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Statement by the Acting Managing Director
on the States of the Former Soviet Union
Executive Board Meeting 92/94
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The Managing Director and I have reported to Executive Directors on Russia on a number of occasions, and you will consider the Russian authorities' request for a first credit tranche arrangement on August 5. On this occasion, I would like to update Executive Directors on developments in the states of the former Soviet Union (FSU) other than Russia. Given the general interest in these countries, and the fact that no papers on these countries will be issued to the Board before the recess, Executive Directors may welcome this opportunity to hear about recent developments.

Economic Developments

There have been many similarities in the economic developments of the states of the FSU. All were severely disrupted by the collapse of the old central planning system, which has yet to be replaced in most countries by well-functioning markets. Although the old regime has remained stronger in some places, such as Ukraine, Moldova, Azerbaijan, Uzbekistan and Tajikistan, than in others, it has not protected them significantly from the general decline in output. Disruptions in trade between the states of the FSU and a lack of financing for imports from elsewhere have aggravated the general output situation. Monetary disturbances in the form of growing substantial interenterprise arrears (including interrepublican arrears) and a shortage of cash have also contributed to the decline in activity.

Incomes in most states of the FSU other than Russia have also been hit by the deterioration in the terms of trade in those cases where they import oil or gas from Russia and other FSU states; and some of the lowest income countries have been further hit by the loss of transfers from the Union budget.

In most of the states of the FSU, output is now expected to be down 20-25 percent in 1992 compared to 1991. There are signs in a number of countries that the fall in output has been diminishing in recent months. A separate note will be circulated to Executive Directors with further details and tables on economic developments and policies in each country.

Economic Policies

There appears to have been a greater variety of policy responses than of basic economic conditions. Regarding price liberalization, some countries are still controlling the prices of some basic consumer product. such as bread, meat and dairy products. There has been little change in this since the Pre-Membership Economic Reviews, but the general cost of

subsidization in those countries retaining price controls has been rising as inflation has persisted at a high, though falling, rate throughout the region. There have also been strong pressures, which have been accommodated in some countries, for increases in budgetary producer subsidies and subsidized credits, especially to agriculture.

Since the Tashkent meeting on which the Managing Director has already reported, little progress in improving the arrangements for the coordination of monetary policy in the ruble area has been made. Only two members of the ruble area other than Russia have raised the central bank finance rate to 80 percent, following the Russian move on May 29. Similarly, the exchange rate has been unified only in a very few states. Russia has now started bilateral negotiations with other ruble area members, aimed at agreeing a set of rules for monetary policy. The Fund staff is advising the Russian working group on ruble area issues on these agreements and other matters, making this advice available to other ruble area members at the same time.

There is a growing sentiment among all members of the ruble area other than Russia that their interests might be better served by introducing their own national currencies. They have been influenced in this by a perception that they will continue to have little if any influence over monetary policy decisions, by the shortage of cash supplies, and, in some cases, by increasing doubts about Russia's ability to stabilize the ruble or provide cash. As the degree of commitment to the ruble area has diminished, some of its members have felt less constrained from issuing excessive amounts of central bank credit. This has been most pronounced in the case of Ukraine, but has occurred in a number of countries. However, in others the ruble shortage has sharply constrained credit expansion, and credit policies have ended up being considerably tighter than in Russia.

Despite the shift in favor of the introduction of national currencies, only a few countries have recently added their names to those which have already announced a clear intention to introduce their own currency. After Estonia, which introduced the kroon on June 20, Latvia freed the Latvian ruble from the Russian ruble on July 20, and now in effect has a separate currency although its official new currency, the lats, will not be introduced for another few months. Lithuania, Ukraine and Moldova are still intending to introduce their own currencies, although the timing is unclear in the case of Moldova. Azerbaijan has recently announced its intention to introduce a currency in mid-August initially as a parallel currency alongside the ruble. Belarus has already introduced a parallel currency to act as a supplement to the ruble because of the cash shortage, but it remains in the ruble area for the time being. There are reports that Georgia is planning to move in the same direction within the next couple of months. Some other states are now actively preparing contingency plans to introduce their own currencies if discussions with Russia on monetary arrangements are not successful in the coming months.

Many states of the FSU are grappling with major budgetary pressures, with the problems being especially acute where subsidies are large,

transfers from the Union have been lost, and there are no natural resources available to provide a relatively painless source of revenue. There have been some successes, especially in the Baltic countries: Estonia and Latvia are both planning balanced budgets in the second half of 1992, despite above average falls in output and deteriorations in the terms of trade, and the absence of natural resources. Good progress is being made in some other countries, notably Kazakhstan and Kyrghyzstan. There are, however, strong pressures in many countries to increase expenditure, especially subsidies and credits to producers, and very large fiscal deficits could occur in those countries if these pressures are not resisted.

The need for structural reform is accepted in the vast majority of countries. Considerable progress has been made in the preparation of privatization programs and in corporatization of state enterprises. Mass privatization, usually through voucher schemes, is more often found now in these programs. Considerable progress has also been made in the privatization of housing. On the other hand, demonopolization is proceeding slowly.

Fund Activities

The Fund staff has visited most of the states of the FSU several times in recent months to discuss economic reform and stabilization programs. In nearly all cases the staff has discussed with the authorities memoranda of economic policies which cover similar ground to the memorandum of economic policies in Russia which Executive Directors saw in March. In a few cases, the discussions about policies have evolved into negotiations over a letter of intent. This process is most advanced in the case of the Baltic countries, and I am pleased to inform Executive Directors that the staff reached agreement, ad referendum, with the Latvian authorities on a letter of intent at the beginning of this week. It is our intention to issue a staff report on Latvia next month, so that Executive Directors can consider a request for a stand-by arrangement before the annual meetings. Negotiations on a program are currently under way with Estonia, and the indications are that they will soon be successful, so that the Board can consider a request for a stand-by arrangement on a similar time table. For Lithuania, negotiations will be resumed in the second half of August.

