retain local staff in the office and have staff members from headquarters visit once or twice a year to help maintain the contact with the authorities. If the authorities actions show that they are serious about reform, we would be willing to start the search for a new full-time staff member.

Mr. Cippà said that the Board considered that the system of a planned economy is not sustainable, and should be liberalized, and that the authorities should move more forcefully in that direction, on the assumption that the sooner that was carried out, the less the cost would be for the economy. The authorities also believed that there was a need to liberalize the economy, which was the official position. The main disagreement with staff was the speed of liberalization. Fully liberalizing the Uzbek economy was a long process, and the issue of the pace of reforms was a long-standing debate between the authorities and the staff. The experience with the transition countries that we have had underscored the difficulties in finding the right balance between speed and minimizing the social and economic costs of the transition.

The Uzbek authorities wished to continue to preserve social peace and to protect the most vulnerable part of the society in the process of moving toward a market economy, Mr. Cippà said. The unification of the exchange rate was only one aspect of the liberalization process. In that respect, he reiterated that liberalization of the foreign exchange market as well as acceptance of the Article VIII of the Articles of Agreement remained a priority for the Uzbek government. Important steps had been made since last May, and credit needed to be given to the authorities for what they had been doing.

Mr. Cippà appreciated that Directors had expressed signals of support for additional technical assistance, as the authorities wished to have more of that. He was also grateful for the support that some Directors provided for keeping the position of the resident representative in Tashkent, as that was also the wish of the authorities. He did not agree with staff about the strain on resources. The resident representative had engaged in sound cooperation, especially with the Central Bank. As Uzbekistan was an important country in the region, the Fund should keep that means of communications open.

It was disappointing that there was no support for providing, at an early stage, financial assistance to Uzbekistan, and that that would be forthcoming only after a monitoring period, probably when that assistance would not be necessary anymore, Mr. Cippà continued. He hoped that the need for a track record would apply to the membership at large.

Mr. Yoshimura noted that he had supported gradual reforms to mitigate the social costs. In the case of Uzbekistan, however, the unification of the exchange rate had been an issue for many years. It was disappointing for his authorities that measures promised had not been fully implemented last year. He urged the authorities to consider immediate action on that front. He believed that active involvement by management and staff through a resident representative was important.

Mr. Cippà assured Mr. Yoshimura that his message would be passed to the authorities and that they would listen carefully to the advice provided by Japan.

The Acting Chairman said that management and staff would further discuss with the authorities the issue of the resident representative, particularly through Mr. Cippà's office.

Mr. Sdralevich made the following statement:

> While economic indicators show some positive developments, such as sustained growth, we continue to be are disappointed by the situation in Uzbekistan. Above all, reforms progress at a very slow pace, despite some advance in the last year and the recent introduction of some flexibility in the foreign exchange market, as just reported by staff. We agree with the candid and balanced staff report. We have in particular some remarks on economic policy, on data provision, and on the relations of the country with the Fund.
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> First, on economic policy, we agree with the staff and do not have specific comments. It is apparent that there is only one way forward, and that is opening up the economy, first of all with the unification of the exchange rate and the convertibility of the current account, and then by modernizing its institutions and reducing the pervasive influence of the state in the economy. The staff has well outlined the possible areas of interventions, so there is no need to go into details. Of course, it is up to the authorities to decide on the pace of transformation of the economy, and we believe the staff has rightly adopted a flexible approach. However there is no doubt on the direction of the transformation.
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> Second, let me underline that the current production and provision to the Fund of statistical information is extremely unsatisfactory. The large divergence of the official and staff's estimates on quite basic figures such as GDP growth and inflation is unacceptable. Even more sectoral indicators are obviously completely out of line with reality. As just one example, bad loans in the banking system are unbelievably estimated at less than 0.1 percent of the total.
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> In this regard, let me stress that the Board has made it clear in the past that the reliability of information is an important element of the cooperation between the members and the Fund for surveillance purposes as well as for financial assistance. Furthermore, the authorities must be conscious that the distorted image of the economic reality depicted by their data will at some point make economic policy impossible. It is very difficult to keep track of the "true" data in a sea of misinformation. Unreliable and outright false data have a cumulative effect and the statistical situation becomes completely

unmanageable in a very short time. I fully agree with Mr. Kiekens on the need for some form of independent statistical institute.

Lastly, we believe that the attitude of the Fund should continue to be based mainly on the Uzbekistan's reform efforts. The authorities should avoid to make their yet insufficient push for reforms conditional to the immediate availability of external assistance, in the form of a "stabilization fund." This unacceptable behavior is very far from the normal relations between the Fund and members experiencing economic difficulties. We would appreciate an autonomous drive for structural change before more substantial assistance is made available. As to the immediate future, we favor continued provision of technical assistance if judged useful by the staff and on the basis of the cooperation of the authorities. It will be important that the limited resources of the staff not be wasted when TA could be given to many needy and more deserving members.

We hope that these stern remarks will be taken by the Uzbek authorities as a constructive contribution towards a healthy change of the course of economic policy.

Mr. Lushin said that the main point he had been trying to make in his statement was that it was impossible to have one sector in an economy operating according to market rules, and other sectors operating according to planning rules. If the Uzbek authorities were committed to going ahead with liberalization and creating a market economy, it was important to move simultaneously on all fronts and not just in one or two areas.

Mr. Charleton made the following statement:

At the outset, I could not agree more with most of what was said by Mr. Yoshimura.

I read the staff report and perceived an economy with many Soviet era features. There is a grand plan to build strong heavy industries on the basis of import substitution with administrative access to foreign exchange. There is allocated preferential credit, and unfortunately loans are state guaranteed.

Key sectors of the economy, such as cotton production and exports are government controlled. Strange enough, economic performance has been respectable, but in essence the economy is going nowhere in the future. To cap it all, official statistics are a political statement rather than economic reality.

I read Mr. Cippà's statement and he is talking about an economy totally committed to liberalization, which, indeed, progressed quite a long way. Instead of chronically overvalued exchange rate he sees one that is markedly depreciated. There is sound policy and banking system with few bad debts, and over the past ten years this economy has clearly outperformed others, especially those that followed IMF advice. Then I wonder if Mr. Cippà's statement and the staff report describe the same economy or if have I read the wrong document. It is most unusual to see two groups of experts analyze the same situation and come to such differing conclusions. I was not sure what to make of it, but staff and the authorities seem to have started from different ends of the spectrum, and observed developments from entirely different angles. One see distortion to cope with inevitable problems, while the others see a major step forward towards liberalization. Last year, Directors pleaded for better dialogue in the way forward, but the Fund and the Uzbeks are still talking a different language. I am not saying that I accept everything that staff say uncritically, but I find overall their arguments very persuasive. The Uzbeks are heading in the wrong direction and compounding their problems. In some sense they recognize this, but reform and liberalization must be very gradual. This situation requires much more radical action and change of direction. There is still no concept of adopting a foreign exchange regime or that ordinary customers can get ordinary foreign exchange to carry out routine business.

The authorities see the need for a great deal of external finance before they could contemplate genuine convertibility. They are reluctant to accept staff's modest cost estimates. Perhaps these differences in perception flow from the idea that removal of distortions will hurt those who benefit from them, and they in some sense must be compensated. I consider this to be a false premise. Removal of distortions creates an absolute gain for the economy. It is essential that redistributional effects take place. If everyone gets compensated, behavior does not really change, and no progress is made. A large amount of Fund resources to help the process may end up funding continuation of the present distortion of resource allocation in some shape or form. I am skeptical of staff's showing large benefits from change in direction but I agree that Uzbekistan should take major steps forward before committing significant Fund resources.

On a related issue, I am perturbed by the striking difference between the staff and the authorities on basic economic statistics. For instance one says inflation is 20 percent and the other said 40 percent. This is a stunning difference which has major policy implications and would make it difficult to agree to the design of a program. I do not know exactly who is right, but I am worried of getting into a program radical data revisions. I must admit, however, I have some sympathy for the Uzbek objection on political intervention when compiling and disseminating data, I find this reference in the report to be strong, and I hope that staff have strong grounds for making it.

I want to make a further point on technical assistance which others have raised. I sense that hard issues are being avoided by calling for re-examination of an issue which has already been examined, and resorting to further calls for technical assistance. Yet, I am not convinced that the authorities are willing to follow through upon technical assistance recommendations. I am not saying we should cut off TA completely, but we cannot forget that TA is a scarce commodity with a high demand, and we have to allocate it to countries where we believe we will get a very good return from it.

On the question of the resident representative, I would be inclined to agree with Ms. Brukoff, that for resource reasons we may justify not replacing the resident representative.

Mr. Cippà said that the claim that the authorities were seeking financial insurances before they would carry out any liberalization was wrong. The authorities would like to have financial assistance which accompanied the change in the unification of the exchange rate. They did not want pre-commitment. Every country that agreed on a program which included a set of prior actions received financial assistance at the same time. That was not unacceptable behavior, but rather normal behavior. At stake was a staff-monitored program. Currently, it would be at least six months before any assistance would be provided, meaning that the authorities would have to start liberalization and unification before any assistance could be disbursed.

Mr. Nadali made the following statement:

We thank the staff for the well-written reports, and Mr. Cippà for his insightful statement.

While macroeconomic imbalances remain, we agree with Mr. Cippà that in view of adverse impact of exogenous factors facing Uzbekistan, the performance of the economy in 2000 has been rather favorable. The budget deficit narrowed, mostly due to cuts in expenditures, while increase in excise tax revenue largely offset the revenue decline from direct taxes. The external current account position turned slightly positive and gross official reserves stood at a comfortable level.

The authorities took some positive steps on the structural side, namely raising energy prices, relaxing restrictions on the operation of commercial banks, and the adoption of a budget law that meets most standard requirements. There was, however, limited success in bringing down the inflation rate in 2000. While the average CPI was lower than in 1999, the end-period rate was higher. The depreciation of the curb market exchange rate, a liberal wage increase, and an accommodating monetary policy were the factors responsible for the acceleration of inflation in the second half of the year that led to a higher year-end inflation.

With emphasis on foreign exchange and trade system, we concur with the staff that uncertainty in exchange rate unification has complicated the formulation of effective macroeconomic policies for 2001. The authorities have taken some important steps and have established necessary guidelines to reform the economy. Monetary policy aims at reducing inflation and real interest rates. In view of the liquidity injection into the economy at end-2000, monetary policy may need to be further tightened. The authorities remain committed to the liberalization of the exchange market and moving toward the acceptance of the obligations of Article VIII. As outlined by Mr. Cippà, several important changes introduced in the exchange rate system have brought Uzbekistan closer to its goal of full current account convertibility. The positive response the authorities have received from the market should strengthen their resolve to hasten the pace of unification and broaden the scope of liberalization. The experience in other countries indicates that lack of serious commitment to the exchange rate system liberalization could result in proliferation of rates. Once the new rates are established, they will run their course with damaging impact on resource allocation and encourage rent-seeking activities. Admittedly, current account convertibility, in general, and exchange and trade system reforms, in particular, are not without costs, and there is substantial difference of estimates of these costs between staff and the authorities. Considering the fact that the estimates provided in Box 5 of the staff report do not include all possible cost of exchange rate liberalization, we welcome the staff's decision to review the case and help the authorities recalculate the cost in the near future. The cost estimates would surely depend on the policy envelope, particularly on the social safety net and other government supports deemed necessary for the success of the program. The risks and cost could be minimized by adopting a comprehensive and coherent reform program.

On the fiscal front, we note that the authorities remain committed to a tight policy in 2001. It is, however, not clear how this objective could be achieved, and how the tightening would impact social expenditures.

