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Statement by the Hon. **VIKTOR KHRISTENKO**,
Governor of the Bank for the **RUSSIAN FEDERATION**,
at the Joint Annual Discussion

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World Economic Outlook

Since our previous meeting last year the global economic situation has improved substantially. Economic recovery in the countries hardest hit by the crisis came about faster than previously expected. Projections for growth in the Asian economies in 1999–2000 have been substantially upgraded, the economic downturn in Brazil turned out to be less serious than previously expected, and in Russia a return to economic growth that was interrupted in 1998 is now expected in 1999.

I would also like to mention the signs of economic recovery in Japan, which has been in recession for a long time. The stabilization of world commodity prices, together with increases in world prices for oil, have helped to improve the financial position of commodity exporting countries. The increase in capital flows to emerging market economies creates a background for stable economic growth in these countries over the medium term.

Despite the general improvement, however, the latest edition of the *World Economic Outlook* notes the remaining uncertainties and risks. In an environment where a slowdown in the U.S. economy seems unavoidable and the recovery in Europe and Japan remains problematic, it is not clear who will act as the “engine” for the global economy. Moreover, the longstanding divergence in growth rates among the leading industrial economies has already resulted in serious current account imbalances.

Crisis Resolution in Emerging Market Countries

In the **Asian region** we see a gradual improvement in the economic situation, which manifests itself in renewed growth and inflow of foreign private capital. This is particularly true of **Korea and Thailand**, which pursued the most steadfast and consistent policies in the period following the financial crisis. At the same time, these countries have not yet completed the complex structural reforms, especially in the banking and corporate sectors.

Economic contraction in a number of countries of **Latin America** this year is explained largely by the impact of the financial crisis in **Brazil**. On the other hand, the decline in output in Brazil itself was not as severe as had been previously expected. This was primarily the result of responsible macroeconomic policy and vigorous structural reforms carried out in the country, which made it possible to restore investor confidence quite rapidly. It is expected that in many Latin American countries there will be a resumption of growth as early as next year.

As far as **Russia** is concerned, we can already say today that the worst fears expressed after the severe financial crisis in August 1998 have not materialized. The policies of the government and the Central Bank largely stabilized the situation. Moreover, the devaluation of the ruble had a positive impact on the real sector. For example, in the first half of this year industrial output grew by 3 percent compared to the same period last year.

A reasonably tight monetary policy helped reduce inflation to 1.2 percent in August 1999 in comparison with double-digit monthly inflation last year. It is expected that this year, as a result of the devaluation of the ruble and higher oil prices, there will be a substantial improvement in Russia's current account (which is expected to reach a surplus of to 14 percent of GDP). This, in turn, is stabilizing the Central Bank's foreign exchange reserves and the exchange rate of the ruble.

Noticeable progress has been achieved in the fiscal sector, which has been the weakest point in Russia's economic policy over the recent years. Tax and tariff collection improved significantly; in the first half of this year federal budget revenues exceeded 13 percent of GDP as compared to 11 percent last year. Moreover, all federal budget revenues are being collected in cash, since the practice of mutual offsets has been terminated. It is already clear that the federal budget primary surplus of 2 percent of GDP stipulated for this year will be successfully achieved. The draft federal budget for 2000 calls for an increase in the primary surplus to 3.2 percent of GDP.

Of course, many problems remain, especially on the structural front. We must complete the restructuring of the banking system, which was hard hit by the crisis. Strengthening payment discipline and reducing the degree of "barterization" of the economy continue to be among the most important objectives.

The government and the Central Bank intend to address all these issues in close cooperation with the IMF and the World Bank. Currently, Russia is successfully implementing a Stand-By program agreed with the IMF.

Strengthening the International Financial Architecture

Increasing globalization of international capital markets is bringing new challenges to ***exchange rate regimes*** in emerging market economies. As the recent experience of many countries shows, defending the exchange rate with interventions counter to the market sentiment merely leads to rapid exhaustion of foreign exchange reserves. Many believe nowadays that the only choice for emerging market countries should be either freely floating system or currency board arrangement.

It is true that, during the recent financial crisis, countries with currency board arrangements successfully defended their national currencies. They paid for this, however, with a loss of competitiveness, and an economic downturn. Meanwhile, some countries that were pursuing a more discretionary exchange rate policy managed to avoid both an economic downturn and a sharp depreciation of the national currency. These countries are known for their healthy macroeconomic situation and stable financial system, and also for a high level of foreign reserves which significantly exceed their monetary base. It seems that precisely these factors also determine the stability of the currency.

Clearly, exchange rate stability is of great importance for robust development of the economy, since it reduces the degree of uncertainty for all agents. Successful management of the exchange rate however requires that a whole range of conditions, such as a healthy macroeconomic situation, a strong financial system, and a high level of foreign exchange reserves. For emerging market countries where these conditions do not hold, it is better to adhere to a floating exchange rate policy. This is especially true for countries that are heavily dependent on world commodity prices, since a floating exchange rate makes it easier to absorb terms of trade shocks.

