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Minutes of Executive Board Meeting 95/26

10:00 a.m., March 20, 1995

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Executive Board Attendance

M. Camdessus, Chairman
P. R. Narvekar, Deputy Managing Director
A. D. Ouattara, Deputy Managing Director

Executive Directors

M.-A. Autheman
J. Bergo
I. Clark
B. S. Dlamini
H. Evans
K. P. Geethakrishnan
D. Kaeser
W. Kiekens
Y.-M. T. Koissy
G. Lanciotti
K. Lissakers
H. Mesaki
C. Saito
S. Schoenberg
D. V. Tulin
E. L. Waterman

Alternate Executive Directors

A. A. Al-Tuwaijri
B. Andersen, Temporary
V. J. Fernández
J. R. Suárez, Temporary
N. Prasad, Temporary
L. M. Cheong
K. Link
R. F. Cippa, Temporary
A. Calderón
H. A. Barro Chambrier
J.-C. Obame, Temporary
N. Coumbis
M. Daïri
E. Wagenhoefer
Y. Y. Mohammed
A. V. Mozhin
J.-H. Kang
O. Havrylyshyn
Wei B.

L. Van Houtven, Secretary and Counsellor
T. Ranaweera, Assistant

Also Present

European I Department: G. Bélanger, S. S. Brown. European II Department: J. Odling-Smee, Director; A. Bisat, O. P. Brekk, D. A. Citrin, J. A. Haley, G. Kwon, A. K. Lahiri, C. B. Rosenberg, M. Shadman-Valavi, L. M. Valdivieso, J. Zettelmeyer. External Relations Department: R. W. Russel. Fiscal Affairs Department: T. M. Ter-Minassian, Deputy Director; G. N. Anulova, J. M. Davis, A. J. Pellechio, C. A. Silvani. IMF Institute: I. C. Lienert. Legal Department: P. De Boeck. Policy Development and Review Department: J. T. Boorman, Director; M. Allen, Deputy Director; T. Leddy, Deputy Director; J. G. Andersen, N. L. Happe, N. Kirmani, A. K. McGuirk, S. M. Shadler, E. Sidgwick. Research Department: V. R. Koen. Secretary's Department: R. S. Franklin. Southeast Asia and Pacific Department: J. H. J. Morsink. Statistics Department: E. O. Kumah. Treasurer's Department: I. Otker. Western Hemisphere Department: E. Hernández-Cata, Deputy Director. Officer of the Managing Director; G. R. Saunders, Personal Assistant; P.-I. Koupaki. Advisors to Executive Directors: J. O. Aderibigbe, S. S. Farid, S. K. Fayyad, T. K. Gaspard, R. Kannan, B. Konan, Y. Margoninsky, G. Mucibabici, T. Oya, C. F. Pillath, K. Sundara. Assistants to Executive Directors: S. Al-Huseini, J. A. Costa, D. Daco, M. Dzervite, J. C. Estrella, M. Giulimondi, R. Glennerster, H. Golriz, C. M. Gonzalez, B. Grikinyté, O. Himani, C. Imashev, T. Isataev, W. C. Keller, A. M. Koulizade, V. Kural, G. A. Kyriacou, K. J. Langdon, B. M. Lvin, T. Lwin, H. Petana, S. Rouai, G. Schlitzer, T. Sitorus, J. B. Wire, Zubir b. A.

1. REPORT BY DEPUTY MANAGING DIRECTOR

The Deputy Managing Director, Mr. Ouattara, said that he had visited London during March 15-16 to attend a meeting of the Standing Committee of the Council of Europe, and to meet with U.K. officials and the press. Together with Mr. Sandstrom, the Acting President of the World Bank, he had presented to the Council of Europe a report on the activities of the Bretton Woods institutions. The European parliamentarians had raised questions about the Fund's recent agreement with Russia, programs with some of the Eastern European countries, and about how the conclusions of the Copenhagen Social Summit would be taken into account in the work of the Bretton Woods institutions. They had also shown interest in the views of the Fund and the Bank on military expenditures, human rights, enhancement of good governance, and technical assistance.

While in London, he had met with officials of the U.K. Treasury and the Minister for Overseas Development to exchange views on multilateral debt and developments in some African countries, the Deputy Managing Director remarked. He had discussed with the press the Mexican crisis and the situation in Argentina, and had briefed members of the African press on global and country-specific developments in Africa.

2. BALTIC COUNTRIES, RUSSIAN FEDERATION, AND OTHER COUNTRIES OF FORMER SOVIET UNION - POLICY EXPERIENCES AND ISSUES, AND REVENUE DECLINE

The Executive Directors considered a staff paper on the overview of policy experiences and issues in the Baltic countries, the Russian Federation, and the other countries of the former Soviet Union (SM/95/46, 3/3/95; Sup. 1, 3/10/95; Cor. 1, 3/15/95), together with a paper on the revenue decline in those countries (SM/95/27, 2/3/95; and Cor. 1, 3/10/95).

Mr. Mesaki made the following statement:

> More than three years have passed since the breakup of the Soviet Union and many of the countries of the former Soviet Union have accumulated experiences in economic reform conducted in cooperation with the Fund. As a growing number of countries are successfully reaching an agreement on a Fund arrangement after a long struggle, I believe it is timely to issue a paper analyzing the experience of those countries and suggesting a desirable future path. In particular, charts and tables in the paper comparing the performance of each country of the former Soviet Union are very enlightening, and are what I have long awaited. They help a great deal in understanding and comparing the different pace and characteristics of economic reform in the countries of the former Soviet Union. I urge all the officials working on the countries of the former Soviet Union, including the officials of these countries, to read this paper at least five times.

I would say, if I may, that the staff could have elaborated on privatization and land reform, which many countries of the former Soviet Union have had difficulty in implementing, and we could have heard the staff's recommendations derived from the successful examples. However, it may be the case that the staff has had too few successful examples and needs more time.

This paper indicates that the Fund's basic therapy, which gives immediate priority to the containment of inflation and rapid implementation of ambitious structural reforms, has been doing very well. However, there is some conflicting evidence shown in the paper. For example, Chart 1 shows that Uzbekistan has achieved a much better performance than has Kazakhstan, while the latter has pressed ahead with economic reform much more strenuously than the former. Both countries are endowed with natural resources. This may prove that something inherent in the gradualism contributes to the improvement of economic situation. I must wait for the staff's further analysis.

As regards the introduction of a national currency, the hottest issue after the breakup of the Soviet Union was whether the ruble area should be maintained, which is fully described in the paper. When asked about whether the countries of the former Soviet Union should introduce their own currency, the Fund staff consistently replied that the choice of currency was a sovereign decision of each country and the Fund staff was not in a position to give advice on which is better.

However, in light of the diverse developments between the Baltic countries, which have introduced their own currency since an early stage, and Belarus, which stayed with the ruble, I believe that the countries of the former Soviet Union would have benefitted more from an earlier introduction of their own national currency. In this respect, I would like to hear the staff's reassessment of its views at that time.

On the exchange rate regime, as mentioned in the paper, the question of "a fixed exchange rate or a flexible exchange rate" has received considerable attention in the past year, both in the public debate and in discussions within the Fund. I feel that the management and the staff have changed their view gradually. The explanation and argument presented in the paper in this respect are very illustrative, clear, and logical. I would agree with most of the general conclusions in the paper; for example, the choice of an exchange rate system in the countries of the former Soviet Union should be decided on a case-by-case basis, taking account of many factors, including the specific fiscal situation and the adequacy of official reserves. In particular, I argue for the staff's view that the failure of an exchange rate peg will entail significant costs, while under a flexible exchange rate regime the program may be adjusted without visibly signaling failure.

Having said that, I am not fully convinced of the staff's conclusion on which countries of the former Soviet Union could adopt a fixed exchange rate in the near future. For example, I wonder why the list of candidate countries for the adoption of a fixed exchange rate include Armenia and Georgia, both of which just entered into Fund arrangements and, if I understand correctly, will have to face huge challenges under tremendously uncertain circumstances.

Finally, I would like to make a brief comment on Russia. As the Managing Director indicated at the Board on March 13, the Russian economy will have to be stabilized to a greater extent before a fixed exchange rate is introduced. I hope that economic stability will materialize as soon as possible to pave the way for the consideration of the introduction of a fixed exchange rate.

It goes without saying that the revenue decline has been one of the major issues in the countries of the former Soviet Union, together with interenterprise arrears and privatization. The paper before us describes clearly the current situation of the revenue decline and analyzes the causes of it extensively. I believe that the abundant good advice contained in this paper will provide a useful guideline for the authorities who intend to accelerate economic reform.

The first thing I notice after reading the paper is that there is little correlation between the degree of revenue decline, in percent of GDP, and the seriousness of the effort of the authorities toward economic reform. For example, in Table 2 on page 5 of the staff paper on revenue decline, among four countries whose revenue in percent of GDP from 1991 to 1993 has increased, there is only one country, Kazakhstan, that has an upper credit tranche arrangement with the Fund; while one of the four countries does not even have an arrangement under the systemic transformation facility (STF), Tajikistan.

At the same time, the Kyrgyz Republic and Moldova, both of which have had good reputations regarding their serious efforts in economic reform, experienced a revenue decline of as much as 8 percentage points. This figure might indicate that the revenue measures are particularly difficult to implement and take much time before they take effect.

I can support most of the advice on revenue measures in the paper and believe that they should be implemented in no time. However, even the measures described in the "immediate challenges" are ambitious enough and it might not be realistic to expect the authorities of the countries of the former Soviet Union to implement them in a short period of time. The major obstacles are political pressure and the lack of administrative capacity.

There seems to be no other royal road to overcome the political pressure than to try to persuade the opposition patiently, explaining the rationale of the new revenue measures. On the strengthening of administrative capacity, however, careful consideration should be given to forming a strategy.

First of all, the Fund should play a major role in providing technical assistance to strengthening administrative capacity. Second, the authorities should attach utmost importance to improving the quality of the human resources. To this end, I propose that the salaries of tax experts in the Government be raised substantially. This measure might also be effective to prevent corruptions. For your reference, tax officials are favorably treated in terms of salaries in Japan, too. Our experience proves that the additional revenues more than offset the additional expenditures.

As regards consideration of industrial policy, the paper does not mention preferential tax treatments for the purpose of subsidizing particular industries. However, such a preferential treatment has contributed a great deal to the rapid and stable economic growth in many Asian countries including Japan, and I would suggest that the Fund give consideration to the effect of such a measure. While I basically agree with the staff that exemptions should be abolished as soon as possible, I am inclined to support moderate exemptions which are granted to particular industries for a limited period.

Decisions on foreign direct investment, which is crucial for sustainable growth of economies in transition, are greatly influenced by the tax system of the recipient country. I would suggest that the Fund, and the Bank, could give attention to the effect of the tax system on the foreign direct investment and encourage the authorities to adopt tax laws designed to attract more foreign direct investment. I can go along with the maintenance of tax exemptions for this purpose. Of course, the stability of the tax system is most crucial to attract foreign investment.

Finally, I would like to make a comment on the consciousness of the people in the countries of the former Soviet Union as a taxpayer. As the people of these countries have long lived under state control, I am wondering whether the people have adequate consciousness of paying taxes as a taxpayer. For example, I feel that it might be difficult to expect individuals to file a complete tax return. While taxpayer education is definitely important to improve the condition, I am afraid that it might take much time before it bears fruit.

If this is the case with the countries of the former Soviet Union, the tax collection system, including the tax return system, is not expected to function well. Consideration should be given to adopting some other compensating measures to prevent further revenue decline. I would suggest two options to deal with this issue.

First, the simplest solution could be an increase in the proportion of indirect taxes. Second, in case the proportion cannot be adjusted for some reason, it is worth considering introduction of withholding taxes on salaries, dividends, and interests.

Mr. Clark made the following statement:

After more than three years of experience with the unprecedented challenge of transformation of the Baltic countries, Russia, and the other countries of the former Soviet Union to market economies, it is worthwhile and timely for the Fund to take stock of developments and review policy and program design. The staff papers set out, in a concise format, a comprehensive analysis of the five issues that have come up repeatedly in our discussions in the Board, and have also been made by outside commentators, on the stabilization process in these countries. Although worthwhile for our own deliberations, the comparison of program design and developments in the transformation process may derive its greatest value from the potential "cross-pollination," or demonstration, effect. Each individual country in this region must be very interested in comparing and contrasting its own developments with those of its neighbors. As the Baltic countries are finally beginning to see their efforts translated into a recovery in output, one would expect that the drive and commitment toward stabilization and transformation in other countries should gather momentum.

I generally support the analysis and the recommendations advanced by the staff. If I were to find a general fault with the papers, it would be that there are many other issues in the transformation process, particularly related to the area of structural reforms, that are also worth addressing. However, I appreciate that some selectivity has to be observed so that our discussion can be focused on the key areas that lie directly within the Fund's domain and expertise. Nevertheless, future work in this area should not only endeavor to expand the analysis as our experience increases, but also address more fully the impact of structural developments on stabilization, in particular the progress with privatization.

The general policy conclusions that are drawn by the staff from our experience with stabilization programs in the Baltic countries, Russia, and the other countries of the former Soviet Union are all eminently reasonable. While perhaps not a surprise, the main lesson that stands out is that a recovery in output and real incomes cannot be achieved without a reasonable degree of price stability. Thus, the key objective under the Fund-supported programs to reduce inflation decisively remains valid.

What remains at issue is how the reduction in inflation should be brought about in the design of Fund programs. The paper provides an enlightening discussion on the difficulties that have arisen regarding monetary management in the short term. Despite monetary and credit restraint in line with program targets, inflation has remained, for a period of time, stubbornly high. Unexpected fluctuations in velocity and money demand, combined with negative real interest rates, appear to be the main culprits; however, the existence of significant interenterprise arrears, which can be characterized as representing privately generated liquidity, has also exacerbated the problem. Such developments argue strongly in support of the need for tight credit and monetary policies to be reinforced and enhanced through the implementation of comprehensive and coherent structural reforms, in order to improve confidence and reduce inflation expectations.

I would also suspect that the nature of the fiscal restraint and the expectation on the sustainability of credit policies may have contributed to the unpredictability of velocity. For example, we have seen in some cases that, through sequestration, fiscal deficits on a cash basis have been significantly contained; however, on a commitment basis these deficits have, in some countries, remained quite large. The difference between the cash and commitments deficit--"expenditure arrears"--leads to a credibility gap. As long as the underlying deficit is not reduced, inflation expectations will include a risk premium associated with the possibility that the Government will resort to credit creation, in the future, to honor its arrears. As noted in the paper on the revenue decline, the integrity of the fiscal stance spills over into other areas, such as tax compliance. The staff's comments on whether this is a valid proposition and its possible relevance to evaluation of program design would be appreciated.

As regards E-Based versus M-Based Stabilization, or the "great taste versus less filling" debate, with the difficulties associated with accurately estimating money demand and the future path of velocity in economic programs, the exchange rate-based stabilization approach naturally drops out as a potential solution. At this juncture, the issue of exchange rate-based versus money-based stabilization is particularly relevant. A few particularly influential countries are embarking on significant stabilization programs and the issue of whether to fix the exchange rate is under active consideration. In addition, this issue also pertains to our future considerations of the proposal for Fund-financed currency stabilization funds.

The discussion presented in the papers provides a balanced account of the advantages and disadvantages of exchange rate-based stabilization. However, one can imagine that there is not a uniform view on this issue among the staff, nor would I expect there to be in this Board. Part of this stems from the criteria used to assess whether a fixed exchange rate can be sustained. They involve making judgments: judgments on the commitment to strong financial policies and, just as important, judgments on the type and frequency of future shocks. Judgments are, by nature, subjective and, hence, I believe that we cannot say ex ante that all programs should be centered on a fixed exchange rate. Thus, I support the staff's recommendation that a case-by-case approach is warranted. Nevertheless, I would appreciate further elaboration from the staff on the following.

First, the staff indicates that no attempt is made to discuss the relative merits of different exchange regimes as permanent policy choices. However, by fixing the exchange rate as a "confidence booster" to the stabilization effort, an adjustment to the regime, after the disinflation phase, may lead to an unraveling of the previous efforts. The exchange rate is being used as a transparent symbol of the authorities' commitment to stabilization and reform, and not only to aid monetary management. Thus, the authorities' whole commitment to reform may be placed on trial even if it may be perfectly reasonable, from an economic perspective, for there to be a change in parity or a move to a more flexible system altogether. Therefore, it is not clear to me that one can divorce the issue of using a fixed exchange rate in the short term, from what one plans to do in the longer term.

Second, the positive experience shown by Estonia and now perhaps Lithuania, with a currency board arrangement, raises the question of whether this approach should be employed more frequently. It is not quite clear from the paper whether the staff would consider a currency board as a more attractive option than fixing the exchange rate. If so, then perhaps support from the Fund and/or external sources should be used to back a currency board arrangement until the authorities have, over a predetermined period, accumulated sufficient amounts of their own earned reserves to fully back their currency. The staff's views on whether this is viable would be appreciated.

Finally, little attention is given in the discussion on the choice of the exchange rate parity under exchange rate-based stabilization. This is a particularly difficult task in countries undergoing economic transformation of the magnitude of that of the countries of the former Soviet Union. Proponents of exchange rate-based stabilization have argued that the exchange rate be fixed in the early stages of the stabilization process. There will be a tendency to aim for an undervalued exchange rate so as to ensure that a country's competitiveness is not undermined. A substantially undervalued currency could, however, fuel inflationary pressure. The ability to determine an exchange rate level that is sustainable should be added to the list of factors that needs to be considered in making an assessment on exchange rate-based stabilization.

I have been selective in my own comments, but look forward to hearing my colleagues' views on these and the many other interesting issues that are raised for our discussion today.

Mr. Andersen made the following statement:

Let me begin by emphasizing that I welcome such reviews on experiences in specific countries and areas, and that I broadly concur with the staffs concluding remarks in both papers. This conclusion could have led to a very short statement from this chair, but the fact that I felt that we might have been able to distill even more from such overviews necessitates some further comments.

After going through the papers, I found the more precise purpose of this discussion somewhat unclear. The papers only sporadically cover the Fund involvement or any discussion about the quality of Fund advice, which I would have preferred, cf. below. But, even without this element, I found the papers rather voluminous and with too little guidance for the Board. A short general summary distilling the main conclusions, messages, and some points for discussions would have been most helpful.

Furthermore, I find such discussions in this Board particularly valuable if put into a context of evaluating whether there is a need for any modifications by the Fund in its approaches to policies that would improve the effectiveness of the Fund's involvement. Thus, I missed a more intense discussion of the lessons for the Fund: have the bad experiences mentioned in a number of countries and areas only reflected insufficient implementation of the Fund's advice, or could examples be given of cases in which the Fund failed in its advice and policy approach? Hence, it would have been interesting and refreshing to have seen both an evaluation and some self-criticism of the Fund's policy advice, which might have given additional lessons, especially in view of the Fund's strong involvement in all these countries from the beginning of their reform efforts, but, also more generally, in connection with future endeavors in promoting appropriate policies before markets force more damaging adjustments. The absence of this element strengthens the arguments for establishing an evaluation unit within the Fund.

In general, it seems justified with a continuous reassessment of the appropriate policy approach, both given the rather short period of Fund experiences in transition economies and, more specifically, the high degree of political and economic uncertainty in many of the countries.

In sum, such reviews could give a good overview of the lessons to be learned from policy experiences and the Fund's involvement in its member countries if papers are properly targeted for that purpose. Last year we had several fruitful discussions in connection with the conditionality review, and a very useful paper has been issued on the experiences from programs supported by the STF, which covers developments in some of the countries of the former Soviet Union.

As already mentioned, I broadly concur with the staff's analysis and concluding remarks. The inclusion of a rather heterogeneous group of countries will always give rise to some problems when trying to draw general conclusions, as the staff rightly emphasizes. Also, the generally poor data quality argues for some cautiousness. In this respect, I noted from the recent publication, Transition, issued by the World Bank, that electric power consumption may be a far better indicator of true economic activity in Eastern Europe and the former Soviet Union than any of the official reported economic statistics. The staff's comments would be of interest.

Regarding the basis for the analysis, it would have gained from taking into account that the process of becoming independent economies had already started in the Baltic countries in 1989, when working groups were formed for the preparation of programs for independent economies, including independent monetary systems and national currencies. For instance, in 1990, the Bank of Lithuania and the Bank of Latvia were established as central banks, responsible for the creation of two-tier bank systems and the implementation of independent monetary systems. This points out that macroeconomic stabilization measures started much earlier in the Baltic countries than in the Russia and the other countries of the former Soviet Union, which makes comparison difficult for the time period covered in the staff papers. Accordingly, the countries discussed in the papers were at a different starting point, as well as at a different degree of readiness, in 1991. In that respect, the Baltic countries would have more similarities to developments in Central and Eastern European countries, which also implicitly seems recognized by the inclusion of those countries in many parts of the papers.

Moreover, the analysis might have benefitted from a more systematic grouping of the countries throughout the papers, and more continuity in the illustrations and presentations.

Regarding the staff's conclusions, I would like to emphasize that some of the lessons are of special importance for the transition countries.

First, the need for applying a case-by-case strategy is important, as it may be rather difficult, and could prove counterproductive, to try to establish a too-stylized path of appropriate policies for countries with wide variations in their political backgrounds and possibilities, as well as in their initial conditions.

Second, experience clearly illustrates that, in the long term, there is no trade-off between inflation and preserved production, cf. the illustrative Chart 1 in the staff paper on policy experiences and issues, and that it does not appear that the countries that have postponed action have been able to reduce the cumulative size of the output decline. Apart from having started the stabilization process earlier, the steadfastness in the implementation of the stabilization measures in the Baltic countries deserves emphasis. It is, of course, encouraging to note that the experiences in countries whose interests are represented by this chair set a good example to other countries in the region as to what can be achieved when there is popular support for, and political commitment to, reforms.

Third, experiences indicate that a case-by-case approach in the exchange rate question has been proper. However, the analysis is hampered by the fact that only one country has chosen a fixed exchange rate throughout the period. The choice of an exchange rate regime--whether to peg, fix, or float--is probably of secondary importance, compared with the significance of strong, supportive fiscal and monetary policies. Any arrangement may collapse in the absence of sustainable policies and, vice versa, be successful with the support of strong domestic policies. However, there might be additional advantages to a fixed exchange rate strategy if the necessary support from other policies is in place. Even in countries where macrostabilization has largely been achieved, inflation remains fairly high and is still a matter of concern. Further explanations of the persistence of inflation would be welcome.

Finally, the experience strongly justifies the need for increasing the attention paid to the design of well-targeted and effective tax systems as well as efforts that prevent the build-up of interenterprise arrears, which also requires well-functioning payment systems. The paper on the revenue decline illustrates a number of appropriate steps to increase tax revenues. Moreover, the suggestions on dealing with arrears are very interesting and deserve further attention. I would support continued emphasis on the training element of technical assistance, and find that prior actions involving implementation of technical assistance recommendations should play a much larger role.

I hope that the valuable lessons would be vigorously translated into future Fund-supported programs for the countries discussed, as they may be of equal importance for other countries in transition.

Extending his remarks, Mr. Andersen said that his chair disapproved of the reference to Baltic countries as "FSU countries".

Mr. Tulin made the following statement:

Let me first commend the staff for its helpful and instructive papers on the issues under our consideration. I find these papers excellent, as usual, but probably less provocative and less inspiring to discuss. One might attribute this result to a certain level of consensus achieved between the staff and the countries of the former Soviet Union as to the policy implications and recommendations proposed by the Fund. Despite very mixed results of the economic policies in many of these countries, a broad direction of transition has already been chosen. Now the authorities in these countries may need to secure the required political equilibria; they may need to be encouraged and assisted, but I believe they no longer need to be convinced of the validity of our standard prescriptions.

On output and revenue decline, even putting aside some extreme cases--such us those of the Caucasian countries which are heavily burdened by various conflicts and hostilities--one may arguably conclude that a substantial and abrupt decline both in output and in the budget revenues was practically unavoidable. The experience of the countries of the former Soviet Union, which pursue to date quite different economic strategies, proves that this phenomenon is deeply rooted in some systemic properties of the traditional Soviet economic setup rather than in current policies. The economic decay of the former Soviet Union, which has visibly accelerated since the late 1980s, was aggravated by uncoordinated political disintegration. Therefore, we have to accept this output and revenue fall as at least a starting point--and even probably as an exogenous factor--in discussing further reform policies for the countries of the former Soviet Union.

The staff provides us with various comparisons of real revenue behavior and movements in the revenue\GDP ratio in these countries. It seems, however, that these comparisons should be exercised with extreme caution owing to an exceptionally flawed database. Output dynamics and revenue\GDP ratios are particularly influenced by statistical problems owing to different coverage of GDP in particular countries and a downward bias of GDP measurement, common to all transition economies. Statistical definitions and methodology have tended to change dramatically over the last few years in the countries of the former Soviet Union. Moreover, the scale of price and output adjustment experienced by these countries--likely to be unparalleled in peaceful periods--renders all indexes highly unreliable. Nevertheless, qualitative conclusions look rather obvious.