On the structural front, we welcome the ongoing reforms in ownership structures and pricing policies for the agricultural sector, the increase in the procurement prices for cotton and grain, and the authorities' commitment to liberalize the state order system. Nevertheless, the full benefit in terms of increase in output and improvements in living standards of the producers would be better achieved by a move to market-determined prices. Enhancing the status of the committee charged with demonopolization and development of competition is another welcome step and should create the necessary environment conducive to private-sector activities, and confer efficiency gains needed for a sustained high-quality growth. Banking sector reform is heading in the right direction. We encourage the authorities to implement the measures stipulated in paragraph 25 of the RED report with perseverance, and rigidly execute the law prohibiting the state and local authorities' interference in banking activities. We welcome the staff or Mr. Cippà's comment on whether this law applies to CBU's operations as well. The intended reduction in the provision of state guarantees for bank loans is also a welcome step.

While the reluctance of the authorities to embark on a more accelerated adjustment and reform program is understandable, in view of the medium-term outlook, the authorities should take advantage of their relatively strong institutional capacity, and expeditiously agree with the staff on a Fund-supported program. We continue to believe that a frontloaded Stand-By Arrangement is a proper arrangement for Uzbekistan. We could support the extension of the Fund resident representative's stay until the next consultation period, with further extensions contingent upon a substantial progress in policy dialogue between the authorities and the staff.

With these remarks, we wish the authorities success in achieving their economic objectives.

Mr. Le Gal made the following statement:

Uzbekistan is a difficult country to analyze not the least because it is rare to have such a divergence of view between Staff and the authorities about the current situation, and the future course of event.

I shall start with the statistics where the differences are striking. Box 2 shows clearly the differences in recent year between the growth and inflation estimates by staff and by the authorities. Mr. Cippà, in his comprehensive preliminary statement plays down this difference because the trend would be the same. It is difficult to follow him on this point since figure 2 illustrates the dynamic of this divergence and how huge is the difference after four years. The annex on statistical issues is saddening and give the sense that the authorities did not really take full advantage of Fund's assistance to improve their indicators and this makes difficult both current and future dialogue. We urge the authorities to follow Fund's advice in this area, rapidly, to allow a more comprehensive and meaningful analysis of economic developments in Uzbekistan.

Turning to the direction and the pace of reforms, it seems that, at least, the facts are recognized but that their interpretation diverge. Regarding the exchange rate, I agree that some steps have been made in the right direction but with hindsight it appears that the original plan of unifying the exchange rate has been postponed and the steps taken so far actually ended with an increased segmentation of the exchange rate market. Therefore, it would be critical for the authorities to design a clear plan and show tangible progress in this area. Moreover, the creation of a centralized import agency as well the intensified import substitution program are steps in the wrong direction.

To conclude, I agree with staff that the situation is deteriorating, slowly but surely. The overvaluation of the official exchange rate is currently hiding the seriousness of the debt situation and the authorities' current strategy of import substitution seems only to delay the necessary adjustment without addressing the actual imbalances. We share the staff appraisal and we encourage the authorities to follow staff's recommendation.

Mrs. Steinbuka made the following statement:

I am in general agreement with many of the concerns raised in the staff papers and Mr. Yoshimura's outlines. It is highly regrettable that the authorities have not been able to keep their promises and to maintain momentum for reforms. A year ago, Mr. Cippà, in his preliminary statement, stated that Uzbekistan was a clear leader among the countries of the FSU and compared Uzbekistan with Estonia. Also today the tone of Mr. Cippà's preliminary statement seems overly optimistic. In reality, the gap between Uzbekistan and the frontrunners of transition is widening further.

Like a year ago, I must say that Uzbekistan's economic policies continue to reflect the typical features of a planned economy. The exchange rate system has a distortionary impact on the economy and has imposed significant macroeconomic costs. The reliance on heavy borrowing to support an import-substitution policy and to develop industrial and manufacturing capacity is a clear way to a dead-end for an economy in transition. Economic liberalization, the unification of exchange rate on a market basis and the introduction of current account convertibility should be a central part of the economic reform agenda in Uzbekistan, if transition to a market model continues to be an objective.

I also wonder why the Uzbek authorities consider such key economic indicators as GDP and inflation to be a "state secret." The official statistics should give an accurate assessment of the true development. If the information is misleading, there is no basis for the correct policy choice. Moreover, like Ms. Brukoff and Mr. Sdralevich I must stress that large discrepancies between the official statistics and the staff's estimate suggest that fruitful environment for misreporting is in place. Without reliable and transparent statistics any access to the Fund's resources would not be justified. Like Mr. Kiekens, I am convinced that setting-up an independent statistical agency is absolutely essential for improving quality of data.

Up to now, "vested interests" effectively block market-oriented reforms. I therefore urge the authorities to review their policy options. I hope that sooner or later common economic sense will dominate among decision-makers in Uzbekistan. I also hope that an active policy dialog with the Fund will be initiated. I encourage the Fund to be involved in the process of economic-policymaking in the country.

With these remarks I wish the authorities every success

Mr. Hagan made the following statement:

This is an interesting discussion and one I hope could move to fruitful dialogue between the Fund and Uzbekistan. Most of my colleagues have made critical remarks about policies in Uzbekistan, and I agree with most of that. We are providing a consistent message, and many Directors have tried to balance their remarks. We hope we could get back to fruitful dialogue, which the staff paper worryingly indicated we were getting away from.

Mr. Cippà raised some interesting issues, whether, in fact, Uzbekistan has a deteriorating performance or not. Most of us would agree today that the policies being carried out are likely to be counterproductive in the medium to long term. However, I agree with Mr. Cippà that it is difficult to argue on the basis of the figures we have that performance is demonstrably deteriorating. Having said that, it is not clear what the figures tell us, and we need much more clarity in the future on the statistics.

In order to advance our own arguments what the right policies are, we do not have the counterfactual at hand how Uzbekistan could be doing. It is undoubtedly well endowed with economic resources and could potentially be the key economy for growth in that part of Central Asia. With the right balance Uzbekistan could do better and should be adopting certain policies to enhance its medium and long term growth outlook.

The dilemma Mr. Cippà proposes about timing of commitment of resources from international community is also an interesting one. Clearly a first step should be to find common ground on what the likely costs of the policies on the economy are. In fact, this is more difficult than agreeing on basic growth and inflation data, even when staff are allowed to have access to the data they need to make that sort of assessment. Therefore, while I understand Mr. Cippà's argument, there is also another factor to be added in, that there is a problem for his authorities, who object to what has become orthodoxy in most of the rest of the world.

Their commitment to new policies which will take the economy towards the market, although expressed is still not entirely clear. And that skepticism stems really from observation of past policies rather than ideological prejudice. We should make that clear.

The concerns that Mr. Cippà and the authorities express about the difficulties of implementing a faster reform program are legitimate, and we know of these difficulties from other countries in the region, and we should not dismiss them. However, having recognized that, even in the recent past and in the recent year, the authorities have hinted at more reform than is being delivered. While the have valid reasons for this, I do not believe that they should be particularly surprised if the international community would like to see more evidence, before committing themselves to finance a program. This is also a consistent line that the Fund has taken in other countries who have shown reluctance to reform in the past.

It seems unfortunate to me that relations have deteriorated somewhat between the Fund and Uzbek authorities since our last discussion, when we had more hopes that a program may come along more quickly. And I hope although some of the feedback the authorities are getting from this meeting may be fairly negative, we could have a more balanced view and have more fruitful dialogue from now on.

Mr. Kudiwu made the following statement:

I would like to associate myself with those Directors who have recognized the difficult situation facing Uzbekistan. However, like Mr. Cippà, I believe it is reasonable to underscore the important steps that the authorities have taken and to give them credit for what has been achieved. In light of the daunting tasks ahead, I agree with previous Directors on the need to provide Uzbekistan with appropriate financial and technical assistance. Regarding the resident representative in Uzbekistan, I share the view that the Fund should keep the post to preserve its dialogue with the country. As to the pace of reform process, the authorities should continue with the gradual speed to assure full public support for the difficult measures that need to be implemented. Finally, we welcome the commitment to economic reform. With these remarks, I wish the authorities every success.

Mr. Kranen made the following statement:

Like most of the previous speakers, we also regret the lack of reforms in almost all policy fields. Over the last five years GDP per capita has not increased significantly. And despite its great potential, Uzbekistan remains a poor country with a GDP per head of less than US$3 a day.

As Mr. Yoshimura pointed out, the authorities should try to improve their relations with the fund. They should realize that there is no viable alternative to market reforms and the creation of a framework for a market economy. In addition, these steps should be decisive, because a mix of administrative and market oriented policy measures could make the situation worse as Mr. Lushin reminded us today. Given the low living standards, I have some doubts that preserving the social peace is the real reason that keeps the authorities from such decisive reform steps. Other transition countries have shown that the main roadblocks are more in the area of vested interests of the former nomenclature than reform angst of the broad population.

> We also think it could be justified to withdraw the resident representative if a clear commitment to a more reform-oriented course of policy is not visible. But, we believe Mr. Cippà that this kind of commitment will emerge soon. In that context, I would like to stress that we share the view of Mr. Yoshimura that there is the need of a sufficient track record before we consider new financial assistance. Also, technical assistance should only be provided if there is the chance that the advice will be valued by the authorities. Technical assistance or a resident representative should not be perceived only as a symbol that there is still a sort of cooperation with the Fund.

Mr. Sdralevich agreed with Mr. Lushin about the complexity of the economic systems. With regard to the staff-monitored program, it was reasonable for the staff to ask the authorities to show their commitment, which was justified by the previous performance of the country. Furthermore, the Fund had asked such commitment of many countries with views much closer to the staff and to the Board than Uzbekistan, and therefore that was not an unjustified request.

Ms. Phang was struck by the extent of the disagreement over the data issue, and wondered what the real issue was. Based on developing countries' experience it was not new that Fund staff disagreed about data. She assured staff that the data was not fudged. While she did not know the situation in Uzbekistan, Mr. Cippà had given assurance that the authorities employed well trained staff. Therefore, she wondered about the discrepancy in the data, and about the siding with staff's assessment, when staff had also admitted that they did not have a strong basis for their estimates. She also wondered whether staff could have as good an estimate of the real CPI as compared to the authorities, who had resources available to carry out a proper assessment.

On going forward with liberalization, it was known from the Asian countries that during a crisis, sequencing of the reform was needed, Ms. Phang continued. It was not possible to fully liberalize and expect that the results would be as laid out in the textbooks. For example, staff had said that the currency had depreciated by 130 percent, but had called for a raise in the real interest rate. However, interest rates above 28 percent would kill any business, especially when adding the 130 percent depreciation of the currency and the fact that companies have to import their capital. Therefore, while currently the banks did not have any nonperforming loans, when those companies closed down, the banks would also be affected. She tended to be more sympathetic to the Uzbek authorities who wanted to move ahead at a slower pace.

Mr. Yanase responded that in his statement Mr. Yoshimura did not claim that Uzbekistan would face difficulties in the near future based on growth or the CPI, but based on the debt payment and the debt burden. Even with the growth rate provided by the authorities, the debt payment ratio would be high in the next years. It was not known if this could be sustained by the authorities. As had been said by Mr. Kiekens, exports were not expected to grow, meaning that even if the growth rate and CPI provided by the authorities was correct, there was no reason to believe that the country could survive in the medium term.

