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Statement by Mr. Aleksei Kudrin, IMF Governor for the Russian Federation and Minister of Finance of the Russian Federation
On behalf of the Russian Federation

STATEMENT
of Mr. Aleksei L. Kudrin
Governor for the Russian Federation
Minister of Finance of the Russian Federation
at the Meeting of the International Monetary and Financial Committee
of the Board of Governors of the International Monetary Fund
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The Global Economy and Financial Markets—Outlook, Risks and Policy Responses

We read with interest the latest issue of the *World Economic Outlook*. We welcome the fact that the world economy remains broadly on track. We note that after exceptionally strong economic growth in 2004—the strongest in the past 30 years—it is now expected to moderate somewhat in 2005.

Over the past six months the now-familiar trends in the main economic regions have not changed. Strong growth in the United States and China combined with weak growth in Western Europe and Japan has been evident for quite some time now. We are aware of the efforts by Western European countries and Japan to implement major structural reforms aimed at enhancing the growth potential of these countries, and we hope that these efforts will bear fruit in the forthcoming years.

The past year has been a particularly successful one for emerging markets, which demonstrates their increasing role in securing global economic growth. Thus, growth in emerging Asia was the strongest since the Asian crisis, in emerging Europe growth was the strongest since the beginning of the transition to a market economy, while in Latin America growth was the strongest since 1980. We are glad that economic growth in Russia and other CIS countries has remained strong. But I would especially like to mention the improved growth performance in African countries. Last year economic growth in sub-Saharan Africa exceeded 5 percent and was the highest growth in a decade, while inflation was at the lowest levels in 30 years.

At the same time, we also see a number of risks for future successful development of the world economy, such as the possibility of a sharp correction of global imbalances or the possibility of a further increase in oil prices.

Although the world economy today is much less sensitive to changes in oil prices than it was during the oil crises of the 1970s and 1980s, further increase in oil prices could lead to a considerable decline in the pace of global growth. The Fund report states that high oil prices will most likely continue over the medium term, and that there is even a risk that they may further increase. The expansion of oil-production capacities is not keeping pace with the growth in demand for oil. In turn, the shortage of spare capacities keeps conditions tight in the oil market and makes prices volatile. Insufficient political stability in a number of key oil-producing regions is another factor contributing to price fluctuations. It is clear that given these

conditions, an increase in oil-production capacities in exporting countries, coupled with measures to restrain fuel consumption, is of particular importance.

In the period since the last meeting of the IMFC, there has been a further widening of global imbalances. The Fund report states that in an environment of growing financial globalization, an increase in demand for foreign assets could mean that current account imbalances may persist for a more prolonged period. Nevertheless, it is clear that the widening of global imbalances cannot go on indefinitely, and there will have to be a correction at some point. In the event that financial markets reassess the appeal of dollar assets, there could be a further decline of the dollar, a significant increase in interest rates, and a slowdown of global economic growth. Therefore, although growing financial globalization enables us to anticipate a more orderly unwinding of global imbalances, this should not serve as an excuse for inaction. The Fund report states that there needs to be a coordinated economic strategy on the part of the United States, countries of East Asia, and the European Union aimed at overcoming the imbalances that have opened up in the global economy. While being in full agreement with this conclusion, we would like to see a more vigorous implementation of this strategy in practice.

The policies of central banks with regard to foreign exchange reserves accumulation have some impact on the development of global imbalances. Therefore, the Fund should track more closely changes in the currency composition of official reserves, which requires the collection of the relevant statistical information. Sufficient demand of foreign investors, both private and official, for U.S. Treasury bills is a key factor for maintaining global financial markets stable. For that reason, the Fund should also monitor closely the composition of the holders of U.S. Treasury bills.

