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WORLD BANK GROUP
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL FINANCE CORPORATION
INTERNATIONAL DEVELOPMENT ASSOCIATION
INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES
MULTILATERAL INVESTMENT GUARANTEE AGENCY

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Statement by the Hon. **ALEKSEI KUDRIN**,
Governor of the Fund for the **RUSSIAN FEDERATION**,
at the Joint Annual Discussion

Statement by the Hon. Aleksei Kudrin,
Governor of the Fund for the Russian Federation,
at the Joint Annual Discussion

1. Global Economy and Financial Markets

The forecast for overall global economic growth has remained almost unchanged from that set forth in the spring issue of the *World Economic Outlook*, and is in the range of three percent for 2003 and four percent for 2004. At the same time, we note that in the opinion of the Fund's experts, the balance between negative and positive risks for realization of this forecast has changed in favor of the latter. Nonetheless, it is clear that there is still considerable uncertainty regarding a number of key assumptions.

Above all, the heavy dependence of global economic growth on growth in the U.S. economy is a cause for concern. Persistent significant current account imbalances among the main centers of global growth mean that the threat of sharp fluctuations in the exchange rates of the major currencies remains. Generally speaking, a state of affairs in which year after year the entire rest of the world helps to finance the huge American current account deficit on the one hand, and on the other hand, expects to achieve growth by increasing exports to the United States, can hardly be considered healthy.

Another important factor contributing to uncertainty is the dynamics of oil prices. In the first half of this year these prices remained high, in spite of relatively weak business activity. It is clear that the expected global economic recovery will bring an increase in the demand for oil, which will put an upward pressure on oil prices. Furthermore, the dynamics of oil prices will depend on changes in geopolitical factors.

We read with interest the *Global Financial Stability Report*, which also notes the presence of a number of risks for both the global economy as a whole and for the economies of individual regions and countries. It is noteworthy that almost any sharp change in the dynamics of financial markets could lead to a heightening of risks. For example, rapid growth in stock market indexes, on the one hand, will contribute to greater investor confidence, and on the other hand, it may be accompanied by a rise in market interest rates. In turn, a steep rise in interest rates could lead to dangerous consequences for the housing market and consumer confidence. Furthermore, growth in stock market indexes and growth in interest rates in developed countries may have negative consequences for bond spreads of emerging market countries. And there will always be the danger that stock market indexes will get out of line with corporate earnings indicators, which means that another correction in equity prices will be possible.

In an environment of globalization, the macroeconomic policies of developed countries have a major impact not only on the economies of these countries themselves, but also on the economies of many other countries, and on the development of the global economy as a whole. It is clear that at the present time in developed countries, given low inflationary pressure and still tentative signs of a business recovery, monetary policy should continue to be stimulating. Both the United States and the European Union have the possibility of a further reduction in interest rates should such a need arise.

The discussion of fiscal policy is much more complicated. It is clear that the opportunities for stimulating business activity with the help of fiscal policy have already been exhausted in the major developed countries. Furthermore, in the United States, the major European Union countries, and Japan the task of devising a medium-term program of fiscal consolidation is on the agenda. This task is necessitated by both a deterioration of the current fiscal situation and the need to strengthen the financial position of social security systems in light of the aging of the population. At the same time, a premature reduction in fiscal stimulation over the short term could undermine the still fragile business recovery.

Over the past several years, with the slowdown in global economic growth, there has been a strengthening of protectionist tendencies. In this connection, it is difficult to overstate the importance of the successful conclusion of multilateral trade negotiations under the Doha Round. We fully support the joint statement by the heads of the Fund, the Bank, and the OECD, in which the leaders of these organizations expressed their readiness to provide effective support to developing countries during their adaptation to an environment of liberalized foreign trade.

We learned with interest that as a group emerging market countries have become net exporters of capital. We realize that this is due to a whole set of circumstances, including payments against external debt and the accumulation of foreign exchange reserves. At the same time, the very fact that emerging market countries are financing current account deficits of developed countries seems to go against the laws of nature. The reduction in flows of direct foreign investment into emerging market countries is particularly troubling.

Given the low interest rates in developed countries, investors have shown a great interest in high yield instruments, which led to a substantial decline in bond spreads of emerging market countries. Many of these countries were able to effect major borrowing under favorable terms in international financial markets with the aim of refinancing their external debt and improving its structure. It is clear that such favorable conditions for external borrowing are not going to last forever. In this connection, all emerging market countries with a high level of external debt need to develop their domestic markets for borrowing, and also seek to strengthen their public finances.