I find the related staff recommendations with regard to improving tax design, collection, and administration to be helpful and comprehensive. There were several initial errors in this area, committed by many countries of the former Soviet Union, that caused substantial losses to their public finances with barely any acceptable justification. Exemption of imports from the value-added and excise taxes is, perhaps, the most striking example of such an error, which painfully and unduly hurt domestic producers. I understand that it is amazing to some observers how long it took for the authorities in various countries of the former Soviet Union--not excluding my own--to correct this error.

The streamlining of accounting rules and practices, as well as bringing much needed stability and clarity into tax laws and regulations, as proposed by the staff, should undoubtedly be expedited. In this regard, my authorities strongly appreciate the Fund staff's assistance in this area. These extremely needed changes remain, unfortunately, a very time-consuming exercise.

Some other flaws and imperfections in the tax area are not easy to fix for some specific reasons, mostly owing to the high political costs of challenging sectoral and regional lobbies that have strong vested interests.

I think that it could be appropriate if the staff were to combine its analysis of the budget revenues with that of budget expenditures since it is their relationship that mostly determines the success or failure of stabilization efforts. What makes the Baltic countries the success story of the former Soviet Union is not some particular trend in their revenue performance, but rather their determination to avoid significant, if any, fiscal deficits.

Fiscal federalism is another issue that warrants discussion in more detail. It is likely that the small size of the Baltic countries contributed to their success. Other countries of the former Soviet Union have no choice but to pursue bold divestiture of both responsibilities and taxing rights to local sublevels, thus making justification and execution of the budget process more transparent and understandable to the public. This problem should, perhaps, be more strongly emphasized by the Fund.

I can summarize the staff conclusions here as a case for early achievement of positive real interest rates and the securing of public belief in the stability of the basic rules of national monetary policy. It also took time for my authorities to become convinced of these principles. For example, at the early stages of the Russian reform some believed that highly negative interest rates had nothing to do with inflation, and that a sudden currency reform might produce any positive outcome. No responsible policymaker could claim these exotic views in Russia now; therefore, I do not see these points as real policy issues.

What deserves to be discussed here is, in my view, the issue of currency substitution, traditionally taken up in the context of Latin America, but much less in the context of the transition economies. The staff admits that its analysis of velocity does not fully take into account the foreign currency component of the public money holdings. Only foreign currency deposits held in domestic banks are counted, thus obscuring a real demand for money balances and making analysis rather weak. A shift to foreign exchange holdings is too often interpreted as undesirable "capital flight"--a very vague term itself--rather than as a rational tendency of the public to protect their savings. Anecdotal evidence of currency substitution in the countries of the former Soviet Union is abundant, exchange operations, often by informals, remain mostly unsuppressed, and most of these countries hardly provide strong incentives for their residents to deposit foreign exchange with domestic banks. It is true that quantitative analysis may appear very perplexing under such circumstances--but that is precisely why policy implications ought to be considered more thoroughly here.

Implications of different policies and approaches toward the use of foreign currency in the transition economies seem never to be discussed in depth by this Board. This issue remains rather an area of economic policies in which decisions are justified often by flawed perceptions or immediate quasifiscal considerations.

I find nothing to disagree with the staff about the arrears problem. I fully concur with the conclusion that the "hands-off" approach is the best one to be employed by the authorities, and that interstate trade should not involve further intergovernmental obligations and transactions.

I may add two important reasons of repeated surges in arrears, both of a systemic nature. The first relates to the specific regime of some providers of basic infrastructure services, such as railways, power plants, and fuel distributors. They are too often restricted in regular commercial rights to deny supplies to nonpayers. Thus the bulk of arrears tends to be concentrated in these sectors. Secondly, in an environment of uncertain property rights, as mentioned by the staff, artificial arrears are often created and utilized by influential insiders to divert cash flow from their enterprises.

The staff made a correct observation about the highly negative side effects of arrears in making budget outlays, for example, semijustified tax evasion and withholding by economic agents. In this regard, we must realize that, in the absence of an extremely tight budget and absolutely clear rules of its execution--which is rarely the case in transition economies--authorities are often facing a difficult choice: what commitments ought to be observed first, explicit budgetary ones or a largely implicit commitment to keep inflation in check.

The issue of a fixed versus flexible exchange regime was discussed extensively last June. This time, the staff has chosen to follow a very cautious approach without making a final judgment about a preferable solution. My understanding is that excessive exchange rate commitment may prove burdensome until comprehensive and consistent reform strategies and underlying political consensus are fully in place, and the outcomes of initial trade shocks are translated into the domestic price level.

Nevertheless it is my impression that a more profound comparative analysis of the possible options for the foreign exchange regimes in the transition economies is still to be done. A more detailed comparison might be warranted between conventional fixing of exchange rates, which has manifested its intrinsic weaknesses so recently, and a much more strict mechanism of a currency board--the only instrument of explicit exchange rate commitment currently employed in the countries of the former Soviet Union. I would like to take this opportunity to urge the staff to expedite its studies on this issue and to share its deliberations with us.

Mr. Link, on behalf of Mr. Kaeser, made the following statement:

The papers provide an interesting review of experiences of the Baltic countries, Russia and the other countries of the former Soviet Union pertaining to the transition process. It concentrates on issues that have presented particular difficulties in the design and implementation of Fund-supported programs for these countries.

Since the beginning of the reform process, the transition countries and the international community have acquired many experiences and findings concerning the transition process. The know-how about the necessary measures and procedures is, therefore, largely available. The problem is, in our opinion, the lack of the authorities' credible commitment to continuing reform strategies. The economical and political zigzag courses provide no stable basis for an economy. We are aware that, compared with the Central and Eastern European countries, the starting position of the countries of the former Soviet Union was even more complicated and difficult, mainly owing to the disintegration of the Soviet Union and the historical background. However, confidence in an economy can only be reached through convincing signals for persistent market-oriented reforms.

At the same time, the choice for economic transition also depends on the initial conditions, and especially the degree, of inherited macroeconomic instability. A radical and comprehensive economic program introduced under extremely difficult macroeconomic conditions can be successful despite powerful external shocks. This seems to be the lesson not only of Central European countries, like Poland, but also of the Baltic countries. Being radical and comprehensive, such programs are able to break down the inertia and structure of the inherited system and benefit from the political support of an increased tolerance for the painful economic measures that emerged after great political breakthroughs. As the staff study shows, the alternative, gradual strategies of tolerating high inflation and of very limited liberalization have practically no chance for economic success. And, although they may appear less risky from the social and political point of view, they are in fact extremely dangerous in these aspects.

We agree with the lessons drawn by the staff, which broadly correspond with the experiences made in the Central and Eastern European countries. Again, there is strong evidence of the importance of early macroeconomic stabilization efforts and of the concomitant implementation of structural reforms. In addition, social safety nets will be necessary for programs to be politically acceptable. As to the question of the appropriate exchange rate system, we support the staff's view that it has to be decided on a case-by-case basis. In any case, stabilization success depends to a large extent on adequate accompanying adjustment policies, in particular, on fiscal and monetary restraint.

Coming now to the sources of revenue decline in countries of the former Soviet Union, the staff tells us that in most of these countries, revenue has been eroded by numerous exemptions from all major taxes. Notably, sectoral lobbies, foreign investors, and regions benefit from exemptions. In Russia, apparently, pressures from regional elites has led to "special rights" being accorded to individual regions by presidential decrees, government resolutions, and parliamentary decisions. This would seem to point to inadequacies in the tax laws. Tax laws should be put in place in each of the countries of the former Soviet Union, setting clear limits on any possible exemptions, including precise criteria that any requests for exemptions must satisfy.

To the extent that decentralization creates difficulties for the Central Government in collecting taxes from individual regions, we agree with the staff that fiscal sovereignty should remain with the Central Government. However, it may make sense to have a mixed system, in which fiscal sovereignty remains with the Central Government for those taxes that only the Central Government can collect efficiently, and with the regions for all those taxes that the regions are capable of collecting. For example, as the staff points out, taxes on large enterprises may be easier for the Central Government to collect, insofar as these enterprises have an inordinate influence on the regional authorities. However, taxes on small farmers may be not only within the capacity of the regional authorities to collect but would conceivably be even easier for the latter to do so than for the Central Government.

We would like to support the staff's view that, given the importance of the emerging private sector, there is an especially strong case for eliminating tax holidays for newly established businesses and replacing them with generous carry forward of start-up losses and/or accelerated depreciation of capital assets. This idea seems reasonable to us, not so much because it would necessarily increase revenues, but in order not to delay the apprenticeship of newly established private businesses in matters of recording and reporting to the authorities the information needed to establish their taxable income. This would also help these individuals who are new players in the game to develop an entrepreneurial way of thinking: for example, to think about how to depreciate their capital assets as quickly as possible. However, because of the need to encourage the private sector, the tax officials will need to be generous in many cases, as the staff has suggested.

Insofar as certain businesses are making enormous profits from the start, the elimination of tax holidays will increase equity, as the staff pointed out. However, insofar as the businesses are struggling to start up in difficult circumstances, putting an end to tax holidays, coupled with generous carry forward of start-up losses and accelerated depreciation of capital assets, may not ultimately bring in significant additional revenues. But, at the very least, the depreciation of the capital assets and the start-up losses will have been declared from the beginning. If the system allows enterprises that have tax holidays to put this declaration off until the tax holiday is over, then in the end the tax holiday will be more expensive than the generous carry forward of start-up losses and accelerated depreciation of capital assets, even in the absence of significant revenues from the latter, in the short run.

Turning to the question of controlling taxes, the staff points out the fact that most countries do not have adequate customs controls, either for assessing and imposing tariffs or for applying value-added and excise taxes to imports. According to the staff, to cope with this problem, some countries attempt to bypass the customs administration and have their internal revenue service collect domestic indirect taxes on imports. This practice seems to us to be excessively complicated and time-consuming. Since the internal revenue service must be informed of the imported goods and to whom they are destined, the customs administration cannot be entirely bypassed anyway; it is obliged to record this information. The time necessary to communicate this information to the internal revenue service and for the latter to subsequently attempt to collect the taxes is greater than would be necessary for the customs administration to collect the taxes itself. Moreover, when goods have not been taxed at the border, much time is lost trying to locate the imported goods.

If there were many internal revenue service people with nothing to do on their hands, this solution might still be conceivable. But according to the staff, the tax officials do not even have time to control the collection process of taxes on internal revenues. Audit units have not yet been set up. So it is hard to imagine who would have the time and the competency necessary to run after imported goods anyway.

To sum up, we are talking about both an inefficient use of the time of customs officials--who are presumably spending their time writing reports about what is being imported, rather than simply collecting the taxes, and an inefficient use of the time of tax officials--who have yet to set up audit units necessary to control the collection process of taxes on internal revenues.

Concerning the excessive current tax rates, the staff has expressed the belief that they should not be reduced as long as the fiscal situation is severely imbalanced. For example, the staff advised the Russian authorities, on the occasion of the last Article IV consultation, to maintain the tax rates until the revenue base and tax administration have been strengthened sufficiently and expenditures are firmly under control. We expressed our concern at the time that maintaining tax rates at an excessive level for any length of time could be counterproductive, as this constitutes a strong disincentive to private business and an equally strong incentive to the propagation of fraud, tax evasion, and corruption. It seems that rather than depending on inordinately high taxes to increase revenues, it would make more sense to set taxes at reasonable levels and thus, by raising tax-payer morale and improving participation, conceivably raising revenues. The issue of controlling tax collection is related to the problems arising from the existence of excessive tax rates, as it would not seem to make sense to try to compensate for the situation described by the staff in which tax returns and other key forms necessary for compliance are not even provided to taxpayers--or if provided carry no instructions--not to mention failure to crack down on tax evasion and corrupt practices, by attempting to collect excessively high taxes.

We join the staff in supporting the raising of excise taxes on goods whose consumption has a harmful impact either on the environment or on public health, such as on gasoline for cars, car imports, alcohol, and cigarettes. The staff mentions that in contrast with market economies, excises have not been a stable high-yield revenue source. This is difficult to justify in the former Soviet Union, particularly as the consumption of these goods increases the burden on already-growing public expenditures, both on environment and on public health.

Another way to increase state revenues would be to introduce charges on emissions and taxes on products and services whose production entails significant pollution. Such taxes have the additional advantage of being market-oriented, creating incentives for enterprises to reduce polluting behavior and to promote conservation of natural resources. They can complete and, in some cases, replace regulations. They also foster least-cost solutions to protecting the environment.

The staff mentions that in Estonia the tax system was capable of taxing incomes outside the enterprise sector, but that this has not proved to be the rule. How did the Estonians do it? We imagine that there is something to be learned from the Estonian experience and we would like very much to learn it. We would appreciate any comments the staff could make on this subject.

Mr. Prasad made the following statement:

The wealth of analysis presented in the papers for today's discussions has considerably enhanced our perspectives and understanding. We agree that it is difficult to separate these issues into two sessions, because they are so complementary. In any case, for the program countries, there is little to choose from among priorities: to address declining growth, arrest inflation, reverse revenue decline, absorb terms-of-trade shocks, and deepen the social safety nets. Three-and-a-half years is not a very long period of time to draw common conclusions, especially when the members in question are so diverse as to have expanded from 1 nation to 15, but it is enough to draw some valuable lessons. The staff has done an outstanding job of elaborating on common developments and common problems, like the issues relating to a common currency area, but the clear message is that there is no likelihood of evolving a common strategy for the reform for each member. Rather like the man who has one foot in a bucket of boiling water and one foot on a slab of ice, we cannot derive a comfortable mean temperature. I have to confess that I have not yet complied with Mr. Mesaki's exhortation to read this paper five times, but I shall endeavor to make some comments based on two readings.

As other Directors have raised a host of issues for the countries concerned, I would like to raise a few quick issues on the lessons emerging for the Fund from the experience, and would like to hear staff responses.

First, presuming that the special factors mentioned in the papers--like geographical proximity, historical trade links, or factor endowments--formed part of all macroeconomic calculations, all these countries could not have been expected to restructure or reform at either the same pace or with the same degree of success. What would really need attention, therefore, are countries that were expected to have performed better than they have done. An added problem in such analysis would be the states who have been caught in regional conflicts; it might be interesting to see a research paper on the costs of war for these countries during these years.

Second, the papers often refer to the political commitment to reform, or the lack of it; again assuming that no country will willingly subject itself to a harder and more impoverishing route to restructuring, to what extent has political commitment been compromised by inadequacies in social safety nets? This chair has often voiced the assessment that reform efforts are at their weakest around the third year of implementation, when the strains of adjustment are felt fully, and that we need to consider building some relief into reform programs around that time. As an extension of this, let us look at the lessons that the staff suggests we examine; there are six, listed on page 26 of the overview paper, and these are broadly similar to the main recommendations of the paper on revenue decline: remove exemptions on taxes, capture private sector activity in the tax net, tax the agricultural sector, enhance trade taxes, increase energy taxes, and set up a taxpaying culture under good governance. The immediate response is that while these all convey laudable policy advice, at least three of these immediately push prices up, increase impoverishment, and will make political commitment all that much weaker. Without commitment, reform will not move forward; World Bank papers often suggest that ownership of adjustment programs is now seen as a prerequisite for their success. When you prepare a patient for major surgery, you must look for a good anesthetist.

Third, on the experience with privatization, we have always felt that the purpose of privatization in the South Asian context gives as much weight to reduction of inefficient public expenditure as to encouragement for private sources of growth, whereas in the context of the countries of the former Soviet Union, the output decline is much more significant than the fiscal deficit; are there lessons relating to increasing the need for the efficiency of state-owned enterprises?

Finally, on the role of the Fund's technical assistance. We have been involved with 61 missions and 26 experts, who have together put in 21 person-years of effort in the region. What, if any, are the lessons emerging from introspection? One frequently mentioned problem relates to the absence of adequate financial administration infrastructure and experience in these countries, and there is enormous pressure on the Fund to help set up this sector. Are we adequately prepared to respond to these needs?

Mr. Havrylyshyn made the following statement:

We have before us a set of very comprehensive and useful papers reviewing and assessing five years of the transition process, and there is a great deal that can be said based on these papers. Let me begin at the beginning, the titles, and quote the words of a well-known leader of one transition country, Vaclav Havel:

The unwitting nostalgia in the West for the old order may be discerned even in such superficial matters as how they refer to our countries. From the Czech Republic to Kazakhstan we are, and will no doubt remain for some time, "post-communist countries" and "former members of the former Warsaw Pact." I am guilty of having used these expressions myself, but I must admit an increasing aversion to them. After all, we did not go through the trouble of getting rid of communism only to have it remain--even with a prefix--forever sewn to our coats. (Foreign Affairs, March/April 1994)

The Western struggle to find a label for this group of countries is reflected in the title of our session and the papers, and the long, awkward result is not, I suspect, fully satisfactory to anyone, being to some extent redundant, and to some extent enigmatic in its partial country references. Perhaps I might suggest a term to which no one can object--the newly independent states (NIS)--a term I note is frequently used in the World Bank, the U.S. Administration, and elsewhere.

I would like to comment on four aspects of this review, with the objective of addressing the issue raised in some statements, namely, the role of the Fund in the process. The four topics that I would like to discuss are: the applicability of conventional fiscal and monetary stabilization to transition economies; the importance of parallel progress on structural reforms; the key fiscal problems of the transition; and the lessons about timing and speed of reforms.

On fiscal and monetary matters, perhaps the most important conclusion in the overview paper is that the conventional prescription for stabilization--fiscal and monetary tightness--is as applicable to transition economies as it is to market economies, despite significant differences in the economic structure and institutional framework. I note here that I may take a different view of this than does Mr. Prasad--that is that I believe there is a commonality to the right policy prescription. This affirms the findings in an earlier Working Paper covering a slightly different sample of countries (WP/95/8 by Sahay and Vegh). Two qualifications to this conclusion emerge. First, even where stabilization does take hold, the time lag of inflation persistence seems quite long in the transition economies. Various explanations are convincingly set forth in the overview paper, and a layman's way of summarizing these explanations is that slowness of the various structural reforms, which were unfortunately "beyond the scope of this paper," impeded the effectiveness of the primary stabilization measures. I will return to these structural reforms later. Second, in transition economies wage-restraint policies may be more critical than in market economies. This is a point that is given less emphasis in the overview paper than in Sahay and Vegh's paper. Perhaps the staff would comment on whether it would consider it useful to elaborate on this in subsequent revisions of the paper-which I certainly hope sees early publication.

As regards parallel progress on structural reforms, it is understandable that a report for the Board should put priority and emphasis on stabilization phenomena and thereby leave "beyond the scope" of the review most of what we categorize as structural measures. But there may be important reasons why somewhat greater attention should be paid to structural issues: the pace of structural adjustments may affect both the effectiveness and the sustainability of stabilization efforts. Thus for example, one would be interested to know to what extent the persistence of inflation can be explained by a lack of or slowness in financial sector reforms or by the various structural reforms that create a hard-budget climate. Further, one would wish to know whether such structural reforms lag behind stabilization because they are inevitably a longer-duration process, which implies that persistent inflation is inevitable and that greater emphasis on wage restraint is needed. Or whether they lag because the political will to start on stabilization may come sooner than that to start on structural reforms. Similarly, it would be useful to test the hypothesis that unsustained stabilization is attributable to inadequate supporting structural reforms.

Incidentally, one limitation to such an extension of the analysis is the restrictiveness of the sample to the 15 countries in the NIS group, in most of which structural measures have only barely begun. I would certainly be very happy to see, in the near future, an expanded review with a much larger sample, including the Central European countries, and indeed it is unfortunate that this opportunity could not have been used to cover a wider group of transition economies. Parenthetically, that would avoid the awkwardness of looking for a proper label--"Overview of Transition Economies" would then have done very nicely.

While the fiscal paper gives a thorough and balanced picture of all the reasons, good and bad, that revenues decline, it is perhaps too balanced and therefore remains ambivalent on what the key problems are. The table of contents lists 15 factors under four headings explaining the revenue decline, but nowhere does one see a clear suggestion of predominant causes or priority concerns. Let me take a risk and suggest, for the staff to refute if I am wrong, that the main problems appear to be: proliferation of exemptions fueled largely by an uncontrolled growth of interest group lobbying; poor tax administration, including corruption, related less to technical skills and moral standards and more to the immense opportunities erected by a combination of widespread exemptions and excessive tax rates; and a political inability to revise the fiscal relations between different levels of government.

On exemptions, besides saying, as the staff does, how problematic they are, I would have liked to see two interconnected things: an estimate, even if very crude, of the amount of tax lost to exemptions; and more emphasis on the way in which slow progress on reforms permits the incubation of interest groups that feed on such administrative measures as exemptions, preferential rates, and foreign trade licenses. To say that there is inefficiency--and even corruption--in the fiscal process that must be removed is correct but not enough. To be able to measure how much is lost to taxes through these phenomena, that is to put before policymakers an estimate of the cost of actions such as exemptions, is perhaps the first duty of the economic analyst, and certainly provides a far more compelling argument. I realize that these are not easy estimates to do, but in many of these countries with which I am associated, the staff generally tries to estimate how much is lost to exemptions as a way of suggesting how to improve the revenue position. A systematic review and use of this information as an argument for getting rid of the exemptions is what I am driving at. The recommendation in Mr. Mesaki's statement for highly paid tax collectors is a wonderful idea.

The debates about the inevitability of output decline, and the alternatives of gradual versus rapid reforms are perhaps the two key issues of policy for the transition process. The staff's overview of output decline allows one to neatly combine discussions of the two. Especially useful are their two or three charts showing output decline in Central Europe and the NIS, groups, as well as the relation of output declines to inflation and money growth. From them we see very clear support for the following conclusions: in the NIS countries, cumulative output decline is, apart from countries in conflict, about the same for all; those countries that started stabilization and reforms earlier saw an earlier recovery of output; a delay in the start and gradualism in the progress of reforms appear to slow down the decline in output at first, but decline then continues longer and is eventually deeper than for early reformers; and greater monetary tightness does not result in greater output declines, because, in fact, any impact of early stabilization is soon offset by a much earlier recovery.

One could not imagine a better set of evidence to underline simultaneously the importance of an early start on stabilization using as primary instruments fiscal and monetary tightness. Parenthetically, not that this conclusion is particularly obvious with a sample of countries that includes Central Europe, as in Chart 1.2 of the supplementary paper.

Finally, let me make a related point on the possible explanations for the earlier starts and earlier recovery in Central Europe and the Baltic countries. This is frequently attributed to the advantage of a more recent history of market experiences. While no doubt correct, one must be careful to avoid a too fatalistic sense of this explanation and the implication that longer delays are inevitable in countries with longer periods of central planning. More recent memory of markets may be important, not so much because people know the mechanics of markets and will therefore react more quickly--with greater elasticities--to new policy measures conveying correct signals, but because such a collective memory creates the weltanschauung climate that permits an earlier start. I am, in effect, proposing a hypothesis still to be tested in many of the countries of the former Soviet Union, namely, that once an effective start on stabilization and adjustment is made, the responsiveness will be about the same as it was in the early reforms of Central Europe.

Finally, the following are a few brief conclusions on the role of the Fund implied by these papers: the Fund should stick to its strategy of developing a strong fiscal and monetary stabilization program in collaboration with the authorities; attention should be paid to achieving minimal progress on structural reforms, so as to make stabilization more effective and sustainable--social safety nets are part of this; and where the political will is not ready for reform, the Fund should persist with a strong presence, as Mr. Mesaki notes, with technical assistance and policy dialogue to promote the creation of a reform climate, and should provide the necessary information, such as the evidence of these papers.

Adding to his statement, Mr. Havrylyshyn said that the ambiguities in the title of the staff paper, which included a reference to other FSU states, could have been avoided if the ten Central European countries had been included in the study to form a larger group, which then could have been labeled "transition economies." Also, the World Bank and the U.S. Administration had referred frequently to the group of countries covered under the present study as "newly independent states".

Mr. Waterman made the following statement:

I found the statements and the papers useful, and I agree with much of what Mr. Mesaki has to say in his statement. However, I would like to pick up on one issue, namely, the issue of stabilization and role of fixed versus flexible exchange rates.

In general, I believe that you need to take a case-by-case approach to this issue, but the conditions needed to maintain a fixed peg in today's world are very demanding. Countries concerned need to be well integrated, with a similar policy approach and flexible internal structures, and the policy commitment to the peg needs to be very firm.

The paper goes over the arguments carefully, both theoretical and in terms of experience, which is rather limited, but the evidence presented comes down fairly clearly against an attempt by these countries under review to try to reduce the high rates of inflation by pegging. So, I am more than a little surprised at the judgment in the conclusion of the paper that a number of countries are at a point where fixing the exchange rate could make a valuable contribution to macroeconomic stabilization. At the end of the day, it is a matter for countries to decide, but I think we run the risk of holding out a false hope, at least at this stage of their economic restructuring.

Most of these countries are having difficulties meeting fiscal targets and that is likely to remain a major challenge, as evidenced by challenges on both the expenditure and revenue sides of their budgets. In this context, the magnitude of fiscal adjustment required to stabilize the economy under a fixed regime is usually larger--sometimes much larger--than that required under a more flexible floating regime.

These countries are going through major shocks and great change and I don't know how you judge where the exchange rate should be set. If it was set at an inappropriate level it would be a recipe for disaster. My impression is that most commentators now agree that the introduction of individual currencies for countries of the ruble area was appropriate and, as Mr. Mesaki argues, a number would have benefitted from an earlier introduction of their own currency.

