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WORLD BANK GROUP
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL FINANCE CORPORATION
INTERNATIONAL DEVELOPMENT ASSOCIATION
INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES
MULTILATERAL INVESTMENT GUARANTEE AGENCY

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Statement by the Hon. **ALEKSEI KUDRIN**,
Governor of the Fund for the **RUSSIAN FEDERATION**,
at the Joint Annual Discussion

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World Economic Outlook

Compared to our last meeting, the situation in the world economy has improved. The upward revision of global growth for the current year is due primarily to stronger growth forecasts for industrial countries, and in particular for the U.S. economy. At the same time, it is noteworthy that growth forecasts have been revised upward for all of the major regions in the world, with the exception of Africa. It is worth mentioning that this year, for the first time, economic growth is anticipated in all transition economies. Correspondingly, their growth forecasts for 2000 have been adjusted upward (for Russia, for example, this forecast has been revised from 1.5 percent to 7 percent).

Nevertheless, some uncertainties and risks remain. The longstanding divergence in growth among the leading industrial countries led to significant imbalances in their current accounts, which sooner or later should lead to a serious correction in exchange rates among the three major currencies. And here there is certainly a risk that the correction will be too sharp, which could lead to destabilization of the world economy. There is a danger of an abrupt reevaluation of prospects for the U.S. economy, which may lead to a global and large-scale price correction on stock, foreign exchange, and money markets. This, in turn, could carry the risk of an international financial crisis. Given this situation, the continuing challenge is to pursue a flexible macroeconomic policy aimed at achieving a “soft landing” for the U.S. economy.

We are also concerned by the increased volatility of world oil prices over the last several years. In this context, we welcome the recent efforts of oil-exporting countries aimed at achieving a more stable price for crude petroleum. The discussions that took place in Prague reflected the increased understanding between oil exporters and importers, and their common willingness to stabilize the oil market.

International Capital Markets

The outlook and risks in international financial markets reflect to a significant degree more general trends in the world economy. For example, the dynamic development of the U.S. economy, against the backdrop of continuing uncertainty about prospects for growth in the euro area and Japan, led to a significant shift in capital flows in the direction of the United States. The large current account deficit in the United States is being financed by significant capital flight from Europe and Japan. At the same time, capital outflows from Europe could be one of the reasons for the prolonged weakness of the euro against the U.S. dollar. Under these conditions, the main risk for advanced financial markets is the possibility of a "hard landing" for the U.S. economy, which was already mentioned earlier.

The situation in the financial markets of emerging market economies continues to be contradictory. On the one hand, there is a clear revitalization in the stock markets, exchange rates are stabilizing, and volatility in the value of their debt instruments is diminishing. On the other hand, the financial markets of developing countries are heavily dependent on market conditions in advanced economies, with all the attendant risks. In addition, the net inflow of private capital to emerging market economies is at a much lower level than it was before the crisis, while borrowing costs are much higher. If net private financing of the emerging market economies remains limited, this poses a risk to a number of them, particularly those that depend heavily on private capital markets for the refinancing of external debt.

Transition Economies—Lessons from the Past 10 Years

Ten years of economic reforms to make the transition to a market economy in a number of countries have allowed for the accumulation of enough experience to make some preliminary generalizations. Below we will focus on an analysis of events in the countries of the Commonwealth of Independent States (CIS) and also in the countries of central and eastern Europe (CEE). We concur with the view that the difference in the results that have been achieved in CEE and CIS countries can be explained to a certain extent by different starting conditions. Without a doubt, 70 years of a centrally planned economy did more damage than 40 years, from the standpoint of erasing the institutional memory of a market economy, the creation of large imbalances, and the development of inadequate motivation for economic behavior. At the same time, we should not overstate the significance of this factor.

An important reason for the discrepancy was the diametrically opposite impact of the collapse of the Soviet Union and CMEA for these two groups of countries. Freed from their ideological and political dependence, the CEE countries moved quickly to restore their historical ties with western Europe through the development of trade and the exchange of people and ideas, among other things. Accession to the EU became for them an obvious long-term goal, and this determined the nature and pace of reforms. The CIS countries that emerged from the wreckage of the Soviet Union started, on the contrary, from practically nothing. Their leaders were faced not only and exclusively with the challenge of creating the institutions of a market economy, but mainly with the need to create genuinely independent states, including the establishment of administrative structures, the introduction of a national currency, the strengthening of borders, and adaptation to the loss of large-scale subsidies. It is not surprising that under these conditions their progress in the transition to a market economy was much more modest.

Now many of these "starting problems" seem to have already been left behind, as demonstrated by the resumption of economic growth in all CIS countries. An additional stimulus for them to accelerate the pace of reforms could be their willingness to become more deeply integrated into the world economy, including through joining the WTO.

Prospects for Economic Growth in Russia

Two years after its severe financial crisis, Russia is experiencing robust economic growth. In the period immediately following the financial crisis, the main factor in economic growth was import substitution, which was a consequence of the significant depreciation of the ruble. Later on, however, this factor lost some of its previous impact, since the real exchange rate of the ruble has increased substantially over the two-year period. Growth can be seen in all sectors of the Russian economy now, which is to say that we have broad-based economic growth.

The implementation of responsible macroeconomic policies, which made it possible to restore relative financial stability fairly quickly, was of great importance in overcoming the financial crisis and reviving economic growth in Russia. It is our firm intention to continue these policies in the future as well. At the same time, we certainly understand that continued vigorous economic growth is not possible without a decisive acceleration of structural reforms. In July 2000, the Russian government approved a new economic program that encompasses a broad spectrum of far-reaching structural transformations. Specifically, this program envisages improving the investment climate, securing property rights, creating an efficient financial sector, increasing transparency, and improving corporate governance. We are firmly determined to implement this program in close cooperation with the IMF and the World Bank.