We read with interest the section in the *World Economic Outlook* devoted to an analysis of public debt sustainability in emerging market countries. The main conclusion of this analysis is that although the level of public debt that can be considered sustainable depends on the combined set of circumstances in each individual country, as a rule this level is quite low. It is also noteworthy that the average level of public debt in emerging market countries, which currently stands at about 70 percent of GDP, exceeds the average level of public debt in developed countries.

The last issue of the *World Economic Outlook* includes an interesting analysis of accumulation of foreign exchange reserves by Asian emerging market countries. We find interesting the main conclusion of this analysis that the accumulation of foreign exchange reserves was justified from the standpoint of overcoming the consequences of the financial crisis roughly up until 2001, while their further accumulation only led to an increase in current account imbalances.

Finally, a few words about economic developments in Russia. In the Fund's report the forecast for economic growth in Russia in 2003 was revised from 4 percent to 6 percent. This estimate roughly corresponds to our own forecast, although we do not rule out the possibility that it could turn out to be conservative. In the first half of this year GDP growth in Russia exceeded 7 percent, while growth in investment was around 12 percent. We believe that this sort of investment growth is evidence of a gradual improvement in the investment climate in Russia.

2. Strengthening IMF Surveillance and Promoting International Financial Stability

We continue to see Fund surveillance as the most important instrument of crisis prevention and welcome the continuing work of the IMF aimed at strengthening it. We support the Fund's activity on the Financial Sector Assessment Program (FSAP) and on assessing observance of international standards and codes (ROSCs). Work in this area is progressing well, as demonstrated by the great increase in the number of ROSCs and FSAP reports. Recently considerable attention has been drawn to a greater operational separation between program and surveillance activities. We agree that in certain cases (for example, for countries hit by a major crisis) this sort of separation may be justified. However, in our view combining surveillance and program activities should not be an exception but rather a norm for the operational setup of the surveillance process.

As recent capital account crises have shown, the significant vulnerability of emerging market economies arises from the excessive level of their public or external debt. Experience shows that frequently the level of debt that used to be considered "safe" is not, in fact. In this connection, strengthening of debt sustainability analysis (DSA) is very important both in the context of surveillance and program work. Another important instrument for revealing vulnerabilities is the balance sheet approach, which can help better understand crises in the emerging market economies and reveal timely the hidden vulnerabilities in the financial and public sectors, such as currency and maturity mismatches.

A great deal of work has been done by the Fund to develop mechanisms to resolve crises, particularly within the framework of the SDRM proposal. In spite of the fact that the this proposal ultimately was not adopted, the work on it was not in vain. It contributed to a better understanding of the problems that exist, and it also generated greater interest on the part of private investors in the inclusion of collective action clauses (CACs) when issuing sovereign bonds.

We welcome the significant progress that has been made recently in promoting the use of CACs in the issuance of sovereign bonds. It is encouraging that the use of CACs in the New York market, following the Mexican placement in March 2003, was not accompanied by an increase in borrowing costs. This could be evidence of the fact that CACs are gradually becoming more acceptable to private investors. We believe that the Fund should continue its work to encourage broader use of CACs by sovereign borrowers. At the same time, the specific conditions recorded in CACs in each individual case should reflect the results of negotiations between the borrower and the creditors, and it is still too early for the Fund to insist on the standardization of CACs or a specific model for them.

We approve the initiative to develop a Code of Conduct for sovereign borrowers and private creditors in the restructuring of sovereign debt. At the same time, we believe that the Fund should refrain from supporting one set of rules or another in this area and should participate in the relevant discussions only in the capacity of an observer. At the same time, if it were to be an agreed Code, the Fund could take its provisions into account while implementing its policy of lending into arrears.

3. Supporting Sound Policies with Adequate and Appropriate Financing: Implementing the Monterrey Consensus at the Country Level

We agree that better external aid is needed to achieve the MDGs in countries with good policies. However, we believe that advocating doubling or tripling existing aid volumes creates unrealistic expectations and detracts attention from the more urgent problem – how to make existing aid more effective and supportive of domestic reform efforts through improving the structure and modality of aid flows.

Current structure of aid is alarming: of the US$52 billion of ODA in 2001 only half was available for expenditures in recipient countries. Increasing this “active” part of aid, improving its delivery and flexibility, better aligning it to budgetary processes in recipient countries, and targeting assistance to sectoral programs could substantially alleviate the need for increased aid volumes.

Modalities of aid often limit its effectiveness. One issue is predictability of flows to countries with good policies. Clarity about the levels of aid and its conditions is often critical for sustaining reforms in aid-dependent countries. The best way to achieve this is to align aid flows with country-owned development strategies through clear and simple conditionality derived from these strategies.

Removing artificial restrictions on aid, such as e.g. allowing recurrent cost financing, could make aid more effective – if accompanied by tangible reform of public expenditures framework and measures to enhance growth, to replace in time donor financing with domestic funds. Harmonizing donor requirements of disbursement, monitoring and reporting is another way of increasing aid effectiveness.

