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

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

**1. The Global Economy and Financial Markets**

Over the last 6 months there was a noticeable increase in the rate of global economic growth, surpassing earlier expectations in practically every region. Thus, the forecast of global GDP growth for 2004 was revised to 4.9 percent, which is almost one percentage point above the year-old estimate. We welcome the encouraging improvement in the world economic situation. At the same time, we are concerned by the fact that as before, the global economy is recovering against a backdrop of persisting imbalances and risks. As previously, the U.S. growth rates continue to play a central role in supporting global growth, while current account imbalances among the main regions not only persist but even continue to deepen. This means that there is still the risk of a significant drop in the dollar's exchange rate and a slowdown in the U.S.

Under these circumstances, there is continuing urgency in the appeals for a cooperative strategy that would include components such as a medium-term fiscal consolidation in the U.S., enhancing growth potential in the euro area and Japan through structural reforms, and more exchange rate flexibility in emerging Asia.

The increase in *world oil prices* in 2004, which was unexpected in many respects, has become a new risk to the recovering global economy. Persistence of these prices at today's level may lead to some slowing of global growth (by 0.3 percentage points in 2004-2005), and to higher inflation. As it became obvious by now, in view of capacity constraints and the limited throughput of pipelines in the main oil exporting countries, the increase in deliveries of oil to the world market is not keeping up with the vigorous growth of world oil demand. Together with ongoing political instability in a number of key exporting countries, this may lead to persistence of high oil prices at least until the end of this decade. Measures to expand the productive capacities of oil exporting countries and to restrain growth of the demand for energy resources take on special importance under these conditions.

A pick-up in inflationary pressures has been observed recently, connected in part with the increase in oil prices. Should these pressures persist, tightening of monetary policy at a faster rate than anticipated today may be needed in a number of advanced economies, which may adversely affect their housing markets and consumer demand. This could complicate the conduct of monetary policy.

The economic situation in *advanced economies* has not undergone significant changes compared to April 2004. Some slowdown in the U.S. growth in the second quarter of 2004 has added another element of uncertainty. The intensity of economic recovery in Japan looks

optimistic. Some recovery in the euro area takes place against a backdrop of persisting weakness of domestic demand. The tasks of medium-term fiscal consolidation, including through reforms of pension and healthcare systems, are becoming increasingly pressing in all developed countries.

We welcome the continuing improvement of the economic situation in *developing countries and emerging market economies*. This is connected in many respects with acceleration of growth in developed countries. At the same time, we would like to make note of the gradual increase in the role of new regional “centers of growth,” such as China and India in Asia, and Mexico and Brazil in Latin America.

In 2004 high economic growth was observed once again in countries of the *Commonwealth of Independent States*. This was facilitated to a significant extent by solid growth in the largest economies of the region (Russia, Ukraine, and Kazakhstan). It is necessary to mention that high growth was observed both in oil-exporting and oil-importing countries and in terms of its growth rates for 2003-2004 the CIS region was second only to China (7.8 and 8 percent as opposed to 9.1 and 9 percent respectively). The dependence of CIS countries on exports of energy resources and metals is their main element of vulnerability over the medium term. In this connection, diversification of the economy is the most important priority for many of these countries. This, in turn, requires improvement of the investment climate and development of market economy institutions through further structural reform.

Significant potential for further increase of growth in the CIS region can be found in intensification of economic cooperation through fostering trade and further integration of capital markets.

## **2. Making IMF Surveillance More Effective and Strengthening Crisis Prevention**

Surveillance is central to the work of the Fund. The global economy and international financial markets are changing, and surveillance methods need to adapt to the new realities. We believe that, on the whole, this process moves fairly quickly. After the Asian crisis efforts were made to promulgate standards for provision of statistical data and increasing transparency and for country compliance with best practices for fiscal and monetary policies. The number of countries taking part in Reports on Observance of Standards and Codes (ROSCs) and Financial Sector Assessment Programs (FSAPs) is constantly growing. We should also commend efforts underway to develop *debt sustainability assessment (DSA)* criteria, the use of *alternative economic development scenarios* when preparing Fund programs, and application of the *balance sheet approach*.

At the same time, surveillance methods should be further improved and new approaches should be applied. For example, at the last IMFC meeting we suggested implementing *regional surveillance* at the Fund. We are pleased to see that the Executive Board has decided to undertake regular discussions of the economic situation at the regional

level, thereby taking an important step toward eliminating a large gap in the Fund's surveillance instruments.

It seems that another step toward improving our understanding of international financial flows and enhancing surveillance would be to heighten the Fund's attention to the problem of *migrant workers' remittances*. The lack of reliable information in this area is contributing to large errors and omissions in countries' balances of payments, which often are automatically interpreted as capital outflows or inflows. According to preliminary assessments, the total volume of inflows into developing countries from migrant workers' remittances exceeds official development assistance. We think that work needs to be done to improve the accuracy in assessing volumes of such transfers, which could be of great importance for the conduct of monetary policy, strengthening banking supervision, and simply better understanding the balances of payments of the individual countries.