Strengthening the Architecture of the International Financial System

We share the desire to make *Fund facilities* more effective and avoid prolonged and excessively large use of IMF resources in the future. At the same time, we believe that the existing instruments allow us to achieve these goals without radical modification of Fund facilities. In particular, measures such as the enhancement of Fund programs by improving conditionality, more caution in granting access to resources, establishment of the appropriate length for programs, and more efficient use of the Supplemental Reserve Facility (SRF) and Contingent Credit Lines (CCL) will help achieve greater effectiveness within the framework of the existing facilities. In this connection, we are not entirely convinced that reducing the length and amount of use of Fund resources may be achieved by introducing *repurchase expectations* and *the graduated rate of charge*.

We would also like to touch upon the issue of *pricing the new lending instruments of the World Bank*. It is not a secret that introduction of new instruments, or modification of existing ones, is often linked to increases in the prices of lending products. In our view, these two issues should be treated separately. The analysis of pricing must be done not in the context of the Bank's activities in borrowing countries, but in the general framework of its financial instruments, its financial performance, and the demand for its products. Let me also mention the issue of *the World Bank financial situation*. We think that the financial capacity of the Bank is already stretched beyond the limits and that funding the new initiatives out of its net income may negatively affect the Bank's viability as a credit institution.

We welcome the Fund's initiatives on *transparency and international standard*s. The joint project of the Fund and World Bank involving the development and voluntary publication of *Reports on Observance of Standards and Codes* is an important step in the area of international standards. A number of countries, including Russia, have taken part in this project. When developing standards, a reasonable balance should be found between their complexity and feasibility. We also believe that standards and codes should be developed very thoroughly, with suggested decisions being cross checked in the course of multilateral consultations. Otherwise it may appear that the standards and codes appropriate for some specific countries will actually be imposed on all countries.

We endorse the steps taken by the Fund jointly with the World Bank to enhance stability and promote transparency in the financial sector. Here it is important to note the work done on the *Financial Sector Assessment Program*. Preliminary results from the program's experimental phase have demonstrated that it may become a useful instrument in the performance of the Fund's surveillance functions. We agree with the decision to continue work on this program in 2001. Russia is currently examining the possibility of its own participation in this program.

Like other Fund members, Russia is concerned by the role of *offshore financial centers (OFCs)* in the international financial system. Russia is one of those countries that suffers from the large-scale use of OFCs by commercial and financial entities, and it is seeking effective means of controlling and regulating activity in that sector. In this connection, we welcome the start of the Fund's cooperation with OFCs. The Fund's first task should be to analyze in detail the existing and potential risks. In turn, Russia is taking steps in the direction of establishing a system for surveillance and controls on the activities of its own commercial and financial entities at OFCs. In particular, work is currently under way to strengthen the law aimed at fighting money laundering. We anticipate that the new text of the law will be submitted to the parliament for its approval by the end of this year. We are also discussing amendments and additions to the law on foreign exchange regulation, which will help improve controls on suspicious transactions.

We endorse the framework adopted by the Executive Board for elaborating decisions on *private sector involvement (PSI)*. We find that this framework is still far from being a set of clear rules. However, one can hardly expect automaticity in the adoption of this type of decision because the Fund has to rely on very imprecise forecasts of capital movements when calculating overall financing needs. Now it is already apparent that difficulties in forecasting the balance of payments, the existing variety of debt instruments, and rapidly changing economic conditions require a case-by-case approach to PSI in specific countries. Nor is it very advisable to peg PSI firmly to a predetermined level of access to Fund resources because this will deprive the PSI mechanism of needed flexibility. The proposal that *the Fund officially sanction standstills* hardly seems constructive. In practice, this may represent Fund interference in relations between creditors and the debtor on behalf of the latter. The Fund's existing policy for lending into arrears is a sufficiently strong mechanism for exerting influence on intractable creditors.

Progress in Implementation of the HIPC Initiative

We support efforts aimed at turning the Initiative into an effective instrument for reducing the long-term debt burden and providing for the social and economic development of the poorest countries. We would like to emphasize, however, that debt relief does not by itself ensure stable economic growth and poverty reduction for these countries. What is required of them, in turn, is effective fulfillment of programs that have been agreed with the Fund and the Bank and are based on Poverty Reduction Strategy Papers (PRSPs) developed by the countries themselves.

We, therefore, welcome a comprehensive approach adopted jointly by the Fund and the Bank and aimed at addressing the poverty problem in the context of PRSPs. It is important that the poorest countries draft these strategies mostly themselves and consider them as their own programs of action and not as the externally imposed conditions for official credits. Within this general framework, however, the administrative capacities of these countries should be taken into consideration. We think that a new mechanism now under construction in the World Bank – the Poverty Reduction Support Credit (PRSC) – will be a useful complement to the Fund's Poverty Reduction and Growth Facility (PRGF). Together, these two instruments will significantly improve the coordination of the Fund and Bank's work in the countries implementing Poverty Reduction Strategies.

In conclusion, we would like to mention that we have highly appraised the recent joint statement by the heads of the Fund and the World Bank, which proclaims common goals and principles in their future work. Along with showing the spirit of cooperation and the desire to work together on achieving strategic goals, this statement provides a good background for a more efficient distribution of responsibilities between the two institutions in their common activities aimed at poverty reduction and the promoting of sustained economic growth.