At a theoretical level, it is possible to establish conditions under which countries with high rates of inflation could make the transition to low inflation but they are very demanding. And in most of the countries that we are reviewing there is likely to be a high risk strategy that if failed could leave economic policy in tatters with obvious implications for ongoing political support.

I suppose I am very suspicious of seemingly simple solutions to complex problems. We have the present example of Argentina that illustrates how difficult the challenge can be, even when the policy settings are judged as appropriate. The staff argues that whether or not a peg can be sustained depends largely on whether there is extensive fiscal adjustment. I agree that fiscal adjustment is an important part of the story. But I also believe that, by focusing on this aspect, we are in danger of oversimplifying the situation. Many of these countries are exposed to an array of exogenous shocks, which could be very difficult to absorb under a fixed exchange rate regime.

In questioning the possible role of exchange rate pegs in these countries, I do not pretend that the way forward is particularly easy with a system of more flexible rates. Setting appropriate targets for money and credit growth is clearly very challenging but I think that the staff paper is somewhat negative in terms of the scope for authorities to deal with money demand shocks. Given the problems on the budgetary side, the challenge is likely to remain that of controlling overly strong liquidity growth, and the authorities may well have the advantage of not having to deal with disruptive capital inflows when they increase interest rates or reduce credit availability through more direct controls on their financial institutions.

To sum up, I believe that the evidence in the papers on these countries and wider experience point strongly in the direction of being circumspect about recommending fixed exchange rate pegs for transition economies, at least at their present stage of development. It is a matter of horses for courses, and such an approach may work in some countries, such as Latvia, but I would be most reluctant to recommend such a policy on a country and would be even more hesitant about the Fund providing financial support for such policies.

Mrs. Cheong made the following statement:

The staff papers on the overview of policy experiences, issues, and revenue decline in the Baltic countries, Russia and the other countries of the former Soviet Union are quite detailed indeed. But, like Mr. Andersen, I am not clear on the precise purpose of the discussion. I have, therefore, concluded that we are evaluating the case studies of countries in transition. In this situation, like Mr. Havrylyshyn, I am rather disappointed that the coverage is not very wide. However, my disappointment stems from the fact that the experiences of the Asian economies, namely, China, Mongolia, Myanmar, and the Indochinese economies, were not included in the papers. With the inclusion of these countries, a comparison of experiences of the East European and Asian economies could provide further insights and enable us to look at the transition process on a broader prospective.

Having said that, I would like to address not so much the specific issues, but rather the approach to the reform process itself, some of which has been addressed by Mr. Havrylyshyn.

There has been some debate on the approach to reform. Even here in the Fund, we do put a lot of thought into the sequencing of reforms to maximize results. It is this aspect that will yield interesting results when we compare the experiences of the Asian transition economies with those in Eastern Europe. I would, therefore, like to pose to the staff some issues regarding the differences in results arising from the different policy approaches adopted by the Asian transition economies in comparison with the Eastern European countries.

I would like to raise a few areas as examples for the staff to make further analysis:

First, the general approach to reform in Eastern Europe is what has been called the "big-bang approach" or shock therapy. The basic idea was to transform centrally planned economies into free market economies in the shortest time possible. Everything, from wholesale privatization--eliminating all price controls, including the exchange rate and across-the-board trade liberalization--was intended to be implemented immediately and, if possible, simultaneously. In contrast, the Asian approach emphasized sectoral reforms and institution building first. At the initial stage, more attention was focused on institutional reforms, agricultural and industrial enterprise reforms, and the reform of the legal framework for public enterprises. The basic idea was to develop the necessary structure for a market economy first, as well as to allow the private sector to develop its capability to efficiently take up the output slack that would be inevitable when the government retreated from economic production activities. It is only when this institutional base is in place, that macroeconomic reforms--including fiscal, monetary, and foreign trade reforms--are being implemented. This is to ensure that the domestic institutional structure is in place through which fiscal, monetary, and trade policies could be implemented effectively. This approach could partly explain why the Asian transition economies have been able to revive output growth, while at the same time stabilizing domestic prices, so soon after initiating their transition process. In this regard, I would appreciate the staff's assessment of the sequencing of economic reforms for economies in transition given the experiences in these 15 countries and in the Asian countries.

Second, the staff paper has explained why export recovery has been slow, and also pointed out the declining trend in gross capital formation. Again, this development seems to arise from the lack of complementary sectoral policies to promote export production. In the Asian economies of China, Vietnam, and the Lao People's Democratic Republic, sectoral policies to increase capital formation through attracting foreign direct investment were given equal attention as price deregulation measures. For example, in addition to fiscal and other incentives to attract foreign capital, infrastructural development in the form of special export-processing zones was set up. Such policies were important factors in attracting capital inflows to bridge the savings and investment gap. In this case, the staff may wish to comment on the importance of coordination between stabilization policies under the Fund's guidance and the sectoral and development policies under that of the World Bank, as well as on the contributory role of the timing of implementation of these policies.

Third, on the exchange rate issue, the staff paper has provided a detailed and useful analysis on the choice of an appropriate exchange rate system. However, the staff may wish to comment on the cautious approach adopted by China and Vietnam with regard to foreign exchange and commercial policies, where the Central Government initially allocated all foreign exchange at the official exchange rate, then gradually allowed a kind of swap market to develop a variable but modest premium over the official rate. With this policy, export enterprises were provided access to a realistic exchange rate despite the general overvaluation of the local currency. Could this approach be a factor explaining why export growth in the Asian economies were less affected by the transition process?

These are only a few of the examples for useful comparison. I am sure the staff can provide more in-depth analysis that would provide useful lessons for all of us on the sequencing of reforms at the sectoral and overall macroeconomic level. In Asia, the gradualist approach is preferred in line with an old saying: when a child is not ready to walk, do not stand him up and move his legs, because he will grow up very bow-legged.

Mr. Desruelle made the following statement:

This set of papers reinforces our basic message on the Fund approach to the transition process. The chapter on the decline in output in countries in transition shows very clearly that declining output is not correlated with any measure of implementation of a comprehensive program of stabilization. The report makes clear that production growth has only come back after some degree of stabilization. Our basic message that macroeconomic stabilization is an essential component of transition is validated in this way. A complementary message--that it does not pay to delay implementation of measures to achieve stabilization--is there as well. What is needed is reasonable progress toward stabilization, such as what has been achieved in Poland and Estonia, with good prospects for further progress down the road of sustainability. Not everything has to be achieved in one day, but a substantial degree of stabilization, followed by growth with low inflation, is clearly necessary.

The two chapters of the paper on the difficulties of monetary control and on interenterprise arrears are extremely illuminating and complement our thinking on both the necessity of following closely interenterprise arrears and the desirability of a pragmatic approach to the conduct of monetary policy. We can easily agree with the analysis that inflation is a monetary phenomenon, and that inflation is reasonably well correlated with growth in the monetary aggregates. However, the relation between the price level and monetary aggregates is subject to instabilities. Moreover, changes in velocity are substantially related to changes in public confidence in the currency and in the volume of quasi-money--interenterprise arrears. We can agree with the conclusions of the chapter. These conclusions reinforce our view that monetary policy should aim for a reduction in the rate of monetary expansion, if necessary through elementary instruments like rediscount windows or--in some cases--direct credit ceilings, the maintenance of a stable exchange rate so as to discourage currency substitution, and, when necessary, supporting measures such as incomes policy and a sound policy to deal with arrears.

We welcome the emphasis given to the issue of arrears. The growth of arrears is a definite risk factor in any program, and may be a symbol of lack of adjustment. The policy lessons are not simple. The authorities must do all in their power to send a message to enterprises that they are responsible for their arrears; the government must not bail them out. However, the practical implementation of this is difficult. The authorities must steer a narrow course between a too ambitious and apparently unsustainable strategy of never dealing with arrears, and standing aloof from them, on one side, and a strategy of providing an array of specific benefits to various entities in the name of the difficulties that they face, on the other. Reliance on the second strategy will convince other economic agents that they themselves will be bailed out, giving rise to rent-seeking activities.

The appropriate course is a selective use of bankruptcy procedures for the worst offenders, so as to convince other firms of the realism of the authorities' strategies. At the same time, the application of favorable treatment to some firms that cannot be allowed to fail may be justified, in order to convince all firms of the realism of the authorities' strategy. How this is done is as important as what is done. In particular, tax exemptions should be prohibited. The goal would be to limit the aggregate impact of the misbehavior of enterprises on monetary and fiscal policies.

Programs that choose the exchange rate as a nominal anchor can be more effective at achieving stabilization than money-based programs, but they are also more demanding. As such, the conditions for implementation of exchange-based programs are tougher than those for money-based programs. Implementation of an exchanged-based program requires several objective conditions that are difficult to meet, in particular regarding revenue mobilization, monetary and fiscal policies, and wage determination. Furthermore, exchange-based programs can only be credible if arrears in the economy do not build up to a point where they are perceived to threaten undermining the macroeconomic stance. We believe in the gains that can be made from a policy of exchange rate-based stabilization. We are also convinced that choosing such a policy requires careful consideration of the factors mentioned above. At this stage, we feel much less confident than the staff in identifying countries for which fixing the exchange rate could contribute to macroeconomic stabilization.

Other issues could have been addressed, and probably should be in future reports. Those include the issue of regional cooperation between FSU countries on trade issues. I understand that in the past, the issue was fraught with difficulties, but as time goes on, and most countries of the region follow stabilization programs, it may become easier to disentangle the currency issue from the financing issue, and look squarely at the trade issue. Regional trade could be a second leg in support of the other leg of multilateral trade liberalization for the countries of the former Soviet Union.

Mr. Kiekens made the following statement:

The three staff papers address a number of important and interesting issues. This opportunity to discuss the experience of Russia, the Baltic countries, and other countries of the former Soviet Union with economic reforms is most welcome because that experience is highly relevant for the design of future reform policies, especially for countries where progress toward a market system has been limited till now.

While the experience of the 15 countries under review differs widely in many respects, it also exhibits basic similarities. This is especially true as regards the deep decline of output in all industries and in all countries. There are as many explanations of the output decline in the transition economies as there are explanations of the recent plunge of the U.S. dollar, and a similar ignorance about the specific contribution of each of these factors. But as the output decline in the transition countries is a unique event connected with the unprecedented task of transforming centrally planned economies into market-based ones, our imperfect understanding of the precise contributions of each of its causes should not make it impossible to design policies that will be conducive to future growth.

Before discussing the issue of growth-supporting policies, I would like to stress one important lesson provided by the recent experience in these countries. The positive correlation between lower inflation rates and lower output decline clearly provides strong support to the hypothesis that the output decline in the transition countries is not produced by insufficient aggregate demand. It does not result from too tight demand policies, nor from an excessive anti-inflationary bias of domestic policies. In fact, the experience of these countries shows that less restrictive demand policies not only fail to stimulate growth but even make things worse. The output collapse has resulted from political uncertainties, trade disruptions, changes in relative prices, and lagging implementation of changes in the regulatory and institutional frameworks. These are all structural and institutional problems and factors related to changes in relative prices, and none of them have anything to do with the level of aggregate demand.

The flexibility of producers in adjusting to changes in structural and institutional factors, and to changes in relative prices, is what determines the speed of recovery from what was an unavoidable but temporary decline in aggregate measured economic activity. The inevitability of this decline is aptly attributed by the staff to the different speeds with which old activities are phased out and new activities are phased in.

All these findings together suggest that in order for economic policies to be growth-friendly, they must be oriented toward speeding the development of new economic activities that can survive in the newly liberalized environment under the new structure of relative prices, while being exposed to domestic and foreign competition. In this regard, I agree fully with Mrs. Cheong that a timely implementation of a new regulatory and institutional framework is of utmost importance. The discussion in the staff papers of different aspects of economic development in these countries also shows that inflation undermines precisely those incentives and conditions that are necessary for achieving sustainable growth.

The very nature of the reform process ensures that the transition economies are vexed by many uncertainties that make long-term economic calculations difficult. Exacerbation of these "natural" uncertainties by high and variable inflation makes it risky and unprofitable to engage in activities that require fixed investments with long gestation periods, thus discouraging the very kinds of investments that are the main motor of economic growth. Under conditions of uncertainty owing to high inflation and an unsettled institutional and regulatory framework, redistributive activities tend to flourish at the expense of the productive activities that would increase the overall wealth of society. All these harmful consequences of inflation on the one hand, and the positive response of output in those countries that succeeded in reducing inflation to low levels on the other, should provide an ample incentive for tough anti-inflationary actions by those countries where this destructive force has, so far, eluded efforts to control it.

Another widely shared problem among these countries is the sharp decline of budgetary revenues. True, this may partly reflect progress toward the desirable goal of reducing the state's role in the economy. But too often the revenue decline results less from lower marginal tax rates and more from poor tax compliance, a reduced tax base, and too many tax exemptions, or is more generally the result of inefficient tax administration. Many of these countries exhibit a vicious circle where the state is neither able to collect taxes nor to provide basic public goods to the business sector, which reduces the incentives for taxpayers to pay taxes. An inflation tax can offset the inefficient administration of orderly taxation only temporarily, and at enormous cost.

I agree with the lessons drawn by the staff on how to address the revenue problem. Many of the measures that would improve revenue collection, like the removal of various exemptions, are hard to introduce for political rather than administrative reasons. The staff also mentions the relatively low petroleum and other energy taxes. Thanks to favorable relative price changes, the energy sector has become profitable and its capacity to contribute to tax collection now seems less than fully utilized. Care should be taken, however, to avoid making financial strength a pretext for confiscatory taxation that will undermine investments and future profitability.

Let me now turn to the issue of the exchange rate regime and its role in stabilization programs. The main conclusion of the staff's analysis of experience till now is that pegging the exchange rate is neither a necessary nor a sufficient condition for rapid and successful stabilization. I think it would be inappropriate to pursue any but a case-by-case approach in designing exchange rate regimes in the transition countries. The advantages and disadvantages of pegged and floating rates depend on the particular circumstances of each country. The Staff Studies elaborated the interesting point that what can be considered as a case against the introduction of an exchange rate peg can, in fact, also be used as an argument in favor of pegging the rate. I refer here to the risk that failure of the peg would entail significant costs, in terms both of losses of credibility and foreign reserves, and of higher inflation. The question arises whether the need to avoid these high costs of failure would not itself force the authorities to pay more attention to adequate policies. I would respond that it is likely but not certain, and also that it matters whether the chance of obtaining better policies is outweighed by the risk of suffering higher costs in case of failure. By the same token, we may ask whether the reversibility of departure from monetary targets under monetary-based stabilization is always an unmixed blessing. Is it not possible that this reversibility actually weakens financial discipline? I would respond in the same nuanced fashion, that it is likely but not certain.

Available evidence from stabilization programs both inside and outside these countries does not provide significant proof that the ability and willingness of the authorities to implement policies favoring stabilization depend on the type of nominal anchor. While the costs in terms of fluctuations in output, employment and other variables can be affected by the choice between money-based or exchange rate-based stabilization, stabilization's final success is determined by more fundamental factors that often go beyond the realm of economics. For this reason, we should not expect that the choice between money or exchange rate stabilization will be the crucial factor in determining success or failure.

In conclusion, the single most important lesson offered so far by the experience of the Baltic countries, Russia, and the other countries of the former Soviet Union in the implementation of market-oriented reforms, is that there is a close interrelationship between successes and failures in different areas of reform. In other words, success breeds success, and failure breeds failure.

Mr. Evans made the following statement:

I welcome this review of policy experience in the Baltic countries, Russia and the countries of the former Soviet Union, and I hope we can learn something from this for the forthcoming programs and maybe avoid some of the mistakes that have been made in the past.

I have some sympathy with Mr. Andersen's comments on what is missing from these papers, but I found them, in general, very helpful. I appreciated particularly the insight in Mr. Tulin's statement and Mr. Havrylyshyn's intervention.

I want to start with the question of measurement. Mr. Tulin refers to an exceptionally flawed database, and the paper refers to well known output measurement problems, but then proceeds almost to ignore it. If one looks at Table 3, the scale of the output decline shown there for countries concerned is about 50 percent, indeed, 47.3 percent for Russia. Now we know that there are alternative estimates of output decline. Some World Bank economists, as Mr. Andersen points out, did some estimates based on electricity consumption and they suggest that the decline was nearer 15 percent than 50 percent, and a recent Fund working paper suggests a substantial underestimation of output by official figures. It seems to me that we have a range of estimates for the decline in output--one extreme may be 50 percent, one third, might be better, or even on the World Bank economist's figure, 15 percent. Of course, as we know, the welfare loss from the output declines is going to be smaller still. These difficulties affect not only the output figures but a number of the other analyses in the paper including that of money velocity and there are, no doubt, also measurement problems with respect to interenterprise arrears and output. The staff will say that it can only work with the available data. But it is sometimes better to be approximately right rather than precisely wrong. I think the time has come to incorporate broad ranges into our analyses rather than the precise numbers here, which seem to me clearly biased in one direction. Perhaps the staff would like to comment on that.

A word about the output and revenue declines. I think in the area of revenue decline, it is striking how much and how far Ukraine sticks out as an exception to the general tendency, and I hope that this is not simply a question of lags and catching up. I hope that the staff will make some allowance for this effect in the revenue projections in the program that we shall be discussing soon.

The evidence presented seems to indicate that delaying reform does not reduce the output decline associated with adjustment, and I agree with what the staff and Mr. Havrylyshyn have said in that regard.

Mrs. Cheong raised the question of sequencing. I think perhaps the main message in the papers is that countries need to get on with reform, do as much as is politically feasible, as quickly as possible, and not worry too much about the precise sequencing. I have some sympathy with that, but no doubt the staff will want to comment.

A word about monetary policy and velocity. We have seen movements in inflation that are not related to changes in measures of broad money, and I think the obvious question arises, if there is no clear relationship between money and prices, what is the role of target limits on monetary growth? I think one implication that can be drawn is that programs in the economies of the countries of the former Soviet Union should rely on fixed exchange rates. I think we should pause before coming to that conclusion.

On the behavior of inflation and velocity, there are three key factors at work: first, there is the usual lag between monetary stance and inflation; secondly, as Mr. Tulin reminds us, there is the extent of currency substitution; and, third, there is the facilitation of higher price levels, not only by increases in money, but also by interenterprise arrears. Although for many purposes these arrears may appear to be money, they are not represented in the money figures, of course, but show up as a rise in velocity.

I think one could draw two lessons from this. One is the important fact that, wherever there are real difficulties in measuring money and shocks to the demand for money, the levels of interest rates--real or nominal--and exchange rates can act as essential guides to the extent of monetary tightening. The second conclusion, of course, is the importance of getting a handle on interenterprise arrears and the fact that monetary policy will not be fully effective until enterprises are much more sensitive to monetary conditions and interest rates. That applies, of course, to enterprises in the privatized sector as much as in the public sector. I found the sections in the papers about interenterprise arrears helpful. We can learn from some of the experiences presented there, and we can look at forthcoming programs with this experience in mind.

I share Mr. Waterman's skepticism on the exchange rate as a nominal anchor. I think most of us would agree that exchange rate stabilization can work effectively, but only where there are a number of conditions in place: a strong level of political commitment, a reasonable level of reserves, and as well an absence of big real shocks or a degree of flexibility that enables economies to expand--to adjust to shocks. It seems that most countries in the former Soviet Union did not fulfill these conditions in recent years.

For countries that have clearly brought their inflation rates under control the benefits of a move to a fixed exchange rate now seem likely to be small and, of course, they would have to give up the flexibility they currently enjoy. That leaves a group of countries that have demonstrated some commitment, but have still a long way to go. The staff paper suggests that it is this group that could benefit most from adopting a fixed exchange rate. That group would include Russia and Ukraine, and although we will be discussing their stand-by soon, it seemed that until there is more of a track record on stabilization, it would be premature to judge performance under these programs.

I thought Mr. Clark made two goods points: one was the difficulty of calculating the appropriate exchange rate in conditions that can vary greatly; and the second was the difficulty of separating the short-term decision from the longer-term decision.

On relations with other international institutions, I was disappointed by the lack of reference to the work of other institutions. We had a good question from Mrs. Cheong on relations with the World Bank, and I wonder about the work of the what papers they have produced.

Finally, a word on publication. Like Mr. Havrylyshyn, I would hope that these papers are taking some account of these discussions can be produced soon so that they can see the light of day, no doubt as staff papers.

Ms. Lissakers made the following statement:

As other speakers have commented quite extensively and I agree with many of their remarks and with the very excellent statements, I will make my remarks fairly brief.

First, I want to say that I think that these are extremely interesting papers and I think the staff has done a very good job of parsing the complexities of this adjustment process. I agree with most of the conclusions in the papers. Like my colleagues, there are several areas where I would welcome some additional evaluation and examination, but that is not said as a criticism of this effort, which I think is very, very good.

Certainly, as others have noted, the review of the experience in the former Soviet Union reaffirms an important point, namely, that maintaining a gradual approach to reforms and higher inflation does not, in fact, prevent output declines but may merely prolong and deepen the output decline. Even in the short term, loose monetary and credit policies do not help to preserve output. Moreover, we agree with the observation that the output fall does not correspond to an equal drop in welfare--Russia being a case in point, where measured real GDP declined by about 15 percent last year while real incomes rose substantially. That may suggest, as several others have said, that our measure of real GDP is flawed, and the papers point out the difficulty of measuring both the "informal sector" and even the new "formal," but private, market activity in these economies. But, as Mr. Evans said, that means that the analysis that is based on treating these output declines as real may lead one to somewhat unsupported conclusions. We are dealing with a very gray area. We do not really have an accurate picture of what is going on in these economies and that makes any analysis about policy options very, very difficult. I think the papers make that quite clear.

With regard to the exchange rate issue, certainly, as the papers state, the underlying financial policies needed to stabilize under a floating rate regime are about the same as those needed under a fixed exchange rate, but the potential advantage of a fixed rate is that this can potentially lead to more rapid stabilization of price levels and perhaps to a more sustained stabilization of prices and reduction of inflation and also, importantly, perhaps to higher levels of investment stability and return of flight capital. It seemed, in that sense, that there are also dangers in adopting this kind of regime and failing, but it also appeared that the paper is perhaps a little too neutral with regard to the preference. Given the advantages when the policy mix is right and combined with an exchange anchor, one could argue that countries should make a serious effort to peg the exchange rate under certain circumstances. The inflation performance, as noted on page 81 of the overview paper makes reference to the Fund conditionality review, which concluded that "measured by the mean reduction in inflation in the first year after stabilization as compared to target inflation, exchange-rate-based stabilizations have been generally more successful than stabilization attempts that did not use the exchange rate as a nominal anchor." In view of the emphasis we place on price stabilization as a key to cushioning the shock to output and generally moving the economy on a positive track; there could be a slight bias in favor of exchange rate anchors, and countries could be pressed to adopt the policy mix that would enable them to use these anchors as a tool, given the apparent advantages of the peg compared with the monetary peg. As Mr. Evans and Mr. Tulin pointed out, the monetary peg is rife with difficulties, because of these velocity surges and the fact that the institutional structure cannot support even a fine-tuning through the traditional monetary policies used in the industrial countries. I thought, in that context, that Mr. Tulin's point about currency substitution was well taken. That is clearly an important phenomenon and one that I would hope we would take a closer look at in the future. Some discussion in the context of the fixed exchange rate issue of currency boards might also be useful.

Mr. Clark pointed out that, if we do adopt a bias slightly in favor of pegging the exchange rate as a tool for quickly stabilizing economies in transition, it leaves open the question of duration and the question that we raised in other countries: how do you get off and how do you decide when to get off? Obviously, before we press countries to adopt this tool, we need to have some answers to those questions--and those are not easy--but I hope that we can do some more work in that area as well.

On revenue decline, there was an interesting comment, more or less in passing, that widespread use of sequestration as a method for controlling fiscal deficits inadvertently encourages tax evasion. There is obviously a chicken and egg element to this that argues that it may be difficult to normalize revenue collection until expenditure management processes become more transparent. I would be interested in the staff's comments on that point.

Finally, I have said in the past that I would be interested in a detailed point-by-point comparison of the adjustment experience of the Baltic countries, Russia, and the other countries of the former Soviet Union, Eastern Europe, and the Asian transition economies, particularly China, which has been at it for a little longer. I was disappointed, as Mrs. Cheong was, that that was not done in this exercise, because I think it would be quite interesting to compare not only the specific policy measures but, as she said, also the sequencing. I would say with regard to the gradualist approach that that may be a luxury that the countries of the former Soviet Union simply did not have, because the whole trade relationship and the economic linkages in that part of the world, in effect, blew up because of political developments. So these countries really had no choice but to find some other way of transforming their economies. It did not seem possible to preserve the trading relationships and the linkages, particularly in the former Soviet Union, under those political conditions. So the policy options may have been rather different for those countries than they were for the countries in Asia, where the political developments were less disruptive. But on the general question of the sequencing of structural and macroeconomic policy reforms in comparison with that of the Asian economies, I continue to hope that this will be done, and I think that it would be very useful, as Mrs. Cheong said.

Mr. Dlamini made the following statement:

The staff papers provide a useful assessment of recent developments in the Baltic countries, Russia, and the other countries of the former Soviet Union, as well as the formidable challenges they face. I commend the staff for their efforts.