The situation in the financial markets of industrial countries over the past six months has remained fairly stable. The gradual increase in interest rates in the United States has not been accompanied by greater volatility in financial markets. At the same time, interest rate levels in a majority of industrial countries remain low, which leads to excess global liquidity and the search for high-yield assets by investors. Further proliferation of financial instruments that provide for the redistribution of financial risks allows large investors to feel more confident in the face of possible negative shocks. At the same time, the introduction of new insurance and pension schemes often means a shifting of risks from corporations and financial institutions to households. Since the ability of retail investors to assess properly the degree of risks remains fairly limited at this time, steps need to be taken to improve the financial education of the general public. Let me also note that the redistribution of risks among various market participants does not imply any fundamental improvement in the stability of financial markets, and that the risk of a financial turmoil still remains.

Excess global liquidity and the search for high-yield assets have contributed to an increase in the flow of funds from private investors into emerging markets. This turn of events can also be explained by the progress made by many of these countries in achieving macroeconomic stability and reducing public debt. Favorable conditions in financial markets enabled a number of these countries to pre-finance their external debt service payments well in advance, and also to carry out operations to improve the structure of this debt. However, the

increase in interest rates in several developed countries and, first of all, in the United States, which has already started, puts a question mark on the continuation of these favorable conditions in the future. Also, more recently private investors have been showing greater interest in financial instruments denominated in domestic currencies of emerging markets. This new development entails risks and therefore merits careful monitoring by the Fund, including on the basis of a more in-depth analysis of the financial markets in individual countries.

The section of the *World Economic Outlook* report concerning migrant workers' remittances was of great interest to us. In a number of countries the flows of remittances have reached levels that have an impact on the balance of payments, on the implementation of monetary policy, and on banking supervision. We are glad that the Fund has recently been devoting a great deal of attention to the analysis of migrant workers' remittances. We would like to make special mention of the Fund's efforts to collect statistical information on remittances, the shortage of which makes this sort of analysis more difficult. To improve the quality of the analysis, the Fund needs to establish closer cooperation with other international institutions, including the International Organization for Migration. Another important question is how to reconcile in a reasonable way efforts to foster favorable conditions for migrant workers' remittances and efforts to combat money laundering and the financing of terrorism.

The Fund's Executive Board recently discussed a report on the economic outlook for Sub-Saharan African countries. This discussion was the first one undertaken under the framework of a new Fund initiative – regional surveillance. We believe that the first step was quite successful, and we call on the Fund to redouble its efforts in this direction. To do this, the Fund will need to take decisions regarding the format and periodicity of such regional surveillance discussions.

This Fund report provides an analysis of factors of economic growth in Sub-Saharan African countries, as well as an assessment of their progress in achieving macroeconomic stability and the implementation of structural reforms. And although in many African countries difficult conditions still prevail, the report provides sufficient grounds for cautious optimism. It appears that a group of countries may have emerged on the African continent that are on the threshold of a significant acceleration of economic growth. In our view, the Fund should be more active in attracting attention of outside observers to the examples of successful development among the countries of Sub-Saharan Africa.

IMF Support for Low-Income Members' Efforts Towards Poverty Reduction And Strong Sustainable Growth

We believe that the Fund has a key role to play in supporting low-income countries' efforts to achieve macroeconomic stability and sustainable growth. In particular, under the PRGF the Fund provides concessional financing to low-income countries to address macroeconomic imbalances and structural impediments hindering faster growth. At the same time, we believe that there should be a clearer delineation of the responsibilities of the Fund, international development banks, and bilateral donors with respect to providing financial

assistance to low-income countries in order to prevent the Fund from the involvement in long-term financing for development, which is outside its area of responsibilities.

We welcome the Fund's efforts to improve the PRGF, which is its primary tool for providing assistance to low-income countries. In addition, we note the useful role played by the recently established Trade Integration Mechanism and also the mechanism to subsidize emergency assistance for natural disasters provided to PRGF-eligible countries. We affirm our readiness to contribute resources to the account for the subsidization of emergency assistance for natural disasters.