Growth is the key to overcoming poverty and aid dependence. Both structure and modalities of aid should be consistent with unleashing local growth potential and increasing national competitiveness. Infrastructure is the vital link between aid, growth and poverty reduction, and we see it as the area where the Bank can make a valuable contribution to achieving the MDGs.

4. Enhancing the Voice and Participation of Developing and Transition Countries: Progress Report by the World Bank

We see stronger voice of client countries not just as a goal in itself, but also as an important mechanism of poverty reduction. Client countries have much to contribute to this cause. Their knowledge and experience of development are essential to make development assistance work. However, it is not in the interests of any client country to undermine the effectiveness of the World Bank. The Bank's well functioning governance structure is based on "governance by consensus". We would not support any proposal that undermines this tradition. Nor would we support actions that could handicap the Bank's financial position and its capacity to mobilize resources.

Thus, instead of opening up the issue of shares and voting rights, we could do much more to enhance the real voice of developing and transition countries:

- by involving borrowing countries into IDA replenishment process;
- by promoting staff diversity and decentralized decision making at the World Bank; and
- by strengthening the capacity of Executive Directors' offices representing a large number of poor countries.

5. Progress Report on Trade

We appreciate the Bank's double role as a source of analysis and financing. In terms of analysis, the Bank's advice is valued and recognized because it has proved itself able to rise above specific political interests. We are happy to see that the Bank takes a balanced approach in this area and urge it to pay closer attention to emerging protectionist practices, especially those in the developed countries. Such examples do much damage to trade liberalization in developing and transition countries, and the Bank's message of free trade must be conveyed to the wide audience in the developing and developed countries alike.

As a financial institution, the Bank has an important part to play in promoting and facilitating trade in its member countries. We urge the Bank, together with client governments, to identify and address key bottlenecks in the area of export finance, administrative trade facilitation and adoption of best practices and standards. For instance, we urge the Bank to continue its active participation in the Integrated Framework and to make every effort to implement its action plans.

6. Implementation Report on Monitoring Policies, Action and Outcomes Needed to Achieve the MDGs

We appreciate the Bank's efforts to improve coordination with international agencies and to clarify its own role in global monitoring of the MDGs. We are pleased to note the ongoing work to improve CPIA methodology and transparency, and especially to involve countries in the rating process. We believe that CPIA can become an extremely valuable instrument of results-oriented global monitoring, reinforced by its link to IDA allocation. In time it can become the basis of an objective and consistent system of indicators to improve our understanding of how policies affect development.

We are gratified that infrastructure has been recognized as a key indicator of growth and investment climate. The Bank should continue developing more objective indicators that would complement and eventually replace an earlier generation of perception-based indicators of governance and corruption. It should also attempt to measure results of Bank-supported operations in the governance and anti-corruption area.

We agree that macroeconomic and trade policies in the donor countries and the quantity and quality of aid are highly relevant to development. Thus, we urge the Bank to go beyond the work by the IMF, WTO and OECD on these issues and draw on its own operational and research experience. Bank reports should examine client countries' policies, but also developments in the trade and aid policies of the industrial countries, and the extent to which these policies conform to the Monterrey declarations. Likewise, there should be a candid assessment of IFI operations and their role in client countries.

7. World Bank Group Infrastructure Implementation Action Plan

We support the proposed Action Plan as an important step in the right direction. We see infrastructure as a key pillar of growth, together with macroeconomic stability, good governance and business-friendly regulatory environment. In this respect we support innovative ways of financing infrastructure projects, including sub-national lending, risk mitigation instruments and "Corporate Projects". We hope that these innovations will be mainstreamed.

When Bank business practices discourage infrastructure projects, borrowers look elsewhere for financing infrastructure needs. This is another example of why country ownership is important. Country governments are both Bank shareholders and political representatives of the will of their people, and the Bank should rely on them to formulate and express the vision of development unique to each country. NGOs and other non-elected entities can also be a valuable additional source of information and opinion.

The role of public-private partnership in infrastructure needs more analysis. While some such partnerships work, we are concerned that attempts to attract private sector into infrastructure projects often lead to open-ended public guarantees. Such arrangements combine unbudgeted public commitments with unfounded private contingent liabilities. The resulting confusion of responsibilities may have serious long-term political implications, including for the overall public sentiment toward the private sector.

Given the importance of infrastructure for sustainable development, we believe that this meeting should become the starting point of a full-fledged discussion of infrastructure issues by this Committee. The Action Plan needs to be supported by further research work, including serious analysis of the factors hindering the expansion of World Bank Group activities in the area of infrastructure.