### **3. Aid Effectiveness and Financing Modalities**

The international community is increasingly focusing on the Millennium Development Goals, and in particular on the steps necessary to accelerate progress in this important area. In this respect we see the approaching fifth anniversary of the MDGs as an opportunity to review the experience so far, and to take a fresh look at the problems of development. The report under consideration takes an important step in this direction. We are particularly gratified to see that the authors of the report have managed to avoid bias and undue simplification in describing the current state of play. We support the analytical approach of the paper, which stresses the need to improve the quality of development assistance rather than calling for a mechanistic increase in aid volumes.

This is not the first time that we turn to the issue of aid effectiveness. The novelty of the latest report is in that it presents a thorough and comprehensive description and analysis of all the options at our disposal. The paper correctly recognizes enhanced absorption capacity as a key condition of reaching the MDGs, and takes a pragmatic and realistic approach towards identifying and addressing the main obstacles in this area. In our view one of the paper's most interesting conclusions is that many such obstacles are found at sub-national levels, and that the IFIs can help to address them. Another noteworthy conclusion concerns the link between country absorptive capacity and sectoral distribution of aid, which we see as yet another argument for increasing the share of infrastructure lending.

We share the concern about the lack of resources for development, and therefore support the work aimed at augmenting aid volumes. Several proposals have been put forward in this area, including some ground breaking ones. We are ready to consider any constructive proposals leading to progress on the basis of international consensus, which, in the case of the more novel initiatives, would likely require piloting as the first step. However, in view of the utmost importance of this issue, we believe that our first priority should be exhausting the opportunities implicit in the existing international financial architecture.

Although we strongly support the efforts to increase aid volumes and improve aid effectiveness, we are also convinced that this work should not distract us from the more important goal, that of fostering economic growth and sound economic policies. Experience has proven that this is the only sure and sustainable way for the developing countries to reach the MDGs, while external assistance can at best play a supporting role. If we look at the record of growth from the early 1960s to today, we will see that the countries that made the most spectacular progress did so almost entirely on their own, without any significant external aid. At the same time all successful countries based their growth strategy on the traditional recipe of macroeconomic stability, trade liberalization and the use of market systems – adapting it as necessary to local conditions. On the other hand, countries that have been receiving massive volumes of concessional financing, often to the tune of 10% of their GDP annually, not only failed to produce comparable growth results but became dependent on external aid for the foreseeable future.

#### **4. Strengthening the Foundations for Growth and Private Sector Development: Investment Climate and Infrastructure Development**

The Development Committee has not addressed the issues of private sector development and infrastructure since the mid-1990s, and in our view this discussion is long overdue. We find it especially appropriate because it responds to the concerns raised recently by many borrowing countries about maintaining the capacity and relevance of the World Bank Group in crucial areas of development. We welcome the respective papers, which are concise and direct in dealing with these issues. We also appreciate an explicit link between these papers and the document on aid effectiveness and financing modalities, which emphasizes the crucial role of economic growth underpinned by private sector and infrastructure development in attaining the MDGs.

We are also pleased to see that access to infrastructure services is identified as a major component of overall investment climate, regardless of the sources of infrastructure development – public or private. These initial studies should be expanded to cover not only the areas pertaining to governance and business regulations but also other important components of investment climate, such as access to credit, financial sector development, competitiveness and productivity factors, and so on.

It is now clear that the decline in the Bank's infrastructure lending during the 1990s was a serious strategic miscalculation. This experience needs to be critically analyzed in order not to repeat these mistakes in the future.

Another area that needs to be addressed is sub-sovereign lending for infrastructure development without sovereign guarantee. Bank's inability to engage in this type of operations despite their increased relevance, large potential demand and direct links to poverty reduction represents a serious gap in WBG services. We look forward to possible solutions in this area and stand ready to support any proposal, including the creation of a

special entity dedicated to sub-sovereign lending if this type of activity could not be accommodated within the existing structure of WBG.

## **5. Debt and Debt Sustainability**

We believe that the issues of debt management and debt sustainability cannot be considered in isolation from the implementation of the HIPC Initiative. We cannot increase lending, even for the noblest of purposes, while at the same time continuously forgiving earlier debts. Such a practice impedes fiscal transparency, undermines international financial architecture and distorts incentives for the borrowing countries. It is time we took a fresh look at this problem and address it in a firm and comprehensive manner. We cannot attain the Millennium Goals through uncontrollably and unsustainably inflating the level of indebtedness.

We hope that the latest extension of the HIPC Initiative for another two years is the last action of this sort, after which no more extensions will be considered. We would also urge the international community to adhere to the existing December 31, 2004 deadline for including new members into the Initiative.

We need to confront the problem of financial discipline and display restraint in extending new credit to low-income countries. The mechanism for maintaining debt of the poorest countries at sustainable levels, which is currently being developed, should give us an adequate tool for addressing this problem. At the same time, we are concerned that the proposed framework for assessing debt sustainability may encourage the quick accumulation of external debt by low-income countries to levels above the thresholds of the HIPC Initiative. In this respect we should also make an effort to develop new financing mechanisms that do not lead to debt accumulation.