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by Viktor Khristenko, IBRD Governor for the Russian Federation, First Vice-Chairman of the Government of the Russian Federation, at the meeting of the Joint Ministerial Committee of the Board of Governors of the IBRD and the IMF on the transfer of real resources to the developing countries (Development Committee)

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Trends in the Transfer of Resources

The situation regarding the transfer of financial resources to developing and transition economies remains complicated. Excessive expectations about the emerging markets that were dominant on the eve of the East Asian and subsequent crises have given way to disproportionate skepticism. Inflows of portfolio investment and bank credits dropped to a much lower level as compared to the peak period of 1996-1997, and may be expected to remain there in the medium term. On the other hand, it is clear that the flows of foreign direct investment resources are relatively stable. Accordingly, developing countries and transition economies should revisit the structure of their preferences within the framework of the overall strategy for attracting foreign resources. Specifically, this means devoting greater attention to structural issues that are of particular importance for strategic investors.

At the same time the emphasis on structural reforms must not undermine macroeconomic stability which is traditionally closely watched by portfolio investors. After all, even after their sharp decline, portfolio and bank flows are an important source of funds for developing countries. In this context, we are pleased to note some decline in the average spreads on emerging markets debt, despite the fact that these spreads remain historically very high. We are also pleased with the fact that the alarmist expectations of impending economic decline prevalent at the start of the Russian and Brazilian financial crises are now widely recognized to have been exaggerated.

Therefore, the international community must do its best to facilitate adjustment to the new structure of financial flows and to reduce associated hardship. It has already been noted that international financial institutions have largely filled the gap in short-term financing required by the developing countries over the past few years. Accordingly, the issue of capital adequacy of these institutions is becoming increasingly urgent. We welcome the recent increase in official development assistance from the OECD countries, but we believe that the global public opinion has not yet fully realized the seriousness of the situation with regard to the overall transfer of financial resources. We must intensify and speed up the debate on this issue in order to reach a practical and mutually agreeable solution.
The HIPC Initiative

We support the initiative for radical debt burden reduction of the poorest developing countries and for the reallocation of resources that are now going toward external debt service to funding poverty reduction programs. We are convinced that the Initiative can only achieve its goals if the magnitude and the speed of foreign debt relief allow the countries pursuing sound macroeconomic, structural and social policies to escape from the “debt trap” in the nearest future. We also support the enhanced link between debt service reduction and poverty reduction. We also think highly of the contribution made by the Bank and the Fund to the implementation of this Initiative, as well as the efforts by creditors and donors who are seeking out and allocating additional resources for the noble purposes of the Initiative. During this process we will continue to fully participate in operations to assist individual countries on the basis of the agreed principles of burden sharing.

At the same time, we are concerned that the proposed expansion of the Initiative has not been bolstered with adequate resources. Our particular apprehensions as an IBRD shareholder and borrower are based on the fact that additional financial requirements the Initiative imposes on the Bank substantially exceed its actual financial capabilities. In the immediate future, the IBRD/IDA must find $2.4 billion in NPV equivalent to cover the needs of supplementary funding for countries that are already participating in the Initiative, including $800 million for countries to which the Initiative may be extended in the period after the year 2000. Given the fragility of the economic and financial situation in most developing countries and consequent high demand for IBRD/IDA funds, coupled with the stretched risk-bearing capacity of the Bank, we believe that the substantial increase in Initiative-related costs to the Bank may be detrimental both for this Institution and for its clients. In any case, this would lead to a violation of the basic principles underlying the Bank’s participation in providing funding for the Initiative, namely: additionality, preserving the Bank’s financial integrity, and the adherence to the principle of fair burden sharing.

In this connection, we believe that the issue of financing the participation of the IBRD and other multilateral development banks in the Initiative should be resolved by their shareholders on the basis of a universal and flexible yet realistic approach to burden sharing. Specifically, proposals to expand the Initiative should be accompanied by a well elaborated financing plan and acceptable ways of sharing the incremental costs. 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 commitments from donors to finance the Initiative can be combined with a more flexible schedule of actual payments. One attractive option is to use loans by official creditors secured by the IDA reflows and to allocate such funds for the immediate needs of the Initiative. This solution could be one component of a broader menu that would include various options for mobilizing funds that provide a certain degree of flexibility to donors.
Among other issues of special concern to us are: possible negative impact of the Initiative on the financial and economic situation of the developing countries that are creditors of the countries benefiting from the Initiative; the financial position of regional development banks whose shareholders include poor developing countries; the interplay between the external and internal debt; and the relations between the beneficiary countries of the Initiative and private creditors. The last issue has been touched upon during the debates, but only in the sense that private creditors must fully share the burden of participating in the Initiative. At the same time, since we view the private sector as a major source of economic growth in the long term, we cannot ignore the question of how the measures proposed as part of the Initiative would affect the prospects of securing external private financing necessary for economic growth while not leading to renewed debt overhang.

