Report No. PIC976

Project Name                  Russia-Second Rehabilitation Loan
Region                       Eastern Countries
Sector                       Public Finance/Administration
Project ID                   RUPA8838
Financing Plan               IBRD US$ 600 million
Negotiations                 August, 1993
Projected Board Date         February 1994

Background

1. The Bank is developing an Accelerated Program of Financial Assistance to Russia, which was announced at the meeting of the G-7 Foreign and Finance Ministers in Tokyo on April 14-15, 1993. The Bank’s first operation as part of this program, the Oil Rehabilitation Loan (US$ 610 million), was approved by the Board on June 17, 1993, at which time the Board reviewed and broadly endorsed the Country Assistance Strategy for Russia. In order for the Bank to realize this lending program, it is essential to reach agreement with the Government on the overall framework for structural reforms, within which subsequent operations can focus on specific aspects of the reform program. The Second Rehabilitation Loan is intended to provide this framework.

Objectives

2. As emphasized in the Country Assistance Strategy, privatization and enterprise reform are at the heart of Russia’s transformation into a market economy. This will require a range of reform measures designed to create an environment within which enterprise reform can proceed in an efficient manner. The Second Rehabilitation Loan will support this process through reforms in the following areas: (i) private sector development; (ii) price and subsidy policies; (iii) trade policies; (iv) pro-competition and anti-monopoly policies; (v) reform of state-owned enterprises; (vi) financial sector reforms; and (vii) social protection. Significant actions have already been taken by the Government in a number of important areas including: (i) increases in export quotas; (ii) reduction or elimination of price controls and subsidies; (iii) elimination of restrictions on surrender of export proceeds to the Central Bank; and (iv) reduction of interest subsidies. The macroeconomic program for the period covered by the Second Rehabilitation Loan would be supported by a Systemic Transformation Facility from the IMF.

Description

3. The proposed loan would be divided into three components: (i) Market-Based Imports Component -- $500 million to finance imports purchased by the growing commercial private sector; (ii) Pre-Identified Imports Component -- $98.5 million to finance a priority list of critical imports for the health and agriculture sectors; and
(iii) Local Implementation Costs -- $1.5 million to finance the services of local procurement agents required for the implementation of the Pre-Identified Imports Component, and travel and operating costs of the Project Implementation Unit. Based on the experience of the First Rehabilitation Loan, the loan is expected to be disbursed in approximately one year following loan effectiveness, and the Closing Date for the loan would be December 31, 1994.

Environmental Aspects

4. Environment Assessment Category C. All pre-identified imports will be screened for environmental concerns and remedial actions, if needed, will be identified prior to approving the final list of imports.

Institutional Capacity

5. The Loan will be implemented using the institutional arrangements introduced under the First Rehabilitation Loan, which have worked effectively. The Department for International Finance and Investment will be responsible for monitoring progress on the reform program in coordination with the Bank. The Central Bank of Russia will be responsible for the Market-Based Imports Component. The Project Implementation Unit in the Ministry of Finance will be responsible for implementing the Pre-Identified Imports Component, with the assistance of external advisers financed by the U.K. Know-How Fund.

Benefits and Risks

6. The Second Rehabilitation Loan provides an important opportunity to establish a coordinated policy framework for addressing the key problems of enterprise reform in Russia. The problem of enterprise reform will be facing the Government for the next decade at least, and it is important that the initial stages in setting up this process should be done well. Given the broad international interest in supporting Russia, the Bank can play a key role in shaping a workable program of structural reforms that can be sustained in the medium term.

7. The reform program has been fully reviewed and discussed with key Government officials, so that they feel comfortable with their ownership of the reforms. However, they recognize that the program will be economically and politically difficult, and many of the targets should be viewed as desirable objectives rather than fully feasible according to the indicated schedule. The most important risk in terms of the implementation of the reform program is the success of the macroeconomic stabilization program, as many of the key structural reforms (especially the trade reforms) may not be sustainable unless the economy makes substantial progress toward financial stability. In this sense, financial stabilization and structural reform should be viewed as mutually reinforcing processes.
Note: This is information on an evolving project. Certain components may not necessarily be included in the final project.