WORLD BANK GROUP

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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 L. KUDRIN,**
Governor of the Bank and the Fund for the **RUSSIAN FEDERATION,**
at the Joint Annual Discussion

Statement by the Hon. Aleksei L. Kudrin,
Governor of the Bank and the Fund for the Russian Federation,
at the Joint Annual Discussion

Distinguished colleagues,

Our Annual Meetings are taking place at a time when global economy is starting to gradually emerge from the unprecedented crisis. We welcome the nascent signs of recovery. Nevertheless, the current situation continues to be marked by significant uncertainty. The recovery could be a reaction to the extraordinary level of public intervention without corresponding support by the private demand. In addition, the situation in the financial sector of advanced economies remains very difficult, with the size of impaired assets continuing to grow, thus forcing banks to limit their lending to the economy.

In the context of the large-scale fiscal and monetary interventions implemented in many countries, the main risk factor is seen in premature withdrawal of stimulus, which could lead to a renewed slump. However, we should also not lose sight of the risks of inflation and of the erosion of fiscal sustainability in the medium to long-term, which may emerge if stimuli are maintained longer than necessary.

Significant monetary stimulus, including so-called "quantitative easing," could lead to inflating new bubbles in asset prices besides traditional inflation risks. In fact, zero interest rates and massive liquidity injections into the global economy have already resulted in overheating of equity markets, especially in a number of middle-income countries. We are concerned by the emerging pattern in monetary policy of advanced economies, where significant monetary easing in response to the "bursting" of another bubble is helping to inflate new asset price bubbles, thus laying the basis for a next financial crisis.

It has now become obvious that the present model of global growth, based on debt-financed consumption and exports in exchange for accumulation of reserves, is unsustainable. Large and growing imbalances inherent to this model are generating increasingly larger capital flows that ultimately destabilize the global economy. We welcome the intention to strengthen international coordination of macroeconomic policies on the basis of the Framework for Strong, Sustainable, and Balanced Growth, approved by the G-20 leaders in Pittsburgh. We expect that within this framework due consideration will be given to such pressing problems as the economic impact of large and volatile capital flows as well as influence of policies in major financial centers on the other countries' economies.

Achieving the necessary rebalancing of global demand will not be easy. Surplus countries would need to increase the level of household consumption, which depends on demographic and social factors and traditions that yield reluctantly to government regulation. In deficit countries the situation appears a little easier, inasmuch as savings by households grew dramatically as a result of the crisis. Any further reduction in deficits will be determined by successes in fiscal consolidation, which depends directly on government policies. It is well known, however, how difficult fiscal consolidation is, especially if it involves tax increases and cuts in social spending.

The situation in the financial sector remains complex notwithstanding the recently observed recovery in equity prices. Banks continue to suffer losses from defaults on earlier loans, which prevent them from maintaining the level of lending to the private sector needed for resumption of sustainable growth. This is why recapitalization of the banking sector continues to be the most urgent task in the short term. Recapitalization of banks and resolving the problem of "toxic" assets are not enough, however, to restore confidence in financial institutions and in regulatory authorities, which has been deeply shaken by the crisis. Without serious reforms of regulation and supervision, financial institutions, especially the largest ones, could get the wrong signal – that excessive risk-taking is rewarded – because they assume that in a crisis the government will invariably bail them out.

We deem it necessary to step-up our efforts in this area because, as the global conditions stabilize, fundamental reforms of financial regulation will become increasingly difficult to implement. It seems to us that the Fund could make a more substantial contribution to reforms of financial regulation. For this, it should not only enumerate the necessary reforms in its reports but also track their implementation. This could enhance transparency of the entire reform process, and possibly accelerate it somewhat.

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Realigning of quota shares continues to be the main issue for us in Fund governance. The prevailing perception that important decisions in the Fund are mostly taken by a small group of advanced economies severely undermines confidence in the Fund and puts in question the very legitimacy of its decisions. We, therefore, welcome the compromise language concerning the redistribution of quota shares adopted at the G-20 Summit in Pittsburgh.

Now about the so-called other issues of Fund governance. Our premise is that the founding fathers of the Bretton Woods institutions thought out the entire system of Fund governance well, including in particular the distribution of powers between the Board of Governors, Executive Board, and Managing Director. We know that this system has worked rather well in the 65 years of the Fund's existence. We feel generally comfortable with it, and we do not see an urgent need for any radical changes in this area.

