Statement by Terrie O'Leary
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Russian Federation: Country Assistance Strategy Progress Report

The Country Assistance Strategy (CAS) Progress Report proposes adjusting the Bank's Strategy for Russia in light of the economic and political developments that have occurred there since the CAS was agreed in December 1999. In particular, the Progress Report suggests moving from the four lending scenarios outlined in the 1999 CAS. These four lending scenarios are: a low case that envisaged up to US$150 million per annum in investment loans; two intermediate scenarios that envisaged up to US$300 million and US$450 million per year in investment lending and; a high case that would see up to US$600 million in investment loans and the preparation of up to US$1 billion in new adjustment lending subject to a CAS update. For the FY01-FY02 period, the Progress Report proposes a base-case of up to US$600 million in annual new investment lending/guarantees and a high-case of up to US$1 billion in new commitments including adjustment loans as well as investment operations. The Progress Report moves annual commitment volumes towards the high-end scenario outlined in the 1999 CAS. In addition, the Progress Report proposes Bank operations provide greater support to the inter-related aspects of public-sector institution building and private sector development. This focus is broadly in line with the 1999 CAS that directed Bank activity to strengthening public-sector institutions and systemic policies and emergency social needs.

A key element of the strengthened focus on private-sector development is a proposed US$500 million structural adjustment loan to promote enterprise start-up and restructuring. The Report notes that the loan, for which the Bank has begun preparation in consultation with the Russian authorities, would seek to reduce the level and dispersion of effective taxes and subsidies, reduce excessive government interference in the operations of business, and improve the targeting and increase the efficiency of social assistance spending. The predecessor of this loan (SAL 3) was cancelled early in 2000 at the request of the Russian authorities, who wanted to focus their efforts on the development of an economic and social reform plan.

The triggers for the base case scenario include: (i) retaining a satisfactory project rating for at least 70 per cent of the portfolio; (ii) finding quality projects; (iii) satisfactory progress in improving the budgeting process and; (iv) no sharp deterioration in the macroeconomic framework. Moving to the high-case scenario will require in addition to (ii) and (iii) above: retaining a satisfactory rating for 80 per cent of projects; a satisfactory macro-economic framework (though it is unclear whether this means an IMF programme) and; satisfactory...
progress in implementing the government's program of priority actions, particularly improving the environment for new enterprises and restructuring (or satisfactory progress under the proposed fourth structural adjustment loan). The Progress Report notes that in the event of a sharp deterioration in portfolio performance, or in the macro-economic framework, lending will be limited to operations that address acute social issues or global concerns (TB/AIDS and northern restructuring projects). The Progress Report does not indicate the lending scenario under which Russia presently falls.

Under the lending volumes proposed in the Progress Report, the outstanding disbursed portfolio is expected to increase from US$6.8 billion in FY00 to US$7.6 billion in FY02 under the "base" case scenario and to US$8.3 billion in FY02 under the "high" case scenario. This is the same level of exposure the 1999 CAS expected for its two lowest lending scenarios. This reflects the fact that these scenarios included expected disbursements under the now cancelled SAL3 as well as numerous investment projects that the Bank has now cancelled/restructured. It is also interesting to note that under the "base" case, IBRD debt service is expected to exceed net Bank disbursements in FY01 and FY02.

The Russian government took a step on the road to reform last year when it developed an economic and social development program to address the significant challenges facing the Russian economy. If implemented, we believe the program will make some headway towards moving the economy onto a path of sustained non-inflationary growth and poverty reduction over the long term. The potential for strong growth is there – the key is to implement the reforms required to achieve growth.

In this regard, progress on reforms has remained limited despite the very favourable external environment that provided the ideal window of opportunity for reform over the past year. The overall environment for private sector development remains little changed from 1999. Progress in building trust in the financial sector, through restructuring of the banking system and strengthening of the regulatory environment for capital markets has been extremely slow as the Russian government has put it very low on their priorities for reform. Progress on reforming natural resource monopolies and the agriculture sector has also been slow. Similarly, little progress has been made in strengthening the social sector and restructuring government institutions. Indeed, reform appears to have stalled since the summer, or at the very best, is moving forward very slowly. This is a cause for great concern. Failure to push forward will leave Russia vulnerable to external and internal shocks.