The economy of these states was seriously affected by the economic upheaval that accompanied the rapid collapse of the Soviet Union. The disintegration of the Soviet Union and of its central planning mechanism had left a vacuum, and there was no framework in place to make it possible for market forces to supersede. The disintegration of the Union also disrupted traditional trading relationships. Moreover, most of these countries faced a drastic deterioration in the terms of trade as the Russian Federation moved close to world market pricing in its exports of energy and other raw materials. These serious economic shocks caused a severe contraction in output and real incomes of the populations without exception. In addition to these shocks, the transformation of the economy was hampered by the general lack of institutions and experience appropriate to a market-based economy.

I welcome the progress made in the Baltic countries and other economies such as the Kyrgyz Republic, Russia, and Kazakhstan and wish the other countries success in their struggle for financial stabilization and the revival of economic growth.

In the countries where stabilization and reform efforts are beginning to take hold, such as the Baltic countries, the main challenges appear to lie in the area of structural and institutional reform. An accelerated pace of progress in this area will be crucial in enhancing confidence in the financial system and further stimulate private investment. This would help move the economies into a new stage of lower inflation combined with a rapid and sustainable economic growth.

In the other countries, high inflation resulting in large part from big budget deficits remains a serious impediment to economic recovery. Many of the countries in this group are less developed and have lower standard of living than the Baltic States. Thus, they may not have the capacity to respond as relatively quickly, as did the Baltic States, to policy changes with a view to correcting imbalances. The achievement of adjustment and stabilization could therefore require a fairly long period. The adjustment process to take place in these countries should avoid high social costs that would undermine public support for reform effort and thereby jeopardize growth and development prospects. While the efforts to move to a more efficient allocation of resources and achieve financial stabilization are understandably important, these countries are likely to be dictated by circumstances to give due weight to the promotion of social equity too. This means that, besides other measures that help to reduce social costs of transition, well-targeted social safety nets to protect the most vulnerable groups have a key role to play in making the reform process more effective.

Mr. Al-Tuwaijri made the following statement:

At the outset, I would like to compliment the staff for producing an informative set of papers that provide a useful background to today's discussion. However, like Mr. Andersen, I feel that the inclusion of an executive summary and points for discussion would have been very useful in facilitating and focusing today's discussion. The issues raised in the papers are complex, and in most cases inter-related. I agree with many of the conclusions reached by the staff and will limit my remarks to only two areas that I found of particular relevance to Fund advice to the Baltic countries, Russia, and other countries of the former Soviet Union.

First, the papers on the overview of policy experience in these countries highlight the diversity of experience among these countries with the role of the exchange rate in overall stabilization. At first glance, the experiences of Estonia, and later Lithuania, with currency board arrangements serve as glaring success stories. At the same time, the experience of some other countries also show that macroeconomic stabilization can be successfully undertaken in an environment of a flexible exchange rate regime. It goes without saying that the credibility of the macroeconomic stance underpinning any particular arrangement is the most relevant factor in this process.

Considering the importance of credibility of the exchange rate arrangement, it is worth asking if an adjustable pegged exchange rate combines the benefits of both a fixed exchange regime--that is currency board-type arrangement--and a flexible rate regime. However, in many instances such a hybrid arrangement may simply combine the disadvantages of both types of exchange arrangements. This is a question that is also relevant to other discussions. At this point, I would simply like to emphasize that this chair remains of the view that the economic fundamentals are much more important than the choice of the exchange rate regime.

Circumstances differ significantly between different countries, making the advantages of one regime over another more apparent.

It is, of course, noteworthy that Estonia, which established a currency Board before Lithuania, enjoyed lower rates of interest than the other countries under consideration. There seems to be some merit in the argument that newly emerging countries that have no track record in monetary management can gain significant advantage through a currency board. Ultimately, of course, it is the nature, credibility, and success of fiscal and structural policies that determine the success of the process of macroeconomic management.

I would add, however, that the degree of currency convertibility is probably more important than the nature of the currency arrangement per se. The Baltics and the FSU countries need to attract significant capital inflows. The fact that the Baltic countries accepted the obligations of Article VIII and established a high degree of capital account convertibility has undoubtedly been a critical element in their relative success.

Second, the Baltic countries, Russia, and the other countries of the former Soviet Union are in an advantageous position to the extent that, as they strive to establish their own economic systems, they can learn from the experience, and particularly the mistakes, of other market economies. It is therefore particularly crucial that these countries emulate the success stories of market economies rather than the norm. A case in point appears in the paper on revenue decline in these countries. Of course, IMF advice, emanating from the Fund's role as a "clearing house" of good ideas and policies, is critical for these countries.

There can be no dispute that the revenue decline in these countries is very troublesome. I am in overall agreement with the staff conclusions in this area. However, in the section "quick yield taxes," the staff emphasizes the importance of raising petroleum and other energy taxes. Comparing taxation of petroleum and energy products with that of the OECD countries, however, only heightens the risk of convergence to the worst case scenario. These countries can start from a clean slate. Surely, petroleum taxes can be a "quick yield" source of revenue, as it is a captive market with few substitutes. The need to raise revenues, however, should not dilute the importance of ensuring that taxes do not distort the choice of production inputs. Learning from the experience of others, these countries should not shy away, despite existing exigencies, from focusing on the establishment of tax systems that do not unduly distort relative prices.

Mr. Lanciotti made the following statement:

In the light of the excellent papers before us today, the main message regarding the transforming economies contained in the World Economic Outlook is proving to be all the more valid: countries which went the way of stabilization and market reforms earlier and in a more resolute manner experienced steeper output declines initially but were also rewarded with output recoveries much earlier. There is little evidence that unduly tight policies may have hampered output growth more than would have been the case if more relaxed policies were adopted. On the contrary, expansionary demand policies would have contributed, and have indeed done so where Fund programs have not been properly implemented, to a further deterioration of fiscal accounts and to inflationary pressures, adding to the destabilization of the economy.

By and large, the staff papers provide convincing evidence that the widespread output decline may be substantially explained by the concept of "transitional recession," which is associated with input supplies disruptions, sharp changes in relative prices, and asymmetric responses of the various productive sectors, that is, obsolete industries' contraction is larger and faster than the growth of the competitive ones. The differences in output performance among countries, apart from the extreme and opposite cases of armed conflicts on one hand and of generous endowment of natural resources on the other hand, are mainly due to the degree of compliance with the stabilization programs. Therefore, the Fund's approach has proved basically appropriate thus far.

However, the staff papers also point out some areas in the design of Fund-supported programs that may be improved. In particular, the unexpected response of inflation to the rate of growth of monetary aggregates in the short run gives important cues for reflection. In some cases, the substantial divergence between money growth and inflation has shown that money velocity was affected by inflationary expectations, exogenous increases in import prices, and interenterprise arrears to a much larger extent than assumed in the programs. Some policy responses are argued in the papers that should be taken into account in future programs. Others, namely, the controversial choice of the exchange rate regime, may require further analysis.

Among the policy actions that are certainly desirable, I would include a further emphasis on financial policies. There is clear evidence that the establishment of positive interest rates in real terms is taking on an increasingly important role in Fund-supported programs with transition economies, which by their very nature are particularly unpredictable as concerns confidence in the economy and money velocity. I also find interesting

Mr. Tulin's remarks concerning the greater effort that could be made to measure and understand the implications of currency substitution in these countries.

The issue of the informal trade credit extended through the buildup of large interenterprise arrears has also been recurrent in the adjustment experience of the transforming economies. Apart from the consequences on velocity, these arrears have given rise to concerns about possible collusive behavior, which would aim at both forcing generalized bailouts by the government and influencing the credit allocation function operated by the banking system through the credit auctions. There is no easy solution to the problem, given the little experience that managers of state-owned enterprises have with the market, the political importance of public sector industries' lobbies, and the social safety role still performed by many of these firms. However, an overall strategy must be pursued vigorously, which combines steadfast resistance to any bailouts, the development of a secondary market where arrears could be traded, the fixing of bankruptcy procedures, the enforcement of managers' accountability, the promotion of managers' vocational training through the provision of technical assistance, and the establishment of clearly autonomous budgetary appropriations for social safety purposes.

The importance, which I mentioned earlier, of lending confidence to the transforming economies leads to the issue of which exchange rate regime is better suited to cope with the intrinsically unstable situation of these economies. The "fixed versus flexible" exchange rate question has received increasing consideration recently. While the propositions that a fixed exchange rate regime may help the stabilization process and must be supported by adequate fiscal and monetary policies are beyond dispute, there is a considerable degree of discretionary judgment and uncertainty about the logical sequencing of a currency peg during the course of the adjustment: is it supposed to prompt further measures and signal credibility in the earlier stages of the stabilization process, or is it assumed to follow and consolidate results that, to a certain extent, have been already achieved? Further analysis is required. I believe that the present staff paper makes clear that in such a highly controversial matter a cautious approach is preferable, since a premature exchange rate commitment is much more likely to entail costs than to yield benefits.

I find that there is little to add to the staff's comprehensive analysis of the fiscal revenue decline. First, the core strategy will remain the construction of a tax system that provides incentives for voluntary compliance, through procedures that minimize the costs of conforming with tax obligations and escalate the costs of not doing so. This is a field where the Fund's technical assistance can play a major role. The disruptive potential of the widespread problem of tax evasion is to be increasingly recognized and addressed in the design of the prior actions and structural benchmarks in the Fund-supported programs. Second, as noted by Mr. Havrylyshyn and other Directors, tax exemptions must be resolutely cut down and their cost for the budget should be highlighted to the authorities also through the provision of technical assistance. Third, the historical experience of the Central European countries proves that the sharp decline in the revenue/GDP ratio is likely to moderate if the stabilization and liberalization process proceeds, as economic activity recovers and tax base is restored.

Finally I would welcome, like Ms. Cheong and Ms. Lissakers, a wider comparison between the experience of transition in Eastern European countries and the Asian ones.

Mr. Saito made the following statement:

In the first place, I want to commend the staff for the interesting papers we have received. Before commenting on the issues discussed in the paper, I would like to say that although the issues left out, such as financial sector reform, privatization and enterprise restructuring, the functioning of labor markets, and the structure of government expenditures, may not be closely linked to the nature of Fund involvement, their importance calls for greater attention on the part of the Fund.

As to specific points, the emphasis given to the continuous decline in output is fully justified, as the political commitment to the structural transformation process is very much connected with the reversal of this trend. Leaving aside several noneconomic factors, such as wars and even shortcomings in the statistics already mentioned by Mr. Tulin in his statement, which tend to magnify the size of the decline in output by failing to capture the increasing contribution to growth from the private sector, the key factor appears to be the structural dislocations and sectoral adjustments brought about by the transition process itself, including the disruptions associated with the dissolution of the Soviet Union.

To dispel the impression that a gradualist approach is being advocated, the staff is quick to add that growth in those countries that slowed down the pace of reforms have, nonetheless, been affected comparatively more than has that of the faster reformers. The paper also mentions that neither monopolistic market structures nor contractionary monetary and credit policies, particularly if we look at the decline of real money stock, have played a significant role in the decline of output. The fact that positive real interest rates accompanied a recent recovery in output in several countries of the former Soviet Union is presented as a counterfactual example. What appears clear from the staff's analysis is that many factors are at work here, which makes it very difficult to isolate the impact of any one in particular.

The main conclusion, that controlling inflation is an important precondition for recovery, is unquestionable--but a greater emphasis on the need to create an environment more conducive to new investment is called for. As the staff itself indicates, the massive amount of capital outflows from the Baltic countries, Russia, and the other countries of the former Soviet Union reveals the critical factor affecting new investment and the transformation process at large; that is the lack of confidence in domestic policies. In this regard, macroeconomic discipline and an unambiguous commitment to structural transformation are essential ingredients in building up that confidence. Particularly important is the need to initiate a full-fledged process of privatizations within a legal framework that guarantees property rights.

The section of the staff paper on the behavior of inflation highlights the importance of velocity in explaining inflation developments in these countries. The link between velocity and uncertainties about fiscal and monetary policies, as well as the importance of positive interest rates to increase the demand for money and slow down velocity, have been clearly demonstrated. The role of exogenous price pressures, such as those coming from imports, wages, or administered prices, has also been stressed. One conclusion with important policy implications is that once an increase in velocity takes hold it becomes protracted, making it more difficult for the authorities to bring inflation down and forcing them to apply tighter monetary policies.

Regarding the interenterprise arrears section, I have found the intermingling of the interenterprise credit and interenterprise arrear concepts somewhat disturbing. While interenterprise credits are a normal feature of market economies, we cannot pretend to extend this sense of normality to the concept of arrears--and least of all when we are analyzing economies in transition. I believe that interenterprise arrears in these countries are a unique phenomenon whose causes and adverse consequences are otherwise well explained in the background paper. The tightening of monetary policies in a framework of underdeveloped financial systems led enterprises to implement financial arrangements among themselves, which, in turn, undermined the effectiveness of such policies. Enterprises progressively came to the realization that the mounting of arrears would eventually force the government to bail them out and a sort of collusive behavior took place. Once the expected outcome occurred through the clearing of net arrears by central bank credit, then the problems of inflation, policy uncertainties, and arrears became ever more difficult to overcome. We face here, again, a problem of lack of confidence in the steadfastness of government policies. It is therefore my conclusion that, unless the authorities are able to regain confidence through a steadfast pursuit of stable macroeconomic policies, streamlined bankruptcy procedures alone will not be effective in deterring the recourse to arrears financing. A credible government program, together with a legal system that ensures a level playing field for all market participants, is what is needed.

Regarding the revenue decline section, let me start by saying that I do not believe that the widening of fiscal imbalances in many countries is basically linked to the inadequate efforts to reduce public expenditures rather than to the sharp declines in revenues. Although there are certainly many unproductive expenditures that should be eliminated--such as subsidies, including tax exemptions, military expenditures, and the wage bill--it is not less certain that many other expenditures should be increased, such as for the economic infrastructure, the social safety net, and the strengthening of the administrative capabilities of the state. It is precisely the latter that is needed to bolster revenue in order to sustain the needs of a modern state. An effective tax administration, including adequate penalties, is critical to bring within the tax net the emerging private sphere as well as the agricultural and energy sectors, which have been largely untaxed so far.

The last issue discussed in the paper, the role of the exchange rate, impinges directly on what we have characterized as the fundamental aspect of the transition process, that is confidence in government policies. In this regard, a fixed exchange rate system, when accompanied by sufficiently strong fiscal measures, could be the quickest way to establish confidence. It entails, however, a significant cost in terms of credibility loss if the exchange rate can not be maintained. A flexible exchange rate system, on the other hand, creates more room for choosing different policy mixes and is not as exposed to confidence shocks. As we see in the background paper, the confidence bonus of this system is not, however, comparable to having an exchange rate anchor, particularly when supported by a currency board agreement. Although there is evidence that in this case higher growth and lower interest rates have been achieved, as in the case of Estonia when compared with Latvia, the staff does not consider that evidence unequivocal and therefore concludes that there is a need for a case-by-case approach, which seems reasonable. I was surprised to read on page 27 of the main paper, however, that the choice of stabilization strategies in those cases of Fund-supported programs was taken by the staff without any reference to the participation of the authorities in that decision. I wonder, therefore, if the ownership principle was respected in all cases. I would appreciate comments from the staff.

Mr. Suárez made the following statement:

Let me start by commending the staff for its very good job in producing a set of papers that address common developments and issues of concerted have emerged across some transition economies. The lessons derived from this experience should be taken into account in the design of future Fund programs and are not necessarily applicable only to transition economies, as Mr. Havrylyshyn already stated. As it is clearly the case, there is not a unique blueprint for designing Fund-supported financial programs for these countries; much depends on the initial conditions, on the institutional framework, and on the political commitment to the reform efforts.

Based on the staff analysis, the continued decline in output reflects mainly the systemic change in institutional and political problems associated with the disintegration of the former Soviet Union, whereas there is little evidence regarding the question of the monopolistic structure of the traditional industries and the contractionary effects of monetary and fiscal policies. For the latter, expansionary effects have started to emerge in those countries that have been strongly committed in their adjustment and reform efforts. At the same time, the countries with better performance in prices are those that have implemented firm tightening of monetary policies and have established and maintained positive rates of return on domestic monetary assets, as well as other conditions that have inspired confidence in the currency, thus making it clear that economic agents are more confident to invest when governments pursue policies that give markets the preponderance in the allocation of resources. For that reason, the Fund should continue to play its role in helping these countries set the foundations on which strong and sustainable growth can arise based on convincing stabilization efforts.

As for the issues related to interenterprise arrears, the staff rightly pointed out that the "lack of financial discipline can retard investment and the process of privatization, and can complicate the conduct of stabilization policies." The structural nature of this problem underscores the need to accelerate the pace of reform in this area. Specifically, proper timing and sequencing in implementing such policies are complementary conditions to a smooth pace of transition.

With regard to the revenue decline, probably the most important factor is the political will to embark upon a serious and permanent tax reform. In this sense, the authorities' determination should be ample enough to handle both the policy and administrative issues that will permit achievement of an adequate level of tax revenue.

On tax policy issues, institutional building is a necessity generalized among all these countries owing to the dramatic changes of certificates in 1989 and the consequent evolution of events in the productive sector. It seems that the administrative infrastructure is not well prepared to cope with the new conditions of the markets. It is extremely important to radically change the procedures of the old tax bureaucracy and implement as soon as possible the new goals of the tax administration. The proposed structural changes suggested during the technical assistance missions to these countries can be taken in parallel with the implementation of new taxes. It is important to stress that, notwithstanding the particular situation of these countries and their priorities in this area, what truly matters is maintenance of the original impetus and consistency. An orderly set of tax measures is an important element in any stabilization programs.

Regarding the particular tax measures, I concur with the staff's three sets of recommendations concerning immediate challenges, short-term to medium-term priorities, and the establishment of good governance. On technical grounds, probably the most important priority is to tax the emerging private sector, while my second priority would be to rationalize tax revenue from agriculture, import tariffs, and fuel consumption in an orderly and consistent manner. The second set of measures, labeled within the short- and medium-term span, seems extremely important as well--so it is reasonable to start implementing better accounting procedures as well as tax administration procedures such as taxpayer education and registration.

The moral of the section of the staff paper relating to tax measures indicates that part of the solution to their economic situation is in the fiscal sector--and, in particular, within the revenue side. It is in the hands of the authorities of these countries to address a comprehensive reform in this area.

Finally, on the question of the use of a fixed exchange rate as a nominal anchor to facilitate the disinflation process. Like other speakers, I think the costs this strategy could entail are associated to government credibility. Therefore, we concur with the staff and other speakers that this approach should be considered on a case-by-case basis. Moreover, consideration should be given to the fact that other country experience in using the exchange rate as a nominal anchor without the preconditions that enhance its effectiveness, such as an adequate degree of financial discipline and a breakaway from indexation practices, has been a failure. If such conditions do not exist, interest rates will go up and economic growth will continue deteriorating. Thus, we consider that governments should not erode their credibility by trying a tactic with a very low probability of success. It would be better for a country to develop strategies aimed at establishing conditions that ensure a more consistent macroeconomic environment, low inflation, a sustainable fiscal position, monetary discipline, a competitive exchange rate, and a buildup of social consensus around these basics for sustained economic growth.

Mr. Daïri made the following statement:

First, I have some difficulty with the assessment in the introduction of the staff paper on revenue decline, that inflation has been made more difficult to control as a result of the transfer to the government of fiscal activities previously undertaken by enterprises or quasi-governmental institutions. I would expect that public absorption of resources would not be affected as a result of such a transfer and that any inflationary effect of these activities would not change with the transfer of responsibility.

Second, there is a need to look closely at the issue of shock therapy versus graduated drawing lessons from the countries of the former Soviet Union and other countries facing systemic changes. The example of China in its gradual approach is very informative.

Third, we need also to look at the effects of the gray economy. Did it exert a smoothing effect, or on the contrary, did it complicate the reform process? How could it be brought to the surface?

Fourth, on the social safety net, more countries were reported to have had low progress than to have had moderate progress. We should also examine whether the social situation did, in fact, worsen in some countries.

Fifth, the report indicates that the revenue decline was due, to some extent, to shortcomings in the tax reform design. It would be useful to know to what extent the Fund was involved in the design of these reforms. I am also surprised that data for revenue for the first half of 1994 are not available to date for some countries. Even if, by Fund standards, extensive technical assistance was provided to these countries, one wonders whether more investment in this area was not warranted, as indicated by Mr. Mesaki, in view of the systemic changes involved.

Finally, I would support Mr. Tulin's call for further analysis of the issue of a fixed versus flexible exchange rate regime.

Mr. Wei made the following statement:

I welcome the opportunity to review Fund policy experiences and the issues in transition countries in transforming their economies into market mechanisms. I find the staff papers comprehensive and enlightening. There are many difficult issues facing these countries in transition and for the Fund in formulating its policies to these countries. However, selectivity of major topics can help us to review the Fund policy experiences and facilitate the formulation of future policies in assisting these countries in transition.

Despite the many difficulties facing the countries in the process of transition, disinflation has been the most difficult and challenging issue facing the authorities and the Fund. Like the staff, I believe disinflation should be the top priority on the agenda of these countries. In this context, commitments to restrictive monetary and fiscal policy are of critical importance.

With these economies under unprecedented transition, it is understandable that rampant interenterprise arrears have further complicated the difficulties in choosing reliable intermediate targets to conduct effective monetary control. Given the enormous uncertainties involved, I strongly support the staff view that timely reviews of money and credit targets are of essential importance in ensuring the prompt adjustment of a monetary policy stance, in light of inflation developments.

As regards the use of the fixed exchange rate arrangement as a nominal anchor for disinflation, I concur with the staff that a case-by-case approach should be the guideline for recommending the adoption of such a nominal anchor to the authorities. The staff has indicated the positive role of a fixed exchange rate in the disinflation process, given the requirements for prudent fiscal policy, political commitments to adjustment, and other necessary factors. At the same time, the staff has shown the costs of lacking these requirements. In this context, a fixed exchange rate could be actively considered by the authorities in their endeavor to disinflation, but equal attention should be paid to the experiences in other states, which have demonstrated the effectiveness of flexible exchange rate arrangements in disinflation. The underlying requirements for addressing the inflation problem, in my view, lie in the strong commitments by the authorities to adopt tight financial policies to achieve macroeconomic stability as early as possible, in order to create a favorable environment for economic recovery and growth and to attract private capital inflows.

Macroeconomic stabilization will not succeed if such efforts are not supported by comprehensive structural reforms and institution-building. The importance for these countries of building new institutions, underlying functioning market economies, cannot be overemphasized. This will take time, as will structural reform aimed at reducing and eliminating rigidities and distortions in order to increase the efficient allocation of real and financial resources. In this regard, imposing financial discipline on state enterprises is of overriding significance. Without financial discipline, the deep-rooted interenterprise arrears will not be fundamentally resolved and the episodic re-emergence of such problems will not be avoided.

Although output declines have been larger than expected in almost all transition economies, the experience in the Baltic countries has shown an early reduction in inflation, accompanied by an early resumption of economic activity. And the cases of some other countries do not pose a convincing argument that slow action on disinflation helps ease the decline in output. Given these experiences, I believe that a firm commitment to fighting inflation would help those countries still struggling with high inflation and output declines to achieve early resumption of economic recovery.

Turning to the revenue issue, the revenue decline experienced by countries in transition has, to a large extent, hampered their authorities' ability to pursue an effective fiscal policy. As the staff has correctly pointed out, this is a complex phenomenon. In this regard, the staff analysis of the causes and consequences of the revenue decline is convincing and enlightening. I would like to endorse the staff recommendation that the authorities take policy measures to deal with the problem of revenue decline.

A system with a high tax rate accompanied by widespread exemptions may not achieve the desired revenue. To reduce distortions in the tax system, the authorities in these countries should take immediate action to remove or restrict numerous exemptions. In addition, they should reform their tax systems to simplify the tax structure and rationalize tax rates in order to broaden the tax base.

Of equal importance is that the emerging nonstate sector must be included in the tax net. With this sector playing a more important role in the economic activities, its revenue contribution should be in line with its increasing economic importance.

In addition, taxes on agriculture should be carefully considered. Given the differences in agricultural activities from those of the manufacturing and service sectors, care should be taken not to discourage the farmers' incentives to produce.

I concur with the staff that another area for immediate action in increasing revenue is international trade. Given the weak administrative capacity, a broad-based simple tariff system would be desirable and would provide an easy way in which to enforce a transparent tariff system.

Apart from these areas for immediate action, I find changes in accounting practices of great importance in facilitating increased revenue. The accounting practices of the central planning system are no longer suitable to meet the needs of those countries transforming to market economies. Accounting practices must be compatible with international standards, in particular to reflect the change from a cash-based to an accrual accounting system.

Tax administration is not only the responsibility of the tax authorities but should also reflect voluntary compliance by taxpayers. To strengthen tax administration, the authorities should enhance their administrative capacity and design the necessary new procedures.

Although experiences thus far are far from conclusive, I firmly believe that the Fund's overall approach in assisting these transition countries to transform from centrally planned to market economies has proved to be effective. Nonetheless, timely reviews of policy experiences, such as this one in the future, will be helpful in improving the quality of policy advice and assistance--both technical and financial--from the Fund.

Finally, on the experiences of some Asian countries, including China, and like Mrs. Cheong, I also believe that it would be useful if the staff could draw useful conclusions from the approaches which have been adopted by Asian countries in adjusting their economies.