Liberalization of capital flows is useful and beneficial. At the same time it does entail considerable risks and requires careful preparation. The main condition for success, in addition to general macroeconomic stability, is the need to have strong financial and banking systems backed by independent regulatory bodies. Prudential control of capital flows (especially short-term ones) are permissible, and in certain cases even desirable. The very term "orderly liberalization of capital movements" assumes the sensible use of restrictions and their gradual relaxation in line with the pace of economic reforms. The advisability of employing such restrictions is determined by a whole set of circumstances, such as the overall level of country's economic development, depth of financial markets, state of the banking system, and so on. As noted in IMF reports, many countries view such restrictions as a useful instrument and their own experience in using these restrictions as an obvious success. Moreover, interest in the experience of these countries has been growing lately. Therefore, we believe that there is a need to continue the studies of experience with using capital control measures.

We are not opposed to amending the IMF Articles of Agreement to add the capital account liberalization to the Fund's objectives. At the same time, capital account liberalization should not become a condition for access to Fund resources.

The question of ***involving the private sector in forestalling and resolving financial crises*** is very important for strengthening the global financial architecture. We have no doubt about the need for the private sector to participate in the resolution of financial crises. At the same time, we believe that this is a very complicated task requiring a cautious approach. On the one hand, we understand the desire to work out a set of rules on this issue, which would both help reduce uncertainties on financial markets and provide for a more equitable burden-sharing among various groups of creditors. On the other hand, any hasty and unwise steps in this area could lead to a drastic deterioration in borrowing conditions for emerging market countries. We would also note that some useful experience is being gained in this area now.

We also need to maintain an ongoing dialogue with representatives of the private sector. We need to explain that the IMF does not seek to impose specific parameters for restructuring private sector claims, and that the IMF simply evaluates the status of a country's balance of payments, while all decisions should properly be based on the outcome of negotiations between creditors and debtors. It is also important that the private sector not get the wrong idea that some specific decision taken with regard to one country or another will henceforth necessarily become a rule.

We support the ***transparency and international standards*** initiatives undertaken by the IMF to increase the degree of openness of its activities, as well as its relations with member countries. Substantial progress has been achieved in the development and implementation of international standards in the areas directly related to the Fund's mandate. We support the strengthening of the Special Data Dissemination Standard (SDDS) with respect to international reserves and external debt. We also believe that the Codes of good practice for fiscal, monetary, and financial policies developed at the IMF will be very useful to countries working to strengthen their budgetary and financial systems. At the same time, we believe that the use of standards in the Fund's activities should be restricted to the analysis of progress achieved by the countries, and recommendations about further improvements; in no way should they be used to categorize countries for whatever purpose.

Cooperation between the IMF and the World Bank

Successful cooperation between the Bretton Woods institutions is a crucial element of the international financial architecture. This cooperation becomes even more important during major financial crises. The IMF and IBRD are currently facing with a dual task: dealing with the aftermath of the crises and preventing contagion and recurrence. We are pleased to note significant progress achieved in this area. The Interim and Development Committees devoted much attention to the specific aspects of cooperation between the two institutions.

This cooperation should be based on two fundamental principles – complementarity and avoiding duplication. On the one hand, each institutions should focus on its own area of expertise; on the other, the knowledge and experience should be shared between the two and integrated into respective policies and documents. Contacts should be established at all levels of the hierarchy. In our view, the activities of the Financial Sector Liaison Committee of the IMF and IBRD may be viewed as a model for such of cooperation.

However, the mandates of the two Institutions remain different. Specifically, national fiscal and monetary policies tend to affect the situation in other countries and regions. The IMF is thus charged with a special surveillance mandate. This function is not a part of the World Bank mandate which, therefore, is not a standard-setting body. The Bank's role is to provide resources for development and poverty alleviation in developing and transition economies. The Bank's valuable role as a knowledge institution should remain client-driven and advisory only.

Heavily Indebted Poor Countries Initiative

We support the HIPC Initiative and the reallocation of resources currently going to service external debt toward funding poverty reduction programs. The countries pursuing sound macroeconomic, structural and social policies should be able to escape from the "debt trap" in the nearest future. The Russian Federation will continue to fully participate in operations to assist individual countries on the basis of the agreed principles of burden sharing. We particularly welcome the new emphasis on poverty reduction in the Initiative design which fits so well the Comprehensive Development Framework.

However, our support for the expansion of the Initiative is conditioned on its adequate financing. At the same time, we would welcome a compromise solution that takes into account budgetary and domestic political problems of individual donors and creditors. Firm donors' commitments can be combined with a more flexible schedule of actual payments.