Statement by Jan Piercy
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Russia Country Assistance Strategy

1. We want to thank Bank staff for their candor in analyzing the challenges facing Russia, and the shortcomings of the Bank’s past program in Russia. The Bank’s assessment in paragraph 90 is particularly frank that “(t)he risks to the Bank Group associated with its operations in Russia - both to its financial standing and to its reputation as a development institution – are substantial.” The importance of Russia’s stability and its economic progress to the region and the world has influenced shareholders in the past to remain, despite serious shortcomings in performance. Going forward, however, we believe that a rigorous approach to conditionality is the most effective way to leverage reform. The Bank and its shareholders must have a credible and frank CAS upon which to base and justify its decisions.

2. We agree with the CAS’s frank assessment that Russia’s progress on structural reform has lagged badly and that near term prospects for improved performance are dim. Russia’s current macroeconomic environment -- buoyed as it is by high oil prices and improved competitiveness resulting from last year’s devaluation -- could, in theory, provide a more stable base for accelerating structural reform. The challenge will be to exploit this opportunity in the face of major obstacles and vested interests. Recent well publicized incidents of apparent abuse of shareholder and creditor rights; non-transparent, below market privatizations; and alleged corruption at the highest levels of government highlight the huge leap needed if the Russian economy is to achieve the basic institutional development required for growth. We can only hope that the political alignment in Russia resulting from the current election cycle will produce greater consensus for deep and systemic structural reform.

3. IMF management’s recent decision to delay consideration of Russia’s next disbursement under its Stand-by Agreement pending completion of several key structural benchmarks, reflects the Fund’s focus on an integrated macroeconomic and structural program. The Fund’s position underscores the view, which we share, that stabilization ultimately can only be sustained by
consistent progress on a broad structural program. Going forward, it is important that the Bank and Fund continue to coordinate closely on program conditionality.

4. Until Russia demonstrates serious commitment to substantial, results-oriented structural reform, the Bank should adhere to its stated approach of getting the greatest development impact from the current program through strong enforcement of conditionality. In this regard, Bank management should carefully examine compliance with conditions on the current Coal SECAL II loan before determining whether disbursement is warranted.

5. We have learned from past disappointments on Russian structural reform that piecemeal reform does not produce results. The G-7 clearly expressed this view in September: “structural adjustment lending should be provided only in the context of implementation of broad and significant structural and institutional reforms to promote private investment, jobs, and growth and to combat corruption.” We believe that this focus on the need for comprehensive reform should be reflected in the Bank’s approach going forward.

6. While recognizing the difficult environment in which this CAS was prepared, we have a number of issues of substantive concern, outlined below.

7. PAST PROGRAM: Clearly the performance of the Bank’s portfolio in Russia is unsatisfactory. It is worth reiterating a couple of statistics in Annex II: in FY00 approximately 82% of projects by dollar volume and 70% by number are categorized as “at risk.” Things are little better when viewed from the perspective of the Bank’s total portfolio. Of the ten largest investment operations “at risk” in the World Bank’s portfolio, half are in Russia. The bottom line is that Russia is one of the Bank’s worst performing borrowers.

8. PROPOSED PROGRAM: The CAS fails to categorize Russia’s current program level (low, low/intermediate, intermediate/high, high). While an element of flexibility is important, the CAS should identify clearly the lending scenario in which the Bank is operating so that all of us, including the Russian Government and the Board, understand fully the intended program. We ask this of other borrowers; Russia should be no different.

9. STRUCTURAL REFORM: The CAS is fairly modest in its expectations of what can be achieved in the coming 24 month period on the extensive structural reform agenda facing Russia. We would like to see tougher CAS lending triggers (page 37), and refer again to the September G-7 statement: new lending to the GOR should only go forward on the basis of significant structural reform. Thus, the Bank’s expectations appear too modest with respect to the “low case” of $150 million in new lending. The Bank should be seeking not only “progress” on SAL conditionality, but fulfillment of conditions as is outlined in the “low intermediate case.” Without GOR commitment to work in a concerted manner with the Bank on the structural reform agenda in a number of key areas, prospects for economic growth and social development in Russia are bleak. The proposed triggers also should indicate explicitly targets on governance issues, specifically progress on anti-corruption measures. Inclusion of governance triggers in individual lending proposals is not enough, a fact recently confirmed in the ongoing discussions on the CAS Retrospective II.
10. CORRUPTION: The CAS appropriately highlights corruption as a key impediment to sound public sector management as well as to private sector-led growth, yet suggests that it may be more a problem of perception than reality. The identification and analysis of governance and corruption issues affecting development effectiveness should be strengthened considerably. The CAS identifies possible instruments to address institutional problems and provide credible justification of its lending program -- National Institutional Reviews, Country Financial Accountability Assessments and full Public Expenditure Reviews -- but then deems them inappropriate at this time. We disagree entirely: candid and thorough assessments of the full range of issues covered by these diagnostic tools is imperative. We are seriously troubled by the assertion that administrative budget constraints may be a factor. We understand that there may be some interest in a governance/corruption task force such as those Mr. Kaufmann and the World Bank Institute are now piloting in seven other countries. We would strongly encourage this approach.