While the authorities could be right, there was no consensus on how the preparation of statistics could be improved between the authorities and the staff, Mr. Yanase noted. That was worrying. Both should be trained professionals and reach some understanding, but that was not evident from the staff report and Mr. Cippà's statement. Staff and the authorities needed to discuss that issue further. While a TA mission had gone to Uzbekistan to provide advice on statistics there was no further information in the staff paper.

Regarding the impact of depreciation, there was a difference between the Asian countries, and former Soviet Asian countries such as Uzbekistan, Mr. Yanase continued. In the case of Uzbekistan, the main exporting industry would be helped by the unification of the exchange rate since a curb market already existed. When managing the economy, in particular the agricultural sector like cotton, most exports took place at a low exchange rate. When the exchange rate unification takes place, that would give an incentive for those producers to export more. That in turn would help Uzbekistan more than the current situation where the authorities were providing a favorable exchange rate to certain industries. That would not work in the medium to long term framework. While a sequencing of the exchange rate was necessary, there was also a good basis for the Fund to recommend the rapid pace of liberalization. In that sense he was not blaming the authorities, but trying to help the country.

While Mr. Yoshimura's statement, on the Fund assistance, said that there was no need to set up a large amount of external finance ahead of the reform program, that did not necessarily mean that his chair agreed that there had to be a staff-monitored program before that finance was provided, Mr. Yanase commented. However, some kind of track record was needed as a prior action. Although, given Uzbekistan's track record, only including a prior action may not be enough. His chair's position was flexible, but would like to see some action before committing further.

Mr. Burnashev wondered how the economy could move ahead as usual when there had been a 130 percent devaluation and 60 percent inflation. As Mr. Lushin, he saw the reason in the fact that the economy may not be a market economy but still an old Soviet style economy which did not react to price or exchange rate signals. That was also the point regarding statistics. The problem was not who was right or wrong, but whether the statistics reflected reality. The Board consensus was that that was not the case. The first step was to have statistics which could be trusted by all parties, and on that basis start talking about differences in policies and approaches.

Mrs. Steinbuka said that the experience of many transitional economies showed that particularly at the beginning of transition, there were large discrepancies between the statistics of the country and staff estimates. A lot of methodological problems existed, however; after transition, those discrepancies disappeared or were marginal. In some countries like Uzbekistan, with a mixed economy and Soviet legacy, the situation was different. In the Soviet Union, statistics were powerful ideological instruments, and perhaps even now, in addition to poor methodological policies, senior policymakers in Uzbekistan continued to think in those terms. However, the authorities needed true statistics more than the staff because the staff had different indirect indicators which could suggest the main economic outlines. The task of the authorities was to get rid of those misleading messages.

Mr. Lushin said that having lived under the central planned economy for 35 years, he had a lot of experience to share. One more explanation on why the results of a steep devaluation were not so visible in the Uzbek economy, and why the situation was different from the Asian countries, was that under a system of multiple exchange rates, even if one of the rates depreciated strongly, it was necessary to consider how many foreign exchange resources were distributed according to another rate. If most foreign exchange was distributed by administrative rates, then even if cash rates overshot, that would no have a deteriorating effect on the economy, because only a small fraction of actual currency foreign exchange would be distributed according to that rate.

In his view, the problem was not that the Uzbek statistical agencies were not experienced in compiling aggregates, the problem was that in a centrally planned economy, the meaning of output and price system was different then in a market economy. Interpreting the CPI based on prices of which some were fixed and some others were not, was difficult to interpret.

Mr. Cippà said that it would be difficult to come to a conclusion on the issue of data. While he agreed that there were problems and some improvement in the data was needed, he was concerned with the fact that the Board was deciding the issue without having full knowledge of the situation. The authorities argued that staff's proposed alternative in the data is not valid, e.g., when calculating the CPI, staff used only a limited number of goods, and limited locations, meaning that it was only valid for Tashkent and not the whole country. The authorities, however, collected prices for a number of goods from all over Uzbekistan. He was worried that a majority of the Board was agreeing with staff's numbers and not giving the authorities the benefit of the doubt.

Mr. Kranen had a lot of sympathy for Mr. Lushin's and Mrs. Steinbuka's views.

The staff representative from the European II Department said that in Uzbekistan, staff from the statistical office had worked hard to solve technical issues, but their inflation figures did not correspond to other economic indicators in the economy. That was what the staff report tried to show, and not that staff's figures were better. Staff did not have the capacity to carry out all the technical work that would be needed to come up with detailed estimates.

On the deterioration in relations between Uzbekistan and the Fund in the last year, he said that while there had been some disagreement on which policies to follow, the staff representative saw that as a fundamental difference between what the Uzbek authorities and the majority of the international community believed were the necessary policies to achieve the economic goals. Staff had tried to find a compromise between those two views but had so far failed. However, that was not for lack of effort, and staff would continue with that dialogue. That should not be seen as a deterioration in the relationship between the staff and the authorities, but only as difference of views on how to proceed.

Mr. Hagan said that he was not referring to the efforts of the staff or the quality of the dialogue between the staff and authorities when he had made the remark about the deteriorating relationship, but to lost discussions leading to a program. Also, the Executive Director for Uzbekistan was refuting a lot of the staff paper. That could be called a deteriorating relationship. It was not judgmental but only an observation.

Mr. Cippà agreed with the staff that they had made a lot of effort in Uzbekistan; however, withdrawing the resident representative would be interpreted by the Uzbek authorities as a deterioration in the relations.

The staff representative from the European II Department said that there was a good basis for the calculation of the social costs, and that there was not much disagreement between the authorities and the staff on that issue. The authorities had even managed to reduce social expenditures in the budget last year.

On the question of the impact of liberalization on banks and enterprises, and the involved costs, the staff representative said that that would be a political decision of how much the authorities would want to subsidize enterprises and banks that would get into trouble from exchange rate liberalization. However, last year, given the big depreciation, there had been no costs in that regard. Costs could occur this year, but staff had not been provided data as yet to carry out those calculations. He hoped that staff from the Bank, who would visit Uzbekistan in March, would be provided with the missing data to make these estimates.

Ms. Phang said that the authorities needed to know how much they would need to compensate, and how much financing could be provided before they could follow the recommendations.

The staff representative from the European II Department said that most financing would consist in an internal transfer among the different sectors of the economy, and that would not require a large amount of foreign financing. While that would not be an easy political process, as it would be necessary to tax those who benefited from the depreciation, the authorities had to face up to that situation.

Mr. Cippà made the following concluding statement:

> I do not have anything to add to at this stage. I thank the Board for their comments today. As always, the particular situation of the Uzbek economy gives rise to an interesting discussion. It goes without saying that we will convey all what is said to my authorities. Next year we will judge that advice. At the same time, let me thank management for their support, and for extending the temporarily the resident representative in Tashkent. We hope this can be extended further. We got some support from the Board on that. I

thank Mr. Hansen and his team for the good job with a difficult dialogue with the authorities. Let me assure you that my authorities are eager to have you in Tashkent again and to continue the discussion.

The Acting Chairman made the following summing up:

Executive Directors broadly agreed with the thrust of the staff appraisal. They observed that the macroeconomic situation in Uzbekistan remained difficult in 2000. A highly overvalued official exchange rate, high and rising debt payment services, and the slow progress on structural reforms, have all put pressure on the balance of payments. They noted that positive real growth and relatively moderate inflation have been recorded, according to official data, but alternative estimates by the Fund staff indicated somewhat lower growth and much higher inflation than shown by the official statistics.

Directors regretted that there has been little change in the non-market orientation of the government's approach to economic policymaking. The opportunity to speed up economic reform following the presidential election has not yet been taken, and the timetable for the introduction of current account convertibility has once again been postponed into the future. Directors expressed concern about some of the measures taken to deal with the balance of payments pressures. While they welcomed the steps to reduce the overvaluation of the official exchange rate, Directors regretted that access to foreign exchange has been tightened, that the foreign exchange market has segmented further, and that several new exchange restrictions and multiple currency practices have been introduced. Directors also expressed concern about the increase in external debt, and in debt service, which pose potential problems for the future.

Directors emphasized the importance of keeping macroeconomic policies appropriately tight, to support the foreign exchange market liberalization strategy. While efforts to tighten policies in the last quarter of the year were welcome, the expansion in monetary aggregates in the closing days of 2000 was worrisome. Directors also expressed concern that the budget for 2001 was based on unrealistic macroeconomic assumptions, and they urged the authorities to closely monitor the implementation of macroeconomic policies in the months ahead.

Directors understood the authorities' concerns about the political and economic risks of introducing current account convertibility. However, they did not accept the authorities' assessment of the need for large up-front financing from the international community, as they considered that the need for foreign financing would be manageable if the authorities adopted a well-designed liberalization program. Such a program, if implemented forcefully and consistently, could qualify for a Staff-Monitored Program, and thus pave the way for Fund financial support and fast-disbursing loans from other international organizations and bilateral creditors to cover the likely external financing requirement.

Directors urged the authorities to cooperate with the Fund staff in establishing as soon as possible a comprehensive economic reform program that would address the fundamental distortions in the economy. Liberalization of access to foreign exchange leading to current account convertibility should be a key element of such a program. In this context, Directors regretted the recent decision to intensify the import-substitution strategy. They recalled that there have been few, if any, countries that have successfully reaped lasting economic benefits from import-substituting strategies. They urged the authorities to adopt instead an export-oriented policy based on current account convertibility. Directors also regretted the decision to centralize the importing of basic consumer goods: they advised the authorities to dismantle this system and instead to allow independent importers to supply the population with consumer goods.

Directors noted that another important element of a reform program would be to phase out the state order system for cotton and wheat, and to quickly pass on the full benefits from the devaluation to producers. This would help reduce poverty in rural areas and provide incentives for farmers to raise output and improve productivity. They stressed that abolition of the state order system, in conjunction with liberalization of the foreign exchange market, would also help reduce opportunities for corruption.

Directors urged the authorities to closely analyze the balance sheet of commercial banks and enterprises to assess their viability in a liberalized foreign exchange environment and to take remedial measures where necessary. They welcomed the authorities' intention to start limiting the extension of government guarantees for bank loans. Directors also urged the authorities to phase out, as soon as possible, the practice of directed lending and to eliminate the remaining restrictions on cash withdrawals from commercial banks.

Directors noted with concern the weaknesses of official statistics which make it difficult to analyze economic developments and which are an obstacle to policy making by the leadership of the country as well as Fund surveillance. They urged the authorities to show their commitment to the production of high quality data by implementing the recommendations of technical assistance missions, and creating an independent statistical office.

It is expected that the next Article IV consultation with the Republic of Uzbekistan will be held on the standard 12-month cycle.

2. TUNISIA—2000 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 2000 Article IV consultation with Tunisia and an update to the report on the Observance of Standards and Codes for Tunisia (SM/01/17, 1/22/01; SM/01/17, Sup. 1, 1/29/01; and Cor. 1, 2/6/01). They also had before them a statistical appendix (SM/01/20, 1/22/01).