Mrs. Wagenhoefer made the following statement:

I join other speakers in commending the staff for the presentation of several excellent, well-balanced, and comprehensive documents reviewing the first years of policy experience in the Baltic countries, Russia, and other former Soviet Union states. As a general conclusion, the staff notes that the success in stabilization and reform has been mixed. We appreciate the staff's emphasis to keep a realistic perspective, as the transformation of centrally planned economies is a complex and time-consuming process that requires careful preparation and institution building.

We fully share the staff's conclusion that evidence clearly points to the benefits from an immediate attack on inflation accompanied by the introduction of a comprehensive and coherent structural reform strategy. We feel, therefore, that the Fund's strategy has proven adequate, and that there is no need to adjust the general approach.

The decline in output, as summarized in the document, was considerable. Apart from the two special factors of armed conflicts and natural resource exports caused by the systemic transformation and the disintegration of the former Soviet Union, it is noteworthy, that there is little evidence that the output decline has been exacerbated by unduly contractionary monetary and credit policies.

The pace of structural change and investment in new business activities are the major determinants in the initiation of sustainable growth in a stable macroeconomic environment. In the context of structural change, I would like to be somewhat more outspoken than the staff. The need for comprehensive institutional reform cannot, in our view, be overemphasized. Any smooth-functioning market economy requires, among other rules for competition, the supervision of monopolies, a well-designed banking sector, functioning financial markets, and laws regarding the functioning of enterprises, commerce, trade unions, and so on. In other words, comprehensive legal and political structures are needed. In addition, transition economies need an overhaul of their educational systems and human capital needs. Therefore, the focus on market-oriented reforms is just one, albeit a necessary, element of the complex transition process. This might, perhaps, raise the question whether closer cooperation between the international institutions is warranted or whether the present degree of cooperation is sufficient. In other words, are we satisfied with the advice given by each of the international organizations and institutions, each according to its field of competence?

On inflation, two major messages with respect to the experience regarding inflationary developments in transition countries are contained in the staff report, and I find them most interesting. First, in contrast to various attempts to explain inflationary developments in transition countries as a result of price liberalization, price increases, according to the staff, have been due primarily to rapid monetary expansion. Second, and consequently, the steady and substantial reduction in monetary expansion supported by fiscal policy is both a necessary and a sufficient condition for bringing down inflation over the medium term.

With regard to the interenterprise arrears, I welcome the analysis provided by the staff. We fully support the staff's advice that bankruptcy criteria and judicial procedures should be streamlined. In addition, financial and administrative penalties on state enterprises might be improved. We concur with the staff that any bailout component in dealing with interenterprise arrears should be avoided.

The next subject of interest is the revenue decline. The structural and systemic change of transition economies seems to be the major determinant of the absolute and relative revenue decline, as has been pointed out very clearly in Mr. Tulin's statement. We would underline most of the recommendations suggested by the staff in order to address the complex and formidable revenue problem. Broadening the tax base by including the smooth functioning and hitherto untaxed sectors, primarily in the agricultural field, and perhaps also in the energy field, should have a very high priority for current tax policy. This should be done in parallel with the elimination of tax exemptions. In that context, would it be advisable, at least for a transitional period, to rely more heavily on indirect taxes than on direct taxes?

The main lesson to be drawn from the policy experience with respect to exchange rate policies is well stated in the staff paper: "pegging the exchange rate may be a useful element in stabilization if the fiscal conditions are right, but pegging is not necessary for stabilizing rapidly and successfully." Consequently, the staff has rightly taken so far a rather pragmatic, case-by-case approach in its advice, taking into account, in particular, the fiscal position and the political commitments to adjustment. In general, we feel that such a flexible approach is the adequate response to differing starting positions and to differences in the political as well as the social circumstances prevailing in the various transition countries.

With regard to specific policy recommendations in the field of exchange rate policies for individual countries, we believe--as is done on page 40 regarding Russia, Kazakhstan, Ukraine, Armenia and Georgia--that it is premature to determine whether the reform strategy should include an exchange rate anchor.

Mr. Kiekens said that, as Mrs. Wagenhoefer had pointed out, institution building was of utmost importance in the transition process. Mrs. Cheong had emphasized the role that the early establishment of a new legal and institutional framework had played in making possible the relatively better economic performance of Asian transition countries. However, Ms. Lissakers had noted that gradual reform had not been possible in the former Soviet Union, in view of the difficulties in preserving economic and other relations.

Even after five years of transition, bankruptcy laws, new tax codes, and well-functioning administrations and judicial systems were still lacking in most countries covered under the study, Mr. Kiekens commented. The lack of progress in institution building was a major factor in the flourishing corruption and other criminal activities. Delays in establishing the rule of law in several newly independent states were as costly as the failures in the fight against inflation.

The sustainability of stabilization efforts depended crucially on progress with structural reform, Mr. Kiekens concluded. Several countries of the former Soviet Union had failed to achieve stable growth, because institution building had been postponed in order to undertake urgent stabilization efforts. The need for early institutional and legal reform should be emphasized.

Mr. Havrylyshyn considered that, as a result of overemphasizing the immediate need for institution building, countries might delay stabilization until a proper institutional framework was in place. It would be better to move on with stabilization efforts regardless of the state of institution building. As soon as stabilization efforts had been started, institutional reform should be introduced, otherwise, the stabilization itself would be in danger.

Ms. Lissakers remarked that gradual adjustment had not been possible in Russia and Ukraine, because their trade and other relations had been severely disrupted by the collapse of the former Soviet Union. In the case of the Baltic countries, the severing of links with the former Soviet Union had been a political decision.

Mr. Kiekens noted that his main point was that institution building should not be overlooked; it was lacking in the countries of the former Soviet Union.

Mr. Daïri observed that when institutional reform was not carried out up front to build confidence, the adjustment process stalled, and the sequencing of reform was blamed for the difficulties.

The Director of the European II Department stated that the staff papers had focused on the main issues of policy/program design with which the Board had been concerned. However, other issues also needed consideration. The staff recognized the importance of structural change and institutional reform in all the transition countries. However, the Fund almost always relied on the Bank's advice on institutional reform, and the countries themselves designed their structural policies on the basis of that advice.

The lesser focus on structural issues in the staff paper had not meant that those issues were of secondary importance.

The current study covered only those countries for which Directors had asked for more detailed information and analysis, the Director commented. In the recent past, the Board had considered studies on developments in Eastern European countries, and trade and financial relations among countries of the former Soviet Union. Furthermore, the 15 countries covered in the current study constituted a homogeneous group, for which some generalizations could be made. The inclusion of Asian transition countries would have complicated the analysis.

The countries of the former Soviet Union, unlike the Asian transition countries, could not have implemented early institutional and structural reform because of their initial conditions, the Director observed. When they had been on the verge of reform, the transition countries in Asia had been largely agricultural economies, whereas the countries of the former Soviet Union had been mostly industrial economies. Moreover, in the Asian countries, public sector involvement had not been as predominant as in the former Soviet Union. The implementation of substantial institutional reforms in the countries of the former Soviet Union would have taken many years and would have delayed the adjustment process; therefore, they could not have followed the Asian model.

The Fund's work on stabilization was coordinated closely with the World Bank's work on sectoral and structural reforms, the Director commented. However, neither the Fund nor the Bank had been satisfied with the implementation of structural reform, which was a slow and difficult process.

Whether independent currencies should have been introduced earlier in the transformation process was a difficult question to answer, the Director remarked. The successful introduction and maintenance of a new currency depended on a country's ability to implement responsible fiscal and monetary policies. Ukraine and Georgia had introduced their own currencies, which had collapsed within a short period owing to a lack of fiscal and monetary discipline. Perhaps some countries might have recognized the importance of fiscal prudence if they had had their own currency.

In the countries of the former Soviet Union, institutional development had progressed in unexpected ways, the Director noted. At the inception of the transition process, he had expected that finance ministries would be quite strong institutions and that central banks would remain weak for a long time. However, while central banks in the region had gained strength faster than expected, finance ministries had remained rather weak.

A number of Directors had doubted that some countries might soon be in a position to adopt an exchange rate anchor to support their financial policies, the Director observed. The staff had not recommended any specific exchange rate policies for the countries under study. The case-by-case analysis of five countries had been given in the study merely to illustrate the experiences with different exchange arrangements available to countries. Of those five countries, Russia and Ukraine had recently agreed on Fund-supported programs that would not be based on fixed exchange rate arrangements. In the other cases, the appropriate exchange rate regimes were still under discussion, with the Fund paying special attention to the countries' ability to maintain a strict fiscal policy regime.

It was the authorities' responsibility to decide on an exchange arrangement, the Director of the European II Department concluded. In 1992, the Estonian authorities had insisted on the introduction of a currency board. The authorities of the Kyrgyz Republic and the Russian Federation had wished to maintain floating exchange rates for the time being.

The staff representative from the European II Department said that, although poor in quality, the available GDP data were nevertheless relied on to assess the relative growth performance of countries of the former Soviet Union. Although electricity consumption data had confirmed that GDP had been underestimated, their importance should not be overemphasized. In transition economies where relative prices of energy were changing fast, electricity consumption data alone were not sufficient to come to any firm conclusions about output changes in the economy. Furthermore, in some countries--for example, the Kyrgyz Republic and Azerbaijan--there had been deliberate policies to discourage electricity consumption and encourage gas consumption.

A comparison of the economic performance of Uzbekistan and Kazakhstan would not be an adequate basis to accept, or reject, the gradualist approach to reform, the staff representative observed. Uzbekistan had not suffered terms of trade losses during the first few years of its existence as an independent state, and, in fact, it had gained from moving to world market prices for its cotton exports. In contrast, Kazakhstan had witnessed a significant deterioration in its terms of trade.

As Mr. Havrylyshyn had suggested, wage restraint had played an important role in stabilization in the countries under review, the staff representative noted. In countries that had succeeded in bringing the velocity of money down, wages had been much more restrained. Also, in the analysis of velocity movements, currency substitution did not appear to have a major influence in general, as movements in velocity had been broadly similar whether or not foreign currency deposits were included in the monetary aggregates. However, the existence of significant currency substitution suggested that raising the return on domestic monetary assets could increase real domestic money demand and contribute to stabilization.

Countries that had maintained a tight monetary stance and had refused to expand the money supply to pay for inter-enterprise debt had avoided arrears, the staff representative observed. For important enterprises that should not be allowed to fail, arrears should be eliminated or reduced by restructuring and identifying budgetary support in the medium term. If policies to encourage restructuring were not specified clearly and implemented resolutely, that could be misconstrued by economic agents as a lack of commitment to enforcing hard budget constraints.

All possible monetary instruments should be used to contain inflation, the staff representative remarked, although the effectiveness of direct credit controls, such as credit ceilings and administered interest rates, should not be overemphasized. Unless market-determined positive real interest rates were achieved, it was hard to establish confidence in a currency.

The foreign reserves cover and the legal and institutional barriers to discretionary policy adjustment under a currency board reflected a firm commitment to stabilization, the staff representative from the European II Department noted. The currency board system was less flexible than other systems in providing temporary liquidity support to banks experiencing problems.

Mr. Havrylyshyn noted that many speakers had pointed out that stabilization based on a fixed exchange rate regime was highly risky, notwithstanding its benefits. He wondered whether a fixed exchange rate system had failed in any transition economy.

The Director of the European II Department replied that Table 7 in SM/95/46 provided information on exchange-rate-based stabilization programs in Czechoslovakia, Estonia, Poland, and Yugoslavia. Despite some initial success, the Yugoslav program had eventually failed.

Ms. Lissakers considered that, despite differences in history, initial conditions, economic structure, and timing of structural reform, a comparison of the policy experiences of Asian transition countries with those of the former Soviet Union could be made, in order to help future policy guidance for transition economies.

Mr. Mesaki wondered what impact structural reform had had on economic performance in Uzbekistan and Kazakhstan. According to the staff paper, Uzbekistan's economic performance had been very good, while its reform effort had been unsatisfactory.

Mr. Evans remarked that the Asian transition countries had not faced significant shocks, and their initial conditions had been quite different from those of the former Soviet Union countries. In view of the enhanced understanding that the current discussion had given, perhaps a comparison of the two groups of countries should not be a high priority for future staff studies.

Mr. Andersen remarked that further analysis and refinement would be needed before the papers could be published.

The staff representative from the European II Department stated that the disruptions caused by the transition to a market economy were mainly responsible for the output decline in the countries under investigation. Evidence suggested that a more gradual transition was not likely to slow the output decline, which had varied depending on differences in initial conditions, economic structure, and the severity of the terms of trade shocks experienced by each country. A slower pace of liberalization, in comparison with Kazakhstan's, was not the main factor behind Uzbekistan's relatively slower output decline.

The staff representative from the Fiscal Affairs Department observed that the Fund provided technical assistance to member countries for the design of tax policies and the development of appropriate systems of tax administration. While the basic tax reforms were good, some countries had later backtracked, implementing tax policies that were not consistent with the Fund's advice. Most important, tax exemptions had been granted, or increased, at the cost of higher rates for the value-added and profits taxes. Sometimes, political resistance had hindered the implementation of reforms, particularly in the area of tax administration.

There was no significant correlation between the revenue yield and the reform effort, the staff representative observed. The slow-reforming countries appeared to have been the most successful in maintaining revenue yield, as they had continued to pre-empt tax revenue from state enterprises. Sooner or later, those countries would need to restructure and stop levying penal ad hoc taxes. Some countries had been able to maintain their revenue base by letting the enterprises borrow from the banking system to pay taxes, but that had had a negative effect on the stabilization effort. In Estonia, broad legislation covering all sources of income, the strong push to register new taxpayers, and the relatively effective procedures for auditing and verifying returns, had helped to maintain the revenue yield.

Reducing tax exemptions was essential to protect the revenue base and yield, the staff representative commented. It was difficult to measure the cost of tax exemptions, partly because they had been granted in an ad hoc manner. In many countries, there were substantial tax exemptions in the agriculture sector, which accounted for a large share of GDP. In Ukraine, the Ministry of Finance had estimated that a third of the potential revenue from the value-added tax had been lost owing to exemptions.

The staff would not recommend selective tax exemptions to encourage foreign direct investment in specific sectors, the staff representative observed. When relative prices were changing fast, as in the case of the countries covered in the study, it was impossible to pick "winners"--sectors that were likely to do well. Experience in many countries had shown that macroeconomic and political stability, and a predictable tax code, were more important for attracting foreign investment than selective exemptions.

Higher wages for tax collectors were needed to attract the best to the profession, the staff representative remarked. However, their pay should also be in line with overall wage scales in the public sector. If tax collectors were to be paid more, they should have less security in the event of incompetence or corruption.

Energy taxes should avoid introducing distortions in relative prices, the staff representative noted. In the countries studied, relative prices of energy products were unusually low, despite the high intensity of energy use. Energy taxes had to play a role both in raising revenue and contributing to domestic and external adjustment.

Sequestration of payments profoundly affected the relationship between the central government and the local authorities, the staff representative explained. If the local authorities could not depend on transfers and adequate expenditure management, they would be tempted not to remit their share of revenue to the central government.

The transfer of some social security functions from enterprises to the central government could not be avoided, the staff representative from the Fiscal Affairs Department concluded. It would not necessarily lead to stabilization problems, provided that budgetary revenue could be raised to finance the increased spending. Unlike in the case of Japan, selective tax exemptions seemed to be inappropriate in the context of the FSU countries.

Mr. Mesaki observed that the experience of Japan and many other Asian countries had shown that special tax incentives for selected industrial sectors had encouraged producers. A comparative study on the role of special tax concessions in different countries could be useful to the FSU countries.

Mrs. Cheong remarked that tax incentives adopted in order to attract direct foreign investment compensated for certain market imperfections. It might be useful to find out why such selective incentives had worked in some Asian countries.

The Chairman observed that tax exemptions needed to be treated with caution, particularly in countries where the public finances were still weak.

The Chairman made the following concluding remarks:

I would like to thank my colleagues for their participation in this discussion and for their suggestions on how the reform and stabilization process can be accelerated to promote the resumption of growth in the Baltic countries, the Russian Federation, and other countries of the former Soviet Union. From the staff paper and the comments of Directors, it is clear that there is finally an encouraging degree of consensus between the these countries and the Fund on the appropriate policy approach.

There was a strong consensus on the need for accelerating structural reform as well as for rapid stabilization to improve the output performance in these economies. Success in stabilization and reform across the 15 countries had been mixed, and widespread hopes of a quick turnaround have been replaced by recognition that systemic transformation will take time. Nevertheless, significant progress had been made in a number of countries, and perhaps because of the successful example of those that have pursued a bold, comprehensive, and coherent reform strategy, the prospects for an acceleration of stabilization and reform in other countries have improved over recent months. There is thus a clear consensus that credible commitment to stabilization and reform policies is essential for the success of these policies, and that gradualism is not a viable alternative. Let me also emphasize--as several of you have done--the critical importance of institution building, in its broad sense, in the stabilization and reform efforts.

The decline in output in the 15 states since the dissolution of the Soviet Union has raised concerns about the design of policies in these states. In that context, it probably needs to be observed, first of all, that the database is flawed and that the output decline may well have been a good deal smaller than the official statistics suggest. Directors noted that, while there appeared to be a direct correlation between the speed of output decline and that of systemic change in the first two years of transition, the rewards, in terms of positive output response, accrue with a lag and the evidence does not suggest that a gradual approach helps to contain the cumulative decline in output. In fact, Directors observed a positive correlation between lower inflation and smaller output decline. They emphasized that the experience in the Baltic countries clearly shows the beneficial effects of sustained stabilization combined with structural reform: inflation has fallen to relatively low levels, and growth has resumed. Directors found little evidence that the output declines in these countries were exacerbated by unduly contractionary monetary and fiscal policies. At the same time, the need to contain the fiscal deficit to avoid crowding out the emerging private sector under tight monetary conditions was underscored by a number of Directors.

All Directors recognized that the rate of money growth remained the single most important determinant of the inflation rate over the medium run. We must not lose sight of the fact that in the group of countries we are discussing here, the role of money in a modern economy was not fully understood. We must also keep in mind that the introduction of national currencies--versus the maintenance of the ruble area--was a complex, time-consuming political issue. Thus, time was inevitably lost; with hindsight, it is clear that a number of these countries would have done better if they had introduced their national currency earlier, and supported them with a tight monetary policy.

Several countries had experienced difficulties in controlling inflation, at least in the short run, owing in part to large swings in velocity--especially in late 1993 and early 1994. Directors noted that a number of factors, including declines in confidence and thus in the underlying demand for money, exogenous increases in import prices and administered prices, and the creation of informal credits between enterprises, had contributed to these velocity swings. Some Directors noted, however, that many of these problems might themselves have resulted from--or at least been aggravated by--inadequate policies. For instance, capital flight could have been stemmed and confidence increased by ensuring positive real interest rates and, in some cases, by committing to exchange rate stability. Mr. Tulin has drawn our attention to currency substitution as a rational reaction of the public to protect its savings. We need to reflect further on this.

Also, Directors agreed that inflation control had been frustrated by the problem of interenterprise arrears. Directors expressed concern that increases in interenterprise arrears signaled a lack of financial discipline in many of the countries, and endorsed the staff's analysis and policy recommendations in this area.

Directors recognized that the revenue decline was to an important extent an inevitable consequence of the transition to a market economy. This decline, however, complicated the task of stabilization and needed to be reversed. Directors were also in broad agreement with the strategy put forward in the staff paper for enhancing revenue, and emphasized the critical role of Fund technical assistance in this area.

Directors noted that pegging the exchange rate had been a successful stabilization tool in Estonia and in some Central European countries. They observed that an exchange rate peg had the advantages of anchoring the price level in conditions of unstable money demand and of constituting a public commitment of the government to stabilization policies, particularly when embedded in a currency board-like arrangement. However, they also recognized that the costs of failure were high under an exchange rate peg, and the chances of failure could be substantial--especially in an environment of large real and external shocks and questionable political support for large fiscal adjustment. Most Directors concluded that, under such circumstances, a cautious approach should be taken in choosing to adopt an exchange rate-based approach to stabilization. Indeed, while anchors had proven useful in several countries, the experience in a number of others showed that exchange rate anchors were not necessary for successful stabilization from high levels of inflation. As has been noted in today's discussion, the choice of an exchange rate regime is probably secondary to the importance of strong monetary and fiscal restraint. In view of the fact that many of the external and real shocks associated with liberalization had already been experienced, and political support for reform had grown in many countries, the view was expressed that there was increased scope for the use of exchange rate anchors in the future. Most Directors observed that, in the case of countries such as Russia and Ukraine, more progress in stabilization and the establishment of a proper track record would be required before a fixed exchange rate could usefully be considered. Directors generally agreed that a case-by-case approach to the appropriate external regime during stabilization remained warranted.

We will continue our work and learn from our experience, which is growing over time. I have noted the calls of several of you for more work in several areas, and I can assure Directors that we will examine these requests, see how and when we can satisfy them, and critically assess the record of our policy advice. The learning curve of our policy experience continues.

3. SYSTEMIC TRANSFORMATION FACILITY - REVIEW OF OPERATIONS AND EXPERIENCE

The Executive Directors considered a staff paper reviewing the operations and experience under the systemic transformation facility (STF) (SM/95/49, 3/8/95).

Mr. Calderón made the following statement:

We have before us a very interesting review of the operations and experiences under the STF. It is not surprising that this report has a significant amount of common ground with the paper on the overview of developments in countries with stand-by and extended arrangements approved during 1988-91 (EBS/94/104, Rev. 1, 3/8/94).

Some of the main conclusions of this paper were the following: the design of programs reflects the enormous frictions in a second best world where political and administrative constraints frequently give rise to short-term trade-offs between macroeconomic objectives; the common thread among the countries reviewed is the unusual severity of their external financing constraints; the monitoring of programs, with its focus on ensuring compliance with the financial program, the adequacy of external financing, an the implementation of structural reforms, provided appropriate support for the broad approach adjustment; and reducing, or in most of the Central European countries containing the deterioration in, large public sector deficit was critical to redressing an overall saving-investment imbalance and restraining the growth of bank credit.

All the countries surveyed in this STF review also faced tremendous political problems, severe financial constraints, and vast fiscal deficits. However, those countries that had better success in stabilizing their economies have much in common.

As regards successful programs, Cambodia, the former Yugoslav Republic of Macedonia, and the Slovak Republic were able to implement both fiscal and monetary policy as programmed. Revenues were increased, expenditures reduced, and positive interest rates maintained. The outcome was as, or better than, envisaged: inflation under the 1993/1994 STF-supported programs was almost always lower than projected. On the other hand, output was also higher than--or the decline was less than--expected. Finally, these policies were decisive in helping to stabilize their nominal exchange rates.

From these experiences we can identify an important conclusion and formulate a question. An obvious, but nevertheless meaningful, finding is the high quality of the programs designed both by the countries and the staff. When these policies were implemented, the results in terms of inflation, output, and the external sector were better than expected. The question that remains is, why were these countries able to execute the programs?

The review gives us the answer and, simultaneously, sets an important precedent for future STF-supported programs. Greater success in program implementation is linked to the strength of prior actions, in particular to issues related to parliamentary approval. More generally, a broad-based agreement on the program is required, in order to be able to carry out successful policies.

It is interesting to see, for example, the difficult and different prior actions taken by most successful countries: the Slovak Republic reduced subsidies, increased the value-added tax rate and reduced expenditures; the Parliament of the former Yugoslav Republic of Macedonia approved the 1994 budget, monetary program, wage control law, and amendments to the Pension Fund law; finally, in Cambodia important revenue measures requiring parliamentary approval were taken.

However, incomplete implementation of program measures was the common denominator of the countries that failed to reduce inflation and that, in general, were not successful in stabilizing their economies. Fiscal targets were missed; reserve requirements were not increased; subsidies were not eliminated; and tax reforms were not implemented. The staff points out that the deficient implementation of agreed measures was due, in part, to insufficient political will and, in some cases, to weaknesses in administrative capacity.

However, the key to why these countries were not to successful, is again found in the prior actions. In table 11A, on prior actions for stand-alone STF purchases in 1993 and early 1994, we find that the successful countries share the following common expressions: approval by Parliament of the 1994 budget; adoption of important revenue measures, reduction of subsidies, and value-added tax rate increases. Whereas the other group has the following common terms: commitment to avoid generalized settlements of interenterprise arrears; commitment to pass through increases in energy costs; commitment to channel all directed credit through the Commission on Credit Policy; and steps toward revenue measures.

It is not an understatement to say that all the countries reviewed faced strong programs. Moreover, the most successful ones were able to implement, not without immense effort, the required monetary and fiscal policies; the results in terms of lower inflation, higher growth--or lower decline--and, in general, macroeconomic stability, were almost always better than envisioned.

The experience in the countries of the former Soviet Union, in particular, the uncertainties regarding the institutional changes, the behavioral relationships, and the weaknesses in basis statistics, underscore the difficulties that these programs have had and the difficulties that lie ahead.

However, in order to increase the probability of success of future programs, increased emphasis has to be put on prior actions--as has been done in recently approved programs, especially those requiring political decisions and social commitments. Furthermore, these actions should rely more, if possible, on deeds rather on than promises.

Mr. Mesaki made the following statement:

I fully agree with the staff that the STF has played a critical role in supporting the process of economic reform in countries that were not yet in a position to adopt a program that could be supported by a Fund arrangement. I believe that what is more significant than the availability of Fund resources is that the STF has enabled the Fund to build more continuous working relations at an early stage with members that had been remote from the Fund for a long time.