This does not mean that we are opposed to all changes in the Fund's system of governance. We would welcome, for example, a transition to the open and merit-based selection of Managing Director, irrespective of nationality. We are also prepared to discuss the size and composition of the Executive Board. In addition, we welcome the aspiration of the Executive Board and Fund's management to enhance effectiveness of the IMFC process.

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We strongly support current efforts by the World Bank to tackle the negative impact of financial, energy and food crises, including through tripling of lending to the middle-income countries. We applaud the introduction of innovative forms of financing provided to the poor countries, be it within the framework of IDA, or through targeted programs and trust funds, launched at the initiative of President Zoellick. World Bank contribution towards enhancing food security is particularly visible – it ranges from development of agriculture to removal of trade barriers and to extending direct budget support to the countries that are most affected by the food crisis. The Russian Government has made a decision to participate in these Bank-led programs and allocated $50 mln. for that purpose. These activities present yet another argument for strengthening the financial capacity of the World Bank.

We have to explicitly recognize constrained financial capacity of the IFC and the IBRD. Our position in this respect can be summarized as following:

1. Firstly, we see the rationale for a **Capital Increase** in order to preserve the IBRD and IFC financial capacity. Such increase should ideally be synchronized among these two institutions.

2. Secondly, we believe that a **Selective Capital Increase** should be an integral part of any package designed to boost the financial capacity of the World Bank Group. Once the **Selective Capital Increase** is implemented, the parameters of the **General Capital Increase,** if still warranted, could be assessed. Progress on this front is linked to a discussion on greater voice and participation by the developing and transition countries in the World Bank. Besides, such an approach offers an

advantage of attaining multiple objectives in a concerted manner. These considerations make us strong supporters of both the **Selective and General Capital Increases** as a single package, but with the above sequencing.

3. Thirdly, we have to express our serious opposition to an emerging idea of continuous **Price Increases** as the major method for achieving certain pre-determined income generation benchmarks and maintaining desired Equity-to-Loans ratio. The **Price Increase** option is not a substitute for the **Capital Increase** as these two processes are completely different in nature and have divergent objectives. The 20 basis points increase has just been approved in IBRD and any further upward revision is counterproductive under the current circumstances.

4. Fourthly, given the overall economic uncertainties, **Income Allocation** within the World Bank Group should focus more on preservation of financial capacity, so the boosting the reserves has an absolute priority over other uses. This objective is clearly stated in the legal framework of the World Bank, and the present environment makes it even more relevant than ever.

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We fully support the objective of strengthening the voice and participation of developing and transition countries in the World Bank. While some important elements of reform have been addressed under Phase 1 – this includes measures protecting the rights of small shareholders and enhancing Board representation of Sub-Saharan Africa, a big outstanding agenda remains. We must secure the results of Phase 1 and move further. Phase 2 should result in a significant increase of developing and transition countries' voting power. In this context we welcome the decision of the G-20 leaders to redistribute at least 3% of the voting power in favor of the developing and transition countries. At the same time we consider this but an interim step towards parity between them and the developed countries.

We also support a provision formulated in the final statement of the Pittsburgh summit that supports a movement towards a more equitable distribution of voting power in the World Bank through development and adaptation of a dynamic formula, based on which distribution of voting power would be calculated. Distribution of voting power based on a flexible periodically reviewed formula would allow timely response to evolving role and weight of countries in the world economy in a manner that takes into account continuously evolving priorities of the World Bank.

Since Russia joined the World Bank in 1992, it has not only grown as an economy, but has also made a major contribution to the development mandate of the Bank as a donor of IDA and other Bank-sponsored initiatives. Based on GDP-PPP, Russia's share in the world economy exceeds 3%, which is greater than its current voting power in IBRD. We strongly believe that Russia's voting power should increase as a result of reform rather than decease, as implied by some calculations that fail to capture the full scale of Russia's role in the world economy and development.

We consider the above-mentioned selective capital increase focused on developing and transition countries as the most practical way to make progress on the shareholding dimension of the Phase 2 of reform. The general capital increase can follow. Such sequencing will reconcile the reform objectives with the capital needs of the Bank.

The objectives of the voice and participation reform cannot be achieved by a shareholding review alone. The developing and transition countries' representation at the Board and the World Bank's responsiveness to their views on development are also of high importance. We do not support any measures that may lead to a change in the permanent status of or in other way weaken the Executive Board, which is vital for the accountability, integrity and good governance of the World Bank.