The staff representative from the Middle East Department submitted the following statement:

> This statement provides information that was recently received by the staff. It does not change the thrust of the staff appraisal contained in the staff report for the 2000 Article IV Consultation for Tunisia.
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> As indicated to the staff during the mission, the central bank recently made changes in its financing windows so as to introduce greater flexibility into the interbank interest rate. Specifically, the central bank ended automatic access to its end-of-day financing facility and introduced a spread of 1/8 of 1 percent between the lending and borrowing rates on the end-of-day operations. It also reduced the amount of liquidity that it injects through 7-day auctions, in favor of the more expensive repurchase facility. Some movement has been observed in the interbank rate around the official intervention rate since the introduction of these measures.
>
> The central bank has revised its estimate of the external current account deficit for 2000 to 3.8 percent of GDP (instead of 3.2 percent). The revision stems mostly from a weakening in the non-factor service balance. Combined with the delay in the disbursement on the last tranche of the World Bank's ECAL II, this resulted in a decline of foreign exchange reserves to US$1.8 billion in December 2000, compared to a projected level of US$2.2 billion. Due to a slight worsening in international borrowing conditions in the closing months of 2000, the authorities refrained from tapping the international bond market to make up for this shortfall, although short-term financing (18 months) of Yen 10 billion was raised in December through a private placement. This information confirms the staff's view that the external accounts merit close monitoring and reinforces the recommendation that reserve coverage of external current and capital liabilities be maintained at a more comfortable level.
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> On banking sector restructuring and privatization, the authorities confirmed that the planned merger of one of the three large public banks (STB) with two development banks (BDET and BNDT) has been completed, paving the way for the release of the last tranche of the World Bank's ECAL II. The government has also privatized Lloyd Tunisien, a medium-sized insurance company, and has announced the privatization of a smaller public

bank (UIB) and the sale of its minority participation in another bank (Banque du Sud).

Mr. Rouai submitted the following statement:

My authorities benefit from the Executive Board review of recent developments and medium-term prospects of the Tunisian economy based on a well-balanced set of staff reports. The Board's appraisal, together with the staff's analysis, provide them with an independent and high-quality assessment of their current economic policy stance and of the remaining challenges. The authorities trust that their participation in the various transparency initiatives will assist the private sector in appreciating the risks attached to and the opportunities offered by the Tunisian economy.

As the staff reports provide a comprehensive picture of the Tunisian economy, I shall only highlight briefly the progress achieved or underway in a few key areas since the last Article IV consultation.

My authorities continue to believe that maintaining a stable macroeconomic framework is a prerequisite for the success of their growth strategy. They agree with the staff that persevering with fiscal consolidation is important for the sustainability of the country's external position and for making more room for the private sector to participate in the economy. They have succeeded in reducing the budget deficit (excluding social security surplus, grants, and privatization proceeds) from 3.9 percent of GDP in 1999 to 3.4 percent of GDP in 2000, and a further consolidation is also programmed in the 2001 budget. The staff are right in identifying containment of the wage bill and reform of social security as the main challenges for fiscal consolidation over the medium term. The authorities are addressing these concerns by limiting new recruitments to higher education and health sectors and by embarking on a wide-ranging reform of the social security system on the basis on an actuarial study now underway. Moreover, they welcome Fund technical assistance in the fiscal area, in particular on ways to further expand the tax base.

The Central Bank demonstrated pragmatism in the conduct of exchange rate policy by broadening the set of indicators used to assess competitiveness. This move reflects further progress in improving its understanding of the working of the Tunisian economy and in enhancing exchange rate flexibility.

The authorities' efforts in strengthening the process of integration of the economy into world markets and in allowing the private sector to play a more prominent role in the economy gained additional momentum last year. In this context, tariff reduction under the Association Agreement with the European Union (AAEU) proceeded as scheduled, and a new agreement covering the agricultural sector was reached. My authorities will continue to be guided by the objective of liberalizing trade on a multilateral basis and by the need to achieve greater regional integration. They are encouraged by the results of their privatization program that has led to an increase in both investment and job creation by privatized companies. They have decided to accelerate, broaden, and introduce more transparency in the program for 2001 by announcing the privatization of 41 public enterprises, including in the financial sector, valued at around 7 percent of GDP. They are satisfied with the recent upgrades in their rating and with the improvement in market conditions, and will continue to aim at strengthening their credibility in capital markets.

The participation of Tunisia in the Reports on Observance of Standards and Codes (ROSCs) exercise and other transparency-oriented initiatives, including publication of staff reports, reflects strong ownership of their reform agenda. The authorities consider that the adoption of a new fiscal code will improve tax administration and, more importantly, clarify taxpayers' and the tax authorities' rights and obligations. Similarly, the posting of the annual monetary program on the Central Bank website and the advance release calendar of monetary data is another indication of the authorities' commitment to transparency and data dissemination in order to enhance credibility of monetary policy. These efforts are being strengthened under the more stringent requirements of the Special Data Dissemination Standard (SDDS), and my authorities expect a formal subscription in the coming months. The delay is because of the need to produce, for the first time, quarterly GDP data. The staff paper adequately covers developments in the financial sector and concludes that all major indicators of bank soundness have improved. The financial sector remains, however, high on the authorities' reform agenda, and a thorough assessment of this sector will be undertaken under a forthcoming Financial Sector Assessment Program (FSAP) Bank-Fund mission.

My authorities share the concerns expressed by Executive Directors and staff in previous Board meetings on the high level of unemployment, and are promoting job creation as the ultimate goal of their economic program. To this end, they are following a two-pronged approach to deal with this serious problem. On the one hand, they are reinforcing their proactive policies of improving job training and placement, relying on micro-credit and other low-cost, job-creating schemes, particularly for youth employment. On the other hand, they recognize that unemployment remains a growth-related issue that can only be addressed through the expansion in the private sector's role and contribution. While the Tunisian economy is now adequately equipped to deliver annual growth rates of 5 percent on average and to stabilize the level of unemployment, the staff and the authorities agree that the country needs to achieve a higher growth rate in order to significantly reduce it. The staff have identified the preconditions for moving the Tunisian economy to higher growth rates (paragraphs 14 to 18 and Box 2 of the staff report). The authorities share the staff's conclusions and are conducting a consultative process with their social partners with the objective of designing a new medium-term growth strategy covering the period 2002–2006 centered on employment. As usual, they look forward to Board's advice and recommendations.

Finally, I am pleased to confirm my authorities' intention to make an early repurchase by advancing by one year the full outstanding amount under the 1992 extended arrangement.

Mr. Shaalan and Mr. Bakhache submitted the following statement:

Overall economic performance in Tunisia has been impressive in much of the 1990s and performance in 2000 indicates a continuation of the favorable trend. Broad based economic growth continued to be strong in a low inflationary environment, while the budget deficit for the most part remained on a downward path. The current account deficit also remains at a comfortable level. The diverse composition of exports is noteworthy and underscores the progress made in diversifying the productive base of the economy. These achievements have not gone unnoticed in international capital markets as evidenced by the upgrading of Tunisia's international credit rating in 2000. This is a testimony to the effectiveness of the authorities' prudent macroeconomic policies and the cautious approach to opening and liberalizing the economy. Equally important has been the focus on social policies aimed at improving social conditions in the country and introducing a number of measures aimed at enhancing the quality of human capital. This strategy has been instrumental in achieving well-balanced growth while preserving social stability.

Looking forward, we are encouraged by the favorable outlook for the economy. With short term risks more or less absent, the authorities seem to be well positioned to further their efforts to address the medium-term challenges facing the economy. While medium-term growth and unemployment objectives (and the underlying assumptions) are ambitious, we believe they are within reach. The authorities' track record in, and commitment to, improving productivity, competitiveness, and the investment environment is reassuring in this regard.

Further fiscal consolidation remains a key element for the success of the overall economic development strategy. In this regard, we are encouraged by the authorities' commitment to maintain a stable macroeconomic framework and hence ensure the sustainability of the external position and promote the role of the private sector, as Mr. Rouai indicates in his helpful statement. Beyond 2001, the staff is right to point out the growing demands placed on the budget and consequently the need to address fiscal rigidities, particularly the wage bill and the narrow tax base. The authorities appear to be fully aware of these shortcomings and are considering ways to address them. The wage bill, which as a proportion of GDP not only far exceeds that of countries in the region but has almost doubled in a matter of two years, needs to be accorded high priority and should not await the completion of a comprehensive civil service reform. Delay in addressing this wage creep could adversely impact competitiveness and unduly affect the budget outlook. It is therefore important to begin addressing this problem by identifying the key areas that require reforms as soon as possible. As for tax reforms, we encourage the authorities to seek technical assistance directed at widening the tax base, including in particular through limiting exemptions. A thorough review of the effectiveness of the tax incentive structure aimed at modifying or eliminating exemptions should be undertaken. Adverse demographic trends also present the authorities with the challenge of arresting the deterioration in social security accounts expected in the coming years. In this connection, deeper reforms over the medium term, as contemplated by the authorities, will be needed to assure the viability of the social security system. Regarding foodstuff subsidies, looking at the past 10 years, the share of subsidies and transfers in the budget has declined substantially. A slight pause, is therefore understandable to alleviate the social impact of high oil prices.

Moving to monetary and exchange rate policies, the authorities should be commended for the success of the framework adopted. Like the staff we believe that disseminating the monetary program would enhance credibility and improve the country's attractiveness to foreign investment. Furthermore, reliance on interest rate signals to allocate financial resources more efficiently should be pursued. The reform of the central bank refinancing window would be an important step in this regard. On the exchange rate, the authorities appear to be mindful of the need to examine a broader set of indicators to guide policy in the future as was done to some extent in 2000. In the banking sector, we welcome the progress made in improving banks' prudential ratios. However, the ratio of non-performing loans continues to be high, particularly for public banks, pointing to the need for measures conducive to the improvement of risk management practices. Strengthening enterprise governance would also be instrumental in reducing the risk of an accumulation of new bad loans. More generally, like the staff and the authorities, we see a need to further strengthen the banking sector and to develop domestic capital markets before embarking on a broad-scale liberalization of the financial sector.

Placing the economy on a higher growth path and improving the prospects for employment growth over the medium term hinges on the authorities' ability to enhance the role of the private sector. The Tunisian economy is well positioned to reap these benefits in the stable social and macro environment which the authorities have carefully nurtured. We therefore encourage the authorities to move forward with their ambitious privatization and liberalization program including, in particular, reducing the higher level of administered prices in the retail sector. The process of liberalizing state enterprises and enhancing the competitive environment in the economy will likely lead to some labor shedding in the short term. Proceeding with labor market reforms, therefore, takes on added importance. In this regard, the measures taken so far as stated in paragraph 44 are encouraging. Further steps, aimed at enhancing labor market flexibility, including through wage differentiation, are still needed however, and the authorities should give the staff proposals serious consideration.

Before concluding, while we have always maintained that the incremental capital output ratio has well-known limitations, one is struck by the relationship between the investment ratio and GDP growth. We understand that the large share of housing in investment may be contributing to the weak relationship, but would appreciate the staff's views on other factors that may be playing a role.

Finally, we welcome the authorities' intention to advance the repurchase of the full amount outstanding under the Extended Fund Facility (EFF) to May 2001, which reflects their belief in the cooperative nature of the institution. We wish the Tunisian authorities well in continuing with their reform efforts so they can attain the economy's potential for a higher rate of growth and reduced unemployment.

Mr. Barro Chambrier submitted the following statement:

I would like to thank the staff for their concise report that clearly highlights the challenges facing the Tunisian economy. Indeed, over the past few years, the Tunisian authorities' outward looking strategy, underpinned by the pursuit of prudent macroeconomic policies and the implementation of key structural reforms have yielded impressive results, as the country has been able to achieve high rates of growth, low inflation and a reduction in domestic and external financial imbalances. The authorities should be commended for this performance and for their skilful management of the economy as well as for their advanced social policies.