My compliments for the STF are not influenced by the fact that the pace of the reform under the STF in many countries was not as fast as initially expected and that the performance in the countries have been mixed, in view of the magnitude of the challenges that the economies in transition faced at the beginning of the economic reform. Can you insist with confidence that you did predict that more than 10 out of 15 countries of the former Soviet Union would have, or would be about to have, an upper credit tranche arrangement in two years? Did you not suspect that such a scenario might be just a wishful thinking?

I will not touch on the reform process of the countries with arrangements under the STF, as I will elaborate on it today in connection with the other items on the experience of the countries of the former Soviet Union, which are principal users of the STF. Regarding the STF, I would like to limit my comments to two aspects, which relate to the mechanism and operation of the STF: prior actions and external financing.

Prior actions are expected to play two important roles: a touchstone that tests the strength of the authorities' commitment; and a safeguard of Fund resources to supplement the conditionality.

In the context of the STF, I would emphasize the importance of the latter. I believe that careful attention should be paid to ensure additional safeguards for the STF because the STF has only two tranches, and therefore 25 percent of quota is available even if the program goes off track immediately after the Board approval; the maturity of the STF is longer than that of a stand-by arrangement, that is, ten years; and the Fund has virtually no information on the track record of the country. It is crucial for the Fund to ensure appropriate safeguards for the STF, and my belief is that nothing is more effective than prior actions.

In this connection, it is welcome that recently approved programs have placed increased emphasis on prior actions, and I agree with the staff that prior actions are most effective when imposed in key areas requiring broad political commitment.

With regard to external financing, the staff says that stand-alone STF-supported programs have generally not been successful in catalyzing needed financing. My authorities have different views from the staff on the issue of the financing of the STF. Let me clarify the issues.

First of all, it is necessary to address a fundamental question--the necessity of closing financing gaps. The staff has repeatedly explained to the Board that financing gaps should be closed even in the case of stand-alone STF-supported programs because economic reform cannot proceed without sufficient resources necessary to support the reform process.

In response to this view, this chair has repeatedly insisted on the following: first, the STF is only a paving facility to go to a stand-by arrangement and therefore it is important to urge the authorities to make a first step forward, regardless of the financing assurance; second, it does not seem to make much sense to calculate financing gaps with huge uncertainties about economic developments and the pace of economic reform in the period ahead, which may change the program assumptions greatly; third, on the donors' side, it would be extremely difficult to explain to their own people and parliament the rationale of assistance to countries with no established credibility at the initial stage of transformation.

The staff rightly says, "Japan explicitly indicated that it would not financially support programs associated with stand-alone STF purchases." I believe this policy is fully justified by the above reasons.

The staff further points out that in some cases a lack of financing assurances has led to the revision of the STF-supported program and endangered the attainment of program objectives. As a measure for improvement, it recommends a strengthening of the mechanisms for securing financing commitments.

On the former point, a revision of the program is not necessary because, from my point of view, as mentioned above, gap filling is not necessary and specific gap-calculation is also not necessary. Even if I agree with the staff on the importance of ensuring financing assurance to some extent in the case of the STF as well, the staff's argument does not seem to be convincing enough. I believe that the staff usually estimates how much each donor will commit when calculating financing gaps. While the staff might have had difficulty with the estimation of donors' commitments at the initial stage of the STF, I expect that experience in the past two years has given them a more accurate understanding on each donor's basic policy on assistance in connection with the STF, and that the staff can make a reasonably correct projection of the possible amount of each donor's commitment. In case the financing gap is not likely to be covered by the expected commitment of donors, past experience indicates that there is very little point in trying to persuade donors to increase the amount of their commitment, because donors have their own policy, reflecting their fiscal situation or relationship with the country in question.

In such a situation, I would rather suggest that the staff adjust the content of the program before circulating the staff report.

Finally, regarding the mechanisms for securing financing commitments proposed by the staff, I cannot support it if it contains the elements of automaticity or obligation, for the reasons I mentioned above.

Mr. Havrylyshyn made the following statement:

The main purpose of the STF approved by the Board on April 23, 1993 was, to quote the original document:

> "to provide assistance to members severely affected by systemic changes--including countries as yet unable to formulate a program that could be supported by the Fund under its existing facilities and policies,"

and, further, to

> "move as soon as possible toward policies that could be supported under an upper credit tranche arrangement."

From the useful and comprehensive review paper, one can conclude that this basic objective has been broadly achieved with SDR 3.4 billion disbursed already to 18 countries, 10 of them as "road-paving" operations. If we add those strongly expected to make requests for stand-by arrangement by midyear, most, if not all, of these ten, will have successfully had the road paved to an upper credit tranche arrangement. As the STF could not have been expected to achieve more than a beginning on stabilization and adjustment, this record can be considered very good. Indeed, many have completed this road in about the expected time, 6-12 months, and I am proud to say that two of our constituency countries, Moldova and Ukraine, will have done so in 3 and 5 months, respectively.

While broadly successful, the STF has not been without shortcomings, and three issues deserve special attention: inadequate parallel financing; the too-limited time period; and enlargement.

The original STF statement of purpose states: "Substantial additional financial support from other sources over a sustained period will also be needed by members that make use of the new facility."

On this objective of the STF, the review paper provides us several pages of unhappy reading, detailing the sad story that comprises the process of catalysis in practice. As the staff states on page 45 of the paper, with refreshing bluntness, this process ended with "a significant shortfall of official external financing compared to program assumptions." I further agree with the staff's assessment of the consequences of such shortfalls: adjustments that ranged from minor to severe; financing from other sources on less advantageous terms; substantial increases in domestic and external arrears; and sharp compression of imports, which affected output and exports.

This last point on exports serves to emphasize that the expected positive circular causation involving domestic adjustment, Fund support, and other financing--can, alas, be reversed if one element falls short, and become a negative circular causation. Let me finally add to the staff's list of consequences of shortfalls from the perspective of recipient countries: shortfalls in financing increase the delays in getting started--Belarus is a case in point--increase the difficulties of progressing, once started; reduce the political consensus for going ahead at all; and, finally reduce, the credibility of statements of support by members of the donor community.

Let me parenthetically respond to one of the arguments sometimes heard from donors, that the recipient countries' own administrative inadequacies delay, and therefore reduce, the financing. I will not deny that new members of the Fund and Bank--some of them newly independent as sovereign states--have a poor knowledge of these procedures and proceed at a pace far slower than is usual. I would like only to note that the "learning-by-doing" process as described long ago by Nobelist Kenneth Arrow and others not only requires some time before approaching full potential, but also, more important, the more volume of experience regardless of time, the quicker one sees an acceleration of learning. In a word, the more financing there is, the quicker these governments will learn to administer the process efficiently.

Finally, let me address the macroeconomic stability achievements under the STF--but only briefly inasmuch as our later discussion on policy experiences of transition is a better forum for more detailed assessment. First, it seems clear that the aim in terms of achieving stability was limited, and necessarily not very precisely defined. Perhaps the most important sign of success will be the establishment of the basis for a viable program supported by a stand-by arrangement or analogous program, by making a beginning on stabilization. On this criterion, if expectations to mid-1995 are fulfilled, we must generally consider the STF stabilization objectives as successful.

I concur with the essential messages of the staff report on the concrete goals, achievements, and shortcomings concerning inflation, international reserves, and exchange rate stability, as well as the reasons they give for shortfalls in targets. As the STF continues, I see little reason to suggest different approaches, or to change the stress on monetary and fiscal control with exchange rate decontrol. But I return to my first point, that the ability to eventually move on to the more solid and certain stand-by arrangements, is the real sign of success of the STF. If slippages occurred, and even if they were large, it is not clear from the staff report, whether this record is any worse than that for Fund upper-credit tranche arrangements, in general.

Let me consider briefly the matter of extension and enlargement. The policy review paper's very first conclusion is:

> The widespread hopes of a quick turnaround in the countries of the region have been replaced with the recognition that systemic transformation will take time.

In that light, and as I have said in my statement of December 12, 1994 extension of the STF to end-April 1995, we can only conclude that the 20-month program period envisaged in the original decision was unrealistically short. The greater than envisaged difficulties of implementation--exacerbated, let me repeat, by financing shortfalls--also argue for a possible future enlargement, both to respond to greater justified needs with larger support and to provide better terms. I am therefore in favor of returning to the question of extension and enlargement at a slightly later, more appropriate time.

Mr. Schoenberg made the following statement:

We share the staff's overall assessment that the Fund's financial involvement under the STF at an early stage of the transformation process has served a useful role as a "paving" mechanism for upper credit tranche programs and has clearly supported initial policy changes in transition countries. In principle, we also share the view that the facility was adequately designed, contributing thereby to initiate a process of stabilization, to launch market-oriented reforms and to improve countries' policy implementation capacity. Notwithstanding these beneficial effects it must be noted, however, that the Fund has taken considerable risks as a consequence of frequent strong "frontloading," limited catalytic effects of stand-alone STF-supported programs, and the unexpectedly slow-moving transformation process in a number of countries. Therefore, we welcome staff's proposals for improving the effectiveness of STF-supported programs, aiming primarily at enhancing the required adjustment efforts.

The staff's recommendations comprise many of the suggestions that have been put forward by Executive Directors in earlier Board discussions of STF requests. However, as we are approaching the present deadline for new STF requests, one might wonder whether a somewhat earlier discussion of this review would have offered the chance of a more profound effect on improving the implementation of the facility. Anyway, we assume that the thrust of the staff's suggestions, most of which will probably be supported by today's discussion, will be taken into account adequately in any still forthcoming STF-supported programs.

I have a few short remarks on individual suggestions. We share the staff's view that using more extensively prior actions would contribute to reducing the risk of inadequate or insufficient implementation of policy measures in major policy areas resulting from insufficient domestic political consensus. This applies, in particular, in those policy domains that require the broad-based understanding and political commitment of parliament and major interest groups. Prior actions can also be considered an appropriate counterpart to frontloading of STF-supported programs.

We agree with the staff's suggestions on how to speed up the process of imposing hard budget constraints on state enterprises. In this context it should be noted that, considering the frequent lack of financial resources and managerial capacities, a broad-based privatization approach, open to foreign financial and human capital, would facilitate the imposition of hard budget constraints.

The staff rightly points out, that an early reform of the tax system and the tax administration and prudent revenue assumptions are essential prerequisites to keep any fiscal program on track. The integration of a quickly growing private sector and often sizable underground economies into the tax system constitute a particular challenge for the tax policies in transition countries. In light of these structural circumstances, the use of indirect taxes, at least in the initial transition stages, seems to be advisable before eventually subjecting the economy to higher direct taxes.

Apparently, the efficiency of the advice provided by various sources is still controversial. The relatively high costs for foreign experts, the lack of coordination among different advisory institutions, and sometimes contradictory advice are also frequently criticized. It would be interesting, therefore, to learn how Directors representing the interests of countries with STF-supported programs assess the effectiveness of technical assistance and where they would see room for improvement.

Last, and most important, as regards securing financing commitments, the staff states that "stand-alone STF-supported programs have generally not been successful in catalyzing needed financing," thus contributing to "significant shortfalls of official external financing."

This experience confirms our view that the Fund cannot, and therefore should not try to, commit bilateral donors by calculating the financing needs of STF-supported programs and designating the financing gaps remaining after the Fund's contribution to bilateral creditors.

Creditor countries have entered the commitment to use their "best efforts" to "help close any financing gaps." From that undertaking the Fund should not conclude that any financing gap will quasi-automatically be covered by donor countries. Rather, staff should examine carefully what amounts of financing can realistically be expected to be forthcoming from donors and then construct STF-supported programs that allow the attainment of their objectives with the financial resources available.

While I agree with Mr. Mesaki that there is little point in trying to "coerce," or persuade, donors to increase the level of their commitment, I do not quite agree with his view that there is no need to close projected financing gaps. Instead, I believe that reasonable assurances of the full financing of Fund-supported programs are an important principle of Fund lending. Even though I agree with Mr. Mesaki that the projection of financing gaps for transformation countries engaging in stand-alone STF-supported programs is regularly burdened with large uncertainties, this cannot mean that the Fund would rely on the hope that somehow large remaining financing gaps will be closed during the course of the program. The appropriate reaction for taking into account such uncertainties should be to integrate financial reserves into the program or to formulate contingency measures to be activated if the need arises. While the consequences of so-called shortfalls in official external financing can, indeed, be severe, as Mr. Havrylyshyn notes, the question arises whether going ahead with an underfinanced program might create even more severe difficulties. So, although I am aware that STF purchases are subject to "softer" financing assurances than purchases under regular Fund-supported programs, I am inclined to urge management and the staff not to take overly large risks in this regard.

In this context, it is worth mentioning that the World Bank does not consider stand-alone STF-supported programs a sufficiently strong basis for its structural and sectoral adjustment programs and that some donor countries have--for similar reasons--declined to participate in the financing of such programs. The question might also be asked whether the conditionality of stand-alone STF-supported programs needs to be strengthened in order to keep the initial financing gaps as small as possible and, at the same time, enhance donors' preparedness to help close such gaps.

Ms. Lissakers made the following statement:

We were surprised that the staff took such a cautious view in their assessment that, overall, the STF has helped begin the process of stabilization and economic reform but that the experience has, nonetheless, been quite uneven and has exposed the Fund to unusual risks. In our view, the STF has, in fact, been a great success and done what it was designed to do.

We should remember that a number of the countries that have utilized the STF, such as the countries of the former Soviet Union, came into existence only three years ago. They were born with huge disadvantages. They had little or none of the legal, tax, and other administrative infrastructure needed for independent statehood. As was discussed by Mr. Kiekens this morning, their political leadership was often weak and divided. They had no experience with national central banks and no commercial banking sector. They began life with virtually no understanding of market economics, had few international trade relations beyond the Soviet command system, were saddled with obsolete physical capital, and had no foreign exchange reserves. They were then hit with the loss of large subsidies from the former Soviet Union, and with an extraordinary terms-of-trade shock as the price of their energy imports soared to market levels. In short, these countries faced unprecedented challenges in extremely adverse economic circumstances. Under those conditions it was simply unrealistic to expect that many of the transition countries could meet the high standards needed to qualify for full Fund programs.

The STF met a critical need at this unique time, and we should not downplay its successes. The more flexible arrangements of the STF allowed the Fund to engage these countries, and the financial leverage provided by the STF made those countries willing to engage with the Fund. Nearly all of the countries that have utilized the STF still have far to go to become stable market economies. But compared with their starting points, the progress is truly remarkable. As the staff paper notes, all of the countries made significant progress in exchange market liberalization, and all but Belarus in price and trade liberalization. Inflation has been brought down from its peaks of 1992 and 1993. Budget discipline is increasing.

Perhaps equally important, the Fund engagement with these countries, made possible by the STF-supported program, has played a huge role in educating the leadership of these countries about the political economics of market economies. Three years ago, government leaders did not understand market basics, such as that subsidies funded by central bank credits produce inflation and debase national currencies. Today, officials in these countries are increasingly sophisticated in their thinking, and the Fund deserves much of the credit. We often speak of the Fund's catalytic role in the form of its lending, but in the context of the countries of the former Soviet Union, I think its catalytic role in policy formulation and basic economic education has been perhaps even more important.

For these reasons, we think the judgment that "overall, the staff would consider that the STF has served a useful role as a paving mechanism" to be unduly reserved. In our view the STF has served an essential role in paving the way for reforms and for full Fund-supported programs, and I must say I would be very surprised if my colleagues from transition countries do not share this view about the central role played by the policy dialogue as a bridge to real economic reform.

The staff paper notes that many of the STF-supported programs, particularly in the countries of the former Soviet Union, were not fully implemented. This should not be interpreted as failure of the STF-supported programs. Full Fund programs in other countries routinely go off-track, but we do not necessarily conclude those programs are failures. Despite varied experiences with arrangements under the STF, nearly all of the transition countries are presently following Fund-supported programs, either under the STF or, increasingly, under full Fund arrangements.

We would note that, owing to the timing of the paper, it did not discuss the most recent STF-supported programs in Ukraine, Armenia, Georgia, and Uzbekistan. These countries' willingness to embrace market reforms with Fund support, under arrangements under the STF, is further evidence of the success of the STF. Ukraine's dramatic turnaround from its failed attempt to preserve its state-run legacy to an embracing of market reforms has been a tremendous success, at least in setting a new policy direction, and thus owes much to Fund support under the STF; having successfully implemented its STF-supported program, it has now moved to a full stand-by arrangement. The story of Ukraine and of the other recent countries with arrangements under the STF not discussed in the Fund paper gives additional reasons to regard the STF as a success.

A number of transition economies, particularly in the countries of the former Soviet Union, continue to face extraordinary needs and challenges as they complete their transition to market economies. The process of economic restructuring to overcome decades of "misdevelopment" has only started. Some countries continue to reel under the twin shocks of losing their old Soviet subsidies and shifting to market prices on energy imports. Their external financing needs are extraordinary.

They have yet to develop adequate social safety nets to cushion the pains of transition and to remove obstacles to restructuring.

In light of these continued extraordinary needs, we continue to believe that the STF should be augmented to include the possibility of a third STF drawing, and the life of the STF itself should be commensurately extended; I hope we can come back to this issue before April 30.

The staff suggests that greater financing assurances should be sought for arrangements under the STF and that stronger prior actions should be required. In view of our assessment of the utility of the STF to date, I do not see a compelling reason to change either policy.

The paper also notes that programs should place more emphasis on developing social safety nets for displaced workers in order better to impose hard budget constraints on state enterprises. We agree that this is a top priority, and should be more fully addressed under the extended and augmented STF.

Mr. Kiekens made the following statement:

The staff has prepared a well documented paper, which draws some lessons from the STF experience. I agree with the staff's overall assessment that the STF has fulfilled its purpose in paving countries way to more standard Fund arrangements and of improving their capacity to implement sound macroeconomic policies. I fully agree with Ms. Lissakers that the STF played a major role in catalyzing the general understanding of market economics and of the need to implement stabilization and restructuring reforms by the political leadership in the transition countries.

Of the 18 countries whose STF arrangements were approved between April 1993 and December 1994, only Georgia and Armenia have at present no stand-by arrangement in prospect. When we look at the comparison tables in Appendix II, with the wide variety of transition countries' problems in mind, we must acknowledge that the STF has an additional major advantage not noted by the staff--namely, flexibility. Recognizing that the STF has served its purpose well does not prevent us from recognizing that countries' performances under the STF have been generally mixed and consistently poor with STF stand-alone arrangements, as opposed to performances under normal stand-by or ESAF arrangements. A paragraph discussing this comparison would not have been out of place.

Nonetheless, the positive outcomes achieved by the countries that implemented their programs more or less as planned show that also in difficult initial circumstances sound policies can still give results. Fiscal consolidation remains the cornerstone of successful adjustment. In the transition countries it is also the area where progress is most difficult, since it involves a shift away from the central economic role of the state and since it makes time to establish a working revenue system. The inflationary pressures that result from the failure to accomplish fiscal consolidation are a great obstacle to the signals and incentives essential to economic activity under the market system.

Like Mr. Calderón, I was struck by the fact that the countries that were most successful in implementing an STF were those with the strongest prior actions. Despite the high level of uncertainty generally surrounding STF-supported programs, prior actions seem reliable to indicate a high degree of program ownership and a strong commitment to reform on the part of the authorities. Since prior actions seem to increase the probability of success, it seems desirable to promote them as a means of protecting the Fund's financial position. These actions should focus not only on the budgetary area but also on structural issues, especially hardening the budget constraint of enterprises since soft budget constraints are often a factor undermining stabilization efforts. In this connection, it is important to involve all enterprises in the reform effort. Many STF-supported programs have gone off track because not enough attention was paid to the accumulation of interenterprise arrears and the evasion of bankruptcy procedures.

An issue that the staff neglected, on which I would have liked some elaboration, is whether transition countries are generally now in a position to accept programs with stronger conditionality, since this might have provided an occasion to debate the question of prolonging a temporary facility like the STF. Nonetheless, the paper does contain some elements of an answer to that question.

First, there remain only a few potentially eligible members--three countries of the former Soviet Union, several Eastern and Central European countries, and a few countries in the Middle East. Several countries have not expressed any interest in the STFs and the rest are engaged in policy discussions with the Fund but have been slow in reaching a consensus for initiating reforms. I believe we should consider the possibility of closing the STF window--not immediately, but after a reasonable time. Doing so would bring pressure on these few remaining eligible countries to keep moving, if they wish to avail themselves of their last chance to undertake a reform program to be supported by an STF arrangement.

Second, it is noteworthy that the STF has little effect to catalyze financial support, which shows that in the eyes of the creditors the STF is less highly regarded than the Fund's stand-by arrangements. As countries have moved on from STF to stand-by arrangements, financing from other sources has materialized, showing that its failure to appear in parallel with the STF was due mainly to the absence of a strong program. The same holds true for debt relief and for cofinancing from the World Bank.

It is also worrisome that six countries had an uncovered financial gap at the time their first purchase under the STF was approved. This imposes risks on the Fund and may lower the quality of the adjustment. It can lead to disorderly adjustment due to extreme import compression and accumulation of arrears, further undermining the political feasibility of the reform process. The staff speaks of the need to obtain better cofinancing for STF-supported programs but without increasing their perceived strength, which means moving the STF closer to stand-by arrangements. This will hardly be possible.

Mrs. Cheong made the following statement:

One of the major conclusions drawn from the staff's paper on the review of operations and experience under the STF, namely, that a combined stand-by arrangement- and STF-supported program is more successful than the stand-alone STF-supported program, is not very surprising. This is because the underlying factor contributing to the success of the combined programs has been a Fund arrangement with strict conditionality requirements, in contrast with the stand-alone arrangements under the STF, which are virtually devoid of any conditionality. This conclusion is consistent with the findings of the study on policy experience and issues on the Baltic countries, Russia, and other countries of the former Soviet Union, which states that stability, the main ingredient of conditionality, is an important precondition for economic recovery.

This evidence of effectiveness of conditionality provides a useful lesson for future facilities. When the STF was newly introduced, it seemed justifiable then to have a stand-alone STF without conditionality, as the authorities were not familiar with the market-based system and did not have basic institutions and policy instruments in place to initiate reforms.

However, in hindsight, the poor results of the stand-alone STF seem to indicate that Fund lending would achieve better results if based on conditionality. The staff and other Directors have referred to prior actions. I would like to go further and say that such prior actions should be made lending requirements, along the lines of Fund conditionality. In the case of initial lending to countries in transition, the traditional macroeconomic target type of conditionality would not have been appropriate. Nevertheless, some form of conditionality, obviously of a different category, if applied, could enable these initial loans to yield more positive results. At the early stage of moving toward a market economy, some of the prerequisites for market-based reform are institution building to facilitate market oriented pricing mechanisms, re-establishing effective revenue system, and designing a payments mechanism to substitute for the bilateral payments arrangements. These are some examples of requirements that could be incorporated as conditions for the stand-alone STF. Such requirements would then necessitate the member to seek Fund technical assistance. Hence, if such conditions or prior actions had been made prerequisites for progressive disbursements, the slow progress arising from delays in accepting or in implementing technical assistance recommendations might not have occurred.

The lack of conditionality in stand-alone STF arrangements was also a factor in the slow response of the international community. As Mr. Mesaki pointed out, donors were apprehensive about giving support in the absence of credibility regarding economic policies. In other Fund lending arrangements, such as under the ESAF, the Fund's involvement generally spurred the confidence of bilateral and private sector participants. This characteristic was lacking with stand-alone STF arrangements. Donors and creditors did not provide financial assistance for programs supported by stand-alone STF arrangements, and there were difficulties in seeking approval of debt relief from official bilateral creditors. Even upfront disbursements did not quell uncertainties of economic prospects of these countries. As Mr. Kiekens noted, the objective of the STF, which is to engage creditors and catalyze their resources more effectively, was not realized, so that Fund lending failed to achieve this important catalytic effect. This is an important consideration because in serious cases of macroeconomic instability, the issue is not the size of lending, as financial requirements are usually extremely large. The Fund alone cannot fulfill all the funding needs. Instead, the role of the Fund lending is to pave the way and create confidence for other countries to move in to fulfill the financing needs. I believe that adjustments in the transitional economies would have been more rapid if the STF had incorporated a different set of conditionality at the institutional level to build up the prerequisite institution building. This could create the confidence of donors that transition economies have been preparing the groundwork to provide the basis for macroeconomic adjustment at the next stage. I believe Mr. Schoenberg also made a similar point.

I understand that this meeting will only address the technical aspects of the facility. I presume that the issue of the future of this facility, which is due to expire by the end of next month, will be appropriately addressed at another forum.

Mr. Havrylyshyn observed that many parliamentarians in Ukraine had objected to the STF purchases because of the tight conditionality associated with them. As the STF was used by countries that had no prior track record under Fund-supported programs, donors were reluctant to commit themselves to parallel financing. The misconception about weak conditionality continued to affect a number of member countries that sought stand-by arrangements with the Fund, after paving the way with the STF.