11. We also believe that Bank engagement to help build institutions could be fruitful -- particularly assistance to strengthen the Russian Chamber of Accounts. This would introduce the kinds of checks and balances in Russia that we have found to be of substantial long-run benefit to promoting accountability, integrity and transparency in the United States and other countries. Progress in these areas should precede future adjustment lending.

12. PUBLIC SECTOR REFORM: The Bank must remain focussed on creating a more responsive, efficient, cost effective public sector in Russia. This includes efforts to shrink Russia's public payroll that appears to have grown even as Russia has transitioned from a state-run to a market economy.

13. PRIVATE SECTOR DEVELOPMENT: The Russian Government must pursue actively an extensive agenda in terms of policy and regulatory reform in order to promote private investment and growth, notably restructuring of the financial sector, as well as improvement in property rights enforcement. In this regard we are skeptical that MIGA and IBRD guarantees are the right instrument for making serious headway on improving the policy environment for private investment (page 23) and would appreciate further staff explanation of the rationale for the use of these instruments.

14. Given the prevailing poor investment climate, IFC and MIGA interventions should be highly selective. The IFC's activities should be directed to truly private sector enterprises, rather than those that are commercial but retain majority state ownership. Broadly speaking, we remain seriously disappointed with the lack of integration of the Bank’s private sector affiliates into this CAS. Given the Bank's present strategy of disengaging from regional projects, we also question the appropriateness of MIGA's desire to proceed with guarantees to sub-sovereign entities in Russia.

15. FINANCIAL SECTOR REFORM: Substantial weaknesses persist in Russia's financial sector, and we would have liked to see a serious discussion in the CAS on the challenges of restructuring it. Progress by the Russian authorities in this key area remains painfully slow.
despite significant focus by the Bank and other donors. Bankruptcy procedures must be improved and the foreign investment regime needs clarification. Procedures for bank liquidation have yet to be developed. Close political ties that many Russian banks have developed impede the ability of the Central Bank to supervise effectively. The ownership structure of banks is typically opaque and consists of interlocking ties between the banks, their borrowers, their shareholders and local political institutions. The Russian government has not acted forcefully enough to investigate allegations of asset stripping. Dealing with these issues is not just a question of new legislation, it is a question of political will, particularly on the part of the central bank. Future disbursements should be tied to concrete action by the central bank to close, liquidate, and restructure banks. The Bank's efforts in this area need to become more effective, otherwise these difficulties undoubtedly will constrain overall economic growth.

16. **POVERTY:** More proactive engagement is clearly required in assisting non-working vulnerable groups such as children, the disabled and pensioners. However, the Russian Government and the Bank must improve the efficient targeting of public resources to the substantial fraction of the Russian population living in poverty. While we appreciate that the Russian Government needs to undertake fiscal adjustment in the coming period, a serious examination of fiscal choices could yield possible options for developing a targeted social safety net. The CAS should have highlighted options for reprioritizing non-productive spending—including military spending—to development objectives.

17. **REGIONAL LENDING:** We fully support the Regional Fiscal Technical Assistance Project, which provides technical assistance to support capacity building in areas that we believe are absolutely critical. We recognize the Bank's assessment that engagement at the sub-national level is premature as it is impossible to pick "performing regions"—they change; systemic leverage is not achieved out of such operations—effects are at best localized; many regions are not creditworthy; and operating costs to the Bank are high. However, given that regional policy is central to the CAS goals of reducing nonpayment, enterprise restructuring, poverty reduction, etc., we believe that the Bank should build on lessons learned to undertake projects most likely to be effective at the sub-national level.

18. **AGRICULTURE:** Has the Bank perhaps missed an opportunity to go beyond continuing the dialogue in agriculture in the operational plan? We expected the CAS to highlight more strongly the need for land reform and privatization in Russia. Land privatization is central from a variety of perspectives—increasing agricultural productivity; reducing rural poverty; and promoting private investment in commercial and industrial real estate. There may be a window during the CAS period when there may be more receptivity to necessary land reforms that would create an enabling environment for poverty reduction in rural areas. Therefore, we suggest that both land reform and poverty reduction should be integrated into the plan under agriculture. We would appreciate staff comments on this point.

19. **DONOR COORDINATION:** We would appreciate a more complete discussion of donor coordination in Russia, particularly on programs relating to public sector institution strengthening, accounting and auditing and anti-corruption measures. We would like staff also to comment specifically on how the Bank coordinates with the EBRD on private sector
development initiatives.

20. PARTICIPATION: This CAS did not include a discussion of the consultations involved in developing the proposed program, which, as we are all aware, are an integral element of assisting implementation and sustainability of reforms embodied in the CAS. We would appreciate staff comment on this.