I agree with the staff that it is important for the authorities to continue their efforts to improve macroeconomic performance, which is critical to the success of their development strategy. The process of fiscal consolidation should be pursued, and in this regard, I commend the authorities for their commitment to deficit reduction. I would like, however, to note that the authorities' strategy should pay greater attention to the reduction of the wage bill which remains quite high at over 11 percent of GDP, and not only on reducing non-wage current expenditure and transfers. I believe that the efficiency of the civil service, through containment of the wage bill, as well as the reform of the social security system, are the main challenges for fiscal consolidation in the medium-term. I would, therefore, join the staff in recommending to the authorities the development of a medium-term strategy aimed at reducing the wage bill, and that this could be done in the context of a wider plan to reform the civil service, and make it more modern, more efficient and better responsive to the needs of the country. In addition, with the expected decline in revenue stemming from trade liberalization, further efforts will be needed to widen the tax base, by stepping up efforts to reduce the scope of tax exemptions, particularly in light of the concerns on the effectiveness of such exemptions, in a context where tariff reductions were placing domestic and exporting firms on the same footing. Finally, I welcome the steps recently taken to strengthen tax administration.

Looking forward, I find it encouraging that the authorities intend to build on the progress achieved in order to further strengthen economic performance, increase the rate of growth and reduce the unemployment rate which has remained high. I am pleased to note in Mr. Rouai's useful preliminary statement, that the authorities intend to promote job creation as the ultimate goal of their economic program. Furthermore, I agree with the staff that increasing private investment and improving the economy's competitiveness, while preserving existing macroeconomic equilibrium will be key factors in achieving the authorities' objectives. Efforts will be needed to focus principally on further liberalization of the economy, the promotion of the private sector's role and contribution, in order to generate sufficient employment gains. Similarly productivity gains to strengthen the competitiveness of the economy, as well as the improvement of the functioning of the financial sector and the labor market will be needed as well.

With regard to the liberalization and promotion of the private sector, much has already been done. However, the privatization program appears to have slowed down in the recent past, and I welcome the decision of the authorities to accelerate the process this year through their plan to privatize 41 public enterprises and to open to the private sector, some of the service sector, notably telecommunications and port activities. While welcoming the staff recommendations for further acceleration in this area, I also note the authorities' gradualist and careful approach which has resulted in a more orderly privatization process that has received workers' support and also helped to build a consensus for the privatization program. I think that the authorities' approach has much merit, but the efforts should be sustained. Similarly, I would agree with the authorities' strategy with regard to trade liberalization. As outlined in Box 3 of the staff report, over the past years, much progress has been made in the area of trade liberalization, which has contributed to maintaining export competitiveness.

With regard to monetary policy, we concur with the staff that the authorities should rely to the extent possible on using interest rate instruments in the conduct of their monetary policy. Furthermore, I believe that a wider dissemination of the monetary program which entails the use of broad quantitative objectives, could reinforce the anchoring role of monetary policy.

In the financial sector, while I welcome that all major indicators of bank soundness have improved, I note that overall asset quality remains a concern, with non-performing loans amounting to 20 percent of GDP in 1999. The financial position of the public banks particularly raises some concerns as it appears that their ratio of non-performing loans to total assets remained high at 33 percent at the end of 1999. Given the authorities' economic and financial objectives for the medium term, and their desire to make the economy more open, a stronger financial sector will be essential, and there is a need to upgrade risk management practices at the level of banks, and to accelerate the process of bank privatization, including allowing larger participation by foreign investors. I also note that on page 24, the staff state that poor lending practices were widespread across the banking sector, especially in the agricultural sector. Could the staff indicate what is being done to correct those practices, and what type of danger, if any, they pose to the financial sector?

In any event, it is important that the authorities further tighten the supervision of banks and take the necessary steps to improve the ratio of nonperforming loans. The insurance sector also appears to be in financial difficulty, and I welcome the plan to reform and restructure that sector, as it can play an important role in improving the domestic savings ratio. In a similar vein, I agree with the staff recommendation as regards the development of the capital market, and I would add that it might not be easy for the authorities to achieve the higher growth path that they are aiming at, unless the financial sector is sound and can adequately play its proper role.

With regard to the labor market, over the past few years, the authorities have implemented an array of measures that have helped to improve labor market performance, while maintaining price and social stability. The more recent measures taken to encourage self-employment and the development of small enterprises are in the right direction. However, the high unemployment rate may be indicative of some rigidities in the labor market, and I would encourage the authorities to review the labor laws and regulations, with a view to improving their flexibility. In this regard, in view of the progress achieved and the diversification of the economy, it is somewhat puzzling to see that young workers who are more educated are finding it difficult to be gainfully employed. I wonder if the staff can shed some light on this unusual behavior of the Tunisian labor market.

To conclude, I welcome the authorities' intention to advance the repurchase of the full amount outstanding under the EFF to May 2001, and congratulate them for their participation in the ROSCs exercise and other transparency-oriented initiatives, and for their intention to subscribe to the SDDS by mid-2001.

Ms. Lundsager and Mr. Weisman submitted the following statement:

The Tunisian authorities continue to successfully manage their economy, producing strong GDP growth, increased private-sector activity, and healthy social indicators. In addition, improvements in Tunisia's credit ratings and successful tapping of international capital markets signal the economy's further integration into global financial markets.

While we agree with the staff that an economy characterized by manageable internal and external deficits, a modest external debt, and low inflation faces few immediate risks, several issues should be addressed quickly to ensure that the prospects of the medium term are not threatened. Among the key challenges are reducing the public-sector wage bill, easing the unemployment rate, placing a larger share of the economy in the private sector, and further liberalizing prices and the trade regime.

The high and rapidly growing public-sector wage bill is the most troubling problem confronting fiscal policy, and we encourage the authorities to exercise greater prudence in this area and to expeditiously develop a plan for rationalizing the civil service. In addition, price controls and poorly targeted subsidies that adversely affect the budget should be dismantled and replaced by more fiscally-sustainable measures that better target the poor. Moreover, given that tariff revenue is expected to fall due to trade liberalization, we urge the authorities to identify specific offsetting measures to maintain fiscal consolidation, including expanding the tax base and limiting tax exemptions.

Unemployment remains a key obstacle to the Tunisian economy. The staff indicate that the strong growth of the past four years, including considerable real per-capita GDP growth, has not reduced the unemployment rate and that a higher growth rate is needed. While we agree that growth rates of 7 percent are attainable, we wonder whether the causation should be reversed, where addressing the rigidities and inefficiencies inherent in the labor market, as described in paragraphs 45 and 46, coupled with enhanced private investment, could provide the engine for higher growth. We would ask the staff to comment more fully on the impediments to higher employment growth. In any event, to both boost growth and help reduce unemployment, we urge the authorities to focus on facilitating an environment conducive to export growth, encouraging private sector industries, and providing more credit access for small and medium-enterprise development.

The public sector remains a sizeable component of the Tunisian economy, where footnote 18 states that the private sector was 50 percent more profitable than the public sector in the mid-1990s. We agree with the staff that the authorities should significantly accelerate their privatization efforts to bolster growth and improve competitiveness, and we urge the authorities to assiduously implement their 2001 privatization program, while planning for further privatization in 2002 and beyond.

In a similar vein, the banking sector continues to be controlled predominately by the public sector. Notwithstanding the government's intention to privatize two small banks, we strongly encourage the authorities to seriously consider further privatization as a means to improve intermediation of savings and foster effective investment decisions. Furthermore, we urge the government to strengthen supervision and regulation, which should accelerate the reduction in non-performing loans. With regard to the financial sector in general, we look forward to the results of the FSAP.

Despite high-level focus and noteworthy progress in trade policy, Box 3 highlights that there is much room for improvement. Appropriate additional measures include rationalizing import duties, removing import licenses, and streamlining customs procedures. To avoid trade distortions and diversion, we urge the authorities to extend their bilateral trade liberalization efforts beyond the EU and neighboring countries to all trading partners. The shift towards a more flexible exchange rate regime is appropriate and will lend support to increased trade liberalization.

We welcome the authorities' decision to publish the documents and urge the government to adhere to their schedule to subscribe to the SDDS by mid-2001. We also appreciate the authorities' intention to advance repurchase of the amount outstanding under the 1992 EFF arrangement.

Mr. Wei submitted the following statement:

We thank the staff for the well-written papers. We also thank Mr. Rouai for his concise and helpful preliminary statement. The Tunisian authorities are to be commended for their prudent and flexible approach to macroeconomic policy, placing the economy on a relatively high growth path for the last five years. We share the optimism for the future of the Tunisian economy—economic growth is strong, inflation is low, the external account continues to improve, and the authorities are strongly committed to pursuing reforms and opening policies. Given that the economic outlook is strong for 2001, staff has correctly focused on Tunisia's medium-term prospects and preconditions for moving to an even higher growth path.

Of major concern to the authorities is the persistent high unemployment, which is likely to remain the single biggest challenge in the foreseeable future. The unemployment rate stood at 15.6 percent in 1994 and 15.9 percent in 1998. The relatively robust growth, averaging at around 5 percent, seems to suggest that it is hard to attribute the problem to slow economic growth or cyclical forces. Given the almost unchanged unemployment rate, growth in employment (and unemployment) must be very similar to that in the labor force, which increased from 3.3 million in 1994 to 3.6 million in 1998, or at an annual rate of about 1.7 percent. The much faster growth in output than employment implies that productivity must have improved considerably, which appears consistent with the economic reform and liberalization that took place in the period. Indeed, staff estimates total factor productivity growth at an average of 1.1 percent between 1994 and 1999 and labor productivity growth at 2.6 percent.

The almost unchanged unemployment rate poses the interesting question of why such high economic growth—presumably resulting from reform-related efficiency or productivity gains—was unable to make even a small dent in the unemployment figures. Staff attributes this partly to insertion of new entrants into the labor force, which may be true for youth unemployment, but, at the aggregate level, labor force growth at 1.7 percent cannot be the major culprit. Staff also identifies rising educational attainment (lengthening the job searching time) and skill mismatch as possible causes. It would be useful to have further clarification. It is easy and convenient, though correct, to argue for faster reform, because additional growth always helps reduce unemployment, other things being equal. But, in the case of Tunisia, the pace of reform does not seem to be the main cause for the high unemployment rate. Mr. Shaalan and Mr. Bakhache highlight the fact that the wage bill is relatively high as a proportion of GDP when compared with neighboring countries, and that it has doubled over the last two years. Is labor market rigidity the real issue here? It would thus be useful if the staff could conduct detailed analysis so that the unemployment problem can be addressed more effectively. This is a pressing task and, as Mr. Rouai points out, Directors have expressed concerns in previous Board meetings which were shared by the authorities.

However, it would be unfair to say that the current initiatives, such as the micro-credit schemes and training programs, and the national employment fund, will not work. They are definitely helpful. But it is more useful if resources can be directed to addressing the problem at its root source. More importantly, this is not to say that we should be relaxed about economic reform. In fact, I very much welcome the authorities' comprehensive liberalization drive over the next 12 months. It is a daunting task to reform 41 wide-ranging public enterprises valued at 7 percent of GDP within such a short period and I admire their determination. The authorities should also be commended for further integrating the Tunisian economy into the world market—cutting tariffs under the Association Agreement with the European Union (AAEU) as scheduled and reaching a new agreement on agriculture. The staff notes that some 19 percent of prices at the retail level are still administered and thus recommends removal of these remaining price controls and distortions. The staff proposes that state enterprise reforms, trade liberalization, and price reforms should be taken further, and I fully agree.

However, I would appreciate it if the staff could comment on the sequencing of these reforms, which must be handled carefully, if they are to succeed and not going to be too costly to the economy.

On statistics, the authorities are commended for the considerable progress in improving the quality and dissemination of statistical information. I particularly welcome their plan to increase the frequency of labor market surveys on an annual basis.

Finally, I welcome the authorities' intention to advance the repurchase of the full amount outstanding under the EFF arrangement to May 2001. I wish the Tunisian authorities every success in their future endeavors.