Mr. Daïri noted that the Fund's catalytic role in financing had to be closely linked with the prior actions required under the STF. It was a mistake to attempt to attract supporting foreign financing during the implementation of a STF-supported program. Donor support should be sought at the time of the implementation of prior actions, before the first drawing under the STF. Prior actions constituted a critical mass of reforms that the Fund could support with perhaps greater access to the STF, and that donors could support with cofinancing. Donor countries could consider the critical mass of reforms as a demonstration of the real commitment of the authorities. By requiring countries to strengthen prior actions, the STF could play a more useful role in policy implementation and catalyzing donor financing.

Mr. Kiekens observed that the conditionality of the recent STF purchases had been stronger than that for purchases approved earlier. In particular, the Board had considered that the STF-supported program for Ukraine was roughly equivalent to a stand-by arrangement. Nevertheless, the STF was associated with relatively weak conditionality because of the absence of reviews.

Under the STF, the Fund's financial support to member countries provided for a relatively long repayment period of ten years, Mr. Kiekens remarked. By contrast, the European Union provided credit only for three years, and transition countries were currently confronted with the need to repay those loans at a time when their balance of payments did not allow them to do so.

Mr. Schoenberg noted that political considerations played an important role in the allocation of donor financing. Donor countries wanted to know whether the adjustment programs of individual countries would succeed and what chances the donors had of getting their money back. At the same time, they had also noted that countries that had made purchases under stand-alone STF-supported programs had relatively smaller private capital inflows.

The Chairman observed that it had been useful to examine whether the STF had indeed paved the way to stand-by arrangements, and whether it had catalyzed donor financing. The Fund had not intended to combine stand-by arrangements with STF purchases, although there had been cases in which the combination would have been desirable.

Mrs. Cheong agreed with Mr. Kiekens that the ESAF reviews demonstrated a steadfast commitment to macroeconomic stabilization, thereby enhancing confidence of the markets and attracting donor financing. The reviews served to make sure that bilateral donors and private creditors had a realistic view of the economic performance of the country.

Mr. Autheman made the following statement:

> I was not a member of this Board when the decision was made to create this temporary instrument, so I can pay my compliments to my predecessors and colleagues who are still here for this wise decision, and especially for their ability to innovate within the framework of our Articles.
>
> The STF was designed to allow the rapid involvement of the Fund in economies in transition that were not yet able to implement a stand-by arrangement. It was also designed to allow these countries to move rapidly, as rapidly as possible, to a stand-by arrangement. Judging from Table 2 of the staff paper, which is complemented by the information on the recent second purchases under the STF of Belarus and Estonia, as well as the prospects for stand-by arrangements with Russia, Ukraine, Belarus, Macedonia, Armenia, and Georgia, I believe that this basic purpose has been fulfilled.
>
> It is true that in some cases it took longer than expected to move to a stand-by arrangement or to have the prospect of a stand-by arrangement. But I doubt very much that anyone could seriously argue that the implementation of comprehensive programs of stabilization and reform has been delayed by the existence of the STF. On the contrary, given the need to build a dialogue with new authorities, and, often, given the initially very weak institutional infrastructure of many countries in transition, I think that the STF has, in many cases, allowed for a more rapid move toward a stand-by arrangement, that is, toward the implementation of our standard conditionality. So, I would conclude that the STF has served a very useful role, both as a paving mechanism and in the process of transformation itself.
>
> On the items for discussion proposed by the staff, I do not have much to say about items A to D. I do not think that they specifically relate to the STF but rather to our relationships on a general footing with countries in transition, as I do not think that there is much of a case now for considering a stand-alone STF. The need for prior action is not, in my view, exclusively related to the STF; it is related to our relationship with these countries. In fact, I would find more reason to consider prior

actions in future stand-by arrangements than in past arrangements under the STF. As we have now had experience from our relationship with these countries, we have been able to build a common understanding; so I would put emphasis on future prior actions.

I have no specific comments on items B, C, and D, which were covered in this morning's discussions.

On item E, I am not a great believer in the merits of technical assistance, and I think that we should continue, and in some cases begin, to constrain supply in order to take due account of the absorptive capacity of the countries.

Like Mr. Mesaki, I was somewhat disappointed by the staff's assessment on point F, namely, the failure to catalyze financing. First, we learned, if we did not know it already, that the calculation of the financing gap is more an art of negotiation than a science of arithmetic. I would not go as far as Mr. Mesaki, who tends to conclude that the staff, in calculating financing gaps, usually estimates how much each donor will commit, as we have a clear demonstration that the staff often overestimates; but I am receptive to that view. It is possible that financial shortfalls contributed to the difficult implementation of some programs, but I would not overemphasize this factor. It seems that policy slippages have played a major role. One could also see several cases in which the reluctance of bilateral donors to provide support has sent to the authorities a clear signal that their commitment to reform fell short of what was needed.

So this limited external financing may have been a handicap in the short term, but when you look at longer-term perspective, it seems to me that the strong commitment by donor countries to stand-by conditionality has sent the right message to the countries concerned, that they should not expect to receive significant support unless they move rapidly to satisfactory conditionality. I would have appreciated a different balance in the staff paper on that issue.

I tend to talk of the STF as a past instrument, first, because I do not see much ground for a stand-alone STF, at least as of less than six months ago, when we were less optimistic about the prospects for stand-by arrangements with countries in transition. And, of course, one could see a case for keeping the STF as a joint instrument, but we need to reflect on the advantages and disadvantages of applying different access policies which would be the outcome of a prolonged use of the STF.

The Chairman asked whether Mr. Autheman preferred to terminate the STF, or keep it as a way to augment members' access under stand-by arrangements.

Mr. Autheman said that it was important to recognize that the STF was a transitory instrument. He would be willing to reconsider the broader issue of increased access limits, if the staff so recommended.

Ms. Lissakers agreed with Mr. Autheman that the STF was a temporary instrument that had been designed for a specific purpose. Its use could be justified for a limited period for taking care of the special problems of some countries in an early stage of transition.

Mr. Kiekens considered that access under the STF could be increased for the existing as well as new programs that could be approved before the scheduled termination of the temporary facility. As Ms. Lissakers had said, much needed financial support to the transition countries could be provided through an increase in access to the STF.

Weak conditionality had not been the only reason that sufficient financing had not materialized, Mr. Kiekens observed. Political considerations had also played a role. In some cases, creditors had not provided enough financing even when the financing gap had been reasonable and stabilization efforts had been satisfactory.

The threat of termination of the STF had induced Uzbekistan and Azerbaijan to use it, Mr. Kiekens concluded. Other member countries might be similarly persuaded to use the facility. If, after a reasonable period, countries failed to use it, then the Board should regard the STF as no longer transitory.

Mr. Al-Tuwaijri made the following statement:

> I join other Directors in commending the staff on their comprehensive and informative paper. I found the lessons that are drawn from the STF experience particularly useful as they could be applied to Fund operations in general. I am in broad agreement with the thrust of the staff conclusions, and would make a few comments for emphasis.
>
> The most relevant lesson that can be drawn from the STF experience is that Fund conditionality is much more important than Fund financing in mobilizing donor assistance, either in the form of new financing or in the form of bilateral debt relief. The general failure of stand-alone STF-supported programs in catalyzing needed financing should send a clear message in this area. Thus, it will be useful for the Fund to focus more on strengthening conditionality and less on doling money. I make this as a general point, not only specifically to the STF.
>
> The second general message that emerges from the paper is the need for the Fund's technical assistance recommendation to take into account the country's capacity to implement these recommendations. The lack of appropriately trained staff,

adequate infrastructure, or the necessary statistics in many STF- and non-STF-eligible countries should be assessed first. The disappointing results in revenue mobilization from newly introduced tax measures in many countries are mainly due to inadequacy in these areas. In this connection, I fully agree with the staff that training should be emphasized. Here, cooperation with the World Bank, the United Nations, and regional organizations would be most useful. Coordination with national authorities that are providing training on a bilateral basis would be also most helpful.

The third general lesson that could be drawn from the paper is the substantial impact of public enterprises' behavior on the success of the stabilization effort. As the staff rightly points out, the STF experience has underscored the importance as well as the difficulties of imposing hard budget constraints on state enterprises. Fund experience with many programs not supported by the STF would lead to the same conclusions. Thus, I fully agree with the staff's emphasis and recommendations in this area.

The final general lesson from the paper that I would emphasize is the importance of prior actions in areas where policy measures need legislative approval, which is a point emphasized by previous speakers. It is encouraging to note that the staff has already been paying more attention to this area in recent STF-supported programs. Such emphasis could be also useful in many programs not supported by the STF.

Finally, considering what has been said by Mr. Autheman and Ms. Lissakers with regard to the future of the STF, I have one question for the staff. Considering that few members appear likely to seek STF support outside the framework of an upper credit tranche arrangement, and in view of our increased access policy, does the staff foresee a role for STF in the future?

Mr. Evans made the following statement:

I think when our predecessors set up the STF the four main objectives were to encourage stabilization, help develop market economies, provide additional resources, and pave the way to upper credit tranche programs. We knew that the STF would involve a greater risk of failure because of the very nature of the countries involved, with no track records, and so on.

We have to ask to what extent it is appropriate for the Fund to take these kinds of risks, and whether providing these resources at an early stage did speed up the stabilization and reform process. In a real sense, the jury is still out on all this. We will only be able to judge when we see the results of the stand-by arrangements.

Taking a narrow view, which is arguably what the paper does, I think one can say that the results were rather mixed. I think in a more fundamental sense--and here I agree more with Ms. Lissakers and some other speakers--the STF has been an unusual and imaginative facility directed at economies suffering the most profound weaknesses. The STF has been an important signal of the Fund's and the international community's support of several countries in the most difficult of circumstances. I do believe it has provided a vehicle for earlier, more intensive Fund involvement. The "John the Baptist" role of paving the way has been, as Mrs. Mesaki says, pretty successful.

For the most part, countries did move straight on to upper credit tranche arrangements, and incentives to make progress were there. In the case of Russia, which received a second stand-alone tranche, I believe this was a useful tool for maintaining the momentum of stabilization efforts at a time when the conditions for a stand-by arrangement could not be met.

I agree with the staff about the frontloading nature of the STF. This clearly reduced the leverage. Prior actions took on greater importance.

I think the staff is right to conclude that stronger prior actions might have been required in a number of earlier programs. I think this has been largely right in more recent STFs. We should encourage prior introduction of more legislation to send a positive signal on commitment to Fund programs.

On external financial support, I endorse what Mr. Autheman said and most of what Mr. Mesaki said in his statement. I do believe that the role of catalyzing additional external financing properly belongs to the stand-by arrangement with its tighter conditionality. The availability of external financing is an important incentive for countries to graduate rapidly to the upper credit tranche arrangement. I would ask the staff to clarify its call for the strengthening of the mechanisms here.

Mr. Autheman referred to the calculation of financing gaps as art rather than science. That seems to be exactly right. I think there is a large amount of invention necessarily in these numbers, particularly once they extend more than a few months ahead.

Mr. Schoenberg raised the question of financing assurances. I differ from him there in the sense that it was more important to get on with the reforms than to be certain about the extent of financing assurances.

Mr. Autheman's warning on technical assistance struck a chord here. There is evidence that quite a bit of our technical assistance has been continued well beyond the point of serious returns. We ought to better evaluate it and cut it off when it is not effective.

Finally, on the possible extension and enlargement of the STF, I share Mr. Havrylyshyn's view, and that of Ms. Lissakers, that we should return to this issue.

The Chairman said that Mr. Evans's view that catalyzing financing must be associated with stand-by arrangements only was not consistent with the view that his predecessor had expressed at the time of the creation of the STF.

Mr. Kang made the following statement:

I believe that the staff has managed to present a well-balanced review of our experience with the STF. I say this bearing in mind the difficulties in drawing firm conclusions about the effects of the programs, given that the initial conditions in the countries concerned varied greatly; the short duration over which the study was conducted; and the limited number of cases available for consideration.

To the extent that the STF is a catalytic facility, it seems to have been reasonably successful. However, I tend to agree with the staff's conclusion--and the comments of Mr. Calderon and Mr. Mesaki--that greater emphasis on establishing prior actions in key areas requiring a broad political commitment would have improved outcomes. As Mr. Mesaki points out, prior actions are an effective way of testing the strength of authorities' commitment to reform, and they provide an additional safeguard to Fund resources to supplement conditionality. Indeed, the benefits of prior action in terms of achieving program goals and protecting Fund resources applies equally to other Fund facilities such as the stand-by arrangements and the ESAF.

The staff does a good job of looking back at the operations and experiences under the STF. But, as others have said, we need to look forward. In that context, at some stage in the near future we will need to consider whether there is a continuing need--or even demand for--the STF to be further extended beyond its expiration date of April 30. Although there is the potential that eligible members could make first purchases under the STF, most have not expressed an interest in doing so. Moreover, there is little demand for the facility that cannot be handled in other ways, although I understand that there are two remaining countries of the former Soviet Union that will not be in a position to make purchases before the April 30 deadline, but may eventually wish to. Perhaps the staff might like to comment.

While the member countries' demand for the STF may have diminished somewhat, we should resist the temptation to move some countries on to upper credit tranche arrangements before they are capable of meeting the associated conditionality. And I expect that any weakening in conditionality in an upper credit tranche arrangement is reflected in a lower level of access. Compromising the quality of these facilities would not be in the long-term interests of the Fund as an institution and would not be consistent with the Fund's core roles and responsibilities.

Mr. Koissy made the following statement:

Like previous speakers, we welcome this review of operations and experience under the STF, which provides us with the opportunity, not only to reassess the strengths and the weaknesses of the facility at this critical stage of the implementation of the Stabilization and Reform Programs, mostly in Eastern Europe and the FSU countries, but also, to make pragmatic recommendations that could improve its usefulness.

From the comprehensive staff before us, it is quite clear that the results achieved so far by the 18 countries have availed themselves of the facility have been rather. Thus, while on the economic stabilization front, progress has generally been slow, owing, inter-alia, to weaknesses in policy implementation capacity, we note that a substantial effort was made on the structural front, particularly in the development of a market economy in most of the countries concerned.

As we broadly share the staff's view that, "overall, the STF has served a useful role as a paving mechanism," I would limit myself to a few points where we see a clear need for improvement in the operations under the facility.

First, on ways to improve the implementation of policy measures so as to achieve the objective of economic stabilization, while we agree with the staff on the need for prior actions in order to broaden the authorities' political commitment to the program, we would, request that such prior actions be limited in their number and well targeted to the most critical areas of the program. Moreover, these prior actions should take into account the social and political environment of the country so as to avoid undue delays in the adjustment process. We are also of the view that technical assistance should be made available to the countries whenever prior actions are needed and for which these countries do not yet have the capacity to implement them.

Second, the new approach that the staff is proposing for dealing with the state enterprises appears to us realistic and we can support it. In particular, we see merit in focusing more on the development and the implementation of the legal framework of these enterprises as well as the design of privatization plans and social safety nets for displaced workers, rather than imposing hard budget constraints on the state enterprises. On this, I will like to agree with the view expressed this morning by Mr. Kiekens on the need for putting emphasis on the building up of institutional and structural reforms in transition economies. Experience has shown that this is also valid in other cases.

Third, key to the success of any program is the availability of trained local staff that could design and monitor the implementation of policy measures. The staff has recognized the weaknesses in human resources in some of the countries concerned. Therefore, we would encourage the Fund to provide to those countries the needed technical assistance they might request. We would also urge other multilateral institutions to join the Fund in that process.

Finally, it is worrisome to note that stand-alone STF-supported programs have generally not been successful in catalyzing needed financing. In this regard, we can go along with the staff's suggestion aimed at strengthening the mechanisms for securing financing commitments and for monitoring developments through periodic financing reviews. However, further information on the operational aspects of the mechanism that the staff is proposing would be appreciated.

With these comments, we would like to reiterate our support for the STF and wish every success to the countries in economic transition who have, so far, availed of it as a spring-board for the formulation of programs that could be supported by the Fund under the existing facilities.

Mr. Lanciotti made the following statement:

Creating a new facility to face the challenging difficulties of the economies in transition was certainly not an easy task two years ago, when the Executive Board approved the new STF. The design of the new instrument was the result of an effort that involved, in the words of the Managing Director, "creativity, a cooperative spirit, and an appropriate sense of urgency to that important task."

Indeed, in spite of the mixed results so far obtained, the facility was the most appropriate tool to cope with new challenging events, which certainly required a special effort by our institution. All in all, the experiment can be deemed broadly satisfactory, in my view, having enabled the benefiting countries to start the process of stabilization and market reform and the Fund to involve new member countries into a close and systematic relationship with the rest of the membership. Today's candid evaluation of our experience with the STF during the past two years can, nonetheless, help us to refine this instrument, should it be extended for a while in the future.

In particular, I would like to touch upon some of the main points already raised by previous speakers, namely those concerning the issues of conditionality, prior actions, and external financing.

The excellent paper prepared by the staff shows that the large differences among STF-supported programs, both in the prior action content and in the design of the final targets, was intended to favor economic stabilization and market reforms in a heterogeneous group of countries which started from extremely difficult background economic conditions and therefore were not in a position to benefit from a full-fledged Fund arrangement.

In the light of this two-year experience, only some of the countries involved recorded appreciable success in the achievement of the targeted outcomes. Such a diversity raises serious questions about the different level of conditionality embedded in the various programs.

As far as this point is concerned, I feel uneasy about the staff's remark that a lack of financial assurances has threatened the achievement of program objectives and that, therefore, a strengthened external assistance coordination would have been needed. While I agree, in principle, with the importance of a better harmonization of external financing, I nonetheless would like to observe that rather than strengthening the mechanism to assure adequate external financing, the Fund should possibly reinforce the program design itself.

Indeed, the scanty ability of a stand-alone STF-supported program to raise sufficient financing, both official and private, can be partly ascribed to its transitory nature--as it is only intended to pave the way to a more comprehensive adjustment program and hence implies a softer policy commitment--and partly to its technical character. In fact, the upfront disbursement structure of the facility heavily diminishes the level of effective conditionality embodied in the STF-supported programs.

In this regard, I certainly agree with the staff's suggestion that the recourse to prior actions in the design of the programs be extended. As noted by Mr. Calderón, compliance with the program targets in the successful cases has been primarily ensured by those actions requiring political decisions and broad-based social agreements, such as parliamentary approvals.

A more pragmatic and homogeneous formulation of the programs which would be warranted by a larger prior action content would help catalyzing the needed additional financing more than any strengthening of the mechanisms for securing financing commitments as well as for monitoring economic developments. A rapid and successful transition to the stand-by arrangement remains, ultimately, the best way to access external financing, as the stricter conditionality of the stand-by arrangement is the most suitable guarantee for international creditors.

Mr. Kaeser made the following statement:

The economies in transition were confronted with a wide array of complicated issues concerning macroeconomic stabilization, structural reform and institution building, which had to be addressed at the same time. These countries were also provided with completely inadequate institutional structures and legal bodies for the establishment of a market-based economic system. The chaotic dissolution of the COMECON and of the Soviet economy lead to further shocks and a virtual breakdown of the trade and payment systems. We have already expressed some views on these problems in our statement for the first item of today's Board meeting.

With the creation of the STF, the Fund assumed its responsibility and responded in a timely fashion. It met the challenge of assisting these economies in their efforts to address this situation and integrate with the world market. The STF has also proved useful to the Fund in entering into early policy dialogue with the new governments and enhancing the practical knowledge of the specific problems of economic transition.

Considering the enormity of the task, and the fact that the STF was merely designed to pave the way to the long-ranging transition process, we can say that this credit mechanism has been, by and large, successful, as noted inter alia by Ms. Lissakers.

The staff has focused its review on a relatively small number of stand-alone STF-supported programs. The results of the review, as presented, allow for drawing a number of conclusions for future programs, under the STF or in the upper credit tranches, in transition countries.

In this sense, the staff makes full account of a rather mixed experience under STF-supported programs in different countries. An initial remark is that the STF has certainly been instrumental in initiating reforms, but that it has been much less successful in catalyzing additional financial support from other sources. Oftentimes it did not inspire the necessary confidence in a government's commitment to reform and in the stability of the reform effort. In this respect, it is interesting to note that, in particular, STF programs apparently did not often sufficiently convince bilateral donors. Alternatively, it could be noted that the financing assumptions were often too ambitious and optimistic, with a potential for frustration and failure when they are not met. It could thus be concluded that the strategy to move ahead with a program, often on the basis of mere indications of donor support was not sufficiently strong. In a number of cases, it left the Fund exposed to risks even higher than the already existing unusual risks, to cite the staff, implied by the STF's design.

Although the STF-supported programs; at least have the potential to trigger significant progress in reform the first programs; at least have covered periods in which some countries were still looking for, or experimenting with, alternative reform paths. This did not help to spread a convincing message of unfaltering political commitment for reforms. Furthermore, this sometimes contributed more to political disorientation than to economic clarification, and this at a time when much internal explanation and persuasion regarding the benefits of reforms was necessary.

A third remark is that the first STF-supported programs also came in a period of "learning-by-doing" for the Fund. As a result, its policy guidance was not always consistent over time. This remark holds particularly true with regard to trade and currency issues in the countries of the former Soviet Union, which were compounded by problems with the payments system. I have repeatedly drawn attention to the Fund's varying recommendations in these areas, and I will not repeat these remarks. However, the review shows that the problems faced by the countries of the former Soviet Union seem to be of a different--more severe--nature than those faced by the other transition countries. I generally concur with the conclusion drawn by the staff. With a stronger accent on prior actions in newer programs, a step in the right direction has been made. Greater efforts in such areas as public enterprise reform, privatization, and the establishment of targeted social safety nets should contribute to building a stronger political consensus prior to a program, and should help to strengthen confidence in reform commitment and thus enhance the chances for success. However, I have a major criticism to formulate on the STF-supported programs designed by the staff and approved by the Board. With the benefit of hindsight, we see that these programs have been overambitious in the fight against inflation. I am not pleading for gradualism. I am, like my colleagues, convinced that economic stabilization and economic reform should be implemented expeditiously if they are to be successful. But I see that the most advanced and successful countries in transition still post inflation rates in the range of 20 percent a year after four years of successful transition, whereas the countries of the former Soviet Union were asked to bring down inflation to 1 percent a month at the end of the first year under an STF-supported program.

The philosophy behind this overambitious performance criterion is that "if you have to cut the tail off a cat you had better do it with one stroke." The results of this veterinarian therapy have been disappointing. Everything looks fine for several months under an STF-supported program. But because their fiscal systems are not yet able to collect enough revenue to finance the vital functions of the state, and because economic sectors that are not yet privatized are powerful enough to extort financing from either the budget or the central bank, after several months we register, in many countries, a relaxation of the fiscal and monetary disciplines and the programs go off track. After a short break, they have to come back on track. In order to do so, they have to take Draconian and unsustainable measures, like sequestration or sharp expenditure cuts. This kind of "stop-and-go" is, to say the least, not enhancing the public acceptance of the transition process. Therefore, I think that it would be better to place at the outset greater emphasis on structural reform and perhaps technical assistance, and to set for the first year a somewhat less ambitious and more realistic inflation target.

Mr. Kaeser, adding to his statement, said that he would have preferred not to discuss the extension of the STF. As the current conditionality under the STF was quite close to that under the stand-by arrangements, it should be possible to use stand-by arrangements as a regular means of helping the countries of the former Soviet Union.

In his constituency, Turkmenistan was not yet ready to conclude an arrangement with the Fund, but wished that the Fund would conclude a stand-by arrangement with Ukraine, which would help to resolve the problem of the payment arrears to their country, Mr. Kaeser observed. Similarly, a stand-by arrangement with Russia could indirectly help Tajikistan, which appeared not to be in a position to use Fund credit.

The Chairman replied that Tajikistan was eligible to use the ESAF, and by doing so could reduce its costs of credit.

Mr. Kaeser replied that it was difficult to determine when Tajikistan would enter into an arrangement with the Fund. Even if the Fund discontinued the STF, the first credit tranche would still be available to Tajikistan.

Mr. Dlamini made the following statement:

Developments in an adjusting economy do not usually follow the program script and, therefore, we should not be surprised that the results of Fund's operations under the STF have fallen short of expectations. However, I can subscribe to the general conclusion that the facility has served the purpose for which it was intended. The facility has provided financing at a critical period, which has helped countries in transition to begin the process of moving from a command to a market-oriented economy. Moreover, a number of these countries have proceeded to put in place strong adjustment programs that could be supported by the Fund under stand-by arrangements.

Although the experience with STF-supported programs has varied widely, and successful programs have been somewhat limited, there are lessons that the Fund can learn to enable it to help the countries concerned move the transformation process forward. In this regard, some of the key observations are as follows:

It appears that the more successful countries are the ones that have been able to mobilize the necessary political consensus at an early stage, enabling them to take strong initial actions. In this connection, the development of appropriate safety nets is one important step towards making the difficult process of economic transformation more widely acceptable.

Even though the countries have been encouraged to make adjustments on all fronts, it would appear that the sequencing of structural reforms is an issue that requires further consideration. In this connection, institution building should be given higher priority as a precondition for the implementation of other critical measures of reform, such as financial and trade liberalization.

The slow process of privatization mirrors what we have often witnessed in a number of countries, even in those where the enabling legislation is already in place. We need to set realistic goals, given that investment decisions in the private sector tend to be affected by a number of factors that are usually beyond the control of the authorities.

