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WORLD BANK GROUP

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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 L. KUDRIN,**
Governor of the Bank and the Fund for the **RUSSIAN FEDERATION,**
at the Joint Annual Discussion

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

1. Developments in the Global Economy and Financial Markets

Since the spring meeting of the IMFC there have been some changes in the global economy due primarily to turbulence in financial markets in August–September. After many years of very rapid global growth, there is now increasing doubt that this trend will continue. Although the latest *World Economic Outlook* (WEO) predicts only a minor slowdown in global growth over this year and in 2008, the existing risks, if realized, may cause more pronounced deceleration.

The situation in financial markets remains the key source of uncertainty. Currently it is hard to foresee how quickly the re-pricing of financial assets will occur, the magnitude of losses that leading financial institutions will have to recognize, and whether there will be a significant increase in interest rates. However, we can already derive some preliminary conclusions about the necessary policy measures. For example, there is undoubtedly a need to have more transparency in the trading of complex financial instruments. Additional measures will likely be required with respect to regulating the banking sector.

There is also a considerable risk that the housing market correction in the U.S. may turn out to be deeper and more prolonged than previously expected. Combined with a tighter lending environment this may negatively affect both consumer demand and investments.

For the emerging market countries, the main risk is associated with the deterioration in external financing conditions. A sudden stop in capital inflows may significantly increase the likelihood of a "hard landing" for countries running large current account deficits and/or relying on large external borrowings to finance domestic credit booms.

Finally, there also remains substantial uncertainty regarding world oil prices. At the same time, even the quadrupling of oil prices that occurred over the last several years has not resulted in any significant increase in inflation. A great deal of credit for this undoubtedly goes to the central banks, whose monetary policy has prevented higher energy costs from translating into higher prices for end consumers. On the other hand, throughout all those years the work of the monetary authorities has been made easier by the fact that wage increases have lagged substantially behind the fast growth of labor productivity. Currently labor productivity growth is slowing in the developed countries, which will make the task of containing inflation more difficult.

According to the latest WEO, the decline in growth will be observed primarily in the developed countries and especially in the U.S. At the same time, it is expected that high growth rates will be preserved in the large emerging market countries, which will help compensate to some extent for the slower growth in the developed economies. These developments should contribute to a gradual reduction of global imbalances. Specifically, the lower growth in the U.S. economy may result in some reduction in the current account deficit. At the same time, rapid growth in the emerging market countries will increasingly rely on domestic demand.

The situation in Russia is illustrative in this context. In 2007 growth is expected to be about 7.5 percent. In the last couple of years, the contribution of net exports to GDP growth has been negative, even despite continued high oil prices. At the same time, private consumption and investments, including foreign direct investments, are growing very rapidly.

2. Reform of the IMF

Reforming quota and voice at the Fund in line with a changing structure of the global economy is a necessary condition for restoring the weakening legitimacy of the Fund. New realities should be duly reflected in the way that country quotas are calculated.

We believe that a blended GDP variable should play a dominant role in a new formula. The weight of PPP-measured GDP in the blended GDP variable should be substantial. We also think that the quota formula should stand on its own merits and be convincing and publicly defensible from the point of view of both its design and outcomes.

We believe that new ways to finance the Fund's administrative budget should be found as soon as possible. A prolonged period of uncertainty is having a negative effect on the morale of Fund's staff and is hampering the recruitment of new highly qualified staff. In this regard, we are prepared to discuss all proposals of the Crockett report, including the use of a portion of members' quota resources for investment purposes and the sale of a part of the Fund's gold.

We do not support a rigid link between the adoption of a new income model for the Fund and a reduction in its expenditures. The Fund needs a new income model regardless of the level of its expenditures. At the same time, we do not object to considering different options for improving the efficiency of the Fund and reducing its expenditures. From our point of view, expenditures should be reduced selectively, in full accordance with a clarification of the Fund's mandate and responsibilities. Without a sound plan, a reduction in expenditures would only lead to undermining the Fund's capacity to carry out its current obligations.