Mr. Djojosubroto submitted the following statement:

The Tunisian economy has achieved remarkable progress in recent years because of the consistent application of prudent macroeconomic policies. Despite a drop in agricultural output, overall growth in 2000 was strong. Inflation remained subdued while the fiscal deficit declined further. The current account deficit stood at a manageable level and substantial progress was also made towards establishing an open and market driven economy. We agree with the broad thrust of the staff's appraisal and commend them for the comprehensive report. We also commend the Tunisian authorities for their achievements in both the economic and social fronts. We will therefore limit our remarks to the issue of maintaining sustainable economic growth over the medium term.

While GDP growth and most of the macro indicators provide a favorable picture of economic performance over the medium term (2002–2006), the economy faces some challenges over the coming years. Although the present fiscal position appears sustainable, government budget is experiencing pressures stemming from both the expenditure and revenue side. On the expenditure side, the present wage bill, at 11.6 percent of GDP is relatively high by international comparison and is not showing any signs of declining. Since the authorities will need additional financing for economic restructuring, human capital accumulation and the modernization of public administration, a higher budget expenditure is envisaged in the coming years. An effective public expenditure management system would be needed to trim the relatively less productive expenditures. In this context we concur with the staff that the authorities should take serious actions to reform the civil service and its remuneration system to lighten the burden of the wage bill on the budget as well as reduce the risk of price instability emanating from the wage system. We note, however, that given the relatively high unemployment rate of 15 percent, which had been unchanged over the past several years, the authorities could face resistance in downsizing the public sector. The only long-term solution to unemployment is to create a conducive environment for the growth of private enterprises which would generate increased employment in the economy.

Regarding the phasing out of subsidies, we concur with the staff that it will not only strengthen the government's fiscal position, but also enhance the effectiveness of spending. However, we note that phasing out subsidies, particularly on foodstuffs, is not an easy task. In a developing country, the government is faced with the dilemma of choosing between lowering subsidies to promote market efficiency and maintaining price stability for basic necessities which is essential for social stability. We will, therefore, suggest that subsidies should only be phased out gradually taking into account the existing economic situation and social structure.

On the revenue side, the relatively high tax exemptions such as those on reinvested earnings seemed unwarranted and should be readjusted. We welcome the authorities' move to stabilize the tax revenue to GDP ratio. In this context, we would urge the authorities to continue its efforts to broaden the tax base, improve tax administration and create an environment which is conducive to private sector growth and attractive to foreign direct investment.

Turning to monetary and financial policies, Tunisia's current framework has served the economy well. The focus of monetary policy on maintaining lower inflation is reassuring. However, increased capital mobility particularly from the FDI inflows associated with privatization proceeds could inject large liquidity into the economy and make it more difficult to achieve the monetary and credit targets. We share the staff's assessment that there could be benefits from greater use of interest rate signals in the conduct of monetary policy. On the exchange rate, despite depreciation of dinar of 0.7 percent in real effective terms in year 2000, the real effective exchange rate (REER) movement since 1993 shows an appreciating trend that could deteriorate Tunisia competitiveness in the future. Staff comments are welcome in this matter.

The ongoing restructuring in the banking sector is also important in achieving efficient financial intermediation that can support economic development as well as the conduct of more efficient monetary policy. While substantial progress has been made, there are still many remaining issues in the reform agenda. In this context, appropriate prudential regulations should be implemented to address the problems of weak lending practices and non-performing loans. Enhanced banking supervision capability is also critical, especially with the progress of bank privatization and restructuring measures.

Structural reforms have to be speeded up in a number of areas to reduce the burden on the public sector by encouraging and promoting the growth of the private sector. In this regard, state-run enterprises would have to be privatized as soon as practicable.

With these remarks, we wish the authorities continued success.

Mr. Al-Turki made the following statement:

I congratulate the Tunisian authorities on the economy's continued impressive performance. Sustained macroeconomic prudence and pro-growth reforms have brought rich dividends. Last year, notwithstanding the drought-induced loss in farm output, growth was again robust with low inflation and improvements in the fiscal and external positions. The economy's strength is also evident from the improved credit rating and ability to access financial markets at more favorable terms. Yet, notwithstanding the favorable outlook, the policy challenge remains since faster growth is essential to address the persistently high level of unemployment. Here, I remain confident of the prospects in view of the authorities' track record and undiminished resolve for policies toward a fuller realization of the economy's potential.

I endorse the consensus that further fiscal consolidation remains a priority. On the revenue side, the policy focus is rightly on rationalization of existing taxes, including a reduction of various exemptions. I also agree that effectiveness of existing export incentives should be studied for an informed consideration of the case for their removal. Further Fund technical assistance to articulate the options for an efficient tax structure has my support. On the spending side, while I can appreciate the staff's general case for civil service reform, it is important to consider the next steps in the local context. In particular, attention is due for the costs of adding to the already high level of unemployment. Here, I support the authorities' emphasis on continuing the time-tested consultative approach for a medium-term strategy, as noted in the helpful preliminary statement of Mr. Rouai.

As the staff acknowledges, incomes policy has contributed actively to the country's social and price stability and external viability. It is thus essential to compare the actual benefits of a deliberate incomes policy, as currently practiced, with the anticipated efficiency gains from a freer market-determination of wages, as the staff suggests. In that connection, it is necessary to extend the interesting international comparison of the relative GDP share of public sector wages in footnote 10. Specifically, it is important to evaluate whether these wage shares are also indicative of the relative economic performances of these countries. Staff comments will be appreciated.

I share the staff's stress on a more effective monetary policy framework. This has gained added relevance in view of the possible excessive liquidity inflows related to the privatization process. I urge the authorities to heed the staff's suggestions in this regard for a more articulate and transparent use of interest rates in monetary management. In that context, the authorities' intent to reform central bank refinancing windows is a step in the right direction. It is also crucial to build on the progress already made in banking sector reform with focus on improved loan risk management as well as increased competition through privatizations, including exposure to foreign capital. I agree with the staff that an adequate strengthening of the domestic financial institutions should precede any significant further liberalization of the capital account.

The current exchange rate policy has helped to maintain competitiveness and should be continued. In that connection, the authorities' move to base assessment of real exchange rates on relative market shares rather than consumer price indices is welcome. Broadening the indicators along the lines suggested by the staff should be also considered. Realistic tracking of competitiveness will be increasingly important as the economy moves further along in the authorities' commitment to trade liberalization.

Before concluding, I join others in commending the authorities' intention to advance the repurchase of the amount outstanding under the 1992 extended arrangement.

With these remarks, I wish the authorities further success.

Ms. Alcaide made the following statement:

I thank the staff for the well written paper on the current economic situation, the recent developments and the prospects on the medium term for the Tunisian economy and I fully agree with the staff appraisal.

The Tunisian authorities should sincerely be commended for the impressive track record of sound economic performance they have attained during the last few years. This progress has been accompanied by progressive social policies.

It has been this commitment to solid economic policies together with a stronger liberalization and a deeper integration in the world economy what has enabled the country to bear the fruits of strong GDP growth, low inflation, improvement of public accounts, sound external reserve position and significant job creation, to mention some of them.

It is because of these successful results that the staff forecasts a high growth scenario in the medium term provided that sound macroeconomic policies be preserved and that structural reforms be implemented in a faster way.

On the fiscal front, and for the purpose of deficit reduction, we agree with the staff's emphasis on overcoming pressures for wage bill increases and extensive tax exemptions, and the recommendation to broaden the tax base to offset the expected reduction on trade tariff revenues.

As for the monetary policy, we commend the authorities for the prudence shown over the last years and, as the staff's paper does, we support their decision to disseminate the monetary program more widely through a more transparent framework.

Concerning the exchange rate policy, the authorities have implemented a commendable flexible approach by using the exchange rate instrument to maintain its external competitiveness.

The Tunisian authorities should also be congratulated for their resolution to place the external reserves to a more comfortable position as a result of the improvement in the access of financial markets.

As far as the structural reforms are concerned, we concur with the staff that further efforts should be made in order to accelerate economic liberalization and to promote private sector development. A broader trade liberalization with a less complex imports' procedure and a new customs code would result in significant efficiency gains. We also welcome the authorities' announcement of the next privatization of 41 public enterprises which would contribute to foster foreign direct investment and would further make it possible to reduce government debt. A greater labor market flexibility would also be welcome to foster employment growth.

Finally, we congratulate the Tunisian authorities for their commitment to subscribe to the Special Data Dissemination Standard, their agreement to undertake a Financial Sector Assessment Program review in the current year, and their intention to make an early repurchase of the full outstanding amount under the 1992 extended arrangement.

With these remarks, I wish the Tunisian authorities further success in their endeavors in the coming years.

Mr. Maino made the following statement:

We join the staff and other Directors before me in commending the Tunisian authorities after years of sound macroeconomic policy and gradual liberalization.

Last year's macroeconomic performance has been satisfactory. It is encouraging that the government is making more room for the private sector to participate in the economy. Tunisia is poised to take aggressive steps to foster a higher rate of economic growth. Important weaknesses persist in areas related to private sector development which require persistent efforts for reform. Greater efforts are needed to reform financial institutions to further deregulate the external sector and to rationalize tax system.

On fiscal policy, at the top of the agenda should be reform of the fiscal deficit. We concur with Mr. Shaalan and Mr. Bakhache that fiscal consolidation remains crucial and that the budget deficit should be eliminated to avoid any potential disruption in monetary policy. If not, the deficit may jeopardize efforts to lower inflation and maintain the stability of the exchange rate. In addition, the country's ability to pursue a higher rate of growth depends not only on the control of budget expenditures but also on the ability to strengthen revenue collection and to widen the tax base. We concur with the staff on the need to revise exemptions, concessions and deductions on personal and corporate income taxes. Also, we would like to ask the staff about reviewing the tax system and incentive scheme to advance a more competitive environment for the overall economy. In this respect, the incidence of the payroll taxes in the labor market, the extent of earmarked taxation, and the effects on competitiveness of the service fee applied to imports and exports should be further analyzed.

The downward flexibility of expenditures stands as a challenge for the medium-term macroeconomic policy. It becomes desirable to prepare a revised budget on the expenditure side, given the budgetary rigidities emanating from the wage bill, subsidies, and controls as underscored in the staff's report. Finally, given the contribution to the fiscal situation arising from the pension system, we would like to ask the staff about the their views on the prospects for reform in this field, and whether private funding of the system might be envisaged.

On monetary policy and exchange rate policy, we welcome the departure from real exchange rate targeting, and also welcome the authorities' move towards an open set of indicators to guide exchange rate policy, as expressed by Mr. Al-Turki. To manage a successful exchange rate regime, the authorities need to support monetary policy aimed at keeping price stability as a permanent objective. We concur with the staff to endorse the monetary policy framework based on quantitative objectives, keeping in mind the need to meet the net domestic assets (NDA) target and to consistently match rainfalls in the instruments of the monetary program with the government's growth and inflation objectives. We encourage the authorities to advance with structural reforms to reduce potential vulnerabilities and gradually replace capital controls with the rainfalls anchoring wall for monetary exchange rate flexibility. The authorities' decision to publish the 2001 monetary framework as part of the budget law constitutes a commendable step, where reinforcing the independence of the Central Bank and developing the money market will help maintain a more liquid banking system.

