

International Bank for Reconstruction and Development

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FROM: The Deputy Secretary

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EXECUTIVE DIRECTORS' MEETING - DECEMBER 14, 1993

Modification to IBRD's Negative Pledge Policy with
Respect to Lending for Investment Projects (R93-199, R93-199/1)

Statement by Mr. Thalwitz

Attached is a copy of the statement on the above made by Mr. Thalwitz at today's meeting of the Executive Directors of the Bank.

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MR. THALWITZ'S RESPONSE ON THE NEGATIVE PLEDGE WAIVER
IN THE BOARD MEETING OF TUESDAY, DECEMBER 14, 1993

Thank you, Mr. Chairman.

I am referring to the amendments and gauging the improvements in the macro situation in those countries (Russia and Uzbekistan), and I would like to reaffirm that indeed the results and the presentations you heard in June on Russia and in October on Uzbekistan on the occasion of the loan for the institution-building technical assistance project essentially remain valid. And, I will note whether there are further improvements beyond the situation presented to you at the time of those earlier discussions.

Let me start with Uzbekistan briefly because it appears that many people have less information on Uzbekistan than they have on Russia. Undeniably, Uzbekistan is a late comer, if you want to say, a late bloomer. It originally tried to insulate its own economy from the upheavals that they thought they saw in the Russian reform program; it tried to avoid the price shocks as relative prices changed in Russia.

They were rather successful in terms of stabilizing output and buying social peace. In fact, the reduction of output in Uzbekistan this year would be less than 5 percent, which is a lot less than in many former Soviet Union countries, and, essentially, there was social peace. But, it is also undeniable that this stability on the output and on the social side had to be bought with very substantial imbalances on the macro management side by a slowing down of the movement in decentralizing down from the command economy. It led to very substantial inflationary pressures, which in fact were larger than in Russia.

I was there in October. The Deputy Prime Minister in charge of the economy indicated that it was time to turn the rudder around and, in fact, they had started doing that. This has a structural component and a macro impact. On the structural components, obviously they had to go the privatization route and they went very fast. On the small scale elements of the production structure, there have been some 40,000 small enterprises very quickly privatized. The housing privatization is practically complete with almost 95 percent of title delivered in Tashkent and about 80 percent in the rest of the country.

On large-scale privatization there is a program under preparation for implementation beginning in 1994 and the very loan that you approved earlier, the technical assistance loan, is going to help them. But, there are also elements that are directly helping to restore some of the macro imbalances. The most important is getting away from price control, which automatically means a reduction of the budgeted subsidies. And that, indeed, has happened within the last few months. The government has reduced direct consumer subsidies for most commodities and what is left is only bread and flour. I expect this to have a beneficial impact on the macro balances and on the budget itself.

And, the second element is the social sector reform. It is a very costly system. They have started targeting benefits and are considering a reform of the pension system. It is with the Cabinet at the moment.

This morning I received a letter from Mr. Hamidov, the Deputy Prime Minister, asking the Bank to make now a concerted effort to assist the Government in moving forward with the structural reforms, bringing in the IMF, deepening the reforms and also dealing with the imbalances on the macro side. And, they have asked us to go ahead with the rehabilitation loan if we come to a conclusion on the nature and direction of the structural change.

The message I am essentially giving you is that until a few months ago, Uzbekistan was not a forerunner in the reform movements in the former Soviet Union. It may still not be a forerunner. But, under the shock and the strain of not being able to agree on a new ruble zone arrangement, it is turning to its own resources; it is turning to the policy changes that would make it possible for the country to introduce its own currency and defend it.

If this is the case, it will need external assistance in the neighborhood of \$500 million to \$600 million. After the experiences we have gained in Kazakhstan and in Moldova in putting financial packages together, I think it will be imperative to assist Uzbekistan in tapping private resources, some of which would be helped by the policy proposed today and to make a reality of the intended change for the improvement of the macro conditions.

In that sense, I believe paragraph 6 in its modification allows us to go ahead.

Let me say very little about Russia. It is obvious that in the constitutional uncertainties of the third quarter of this calendar year there were slippages. There were big slippages. And, it was equally obvious that some of the targets set up by the IMF under the STF became out of reach in the third quarter.

Nevertheless, with all the constitutional uncertainties, there are two elements that have gone ahead that I want to emphasize at this stage. One are some parameters on which the rate of inflation depends, which have, in fact, improved. There has been in the last two months a slowing down of financing of the banking system by the central bank.

This, I think, is one of the contributing factors to the decline of inflation. The monthly rate today--we don't have the latest number at this stage-- may be somewhere between 15 and 18 percent, certainly down from the 25 percent or more inflation per month that we had witnessed in the third quarter, which was a bit disappointing after the promising start last spring. In financial intermediation there are now perhaps as many as 100 banks, and certainly 20 or 30, that function by market principles. These banks charge positive rates given the inflation.

The Government has also reduced the amount of import subsidies, which again has a stabilization impact. The plan is to eliminate import subsidies

entirely by the beginning of the new year. That, of course, will be the business of the new government that we cannot gauge at this stage.

Privatization continues and, in fact, has accelerated. It has accelerated to the extent that now some 13 percent of total output is produced in private industry. There are still very little privately owned assets in agriculture and that is, of course, a big sector in Russia.

So, in spite of all the constitutional difficulties and the difficulty of mustering the political will for the hard elements of a structural and macro development program, I think we are witnessing some improvements which under the language before you should entitle us to go ahead.