In light of the significant operational and reputational risks associated with Bank operations in Russia, we would like to see the Bank proceed cautiously in implementing the lending scenarios proposed in the Progress Report. We call on the Bank to respect the on-going priority assigned to quality over quantity in project lending. The Bank has a responsibility as a creditor to ensure that its financing to the already heavily indebted Russian government helps to support a process of long-term growth and poverty reduction that will allow debt service payments without undue sacrifice on the part of citizens.

In the past we have called for a greater focus in Bank programmes on reform outcomes as an
important determinant of increasing Bank exposure. The cursory treatment of triggers in the Report does not allow an assessment of whether they place sufficient focus on outcomes. In addition, we understand that the Bank and the Russian government are developing a joint monitoring program to review on a regular basis the implementation of the government's reform strategy. The Report notes that the monitoring program will provide an independent view of the progress of structural reform in Russia and a basis for assessing the readiness for high levels of Bank financial support to Russia. We would like the Staff to explain issues surrounding the independence of this review process as well as how this monitoring programme will fit with the proposed triggers in the Progress Report.

From our perspective, increasing exposure should also be contingent on a continuous improvement in budget accountability and transparency. Bank work on public expenditure benchmarking over the last twelve months indicates that data deficiencies and large areas of missing coverage limit the possibility of a comprehensive measure of public expenditures. Moreover, deficiencies in budget planning and execution undermine and threaten the capacity to implement public policy.

The Progress Report’s emphasis on building public-sector institutions to support private enterprise development appears appropriate and supports the Government’s own economic plan, which emphasises improving the business and investment climate as a key area of focus. However, given the strong balance of payments and fiscal position of the Russian government, we question whether Russia really needs Bank financial support (adjustment lending) to move forward with structural reforms in this area.

With respect to Bank programming, we have serious concerns about the proposed focus of IFC investments on large Russian corporates operating in the energy sector. While the resource sector is a key one in the Russian economy, and must be a priority for reform given its potential to deliver growth to the economy, we do not believe the needed sectoral reforms will be supported by IFC investment. Moving forward reform in this sector will require political will to enforce behaviour that is consistent with good corporate governance and transparency. At present, we believe this situation does not exist. Therefore, we believe IFC involvement with large Russian corporates opens the Bank Group to significant reputation risk.

From our perspective, the IFC should focus its efforts on small and medium sized enterprise development. We believe such an emphasis will best support the IBRD’s intensified program of policy and technical assistance to support private sector development. In addition, a vibrant SME sector has the potential to create jobs, which can mitigate some of the social costs associated with large enterprise restructuring. As Canada has noted in the past, the growth of a small and medium sized enterprise sector also has an important role to play in creating a broad-based constituency for reform in Russia that can act as a counterweight to powerful vested interests. Such a constituency would help to move forward the reform process.

We welcome the progress in making the attack on corruption a more explicit part of the Government’s agenda. This is a step in the right direction for private sector development. As the CAS Progress Report rightly points out, much remains to be done. For its part, Canada was
pleased to be associated with the major effort launched by the WBI on designing a Transparency and Governance Program for Russia with focus on decentralization, corporate governance, macroeconomic management, and empowering civil society.

With respect to the financial sector, we understand that the Bank is continuing to provide technical assistance to the Russian authorities. This sector has received significant technical and financial assistance over the last years with little progress made in terms of restructuring, regulation and supervision. Given the Russian government has been quite clear that it wants to move slowly on banking sector reforms, how can the Bank make the progress needed in this area and does it agree with the Russian authorities view? How does the proposed technical assistance help to move forward the reform process in concrete terms?

Finally, we would like to see the Bank engage the Russian government, at both the federal and regional levels, in a policy dialogue on how to strengthen the social sector in Russia. We find the importance of progress in the social sector is given limited attention in the Progress Report.

To conclude, while we wish the Russian Government more success in implementing the CAS, we cannot ignore our policy and development failures in the past. There is much riding on our future investments being made more realistic and concrete. For Russia and the World Bank, the path forward will be challenging to be sure and this time our interactions must lead to real and tangible benefits to the people of Russia.