In the Banking sector, we share the concerns of other chairs that the level of nonperforming loans in commercial and developing banks may become a liability for the overall economy, and might impede the success of any stabilization attempt. It is particularly important that the regulatory oversight on the banking sector be strengthened in accordance with international accepted standards and codes to limit the credit and market risks of solvent banks. Nevertheless, for an economy like Tunisia that relies heavily on capital controls, progress is predicated on the closing of insolvent institutions. Bankruptcy procedures and the insurance laws should be reinforced.

Tunisia's financial sector growth should be centered on the standards of capital adequacy and greater transparency. Opening to foreign competition at this stage is an important element any banking system, not only to provide better services for customers and greater sufficiency for the overall economy, but most importantly to provide intertemporal solvency through stronger balance sheets and improved capitalization.

We also welcome the request for a financial sector assessment program review to detect the weaknesses and vulnerabilities in the overall financial sector and as a means to facilitate the resolution. Technical assistance should be available to bring this about.

Operational inefficiencies such as high cost and spreads, together with the cost of financial restructuring might translate into high interest rates. Financial restructuring can be reduced by attaching sales of impaired assets on secondary managers and by expediting the transfer of the government equity positions in banks to private hands, thereby ameliorating the burden of expensive bank lending.

On the pending reform agenda, as noted by the staff, there is ample room capital markets to take on a larger role in allocating savings. The securities market in Tunisia remains underdeveloped, and there is evidence of a lack of experience concerning risk analysis by market participants. A well sanctioned securities market would contribute to provide much needed capital for enhanced income growth. It is important to streamline institutional building and legislation and to expedite the process leading to establish clear guidelines for trading securities. A new asset backed securities market and further consolidation of the government bond market will be instrumental in promoting capital markets.

Structural reform relies heavily at this stage on further deregulation to speed-up privatization efforts. We respect the decision concerning privatization of 41 public enterprises, though there are significant challenges ahead to create the necessary conditions to foster private sector development.

Although export performance in Tunisia has experienced significant growth, there is still important steps to be taken in the medium term. We encourage the government to keep working to reduce tariffs under the umbrella controlled by the association agreement with European Union, and encourage greater regional economic cooperation to harmonize customs and tax administrations.

Finally, we remain concerned about the prospects of unemployment in Tunisia. An export driven economy requires a labor market with minimum restrictions to allow smooth reallocation of resources under the forward-looking wage setting mechanism. We concur with the staff on the need to advance labor market flexibility and to increase sectoral wage flexibility.

We agree with the overall positive assessment of the Tunisian economy as presented by the staff. We encourage the authorities to persevere in the reform agenda by enhancing the restructuring momentum and by deregulating the economy.

Mr. Bauche made the following statement:

I would like to commend Tunisia for its strong economic performance achieved during the last several years. GDP growth has expanded steadily in the 1990s and it seems that the country is, to borrow the words of Mr. Rouai in his useful preliminary statement, adequately equipped to achieve annual growth rates of 5 percent on average. Looking at the broader picture, almost all children enroll in primary school, and poverty affects less than 10 percent of the population. All these elements confirm that tangible achievements can be realized by cautious economic policies, together with social policies aimed at ensuring social cohesion and backed with a credible strategy of integration into world markets.

But it is also true that for a small open economy in an increasingly globalized world, more outward looking economic policies are critical. Demographic evolutions, combined with unemployment pressures, are posing renewed challenges to the authorities. In that respect, let me note that the results of the economic policy in terms of growth are between the low and the base case scenario established by the World Bank in its Country Assistance Strategy last year. Therefore, I would hope that the preparation and implementation of Tunisia's five-year development plan will provide the authorities with an opportunity to deepen their actions in three areas that the staff identify as crucial to a more growth-friendly framework.

First, further reforms of the financial sector are needed to help mobilize private savings, but also with a view to address the issue of non- performing loans and, more generally, better prepare that sector to weather a larger liberalization.

Second, the authorities should implement a more ambitious fiscal consolidation stance, especially in light of the projected pressures on the social security accounts and of the expected decline in trade tariff revenues. We agree with the two major priorities identified by the staff, i.e. the size of the wage bill which constrains the fiscal room for maneuver in case of adverse shocks, and the need to address the narrow tax base.

Third, the privatization program should be implemented, not only with a view to reduce the role of the state in the economy, but also as a way to enhance the competitiveness of Tunisian companies that will be confronted by increased foreign competition within a few years. Here, I have a specific question concerning enterprise restructuring. In paragraph 40, page 26, of the staff report, the staff indicates that they are encouraged by the considerable success registered under the government's program of enterprise modernization. Indeed, in quantitative terms, 1500 companies have applied to the program, which is significant. At the same time, the fact that a lot of enterprises apply for a subsidized program is not really surprising, and I would appreciate more details from the staff on their qualitative assessment of this program.

With these remarks, I wish the authorities continued success.

Mr. Kelmanson made the following statement:

Tunisia is an economy with a good macroeconomic policy track record, which is making good progress in economic and structural reforms. The commitments under the EU association agreements provide important momentum, and if the reform process continues, Tunisia has a realistic prospect of becoming an increasingly competitive player in a global economy.

While progress has been solid, we agree with the staff that liberalization and further development of macroeconomic policy with regard to the unfolding trade liberalization under the association agreement needs to be enhanced. Tunisia is at a challenging stage of reform with real risk to the economy. Liberalization, including further privatization to which the authorities are committed, will expose inefficient industries and service providers to competition. It is difficult in advance to say which industries will improve in competitiveness and which will not. For this reason, the optimistic medium term scenario which the staff endorse is not the only possible outcome; there could be falls in production while the economy adjusts.
This is not to say that the authorities should reform slowly. Going slow now to protect vested interest is not an attractive option if it merely delays the inevitable and risks slowing growth. The authorities' commitment to use the exchange rate to maintain external competitiveness is important in this regard, and the staff are right to urge the authorities to look carefully at the issue of competitiveness.

On the labor market, we agree with those Directors who stress the importance of the challenging issues presented by unemployment. Addressing rigidities in the labor market will be increasingly important and could have positive growth and social effects. Staff views on the current impediments to higher employment growth both for male and female workers would be welcome.

Mr. Rustomjee made the following statement:

The report by the staff on the Tunisian economy for 2000 and the prospects for the medium term is comprehensive and helpful. We commend staff for a well-balanced document and Mr. Rouai for his detailed and helpful preliminary statement. The Tunisian economy continued to improve in 2000, in spite of declining revenue and a stable tax to GDP ratio, thanks to the authorities' commendable efforts at fiscal consolidation and prudent fiscal management. The targeted level of external reserves of 3 months of the import bill was also met, while there is expectation of further improvement in other domestic and external economic indicators in the projections for 2001–06. The economy's market access and ratings by international capital markets have improved. Also noteworthy, is the authorities' strong performance in the areas of transparency practices, and the initiative being taken to subscribe to the SDDS. We are also pleased to note the authorities' agreement to release the staff report.

I concur with the comments of Mr. Alcaide and Mr. Al-Turki on the conduct of monetary policy and with those of Mr. Shaalan and Mr. Bakhache on the central importance of fiscal consolidation, and also with Mr. Maino on the need to rationalize incentives.

Some important and unsustainable economic issues remain outstanding however. These include, the civil service wage bill which accounts for 11 percent of GDP; ongoing public retention of some selected public enterprises that in our view might be more appropriate to privatize, the high level of non-performing loans to the private sector; and the need for further trade liberalization. If these problems are not adequately addressed, they may continue to hinder substantial foreign direct investment in key sectors, constrain active participation of the private sector in the economy, and impede fiscal viability along with a sustainable and competitive external sector. We would urge the authorities to take strong and early corrective action in these areas if medium-term goals are to be fulfilled.

There are some important and appropriate economic policy strategies adopted by Tunisia which are worthy of emulation by developing countries, including other African economies. Three of these seem to be of particular value. First, the three-year national wage negotiation arrangement with social partners, with its built-in mechanism of annual average increases, is worth noting. This arrangement seems to have contributed to price and social stability and has limited labor-related disputes, thus seeming to facilitate the implementation of uninterrupted and effective economic development programs. The staff report notes that there are some important limitations to this procedure, including limited wage flexibility and wage dispersion across enterprises, although in general this 3-year framework clearly seems to have served the country well. The staff's comments on whether there are lessons in this approach for other countries would be welcome.

Second, adherence to standards and codes, including transparent practices, has improved Tunisia's credit rating and allowed her to borrow on international markets at a much lower spread than before, thereby enhancing prospects of external capital inflows, including foreign direct investment on a sustainable basis. The reduction in spreads is very significant—from 280 basis points to 130 basis points in just one year- and sends an important and valuable message to other African countries that successful policies, consistently applied, can lead to a breakthrough into international capital markets.

Third, Tunisia's housing policy and home ownership strategies are quite innovative. The staff report indicates that 78 percent of households own homes and this home ownership is evenly distributed across income levels. The strategies adopted include, investment of 4 percent of GDP in housing programs in the last ten years; the offer of adequate tax incentives to housing construction; and what appears to be an interesting appropriate mortgage lending process and subsidized credit, as well as other saving and investment incentives. These all represent an important collection of elements that could form the basis of a study of methods of addressing housing development, which is after all one of the main challenges for poverty reduction in developing countries. Again, any comments by the staff on whether these strategies could be useful to a broader group of countries would be of interest.

We commend and support the authorities in their desire to advance to May 2001 the repurchase of the full amount outstanding under the 1992 EFF arrangement. With these comments, we wish the authorities the very best in their economic development efforts.

The staff representative from the Middle Eastern Department pointed out that there had been employment growth in Tunisia. From 1994–1999, about 300,000 jobs had been created—a growth rate of 2.5 percent a year. It was true that GDP growth had been twice that rate; but half of GDP growth had come from total factor productivity growth. The gap observed between GDP growth and employment growth had stemmed from exogenous factors, and had not been the result of a bias against employment. The 2000 employment survey confirmed that unemployment was concentrated among youth, and to a lesser extent, among the older unskilled workers. Two out of three unemployed were under 30, and

35 percent were counted as first time job seekers. This suggested that unemployment in Tunisia was primarily a problem of first time insertion into the active labor force.

On the question of whether labor market policies had created incentives against employment creation and contributed to higher unemployment, the staff representative commented that rigid firing provisions had raised the real cost of employment, and had prolonged job searches for newcomers into the labor force—the group that suffered most from unemployment. Similarly, the absence of wage dispersal across enterprises might have reduced employment opportunities while interfering with an efficient allocation of capital. Further, by creating very high homeownership through a successful housing policy, homeownership preceded labor mobility and might have contributed to structural unemployment. Reducing all of these rigidities would create additional employment. Even if the labor market had been more flexible over the last five years, it was not likely that a significant decline in the unemployment rate would have occurred. as the market would not have been capable of absorbing all the new entrants.

The authorities had viewed such rigidities in a different light, the staff representative continued. Labor rigidities and the high wage bill had brought about the benefit of stable labor relations which had allowed for increases in productivity and prosperous enterprises. The authorities recognized the unemployment problem, but their approach had not been to liberalize the labor market. Instead, they addressed the issue through active labor market policies, which consisted of training programs, improved job search services, and subsidies for first-time employees. For older unskilled workers, another set of policies had been developed to provide employment outside of the formal sector through microcredit and public service. It was too early to draw any final conclusion on the success of these active labor market initiatives, but it was observed that for the first time since 1994, unemployment had declined in 2000. These measures, experimental as they were, certainly deserved support; however, labor market rigidities, rigid firing provisions, and a very compressed wage structure might come to bear on the economy. As the economy opened up, employers would face more uncertain economic conditions, and would have to be able to adjust their labor needs accordingly.

