Russia: Country Assistance Strategy Updating Note

General

1. We commend Bank staff for a forthright appraisal of the situation in Russia and open acknowledgement of the difficult challenges ahead. As we navigate the uncertainty of the coming months, flexibility and creativity will be essential. This is a critical period for the Russian Federation. The Government still faces enormously difficult economic and social challenges. We would like the World Bank Group to play a dynamic, pro-active role in advancing sectoral strategies that promote reform and provide the necessary underpinnings for a healthy, prosperous economy. The Bank’s ability to play such a role is of course dependent on the Government’s commitment to, and ownership of, sound policies that promote economic reform, structural adjustment and social development. We believe it is essential that the Bank retain the capacity and willingness to respond quickly in those areas or sectors where the Government demonstrates such genuine commitment to reform.

2. We believe that addressing the social impact of the crisis, promoting growth in the “real” sector, and jumpstarting bank restructuring should be top priorities for the Russian government and for the Bank’s reform program in the near term. At the same time, inflation must be kept in check and Russia must not regress in other crucial areas such as tax collection.

3. We welcome the joint Bank/Russian effort to develop a new social sector project that will build on successful pilot projects on targeting social benefits and launch new pilots in the areas of public works and social funds. We encourage the Bank to look for additional opportunities in the social sector.

4. In the real sector, the current GOR plans appear to emphasize directed credit and nationalization rather than liquidation and restructuring. We believe that the structural program negotiated with the Bank prior to the crisis remains fundamentally correct. Adjustments will be needed but we hope that the ongoing discussions between the Bank and the government will continue to emphasize the need to adopt policies that are fiscally sustainable and promote enterprise restructuring and new business development.

* Given that policy and structural reforms will need some time to take hold, we wish to highlight the role that IFC programs could
have in providing a positive demonstration effect by helping to spur new business creation and foreign direct investment through investments in venture funds and export-oriented companies which might benefit from the ruble devaluation. Anecdotal evidence of some increased foreign investment interest is intriguing and we would be interested in additional information as it becomes available.

5. We applaud the intense effort that the Bank is making to encourage progress on restructuring the banking sector. Coordination with the EBRD and other interested players is essential. We encourage the Russian government to move forward quickly on both the organizational and legal actions necessary to get the process moving. If restructuring momentum builds in this sector, we would encourage the Bank to consider the possibility of a financial sector adjustment project.

6. The best efforts of all will fail if problems of corruption are not addressed. It is not an exaggeration to say that corruption is at the root of Russia’s inability to pursue fundamental reform.

- We are pleased that the Bank and the Government of Russia appear close to agreeing to undertake a diagnostic survey to document current practices and identify weakness in public fund management and public administration systems. In collaboration with the IMF, the Bank should rapidly press ahead with public expenditure review work which will help ensure that scarce public resources are directed to development needs without leakage.

- This will require, however, a serious commitment by the GOR to make its budget and expenditure reporting processes more transparent so that all parties (Russian government, Duma, civil society and the international community) can fully understand and analyze economic and financial realities.

- To foster greater accountability over public resources, we would also urge the Bank to assist the GOR meet international auditing standards and ensure reporting of all public expenditures, including military, to civilian authorities.

Interim Operating Plan

7. We support the Bank’s approach to focus during this interim period on better understanding Russia’s own strategies for facing its challenges, and to remain ready to support realistic objectives built on coherent economic policy steps.

8. A sense of such commitment to serious reform will come from vigorous engagement with the Government to evaluate progress on structural reforms and assess the Government’s ability and willingness to pursue continued reforms under the SAL III, SPAL, and Coal II loans.

- This evaluation should assess prospects for structural reform under a range of macroeconomic scenarios and identify areas where reform can continue even in a potentially unstable or inflationary macro-economic environment.
• While we believe the basic architecture of the adjustment loans remains sound, we also believe that the Bank should be prepared to be flexible in making adjustments to support reform categories which show the most promise.

9. The inclusion of the Highway II project in the FY99 lending program indicates that certain project loans are feasible even when structural reforms are stalled. We were pleased to hear that several other project loans are progressing fairly well and hope that they will indeed come to fruition in the coming months. We will particularly welcome proposals which focus on addressing the social consequences of the crisis.

• The Bank should continue to actively pursue such opportunities in parallel with its work with the Government on the larger structural program.

10. In line with our comments above on public expenditure work, we welcome the Bank’s commitment to accord prominence in its Russia work program to improving the efficiency and transparency in use of public sector resources.

11. Missing from this Interim Operating Plan is a sense of how it is grounded with other assistance activities. Of particular interest is the sequencing and operationalization of this plan against the background of IMF discussions as well as a division of labor between the Bank and the EBRD. We would like to see additional information on this.

Elements of Full Russia CAS

12. While largely supporting the Bank’s proposed interim operating strategy, we wish to highlight several areas we hope will be addressed in the full CAS:

• Donor Collaboration: discussion of engagement by other donors and their approach during crisis and beyond. Special focus on IMF and EBRD collaboration.

• Country Portfolio Performance Review (CPPR): we would like to see explicit links between the findings and recommendations of the special CPPR and the proposed lending strategy.

• Building Blocks of the CAS: as a precursor to the full CAS, and in keeping with IDA-12 directives, we hope to see prior completion of the Public Expenditure Review (in collaboration with the IMF), a Country Procurement Assessment, and a Country Financial Accountability Assessment -- all of which will serve as objective indicators of governance.