Statement by
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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 Development Committee turns 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.

The issue of the quality and concessionality of aid links the task of reaching the MDGs to the problem of debt sustainability. Increasing resource requirements of some of the poor countries have been sometimes seen as contradicting the need for maintaining external debt at manageable levels. It has even sometimes been suggested that sensible debt management is an obstacle for reaching the MDGs. While we certainly do not share this view, we welcome recent steps to resolve this apparent contradiction, in particular, progress in designing the system of external aid based on sustainable debt levels. This is essential for preventing debt crises in poor countries while at the same time maintaining their access to external financing. We support the emerging outlines of the new system of international development assistance and the general direction of its development, while also noting the obvious need for further work and improvements in its methodology.
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 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 1960es 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.

**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-1990es, 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.

The World Bank has recently been paying much attention to assessing and improving investment climate in the borrowing countries. We strongly support this work. For example, the “Doing Business” project is a unique source of objective information on investment climate and a real eye opener for the authorities and investors. It clearly indicates the so far untapped reserves of incremental growth and employment generation. 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.
In this respect we welcome the continued support offered by the World Bank Group to its clients in implementing their investment climate reform agendas. This support takes many forms, including advisory services in combination with policy-based lending, and stand-alone advisory services. The Bank should be ready to respond to client needs in this area independent of their current fiscal and balance-of-payment situation, which presumes adequate administrative budget.

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.

We are pleased to see that in the framework of its Infrastructure Action Plan the WBG started to rebuild its lending portfolio and infrastructure knowledge base while adopting a more realistic approach to the respective roles of the public and private sectors in providing infrastructure services. This especially concerns the area of public-private partnerships. It is not a secret that some previous attempts to attract private investors into infrastructure and energy sectors at any price in a weak institutional environment resulted in the accumulation of government contingent liabilities and eventual costly lawsuits. But the idea of the PPP in different forms remains a viable and important one, and properly structured PPPs could well be the way forward. The WBG needs to expand its use of traditional and new instruments that could mitigate non-commercial risks for investors while limiting government liabilities and promoting fiscal transparency.

Related to that is the issue of infrastructure tariff and subsidy policy, which is in turn linked to the problem of affordability and socio-political stability.

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.

**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 must resist temptation to extend this deadline any further.
We need to confront the problem of financial discipline and display restraint in extending credit to non-creditworthy 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. In this respect we should also make an effort to develop new financing mechanisms that do not lead to debt accumulation.

**Enhancing Voice and Participation of Developing and Transition Countries in Decision Making at the World Bank and the International Monetary Fund**

The question of the voice of developing and transition countries in the Bretton Woods institutions continues to occupy an important place on the DC agenda. The core of the issue is how to improve the reflection of the client countries’ true needs and priorities in the Bank’s and Fund’s policies and practice. The analysis of development assistance over the past decades draws a key conclusion: the impetus of growth comes from the inside, and development models cannot be easily transplanted or replicated. The only successful kind of development assistance is the one that nurtures this internal impetus, encouraging local priorities and capacity.

In this regard we strongly support the recent commendable trend of basing projects and programs of assistance on existing country development programs, as exemplified by the PRS process. The next logical step in this work should be greater reliance on the countries’ own institutional and implementation capacity, in particular, setting up fewer parallel structures and systems for project implementation. Obviously, this move to the use of country systems should be gradual, only where it makes practical sense, and should not undermine the high standard of Bank supported operations. Nevertheless, given the centrality of this issue for ensuring country ownership, we hope that the work on the use of country systems could be accelerated.

From the point of view of improving the voice of client countries, mechanisms of establishing their true developing priorities are of the utmost importance. Unfortunately, to date this discussion has centered on the possibility of redistributing the votes in the Bank and Fund Boards. We believe this approach to be a dangerous mistake. On the one hand, demands to redistribute the votes necessarily cause tensions among the shareholders, thus undermining the long-standing and well-functioning principle of governing by consensus. On the other hand, continued attention to this controversial proposition distracts attention and energy from the real issues, which, as evident from the presented report, do have practical solutions.