Board Meeting of May 19, 1998  
Statement by Boris Lvin, Temporary Alternate

**Latvia CAS**

We found the CAS paper on Latvia well-balanced and informative. We agree that the generally successful process of economic transition in the country warrants more attention to be devoted to the areas identified as priorities in the CAS - i.e., fiscal federalism, further strengthening private sector environment, reshaping the role of the state, and improving financial sector.

We noted that neither the authorities nor the IFIs are fully comfortable with the relatively large current account deficit. However, as long as its origins are related to FDI, there should be no real concern; moreover, any attempts to curb such inflows would turn counterproductive. The question is to what extent domestic banks have learned the lessons of the extremely severe banking crisis and whether they display due restraint in contracting short-term foreign debt to finance longer-term investment. It may be expected that foreign lenders are now fully aware of potential dangers and lend to the banks with caution. Given this, I have some doubts that simply limiting the current account deficit should be made a top policy objective. If anything, the policy should be aimed at dispelling any notion that the state guarantees private obligations. At the same time the authorities should maintain and reinforce the combined policy of strictly limiting the official debt, balancing fiscal accounts, and prohibiting investment borrowing by the central government. I fully agree in this respect that remaining public sector borrowing (by local governments, agencies, SOEs) should be scrutinized and put under strict control.

As far as the dramatic regional disparities are concerned, I would suggest that the government should identify administrative barriers which in practice impede growth outside the capital. This may be much more effective than any form of direct support which cannot be but drastically limited by stringent fiscal requirements. For instance, it is clear that having 550 local governments is too heavy a burden for such a small country.

The fact that the authorities increasingly turn to non-lending services should be viewed as a sign of maturity. Moreover, it seems that in the area of technical assistance some bilateral donors have comparative advantage over the World Bank.
Finally, we noted that the Bank acknowledges the potentially harmful effects of the civil exclusion of the large group of residents. We agree with the observations made in the CAS paper and believe that a resolution of this problem would benefit all parties concerned.