Timely and adequate external financing is critically important for successful adjustment. One of the problems with STF-supported programs was that they were not very successful in attracting the necessary level of external assistance. What is important to note is that the problem of external financing shortfall is more widespread. One consequence is that adjustment entails a greater burden on domestic absorption, with a potentially negative impact on economic growth. If growth is not to be too strongly affected in the short term, some accommodation would have to be made with regard to the speed of adjustment.

Finally, the importance of technical assistance cannot be overemphasized in situations where the administrative capacity for implementing strong and comprehensive programs remains fundamentally weak. Thus far, the Fund has responded remarkably well to the circumstances of the economies in transition.

Mr. Bergo made the following statement:

To begin with, I would like to commend the staff for this interesting and well-written analysis of the experiences under STF-supported programs.

Although a number of factors makes it difficult to draw firm conclusions--the relatively few cases of stand-alone STF purchases, the short duration of most of these programs, the wide variation in initial conditions, and poor data quality--I agree that the review provides a useful basis for some preliminary observations about the effectiveness of the approach taken.

Of the earlier statements made by Directors, I found myself in almost total agreement with Mr. Kiekens' main statement, and can support also many of the views of Mr. Kaeser, Mr. Autheman, and others. I can thus be fairly brief and will concentrate my remarks on whether the STF can be said to have fulfilled its main aims, and on the steps that could be taken to strengthen performance under future programs.

The ability of the STF to pave the way for a stand-by arrangement may not have been as strong as anticipated, and it is somewhat disappointing that some countries have yet to begin the process or have encountered serious setbacks. Moreover, many countries making use of this window of opportunity have failed to maximize their use. In particular, it has taken a longer time than expected to proceed from an STF arrangement to a stand-by arrangement. At the same time, it is difficult to claim that the STF has not served a useful role in promoting the reform and stabilization process, not least because the outcome of any alternative strategy is unknown; and more pronounced failure in the needed transformation process could have had serious implications for the entire international monetary system. Moreover, the establishment of the STF has, in general, allowed the Fund to provide financial assistance at an earlier stage than otherwise possible; and has thereby helped begin the process of stabilization in many cases and helped to build needed working relations. However, success has been uneven, and economic disparities have increased among the transition countries.

Experience from the "good performers" suggests that policy design and conditionality have been appropriate under the STF, and that lack of stabilization in most cases has been a result of faltering policy implementation. In particular, building consensus for reform has in several cases taken much longer than anticipated. Taken as a whole, I tend to agree with the staff that the STF has served a useful role as a paving mechanism for a normal Fund arrangement.

My conclusion regarding the role of the STF as a paving mechanism for external financing regrettably has to be more negative. Thus, it is evident that stand-alone STF purchases generally have proven to be insufficient in catalyzing external financing so far, and that limited access to external financing may, to some extent, reverse the stabilization process in these countries. The result is that the Fund has been exposed to unusual risks. At the same time, the STF might have played a role as an indirect catalyzer of external financing at an earlier stage than otherwise would have been possible, namely, to the extent that it speeded up the implementation of a normal Fund arrangement.

Let me now turn to the lessons to be drawn from this review.

I agree with the staff that overall policy conditions appear appropriate, but that experience suggests a number of steps that could be taken to strengthen performance under STF-supported programs. Here I am in broad agreement with the suggestions mentioned in the concluding remarks, and I am encouraged to see that, to some extent, those lessons have already been taken into account in the most recent programs. As the number of future stand-alone STF purchases may be limited, I would also hope that these valuable lessons are integrated into the formulation of future Fund arrangements in general.

In addition, the review clearly illustrates that STF-supported programs must be designed so that sufficient measures to secure steadfast policy implementation are taken. I would also like to emphasize the need for more extensive use of prior actions, and that greater attention should be given to prior actions involving implementation of technical assistance recommendations and strengthened commitment to implement such recommendations, for example, concerning tax reforms and improvements in tax administration. Thus, I fully agree with the staff statement on page 32 of the staff paper that: "greater success in program implementation was linked to the strength of prior actions, particularly those requiring parliamentary endorsements of key elements of the program." In this respect, it is encouraging to take note that recently approved programs have recognized the importance of prior actions, as clearly illustrated by comparing Table 11B of the paper with Table 11A. I would also support some stricter monitoring of the implementation of measures during the program period, where some phasing of payments could be considered as a way to strengthen the incentives.

Finally, on the unsuccessful role of the STF in catalyzing needed external financing, I can agree with the staff that a strengthening of the mechanisms for securing financial commitments and for monitoring developments through periodic financing reviews would be appropriate. However, it is of equal importance that the design of the program is formulated in a way that makes the financing need commensurate with realistic assumptions on external financing. As an increase in access under the programs would only raise the already high Fund risks, it may require more ambitious adjustment measures, especially in view of the need for the staff to take a cautious and prudent line regarding program assumptions.

Mr. Clark made the following statement:

I agree with the assessment that the STF has served a useful role as a "paving" mechanism. I generally concur with the staff's conclusions in relation to future STF drawings and as they pertain to Fund stabilization programs in these countries more broadly. I will just make three points.

The raison d'être of the STF was to facilitate and encourage the stabilization process in those members undergoing systemic transformation of an unprecedented magnitude. One of the primary motivations behind its conception was the recognition that these countries needed to build up the necessary administrative and institutional capabilities in order to implement a more profound stabilization effort. Thus, it is quite disappointing that there have been difficulties for some members in accepting, let alone implementing, the Fund's technical assistance. I support the staff's suggestion for linking the implementation of the Fund's technical assistance over an agreed timetable as a part of an overall set of prior actions.

With regard to the failure of the STF to catalyze external financing under stand-alone purchases, other speakers have addressed this issue with respect to official donors and creditors. However, the aspect that I found perplexing was that financing from the World Bank did not materialize as expected under the STF. Is this something that we should have been better able to foresee at the outset? Considering how important it is for there to be structural transformation and improvements in capacity for these countries to achieve and sustain macroeconomic stabilization, it is perhaps troubling that the World Bank ruled out structural and sectoral lending as a result of what they considered a insufficiently strong macroeconomic framework under

STF-supported programs. The World Bank cites insufficient implementation capacity on the part of recipients as an additional factor. I would like to ask that Mr. Evans and Mr. Autheman use their good offices to ensure that the Bank is taking steps to help the countries improve their implementation capacity.

Like Mr. Mesaki and most of the speakers this afternoon, I believe that the STF has played a critical role in familiarizing members undergoing systemic change with the role and working practices of the Fund and the workings of a market economy, more generally. With more and more members moving to upper credit tranche arrangements with the Fund, it is not a surprise that our standards for performance under the STF should be enhanced. The STF is a time-dependent facility. As time passes and opportunities arise, there are fewer and fewer legitimate reasons for members not to be in a position to undertake stronger stabilization programs. Thus, one can envision that stand-alone second purchases will become a thing of the past.

Finally, I agree with Mr. Kiekens that the STF window should be phased out eventually, but that is likely to be after April 30, 1995 and I look favorably on a proposal to extend the April 30 timeframe.

Extending his remarks, Mr. Clark said that the implementation of technical assistance recommendations should form part of prior actions required under a Fund-supported program.

Mr. Saito made the following statement:

If we take into consideration that the principal aim of the STF has been to pave the way to upper credit tranche financing for countries at the very early stages of the transition process, we can agree with other speakers that the facility has been quite successful. Most of the countries that made STF purchases on a stand-alone basis have adopted, or are expected to adopt, a Fund-supported program in the near future. However, if we take into consideration the actual progress in key areas of the systemic transformation process, particularly in countries of the former Soviet Union, the results leave much to be desired. Many countries in this region did not implement basic adjustment and structural measures that were part of their initial STF commitment. Some might argue, therefore, that the STF, by providing financing without the proper degree of conditionality, has helped to slow down the pace of reforms. This would certainly be a wrong conclusion, because even those countries that failed to implement needed measures had the opportunity to experience the road they had to travel and the obstacles that will need to be overcome in order to reach sustainable growth and a harmonious working relationship with the international financial community.

The obstacles are indeed enormous, starting with the lack of consensus within governments on the breadth and pace of reform, continuing with the weak institutions, policy instruments, and databases, and concluding with the limited availability of appropriately trained staff. I concur with other speakers that in these circumstances the greater use of prior actions that recently approved programs have incorporated is a welcome development, and I encourage the staff to persist with this policy.

Regarding the difficulties in drawing firm conclusions about the effects of the STF-supported programs, I have found that several observations by the staff reveal the fact that the traditional benchmarks to measure the success of a program should be applied with some caution. For example, output performance in the cases of Belarus, Moldova, and Russia was better than projected owing to "the slow pace of enterprise restructuring, which allowed continued production of obsolete goods, many of which accumulated as stocks." Reserve targets, in turn, were all met, with the exception of Belarus, but "in the context of substantial import compression and/or higher-than-projected interstate or other external arrears." In the fiscal area we also find that in the cases of Belarus, Moldova, and Russia, ad hoc budgetary measures such as sequestration and cash rationing were implemented in order to contain the deficit, but at the cost of much higher public sector arrears with spillover effects to the whole of the financial system. It seems, therefore, that a general approach is needed in order to evaluate progress with STF-supported programs. The staff paper highlights the interactive and complementary nature of the three main objectives of the programs: macroeconomic stabilization, development of a market economy, and improvement in policy implementation capacity. This imposes the need to reach simultaneous progress in these areas in order to qualify as a successful program. I consider that this should be an important part of the understanding between the Fund and member countries that wish to avail themselves of purchases under an STF-supported program.

I encourage the staff, therefore, to emphasize this point in its discussions with the authorities.

Mr. Mohammed made the following statement:

At this stage of the discussion, I shall limit myself to a few remarks on some of the main conclusions the staff has drawn from their review of operations and experience under the STF.

Overall, I share the staff's assessment that the STF has served a useful role as a "paving mechanism." There have been, to be sure, varying degrees of success or failure across the cases reviewed, and the staff rightly concludes that the experience with the facility has been quite uneven. Several factors could plausibly account for this uneven experience, and the staff identify a number of those. While the circumstances of the countries that have received STF support were distinctly different in important ways from those of countries with more traditional forms of Fund support, there is a considerable overlap between the factors cited as underlying the uneven performance under the STF, on the one hand, and those associated with other Fund arrangements or facilities, on the other.

One lesson that the staff draws from the experience under the STF is that use of prior actions has reduced the risk of inadequate policy implementation and that relative success in some programs appears to have been associated with legislative prior actions on key elements of the program. The qualifying phrase "key elements" that the staff uses is very important, and the absence of such a qualification from Mr. Calderón's several references to prior actions is notable. The point I wish to make here is simply that the risk of inadequate policy implementation can obviously be eliminated altogether by a broad use of prior actions. It is equally obvious, however, that such use of prior actions, particularly in areas requiring legislative action, is not risk-free, as it could easily lead to costly delays in the adoption and implementation of adjustment and reform programs. Thus, while not questioning the desirability or even the necessity of prior actions in certain areas, I think that selectivity is critically important. An important question that should be asked before insisting on a prior action in a particular area is whether such action is deemed essential to the success of the adjustment effort.

The limited availability of appropriately trained local staff is cited as having interfered with the timely implementation of technical assistance recommendations. Again, this is not uncommon in the experience under other Fund arrangements. A key to resolving this problem lies in placing greater emphasis on the training element of technical assistance.

Finally, I agree with the staff's recommendation to strengthen the mechanisms for securing financing commitments and for monitoring developments through periodic financing reviews. It is regrettable that stand-alone STF-supported programs have generally not been successful in catalyzing needed financing. The perception of weak conditionality may have something to do with this outcome, although I have to say that when the STF was established it was our understanding that, notwithstanding its "paving" character, the facility was to catalyze, not substitute for, support by others, including other international institutions. This situation calls for shortening the paving period as much as possible. But there are limits to how far the countries can go without adequate external financing in the interim.

Mr. Wei made the following statement:

The staff should be complimented on their excellent work in preparing a review paper on the STF for today's discussion. Although the tentative conclusions are based mainly on qualitative analysis, I find the overall tone of the assessments encouraging. Generally speaking, limited experience has shown that the facility has served its purpose well in providing a paving mechanism to members undergoing balance of payments difficulties resulting from systemic changes. Today I shall confine my comments to a few areas.

First, I agree with the staff that to facilitate the success of programs under the stand-alone STF, prior action in key areas is effective in galvanizing broad-based support for the program. In addition, such prior action is conducive to helping ensure the safety of the Fund's financial resources by providing a better chance of successfully implementing programs.

Second, the path taken by the Fund in setting up the STF has demonstrated its ability to adapt to the changing world economy. The STF plays an important role for members moving toward a conventional Fund arrangement. More important, it is expected to play a catalytic role in attracting financial assistance from other sources to enable the program countries to address their difficulties. We believe that financing assurances from other sources are important and indispensable to the successful implementation of programs.

Third, I am fully aware of the difficulties facing program countries in imposing hard budget constraints on state enterprises and in building the necessary infrastructure for macroeconomic management and a functioning market economy. For almost all the countries under review, an underlying institutional and legal framework was lacking or nonexistent before initiation of transformation. Therefore, institution building is as important as macroeconomic stabilization in the early stages of transformation. The Fund's technical assistance is critical in this regard. I appreciate the staff's great efforts in providing technical assistance to program countries in all areas of Fund expertise. On the part of the program countries, greater efforts are needed to implement the recommendations along the lines provided by the staff. An important part of the Fund's technical assistance in relation to the STF should be attached to training government officials to serve the mission of transformation to a market economy. In this respect, we commend the Fund for the establishment of the Vienna Institute, which has played an important role in training officials from transition countries.

Finally, the authorities in these countries are encouraged to double their efforts to improve their statistical systems so the programs can be implemented and monitored better.

Mr. Mozhin made the following statement:

I believe this review of operations and experiences under the STF is important and pertinent. It has been almost two years since the Fund established a totally new facility to assist a group of countries directly or indirectly affected by transition to a market economy. Since then, 19 countries in Europe and Asia have resorted to this facility, bringing the amount of allocated resources to SDR 3.5 billion.

It is worth mentioning that this Board's decision to extend the STF first purchase deadline until April 30, 1995 was reasonable and justified. It allows two more Fund members to take advantage of the facility. Without this extension, these economies would have been left out. In January 1995 we approved an STF drawing for Uzbekistan. Discussion of Azerbaijan's request for purchase under the STF is scheduled for April 19. This would bring the number of STF recipients up to 20.

The overall assessment of STF experience, in my view, is positive. As a group of member countries, the STF became the first experience of practical interaction with the Fund. The very process of discussions and program preparation did allow the respective authorities to address the crucial issues. Not in a few cases the negotiations with the Fund contributed to strengthening of the reform policies and of the reform wing in the governments. And it is very important to maintain and develop this dialogue framework and channel of mutual communication.

In the field of macroeconomic stabilization under the STF, however, progress has been mixed, which is clearly demonstrated in the staff paper. Along with success stories when inflation was reduced down to targeted levels--Cambodia, the former Yugoslav Republic of Macedonia, and the Slovak Republic--there are also opposite cases when stabilization was not achieved.

One might argue about how strong the correlation between an STF-supported program and macroeconomic performance has been, and whether success or failure of monetary stabilization simply coincided in time with implementation of the program. More substantial differences can be revealed if transition economies are analyzed by the type of policy pursued--money-based stabilization versus exchange rate based stabilization--as in the other staff paper for today's discussion, on an overview of policy experience. Anyway, even in problematic cases performance under the STF was usually better than prior to it. Another argument would be that no program is risk-free and that there have been stand-by arrangements that did not succeed, despite a much stronger conditionality and monitoring than under the STF.

We would agree that apart from macroeconomic measures, preparation and implementation of STF-supported programs has contributed significantly to systemic and structural reforms, though here too performance varies from country to country. The staff rightly points out the progress in price liberalization, trade and exchange system modernization, financial and fiscal system reforms, and improvement of national statistics.

The STF was from the outset designed as a bridge towards more advanced Fund arrangements, namely, stand-by arrangements and arrangements under the ESAF. As a matter of fact, STF-supported programs were followed by Fund arrangements in the majority of cases, especially if we add here the forthcoming stand-by arrangements with Ukraine, Russia, and the former Yugoslav Republic of Macedonia. In the process of implementation, however, there emerged a notion of stand-alone STF-supported programs, to reflect the reality of respective countries and their degree of readiness to take commitments under a stand-by arrangement.

It would be fair to mention that notwithstanding the quick disbursing nature and reduced conditionality of the STF as such, there was no automaticity in the concession of STF arrangements to all eligible countries before they adopted appropriate policy packages. I am referring to the fact that countries like Ukraine, Armenia, Georgia, and Uzbekistan made first purchases under the STF in late 1994 only, and some others have not drawn at all.

With respect to the issue of the possible extension and augmentation of the STF, I agree with a number of previous speakers that it would be appropriate to discuss this issue separately at some later date.

Looking now from a slightly different angle, the implementation of the STF-supported programs has promoted mutual acquaintance and learning between the Fund staff and local staff in the respective program countries. Informational and intellectual breakthroughs such as those achieved under the STF-supported programs could not be accomplished otherwise, say, in the course of regular technical assistance missions of the Fund.

In conclusion, I would like once again to emphasize that by creating the STF and making it work to the benefit of market-oriented economic transition, the IMF has once again demonstrated its great flexibility and ability to promptly respond to global challenges.

Mr. Suárez made the following statement:

In light of the radical institutional and policy transformations required in the economies of transition, of their varying degrees of prior market experience, of their differing underlying political situations, and of the severity of their financial constraints and other economic disequilibria, it is not surprising that progress under the STF has been uneven. Nonetheless, I would concur with the staff and previous speakers that the STF has served a useful role as a paving mechanism towards the development of market-oriented economies.

As other Directors have noted, the adoption of prior actions has been critical in contributing to the greater success of the STF in some of these economies. This has been the case because such actions reflect either a greater effective political commitment to the transformation process, a more stable underlying political situation that makes it less difficult to achieve the necessary consensus, a sounder institutional framework, or a combination of these factors.

It is clear, however, that where prior actions have been stronger the programs have generally been more successful, and that recently approved programs have correctly increased emphasis on prior actions. This is particularly important in light of the relatively low degree of conditionality of the STF and the consequent need to safeguard the Fund's resources, as pointed out by Mr. Mesaki.

On the policy front, it is also clear that where fiscal, monetary, and exchange policies were implemented as envisaged, macroeconomic results were satisfactory and program targets were better achieved. So I agree with Mr. Havrylyshyn that there is little reason to suggest different approaches in this regard. The question is whether some transition economies were better able than others to adopt the envisaged policies because of better underlying institutional conditions, as well as better statistics and more favorable conditions for political consensus building. I suspect this is probably the case.

It seems, therefore, necessary to continue to emphasize technical assistance for institutional building, such as tax administration, legal infrastructure, and statistical capabilities, among others, and the concomitant training requirements of local staff, in order to continue to strengthen prior actions and the necessary capacity for policy implementation. The development of appropriate safety nets for displaced workers should also be given priority, as a means of accelerating privatization and thereby facilitating greater budgetary discipline and efficiency. Concentrating on privatization and well-focused technical assistance programs could also contribute to catalyzing needed external financing and to advancing toward the use of other existing Fund facilities.

Mr. Havrylyshyn points out that it is not clear from the staff paper that the record for the STF is any worse than that for upper credit tranche arrangements, and it would be desirable for the staff to comment on possible comparisons with other Fund-supported programs. We stand ready for further discussions on the future of the STF.

The Deputy Director of the Policy Development and Review Department said that the STF had been useful to several new member countries. Although conditionality under the STF was somewhat different from that under a typical stand-by arrangement, it was not a "soft" facility. The focus of the facility was on urgently needed institution building in new member countries.

The creditor countries had encouraged the Fund to assist the stabilization and adjustment efforts of new member countries at an early stage with financing based on somewhat easier terms than the Fund typically stipulated, the Deputy Director remarked. Despite donors' promises, countries making stand-alone STF purchases had experienced difficulties in mobilizing adequate donor financing.

As Mr. Havrylyshyn and Mr. Kiekens had pointed out, it was difficult to project accurately the financing requirements of the countries that were using the STF, the Deputy Director observed. However, shortfalls in financing had affected adversely the countries' adjustment programs, resulting in a lower level of exports and a higher level of arrears. As a result, the Fund's ability to encourage countries to move toward a stand-by arrangement had been constrained.

If there were to be further stand-alone purchases under the STF, more emphasis would need to be given to securing additional financing, the Deputy Director said. Although the Fund could not force the donors to commit resources, it could improve the effectiveness of the mechanism for securing their commitments. For example, efforts could be made to organize early meetings of consultative groups in order to determine financing requirements, and periodic reviews of the progress toward securing financing could be strengthened.

At the beginning, the Fund had not anticipated that the World Bank would not support policy-based lending, the Deputy Director remarked. The Bank had proceeded with import rehabilitation loans, but only after the establishment of the STF. The shortfalls in World Bank financing were basically due to administrative problems associated with familiarizing the authorities with the procedures required for borrowing. Nevertheless, the World Bank should be urged to lend greater support to the STF.

Few remaining countries were likely to be eligible and might be interested in the STF, the Deputy Director concluded. As Mr. Kaeser had mentioned, it was difficult to ascertain how quickly Tajikistan might qualify, or whether it would be interested.

Mr. Kiekens said that financing was crucial for the economic sustainability of an adjustment program. The leaders of the countries concerned faced difficulties in convincing their populations and parliaments to adopt strong adjustment programs. If the Western countries would not support those programs with adequate financing, their political sustainability would be in danger.

The Chairman made the following concluding remarks:

> Many of the substantive policy issues related to the experience under STF-supported programs were covered during our discussion this morning. I will therefore confine these concluding remarks to the following points.
>
> Executive Directors generally agreed that the STF had played a very useful role in allowing the Fund to provide financial assistance to members at an early stage in the transformation process, and in helping these members begin the process of stabilization, market-oriented reform, institution building, and establishing working relations with the Fund and other creditors and donors. Overall, the facility had served as an effective "paving mechanism." Although progress toward Fund arrangements had taken longer than expected in some cases, most of the countries that had used the facility on a stand-alone basis had subsequently adopted a Fund arrangement with upper credit tranche conditionality, and the others were expected to move to such arrangements in the near future. For other countries that had made STF purchases in the context of a stand-by arrangement, the facility had provided resources on longer repurchase terms and, in some cases, in greater amounts than would have been available solely under a stand-by arrangement.
>
> While the experience under programs supported by stand-alone STF purchases had been mixed and too limited to draw more than tentative conclusions, Directors considered that there were several areas in which greater emphasis could have led to stronger program implementation.
>
> Directors agreed that prior actions had helped to improve program implementation, particularly in those areas where political consensus was critical. They were encouraged that

recent STF-supported programs had placed increased emphasis on prior actions.

Directors noted that imposing hard budget constraints on state enterprises had proved particularly difficult in many cases. Effective measures to strengthen programs in this regard were essential to convince enterprises that there would be no government bailouts.

The general problem of revenue weakness during the transition process pointed to the need for cautious assumptions regarding revenue performance and early action on tax reform and improvements in tax administration. Directors noted the extensive technical assistance that had been provided in these and other areas in the context of STF arrangements and they believed that emphasis should be placed on ensuring the effective implementation of technical assistance, including training to improve implementation capabilities. Our technical assistance resources are scarce, and we must see to their effective use. An evaluation of some areas of our technical assistance is being put in train with a view to assessing its effectiveness; its results will be presented to the Board.

A number of Directors noted that stand-alone STF purchases had not been fully successful in catalyzing financing from other sources. Some felt that the problem was related to a perception by creditors and donors that the STF was not paving the way rapidly enough toward a comprehensive program, which could be supported by a stand-by arrangement. Shortfalls in financing had posed risks for programs and for the Fund in providing its own early support and was an area that needed to be given close attention in the event of further stand-alone purchases.

Differing views were expressed regarding the future of the STF, an issue to which we will return soon in the context of our preparations for the forthcoming meeting of the Interim Committee and, anyway, before April 30.

Mr. Autheman said that it would have been useful to emphasize that part of the difficulty of mobilizing additional financing had been due to donors' strong preference for comprehensive programs that could be supported by a stand-by arrangement.

The Chairman replied that too much emphasis on the preferences of donors might encourage them to wait for a stand-by arrangement before providing the needed financing.

Mr. Evans observed that the reference to technical assistance in the concluding remarks seemed to be rather more encouraging than he himself had expressed. Although his Government provided substantial technical assistance to many countries, he believed that resources devoted to less effective technical assistance could be better used elsewhere.

The Chairman remarked that the Fund's technical assistance, particularly in the monetary field, had enabled the central banks of Ukraine, Russia, and several other countries to implement monetary policy using modern instruments. However, he agreed that ineffective technical assistance should be discontinued. An independent evaluation of the effectiveness of technical assistance would be presented to the Board during 1995.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/95/25 (3/17/95) and EBM/95/26 (3/20/95).

4. SWEDEN - SELECTED BACKGROUND ISSUES - PUBLICATION

The Executive Board approves the proposal to publish the background paper for the 1994 Article IV consultation with Sweden as an Occasional Paper. (EBD/95/37, 3/13/95)

Adopted March 17, 1995

5. APPROVAL OF MINUTES

The minutes of Executive Board Meeting 94/44 are approved.

6. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAM/95/41 (3/16/95) is approved.

APPROVAL: November 26, 1996

LEO VAN HOUTVEN
Secretary