In conclusion, we would like to stress that we are not prepared to support the expanded framework of the Initiative in the absence of its financing plan. In order to preserve the credibility of the enhanced HIPC framework its expanded goals should be matched by adequate resources. Only in this case the Initiative will succeed in achieving debt sustainability for developing countries pursuing sound economic and social policies, and not lead to disruptions in development finance mechanisms.

**Strengthening International Financial Architecture**

**Bank-Fund Cooperation in the Area of Financial Sector Reform**

The Bretton Woods institutions remain a major pillar of the international financial architecture. Their cooperation is paramount for effective international actions aimed at crisis prevention and resolution. I am pleased to note significant progress in this area. The contacts between the two institutions are continually expanding, and there is a fruitful exchange of knowledge and experience at every level.

Contacts of this kind are particularly important now when the international community is facing the complex problems typical of the 1990s, which encompass issues of fiscal and monetary policy as well as structural and social problems. Thus we welcome the activities of the Bank-Fund Financial Sector Liaison Committee.

Careful consideration of the specific tasks of the two institutions would facilitate the division of labor between them and avoid unnecessary duplication. In this context the task of surveillance should remain the prerogative of the IMF. The reason for this comes from the specific nature of national fiscal and monetary policy — namely, that it tends to immediately affect economic developments in other countries. The World Bank should have no surveillance function, for it is not consistent with the principle of client orientation.

On the other hand, the complex nature of development requires that full consideration be given to structural and social factors in the assessment of monetary and
fiscal policies when the relevant IMF recommendations are drawn up. We therefore believe that the IMF should rely more actively on the unique experience and expertise of the World Bank in this area. Specifically, support should be given to the idea of taking into account the Bank’s poverty assessment and other structural reviews within Article IV consultation process.

We welcome the Bank’s initiative to organize international fora on issues such as financial stability and corporate governance and to ensure widest stakeholder participation in them. However it is necessary to point out that recommendations worked out at such fora cannot and must not be in any way binding on the Bank or its shareholders. We should not forget that the Bank’s main objective is lending for development purposes, not establishing standards of behavior. Therefore, conclusions and analytical observations of such fora should not be construed as another tier of conditionality. The task of defining lending conditions is vested in the Bank itself, its Management and the Board of Directors.

**Social Consequences of Financial Crises**

The financial crises of the 1990s have presented the international community with a host of new challenges. The World Bank whose mandate is to fight poverty must place special emphasis on overcoming the social consequences of these crises. In the early stages of a crisis, it is necessary to identify the most vulnerable groups and to give special attention to the prevention of irreversible social losses. Scarce budget resources ought to be reallocated to ensure maximum social effectiveness, in particular addressing the deterioration of human capital (decline in school attendance, worsening of neonatal care, unemployment and loss of work ethics). Finally, it is essential that targeted assistance be provided in the form of food, allowances and public works programs for those who especially need such help.

We believe that this approach fits well with the Comprehensive Development Framework. We wholeheartedly welcome the Bank’s efforts to implement this initiative.

As the Bank’s documents correctly point out, the basic tool for eliminating poverty is sustainable economic growth. Thus, the post-crisis situation presents governments with a complex dilemma: how should growth-oriented policies (budgetary stability, low taxation, limiting government intervention in the economy) be balanced against the pressing tasks of dealing with the social consequences of the crisis? This trade-off must not be ignored. The choice of tools for economic and social policy, to be sure, is the prerogative of the government, which is the legitimate representative of the country’s interests. The World Bank, however, as a knowledge institution, can and should help the governments in making an informed choice in this matter by analyzing possible policy options for post-crisis period and long-term implications of each alternative. This is where we see the essence of the Bank’s evolving role in the new millennium, as unbiased adviser reacting not only to economic indicators but also to social, political and institutional needs of the countries.
However, it is important to note in this regard that best practice in social policy should be seen as good advice rather than as mandatory requirement. Furthermore, a distinction should be drawn between the goals of long-term development, which may call for profound structural reforms, and the short-term tasks of minimizing social damage caused by a crisis. Precisely because institutional and structural reforms require great effort, time and expenditure, they should not be pushed during a crisis.

**Strengthening Corporate Governance**

In the wake of the Asian crisis and following the massive privatization in transition economies, there has been a surge in interest to corporate governance issues. We welcome the participation of the Bretton Woods institutions in the analysis of these problems.

We should take special note of the participatory approach displayed by the Bank in dealing with these matters. The establishment of partnerships with international organizations, regulatory agencies and the private sector sets a valuable example of fruitful cooperation.

At the same time, it should be acknowledged that the organization and regulation of corporate activity is a completely new subject for the Bank. Therefore we should carefully consider possible consequences of this proliferation of interests, as well as possible mechanisms for the Bank’s relations with the client countries on this issue.

Specifically, we share the view that the structure of corporate governance should depend on the country’s specificity, including the established types of economic activity and cultural and legal traditions. Such diversity has been documented in detail in the case of industrial countries. And, as the range of countries under review expands, we can also expect this diversity to increase. Therefore we must be extremely cautious in any attempts to formulate common standards for corporate governance, let alone in trying to impose them on member countries. In this regard, we hope that the Global Corporate Governance Forum will become a place for equitable and unbiased debate by all parties, rather than a tool for imposing specific views of a single country or a group of countries.

