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Statement by Aleksei L. Kudrin, Minister of Finance of the Russian Federation

STATEMENT
of Mr. Aleksei L. Kudrin
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Minister of Finance of the Russian Federation
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of the Board of Governors of the International Monetary Fund
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1. The Global Economy and Financial Markets

We welcome the noticeable improvements in the world economy that have become evident in recent months. This made it possible to revise upward the projections of global growth in the latest issue of the ***World Economic Outlook***. These revisions concern primarily the projections of growth in the US, the UK, Japan, and a number of developing countries in Asia, as well as in the CIS. This notwithstanding, we are concerned by the fact that the global recovery may be lacking a sufficiently firm underpinning. Indeed, the increase in domestic demand is generally the strongest in those countries with the largest current account deficits. At the same time, current account surpluses remain very large in some Asian countries, which continue to rapidly accumulate reserves. In such conditions, the recovery is tending to exacerbate the imbalances prevailing in the global economy.

Unfortunately, the economic policy across the major countries and regions does not always meet the objectives of a gradual and orderly resolution of existing global imbalances. As rightly mentioned in the ***World Economic Outlook***, the attainment of such a goal requires a cooperative strategy that includes a medium-term fiscal consolidation in the US, enhancing growth potential in the euro area and Japan through structural reforms, and moving toward greater exchange rate flexibility in emerging Asia. Nevertheless, the abovementioned countries and regions are not yet manifesting a great willingness to adhere to such a cooperative strategy. This means that global imbalances will persist in the future, and with them the threat of sharp corrections of exchange and interest rates.

Another risk factor for the world economy is the extraordinarily low level of long-term interest rates underpinning the ongoing recovery. These rates will rise sooner or later, which will inevitably affect the level of economic activity. Furthermore, prolonged low interest rates are conducive to formation of price bubbles in financial and real estate markets. In addition, as one recent issue of the ***World Economic Outlook*** showed, the bursting of these bubbles may lead to significant negative consequences for the real economy.

Low interest rates in advanced economies are promoting a continuing improvement of financing conditions in emerging market countries, which is reflected in the steady decline of spreads on their sovereign bonds. Such a spread dynamic, however, largely reflects the existence of abundant global liquidity due to the easy monetary conditions in advanced economies rather than a significant strengthening of economic fundamentals in emerging market countries. In this connection, there exists a significant risk that spreads on developing countries' sovereign bonds may increase significantly when the era of low global interest rates comes to an end. This in turn may lead to new balance of payment problems in these countries.

Growth of the **US** economy accelerated significantly in the second half of 2003 in response to the considerable monetary and fiscal easing of previous years. Recently the recovery was finally buttressed by a long-anticipated increase in employment. In this environment, the prerequisites for a transition to a more neutral monetary policy stance are gradually taking shape, and restoring a sustainable fiscal position is becoming a priority.

The pace of recovery in the **euro area** remains below earlier expectations mainly due to weakness of domestic demand in the largest economies of the region. This is partially explained by the persistent real interest rate differentials across countries in the euro area, where despite a single nominal interest rate, significant differences among individual countries persist in inflation rates. The fiscal situation in the region is also a matter of some concern in that the largest countries have not been observing the conditions of the Stability and Growth Pact for several years now.

In **Japan**, conversely, the pace of economic recovery has largely surpassed previous expectations. One would hope that this time the resumption of economic growth will be of a more durable nature. A certain concern remains due to the fact that growth in Japan is to a large extent driven by external demand, which makes it sensitive to fluctuations of the exchange rate of the yen. The latter circumstance prompts Japan's monetary authorities to perform large-scale currency interventions. A transition to greater reliance on internal sources of growth, which is possible as a result of further structural reforms, could become an extraordinarily favorable occurrence both for the Japanese economy itself and for the world economy as a whole.

The **CIS countries** have again demonstrated strong economic performance in 2003 underpinned by solid growth in the largest economies of the region (Russia, Ukraine, and Kazakhstan). It is noteworthy that growth was uniformly strong both in oil-producing and oil-importing countries. The structural reform agenda still remains challenging in all CIS countries, particularly in strengthening financial sectors and developing institutions and structures of a market-based economy. One may hope that higher growth would make solving of these structural problems easier. For the CIS-7 countries the major challenge is to tackle the still existing intra regional trade and transportation barriers. This will require a cooperative approach and goodwill on the part of all the countries affected by these problems.

The economic situation **in Russia**, which is characterized by continued high growth and a gradual reduction of inflation, remains favorable. It is encouraging that domestic demand plays a significant role in economic growth (for example, investments grew more than 12 percent in 2003). The conduct of monetary policy is still encountering certain difficulties in connection with a continuing influx of foreign exchange. In the year to March 2004 the ruble has appreciated against the US dollar by more than 10 percent in nominal terms. With the end of the election period in Russia one may anticipate a significant acceleration of structural reforms, particularly in the banking sector, infrastructure monopolies and public administration.

2. Crisis Prevention and IMF Surveillance

We continue to believe that **Fund surveillance** of the world economy as a whole and of the economies of the individual countries and regions plays an important role in crisis prevention, and we welcome ongoing work at the Fund to strengthen it.

The biannual **World Economic Outlook** and **Global Financial Stability Reports** remain the Fund's main tools for **multilateral surveillance**. We are pleased to note the improved quality of these reports, including the fact that they pay increasing attention to emerging market countries.

