Statement by Richard Kaijuka  
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Russian Federation: CAS Progress Report

The Russian economy went through difficult periods of high unemployment, poverty, and financial difficulties culminating in the financial meltdown of August, 1998. However, since then, the economy has shown a remarkable recovery in the last two years, with a healthy growth in real GDP, lower unemployment and inflation, a surplus in the balance of payments, a relatively large amount of international reserves, a more stable exchange rate, and a substantially improved fiscal position. The impressive economic performance has been, mainly, due to the sharp depreciation of the ruble, the increase in oil prices, and the sound fiscal and monetary policies followed by the Russian Government.

However, to sustain the positive economic performance, the Government needs to do more. The policies and structural reforms that the Government is embarking on currently, with the assistance of the Bank Group and its other development partners, should help in propelling the economy forward in a sustainable fashion. In this connection, we support the Government's comprehensive long-term economic development program and its emphasis on improving the environment for private sector development, social safety net and social sector development, and the restructuring of the branches of government. The ownership of the reform program should contribute to the effective implementation of the reforms.

Having said this, I would like to make the following specific comments.

1. Foreign Exchange Intervention

The surplus in the balance of payments has led to the appreciation of the ruble. This may adversely impact Russia's competitiveness in world markets and production in the domestic market, thereby eroding some of the economic gains realized so far. It is, therefore, prudent that the Central Bank of Russia follow policies that underpin the stability of the foreign exchange rate, without generating inflationary pressures, through carefully selected instruments and timely intervention.

2. Land Policy

The Progress Report identifies land ownership and the absence of functioning real estate markets
in Russia as a principal constraint to new enterprise development and an obstacle to the efficient allocation of resources. Given the importance of land to private sector development, economic growth and poverty reduction, there is a clear need for addressing the land issue.

We are pleased to note that there is support for land legislation at the highest levels of the Russian Government. Recently, President Vladimir Putin told a meeting of regional leaders of Russia that there is an urgent need for land legislation. Furthermore, the State Duma has passed a draft land code on the sale and purchase of nonagricultural land. Given the stated interest of the Russian leaders in land legislation, what plans does the Bank have to assist in this matter? Staff comments would be appreciated.

3. Pension Reform

One of the key areas of reform in the Government's long-term economic development program is social safety net and social sector development. Reform of the pension system is included in that area.

The increase in the minimum pension benefit that has already been implemented is a step in the right direction. We also welcome the proposal for a fully-funded pillar and the indexation of pension benefits. The Bank has considerable expertise in pension reforms, and indeed has been involved, through the World Bank Institute, in the social policy reform in Russia. However, it is not clear what role, if any, the Bank intends to play in the development of the fully-funded pillar. Staff comments would be appreciated.

4. Deposit Insurance

The proposal to introduce deposit insurance could increase consumer confidence and contribute to the overall safety of the commercial banking system, and we support it. However, we agree with the Staff that it should be preceded by improvements in bank supervision, accounting and auditing. There should also be adequate capacity and appropriate financial infrastructure, particularly, in the areas of legal and regulatory framework. Without these, deposit insurance could lead to greater risk-taking in lending by banks, and complicate a system that is already burdened by highly concentrated lending, non-transparency and poor internal controls.

5. Lending Triggers

We broadly support the proposed Progress Report's triggers for the low-case and high-case lending scenarios, although we think the country falls in the low case scenario. However, we feel the macroeconomic framework trigger for both the lending scenarios is not specific enough. Satisfactory macroeconomic framework is required, but it is not clear what constitutes satisfactory. Since the term "macroeconomic framework" is broad, it would be difficult for the authorities to understand what exactly is expected. The use of specific inflation and real exchange rate targets or benchmarks, and regular review and consultation with the authorities to assess progress toward the fulfillment of those triggers may be advisable.

Finally, we would like to commend the Staff for a well-prepared document and wish the Russian...
authorities success in implementing their reform programs.