Considerable progress had been made with regard to banking sector reform, the staff representative remarked. Banks had become much better capitalized, and were supervised very closely by the central bank. Also, risk analysis across the banking system had improved. Tunisia's largest public bank had restructured its management, and had created a board that would be specifically charged with both maintaining internal control and monitoring the performance of the Bank. Other measures had been taken to improve the financial sector with particular regard to agriculture. Direct budgetary subsidies had been provided to non-farmers and the amount of insurance that viable farmers could purchase had been increased. This had been designed to avoid repeated debt forgiveness on bad loans.

On the question of what sequence Tunisia should follow in terms of privatization and liberalization, the staff representative noted that the calendar for trade liberalization had already been set. By 2008, Tunisia would be in a free trade agreement with the European Union with regard to industrial goods. It was important that the country begin price liberalization now to foster a gradual approach up to 2008. The core issue for tax reform would be greater neutrality in the tax treatment of the offshore and the onshore sectors, eventually eliminating this dichotomy, which would not prove useful once the economy had been fully opened to imports from the European Union.

The size of the wage bill in relation to GDP was certainly not the only criterion that should be considered when considering the appropriate size of the civil service, the staff representative stated. Nonetheless, the correlation between the size of a government's wage bill and its contribution to welfare was not strong. In the case of Tunisia, the wage bill had been approximately 11.5 percent for many years and reflected the concern authorities had for improving social policies and hiring teachers. At present, this had resulted in large pockets of the bureaucracy that would not be needed once the economy liberalized further.

On questions about the "Fonds national de l'emploi" program designed to foster employment and small businesses, the staff representative observed that the average subsidy of the program had been 14 percent, which was not a large amount. To benefit from the subsidy, enterprises had been required to present a project to the central bank, and the degree of subsidy would increase the more the project became self-financed.

It was unclear whether the successful housing model in Tunisia could be replicated other countries, the staff representative remarked. It was the case that measures that the authorities had put in place could be found in other countries. The authorities had also been successful partly because these measures had been taken in a culture that highly valued homeownership. Stable macroeconomic and employment conditions had also significantly contributed so that housing loans could be repaid and profitable.

Mr. Rouai thanked the Directors for their remarks and hoped that the Acting Chairman would share them with authorities at the next high level seminar on Africa and globalization next April in Tunisia. In response to questions, it should be noted that while the Tunisian authorities were encouraged by the progress achieved so far, they understood that emphasis must be placed on fostering the private sector if the economy was to become more diverse and competitive. To this end, the authorities agreed with Directors' recommendations to maintain a prudent financial framework, and to accelerate the implementation of structural reform, in particular in the area of privatization and administrative reform.

Directors had rightly emphasized the urgency to tackle the issue of unemployment, Mr. Rouai continued. Nonetheless, the problem of unemployment was not as dramatic as the figure might imply because of the culture of solidarity among the people in Tunisia, and because of the large contribution of the informal sector. More generally, the authorities' strategy to sustain growth and enhance the role of the private sector had already started to positively affect the unemployment situation as indicated by the staff: the recent annual employment survey showed for the first time a decline in the unemployment rate.

The authorities would continue to pay attention to reducing external vulnerability through prudent management of external debt reserves and programmatic exchange rate policy, Mr. Rouai concluded. The authorities were also aware that transparency was crucial to future growth and stability.

The Acting Chairman made the following summing up:

Executive Directors agreed with the thrust of the staff appraisal. They commended Tunisia's strong economic performance and social achievements, which they attributed to a combination of prudent macroeconomic policies, gradual liberalization and progressive social policies. Directors noted with satisfaction that the sustained implementation of these policies had resulted in improved credit ratings and access to the international capital markets.

Directors considered that Tunisia's growth and employment performance could improve further, by stepping up the process of liberalization and transition to fully opened and market-driven economy. In this respect, they underscored the importance of complementing the ongoing trade liberalization with the EU with comprehensive trade and price liberalization measures and sustained structural reforms.

Directors welcomed the importance which the authorities are attaching to maintaining macroeconomic stability as a prerequisite for growth and investment and to contain potential rising pressures on the external accounts. In this context, they encouraged the authorities to maintain their fiscal deficit on a clear downward path while improving the structure of the budget. While welcoming the efforts to contain the deficit in 2001, Directors believed that more ambitious deficit targets should be set in the future, in view of the deficit reduction strategies, in view of the favorable short-term growth prospects, and to offset the structural deterioration in the social security accounts. They specifically urged the authorities to initiate work on civil service and tax reforms to address the two main sources of budgetary regime, namely the high wage bill and the extensive system of tax exemptions. Some Directors also recommended to step up the phasing out of generalized food subsidies given their inefficiency in terms of income distribution, but others stressed that the authorities' gradual approach had permitted to maintain stability. On medium-term challenges, Directors looked forward to the comprehensive reform which the authorities are planning to put the social security system on a sound financial footing.

Directors commended the authorities for achieving and preserving price stability and noted the dual role played by incomes and monetary policies. They recommended that monetary policy take on a more explicit and central anchoring role for inflationary expectations in the future, and welcomed, in this regard, recent initiatives to increase transparency and announced monetary policy objectives. Directors also saw scope for increased reliance on interest rate signals in line with the improved financial situation of banks and the development of the treasury bill market.

Directors observed that the real exchange rate target followed by the authorities has served the country well, but noted that this rule will become a less reliable competitiveness indicator in the context of trade liberalization. In this light, they supported the central bank's recent decision to broaden the set of indicators used to guide exchange rate policy.

Directors stressed that structural reforms and sustained trade, price and market liberalization hold the key to moving the economy to a higher growth path and delivering on the authorities' primary objective of reducing Tunisia's high unemployment rate. They commended the authorities for their efforts to prepare the private sector for stiffer competition and to open the service sector to private sector activity, notably in telecommunications and port activities. They particularly welcomed the recent plan to prioritize 41 state enterprises over the 12 months and encouraged the authorities to follow through with this program and plan further privatizations in 2002 and beyond.

Directors underscored the importance of ongoing trade liberalization with the EU as an important source of productivity gains and growth potential for the economy. Directors, however, expressed concern about the potential serious trade distortions that could arise from the growing up between the trade regime with the EU and the most favored nation trade regime and urged the authorities to reduce the MFN (most-favored nation) tariff rates at a faster pace.

Directors congratulated the authorities for the progress made in strengthening the banking sector, but noted that the large portfolio of nonperforming loans continues to weigh heavily on the economy. They agreed that, in addition to tight supervision and regulation, greater corporate transparency and improved risk analysis in the banking sector are needed to limit the risk of accumulating new bad loans. Directors noted that opening the banking sector to foreign investors would contribute to the reinforcement of risk management. Directors welcomed the authorities' decision to participate in the FSAP in 2001.

Directors considered that Tunisia would benefit from closer integration into world capital markets, but agreed that significant further liberalization of the financial account should wait until additional progress is made in strengthening the banking sector and deepening domestic capital markets.

On labor market policies, Directors welcomed the recent measures to improve job placement, training, and self-employment. In view of Tunisia's persistent high unemployment rate, it was clear, however, that additional steps to eliminate labor market rigidities would be needed. While recognizing the positive contribution of the present wage-setting mechanism to price and social stability, Directors thus encouraged the authorities to find ways to allow productivity considerations to play a more prominent role in the wage-setting process across enterprises and sectors. They also recommended to adapt labor market regulations to the needs of a more flexible labor market.

Directors welcomed the substantial improvements in the quality and dissemination of statistical information and looked forward to improvements which should result in Tunisia's subscription to the Special Data Dissemination Standard by mid-2001.

It is expected that the next Article IV consultation with Tunisia will be held on the standard 12-month cycle.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/01/12 (2/5/01) and EBM/01/13 (2/7/01).

3. PEOPLE'S REPUBLIC OF CHINA—INCREASE IN QUOTA—GOVERNORS' VOTE

The Executive Board approves the report of the Secretary (EBD/01/2, Sup. 2, 2/6/01) on the canvass of votes of the Governors on Resolution No. 56-1, with respect to the ad hoc quota increase for the People's Republic of China, approved by the Executive Board (EBM/01/1, 1/4/01) for submission to the Board of Governors. The Governors' vote on the Resolution is recorded as follows:

Total affirmative votes	2,101,370
Total negative votes	0
Total votes cast	2,101,370
Abstentions recorded	0
Other replies	0
Total replies	2,101,370
Votes of members that did not reply[1]	48,411
Total votes of members[2]	2,149,781

(EBD/01/2, Sup. 2, 2/6/01)

Decision No. 12423-(01/13), adopted
February 6, 2001

[1] Barbados, Ecuador, The Gambia, Grenada, Guyana, Iraq, Libya, Madagascar, Nigeria, and Vanuatu. The Secretary's communications were not sent to the Islamic State of Afghanistan and Somalia. Communications from El Salvador and Papua New Guinea were received too late to be counted.

[2] The Democratic Republic of the Congo's voting rights were suspended effective June 2, 1994, pursuant to Article XXVI, Section 2(b) of the Articles of Agreement; therefore, the total votes of members excludes the votes previously exercised by the Democratic Republic of the Congo.

4. COOPERATION WITH INVESTIGATIONS ON FUND ACTIVITIES BY AUDITING INSTITUTIONS OF MEMBERS—PROCEDURES

The Executive Board of the International Monetary Fund adopts the following procedures to cooperate, upon request, with investigating agencies of members for the preparation of reports on the Fund and its activities. In keeping with the multilateral character of the Fund and in light of the many existing mechanisms to assess the Fund and its activities, the Executive Board expects that restraint will be exercised in requesting such investigations.

1. All requests from official investigating agencies will be notified to the Executive Board at least two weeks before the commencement of any cooperation with the agency pursuant to the request. The notification will include the full text of the terms of reference of the enquiry and any special features of the enquiry. Executive Directors will have an opportunity to comment on all aspects of the notification, as they deem suitable.

2. Management and staff will be prepared to meet a request if it is channeled through an Executive Director's office and provides:

(i) a precise description of the terms of reference of the enquiry; and

(ii) written assurances that:

- confidential information provided in the course of the enquiry will not be disclosed;

- management and staff will be given an opportunity to review any report resulting from the enquiry before its circulation outside the agency to ascertain that no confidential information is being disclosed in the report and that the factual information is correct; and

- the views of management and staff will be included in the report in an acceptable manner.

3. In principle only documents and information available to the Executive Board will be made available to the agency; the consent of Executive Directors whose statements are involved should be requested before transmitting preliminary statements or Executive Board minutes to the agency. Requests by the agency for access to additional documents and information (other than those relating to the Fund's internal advisory procedures) will be submitted to the Executive Board for approval if management supports the request. The Executive Board will not approve the request unless it has reviewed the relevant document or information; the procedures for the review will ensure the confidentiality of the document or information.

4. The Executive Board will be informed of requests which are denied by management under paragraph 2 or 3. In such cases, management or the relevant Executive Director may consult with the Executive Board.

5. All published reports resulting from such investigations will be circulated to the Executive Board for information, together with an assessment of the staff resources used by the Fund in the enquiry.

6. If, in the judgment of management, an investigative agency did not respect the written assurances provided in accordance with paragraph 2(ii), it shall so inform the Executive Board and propose any remedial action it considers necessary.

7. These procedures will be reviewed not later than January 31, 2003. (SM/00/97, Rev. 1, Sup. 2, 2/2/01)

Decision No. 12424-(01/13), adopted
February 5, 2001

5. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 98/67, 98/88, 98/96, 99/1, 99/20, and 99/125 are approved.

APPROVAL: July 25, 2001

SHAILENDRA J. ANJARIA
Secretary