With respect to the Fund's **bilateral surveillance**, **Article IV consultations** continue to be the main tool. We welcome the Fund's intention to increase the candor of Article IV reports. In this context it is important to maintain a bilateral dialogue with member countries and to ensure that the feedback mechanism is strengthened, especially in the Fund's relations with developed countries. Much still remains to be done in this area.

In addition to enhancing multilateral surveillance at the level of the world economy as a whole and bilateral surveillance at the level of individual countries, we believe that the Fund should make further efforts in the area of **regional surveillance**. We know that more attention has been paid recently to the developments in individual regions both in reports on the world economy and in Article IV reports. At the same time, consideration could be given to the establishment of a separate regional surveillance tool—reports on the developments in individual regions. Such discussions would facilitate better understanding of the influence of regional factors and contribute to a greater exchange of experience among neighboring countries.

We know that the Fund is continuing work on a number of other ways of strengthening surveillance. We would like to note the solid progress made by the Fund on **Financial Sector Assessment Programs** (FSAPs) for individual countries, and also on the collection and dissemination of basic **Financial Soundness Indicators**.

Timely identification of potential vulnerabilities in the economies of various countries is of great importance. In this context we note the special attention recently paid by the Fund to the **balance sheet approach**, whose development will help integrate vulnerability indicators for the public and private sectors. Currently, practical implementation of this approach is hampered by the lack of necessary data. With time, however, it may become one of the most important surveillance tools.

At the same time, there is also a need for further improvements in the set of tools for assessing debt sustainability indicators of the public sector. Significantly, the main cause of crises over the last decade was, in a majority of cases, precisely an excessive public debt burden. Therefore the development at the Fund of a **common framework for debt sustainability analysis** is of great importance.

Economic growth is a key condition for reducing vulnerability and preventing crises. We have seen how in a number of countries the absence of economic growth hampered resolution of the problem of a high level of public debt. Therefore we welcome efforts at the Fund to improve its **analysis of economic growth factors** such as implementation of structural reforms, strengthening institutions of governance, and investment in infrastructure development, in other words, everything that falls under the notion of improving the investment climate.

Fund work in the area of **anti-money laundering and combating the financing of terrorism (AML/CFT)** is of great significance for reducing member countries' financial sector vulnerabilities. We welcome the decision of the Fund and the Bank to expand their efforts in this area and assess the implementation by countries of all the 40 plus 8 standards. If an increase in the Fund's budget is required for proper implementation of this effort and for provision of the necessary technical assistance in this area, we would certainly support such a step.

With respect to the Fund's financing instruments, we note that such a facility as the **Contingent Credit Lines (CCL)** had never been used and ultimately had to be abandoned. At the same time, the idea itself of providing easier access to Fund resources to countries pursuing sound economic policies remains attractive. Therefore we hope that proposals under review at the Fund for improving **precautionary financing instruments** will help identify alternative approaches in this area.

Speaking of Fund financing instruments, we cannot help but address the issue of the provision of **exceptional access** to Fund resources. In our opinion, Fund decisions to provide exceptional access remain insufficiently predictable and transparent for financial market participants. It is difficult for outside observers to understand the Fund's use of various combinations of financing arrangements and the various kinds of repayment expectations and obligations and other terms of loan repayments. **Policy on lending into arrears** also requires clarification. It seems to us that there is still much to be done in these areas to improve the predictability and transparency of Fund's decisions.

3. IMF Support to Low-Income Countries

We share the opinion that the Fund will need to be involved in low-income countries (LICs) for a substantial period of time in terms of surveillance, policy advise, and provision of technical and financial assistance. We welcome recent Fund actions to improve long-term approaches to its interactions with poor countries. In particular, we welcome steps taken by the Fund to create more adequate and flexible tools for providing assistance to the various groups of LICs **under PRGF-supported programs.**

The streamlining of **interactions between the Fund and the World Bank** is a key factor in improving the effectiveness of assistance provided by those organizations to LICs. The main priority in this area is to further reduce duplication in their operations by more clearly delineating their responsibility. Collaboration between the Bretton Woods institutions should be improved through greater reliance on economic development and poverty reduction strategies that are developed and implemented by the countries themselves.

We support the actions of the Fund and the World Bank aimed at developing a common framework for ensuring **sustainability of the debt burden of the poorest countries** over the long-term period. This framework should incorporate the interests of both debtor countries with respect to obtaining new financing and creditor countries interested in ensuring that LICs will continue to be able to service their external debt. If this initiative is to succeed, we consider it vital to reach general agreement on what constitutes debt sustainability for LICs. In its current form, this concept is too vague and subject to different interpretations. In addition, there is a need to establish a clear correlation between volumes of new financing obtained by LICs and the quality of their economic policies. This is necessary in order to minimize moral hazard and prevent the development of their excessive dependence on official development assistance.

We attach great importance to progress on the **HIPC Initiative** and welcome the efforts of the international community to accelerate the achievement of completion points by its participants. Nonetheless, we are concerned that recent discussions of external shocks and topping-up have increasingly served as a substitute for difficult solutions concerning the links between sound economic policies, debt sustainability, and responsible lending to LICs on the part of international financial institutions.

Finally, we believe that the HIPC Initiative and the new strategy to ensure external debt sustainability are only tools and do not guarantee that LICs will be able to resolve successfully their debt problems. Therefore the main responsibility lies with the LICs themselves, which should pursue a sensible strategy of attracting new financing and adhere to a responsible and growth-oriented economic policy.