Other countries where we foresee a realistic possibility of reaching agreement on a program within the next few months include Belarus, Kazakhstan and Kyrghyzstan. The authorities are keen to move ahead fast and progress is being made. However, much work still remains to be done in these countries, and at least another two missions to each will be required. It is not possible at this time to predict how long the process will take, or whether it will in fact be possible to reach agreement.

In all these countries considerable financing requirements are envisaged. The usual financing assurances will be required before the requests for stand-by arrangements will be brought to the Board. In the case of the Baltic countries the process of obtaining financing assurances

has already begun within the G-24 chaired by the EC Commission. It is hoped that the meeting in Brussels next week will establish that sufficient financing will be forthcoming for these three countries to enable the programs to go ahead. In the case of the other countries, it is intended to seek financing assurances in the context of consultative groups for each country. The World Bank will chair these groups, and the Fund will take the lead in work relating to balance of payments financing. The Bank is planning to launch this process in a series of meetings in the capitals of potential donors and creditors, beginning next week. The initial series of meetings will focus on Kazakhstan and Kyrghyzstan, and will not discuss specific financing requirements. The Fund staff will participate. When agreement is reached between the Fund staff and a country about a program, the World Bank will arrange a consultative group meeting for that country in order to seek financing assurances. Fund staff will keep Executive Directors informed of developments in advance of such meetings, as has been done in the case of the Baltic countries.

The Fund staff has been discussing the major elements of a suitable economic reform and stabilization program with Armenia, and a staff visit to Yerevan is currently in progress. However, the regional conflict is having adverse economic effects, both direct and indirect, which will make it difficult for a program to achieve its economic objectives. The staff has, therefore, indicated that the prospects for being able to conclude negotiations on a Fund supported program are likely to depend on, among other things, a diminution of the impact of the conflict on the economy. The same would hold in the case of Azerbaijan where, however, discussions on a program are at a very preliminary stage, partly because of recent governmental changes.

Four European II Department missions to Ukraine in the past seven months have been preparing the ground for negotiations on a program that could attract Fund support. The outline of a possible memorandum of policies was left with the authorities in May, on the understanding that the staff would return in June to discuss the Government's considered response and begin quantifying program objectives. In the event, no such response was forthcoming, and policy discussions were confined to the problems of short term crisis management. In the meantime, monetary and fiscal policies have become markedly weaker, and a sharp acceleration in inflation is a distinct possibility unless policies are changed. The impact of this situation on the stability of the ruble is causing concern among the Russian authorities and is damaging economic relations between Russia and Ukraine. Ukraine has agreed with Russia to leave the ruble area by October 1, but much clearly remains to be done to ensure the satisfactory introduction of a fully independent monetary policy and currency.

Extensive technical assistance has been rendered to all states of the FSU in the last few months. The emphasis has been on providing advice on changes in the fiscal, monetary and statistics systems which could be implemented quickly and which would improve the prospects for the success of economic reform and stabilization programs in the near future. However,

advice about longer-term institutional improvements has also been provided. In addition to providing guidance in the area of tax and expenditure policies, the Fiscal Affairs Department has also provided advice aimed at improving fiscal management through strengthening budgetary procedures, establishing a Treasury, reforming tax administration, and streamlining and targeting social safety nets. The scope of technical assistance from MAE has been comprehensive, covering all major central banking functions in order to support the immediate operational and structural changes needed for effective implementation of monetary and exchange policies. Mission work has been concentrated most on Ukraine and those countries, such as the Baltics, Belarus, Kazakhstan and Kyrghyzstan, which are closest to effecting economic reform and stabilization programs with Fund support. In all cases clear recommendations have been left with the authorities, who have often expressed their great appreciation for the Fund's contribution in these areas. However, the implementation of the recommendations has often been slow or non-existent. The IMF Institute has not only included participants from the FSU in its courses in Washington, but has also conducted short courses for high level officials in a number of FSU states, and longer courses in Moscow. Courses at the Joint Vienna Institute will begin next month.

The Fund staff has continued to cooperate closely with other international institutions, member governments and central banks. MAE technical assistance has been supported by experts from 22 cooperating central banks and staff from BIS and OECD. Cooperation with the World Bank has been close, with Fund staff relying on Bank staff to provide advice on many areas of structural policies, and Bank staff following Fund staff advice on macroeconomic policies. There has been virtually no overlap between the work of the Fund and the other international and multilateral institutions such as the EBRD, the EC Commission and the OECD, but there has been full exchange of information about each other's activities.

The placement of resident representatives and advisers in the states of the FSU is progressing satisfactorily. There are now two resident representatives in Moscow, and one each in Estonia and Lithuania. Others will take up their posts in Kazakhstan, Kyrghyzstan, Latvia, Moldova and Ukraine in the next few weeks, and in Belarus a little later. We are in the process of confirming or seeking to identify resident representatives for the other countries. In addition, resident advisers in central banks are beginning to take up their positions. Advisers in Lithuania and Ukraine have already begun their assignments and advisers in the Central Bank of Russia will begin soon. These advisers are on secondment from cooperating central banks.

A separate note will be circulated to Executive Directors with further details of missions, resident representatives and advisers, and membership status.

Conclusion

As the Fund's familiarity with the states of the FSU increases, the diversity of economic situations and policy responses becomes more apparent. Management and staff will tailor the activities in each country according to its specific circumstances. But whatever these may be, there can be no doubt that the contribution which the Fund can make to economic reform and stabilization is very great indeed, and will continue to justify a major, and probably growing, allocation of our resources in this direction.