We also share the opinion that it would be useful to establish a Policy Monitoring Arrangement (PMA) that does not envisage borrowing from the Fund. Such a facility could play the role of a signaling mechanism for donors with respect to those low-income countries that do not have a need in the Fund's financing.

We note the progress made on implementation of the HIPC Initiative. Since our previous meeting another four countries have reached the completion point, bringing the total number of such countries to eighteen. Unfortunately, many countries have gone off track in the interim period between the decision and completion points. This keeps them from enjoying full benefits offered by the Initiative in terms of debt relief. According to the calculations of Fund staff, in countries that obtain debt relief under the HIPC Initiative the NPV of debt-to-exports ratio will decline to an average of 120 percent. This represents a substantial easing of the debt burden compared to the level prior to the HIPC Initiative, when the NPV of debt-to-exports ratio averaged about 275 percent.

We understand the intention of the international community to take additional steps to provide further debt relief for the poorest countries, *inter alia* on the basis of additional forgiveness of debt owed to international financial institutions (IFIs). Assessing this proposal with respect to the Fund, however, we see that its share in the total amount of outstanding debt of low-income countries is relatively small -- less than 10 percent. As a result, we believe that the Fund should not provide further debt relief given that this will not lead to any substantial easing of the debt burden of the poorest countries, but can only undermine existing Fund arrangements for providing financing to those countries, in particular the PRGF.

Moreover, further debt relief should not jeopardize the HIPC Initiative, which has not yet run its course. Therefore, if it is decided that certain IFIs should undertake additional debt forgiveness, it would seem advisable to limit eligible countries to those that have already reached a HIPC completion point and are continuing to implement sound economic policies.

Given that we do not deem it necessary for the Fund to provide additional debt relief to low-income countries, we do not see the need for the sale of Fund's gold to finance such debt relief. We are also opposed to the use of existing PRGF resources for this purpose, because it will reduce the Fund's future capacity to provide lending to those countries.

We attach great importance to the establishment of a transparent and effective debt sustainability framework for low-income countries over the long-term. On the whole we approve the format proposed for that framework. Its latest version is far more consistent with the parameters and procedures of the HIPC Initiative.

Shaping the IMF's Strategic Direction

We are following attentively the development of discussions within the Fund's Executive Board concerning the preparation of a strategic document.

We consider it useful to focus attention on the role of "broad" institutions. Indeed, the level of development of such institutions as the judicial system or the law enforcement system is of great importance for successful implementation of macroeconomic policy and achievement of high rates of economic growth. Perhaps, when providing policy advice to its members in the elaboration of macroeconomic stabilization and structural reform programs, the Fund should take into account the overall level of development of the "broad" institutions. At the same time, we would question the idea that the Fund should provide assistance to its members in the development of such "broad" institutions. The Fund does not have either the mandate or the expertise to do this.

On the whole we support the Fund's intention to engage in a broader dialogue with its members on the issue of capital account liberalization and also to provide them technical assistance in this area. Currently many emerging market economies are already moving in this direction and are in need of the Fund's advice. At the same time, the Fund should not put pressure on its members and require that they accelerate the lifting of restrictions on capital transactions. Nor do we consider the adoption of a relevant amendment to the Fund's Articles of Agreement a pressing matter.

The report on the Fund's strategic direction discussed recently by the Executive Board is focused primarily on medium-term issues. We believe that the Fund's final strategic document will benefit greatly if it incorporates not only medium-term but also long-term issues. In particular, why not include in the strategic document possible scenarios for the development of international financial system and the corresponding change in the role of the Fund?

We anticipate that work on the Fund's strategic document will be largely completed by the fall meeting of the IMFC.

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In conclusion, we would like to say a few words about relations between Russia and the Fund. At the end of January we completed the early repayment of our outstanding obligations to the Fund and thereby embarked on a new stage in our relationship, in that Russia is now making the transition from borrower to lender. At the same time we still value highly our

dialogue with the Fund on issues of macroeconomic policy and structural reform and look forward to a continuation of that dialogue.