3. The World Bank Strategic Directions

We welcome the achievement of a broad consensus on the Bank’s strategic directions. The World Bank President should personally receive much of the credit for this accomplishment. We broadly share Mr. Zoellick’s vision of the Bank’s strategic direction that was outlined in his last week’s speech. In this regard, we would like to make just a few clarifying remarks.

Poverty alleviation and sustainable growth-based development have always been and should remain the main objective of the Bank. Today, we should focus our attention on addressing these issues in Sub-Saharan Africa and the post-conflict countries. External aid should help to put in motion mechanisms of sustainable development, facilitate mobilization of internal resources and thus gradually reduce aid dependency.

The lag in industrial development appears to be the main reason for the widening gap in progress towards the MDGs between the counties in Sub-Saharan Africa and other developing countries. Without in any way questioning the importance of agriculture for the poor countries – particularly in the short- and medium-term perspective – is it not the time to acknowledge that it is industrialization, coupled with the infrastructure that supported it, that has always been the primary vehicle of development? We believe that the World Bank can and should lead a movement aimed at the industrialization of Africa and other poor countries. In doing so, the Bank can rely on its experience in assisting clients that since have joined the most developed nations. IDA and IFC should increase their financing in this area. In this regard we particularly welcome the expansion of IFC programs in Africa.

We should examine what impedes a greater use of the already available Bank instruments. A case in point is provision of guarantees to the IDA clients. Such guarantees are meant to facilitate private sector development, foreign investments and the overall economic development. Although appropriate decisions were taken about ten years ago, such instruments have virtually never been used.

Assistance to the post-conflict countries is another important area of the Bank’s work. Among the principles of post-conflict assistance, one should stress impartiality and non-interference in internal political affairs. Political neutrality, which is a cornerstone of the Bretton Woods system, is particularly critical the context of the post-conflict work. This is why the Bank should be careful and considerate, and cooperate with all the bilateral and multilaterals donors while preserving its complete political neutrality.

The principles of ***Bank's cooperation with the middle-income countries*** (or, to be precise, with IBRD borrowers) are changing. One should recognize that the majority of IBRD borrowers have reached a new level of development and want to see the Bank as their partner of choice. From this angle, we are satisfied that the new model of the World Bank Group country partnership strategies, with their increased flexibility and country-defined prioritization of activities, reflects the new realities.

Modernization of the IBRD lending terms is of paramount importance. Transition to country systems announced almost ten years ago, is extremely slow and should be accelerated. The costs of doing business should be further reduced, and operating procedures reviewed in order to identify and abolish outdated requirements.

Another strategic direction of the World Bank's work is ***assistance in the provision of the Global Public Goods,*** such as fighting infectious diseases or resolving the climate change problem. With regard to the latter, we should note that the crucial role of the energy sector for poverty reduction in developing countries cannot be called into question. The developing countries will never give up their plans to bridge the huge energy gap in their fight against poverty. We should support their efforts and focus on the most efficient conventional energy generation technologies and refurbishment of the existing power facilities. This presents us with an opportunity to integrate two global priorities – climate and energy.

In this respect, it is appropriate to reiterate the proposal we made one and a half years ago. We need to revisit the World Bank taboo on all things nuclear. In our opinion, this holds a great potential to advance on an entire spectrum of issues – from clean energy to safety monitoring and nonproliferation.

4. IDA and the Global Aid Architecture

We believe that IDA remains a key element in the global aid architecture. At the same time, the effectiveness of the Association can and should be increased. The necessary steps should include simplification and modernization of its operational procedures, better alignment with recipient countries' priorities in determining the sectoral composition of aid, bringing more flexibility into the use of financial instruments, enhancing the objectivity of CPIA as well as reaching out to the new categories of donors.

We have already witnessed some important steps in the right direction. These are facilitated access to the additional financing, new mechanisms for rapid response to crises and emergencies, simplification of investment lending as well as increased allocations for infrastructure and energy. Further steps should include more active use of guarantees and improved collaboration with donors in designing and implementing large national and regional investment projects.