Furthermore, it is essential that a direct connection be established between the reform of corporate governance and issues of deregulation. The lack of transparency in governance, violations of the rights of investors and creditors almost always prove to be related to inadequate deregulation and possibilities of collusion between bureaucrats empowered with broad discretionary rights on the one hand, and vested interests -- on the other.
Developing Countries and Issues of International Trade

We support the Bank’s efforts to assist developing countries in preparing for a new round of WTO negotiations. These efforts are aimed at maximizing the benefits derived from the liberalization of international trade and at increasing their degree of integration into the world economy. In this context, we would like to stress that the ultimate success of developing countries in this area depends on two factors: their own efforts to establish an export-oriented regime and the actions of their trading partners.

With regard to the first factor, the World Bank is a natural partner for developing countries, and especially for the group of the least developed countries, in devising an appropriate integrated economic strategy and institutions designed to carry it out. The experience of the 1990s shows that the liberalization of the trade regime by itself, without strengthening the state’s regulatory functions and without an appropriate institutional framework, is fraught with negative consequences. This applies to the trade in traditional commodities, and even more to the services (finance, telecommunications, tourism, etc.) that have recently been added to the sphere of liberalization and are extremely sensitive to regulatory measures. The fundamental issue is the balance between the costs and benefits, especially in the short term when the potential benefits have not yet been realized and the costs are significant.

The Bank should not adopt any separate program to promote the development of trade. Nevertheless, it can provide a strong impetus for the efforts of borrowing countries in this area through country assistance strategies and structural adjustment lending. Particular attention in this regard should be given to the problem of maintaining the fiscal balance in countries where tariffs make up a considerable share of government revenues.

As for the second factor, we must be conscious of continuing distortions in the world trade system, including various quantitative and other restrictions still prevailing precisely in the sectors where many developing countries have a comparative advantage. This includes, for example, agricultural commodities, textiles and clothing, steel and a number of other products. The principal efforts in this area should still be made through the WTO, and we call on the major trading powers to make every effort to eliminate this imbalance as soon as possible.

I would like to note in this regard that neither the international community as a whole nor the World Bank in particular seem to have fully appreciated the importance and the scale of the liberalization of foreign trade that has been carried out in transition economies. It would not be an exaggeration to say that modern history has not seen such fast, profound and comprehensive changes as when an entire group of countries moved from a total absence of freedom in foreign trade to a largely open economy. The circumstances and problems associated with this leap are still awaiting their researchers. At any rate, these countries have taken far more steps in the direction of free trade than their partners. I think many of these countries experience a certain disappointment when they see that their efforts in the area of trade liberalization have not met with matching
response from a number of industrial countries. The latter continue to retain many old protectionist barriers including the non-tariff ones; moreover, there are cases when new barriers are erected against particularly efficient exporters from developing and transition economies. This myopic approach openly contradicts the policy of assisting the countries that have suffered from the crisis, slows down the pace of recovery and ultimately leads to additional demand for financial assistance from international institutions.

**IBRD Capital Adequacy**

A thorough analysis has shown that the World Bank is approaching the limits of its risk-bearing capacity consistent with its high credit rating. Analytical studies clearly demonstrate that future shocks can seriously affect the Bank’s financial structure and its ability to provide development financing. The methodology used in this analysis and the basic conclusions that it yielded received high praise from leading independent experts.

Continuing economic problems in the developing countries, their decreased access to private capital market and political instability in some important regions are likely to result in a high demand for loans as well as in increasing claims on the Bank’s net income. Therefore the shareholders should take steps to protect the Bank against future shocks and maintain its high credit rating. The practical achievement of this objective implies some difficult decisions that can include areas such as more active balance sheet and risk management, income allocation and increasing the Bank’s paid-in capital. A combination of these measures, based on the principle of fair burden sharing, seems to be an appropriate strategy consistent with the cooperative nature of this institution. Any asymmetrical solution of this problem that shifts the balance among shareholder groups is unacceptable. The 1998 increase in the cost of funds for borrowers led to a noticeable rise in the Bank’s profitability. As a result of that, the borrowing countries have already made a substantial contribution to strengthening the Bank’s financial capacity. At the same time, the recommendations regarding the establishment of an adequate mechanism for financing a number of programs of interest to a number of shareholders in the form of a Trust Fund that would reduce the burden on the Bank’s net income have not yet been implemented.

That is why we disagree with any unbalanced approach to strengthening the Bank’s financial condition through a further increase in the cost of borrowing. This approach is especially unacceptable during crises when the terms of access to international capital markets by developing countries are worsened and the problem of servicing the foreign debt becomes more acute. An increase in the Bank’s paid-in capital and the adoption of other measures aimed at improving the institution’s financial condition seem imperative in order to preserve its financial integrity and development role.

We support the idea of differential pricing for various types of financial products depending on the clients’ demand for them and the impact of the relevant operations on the Bank’s financial structure and its ability to provide support to all borrowers. We also
believe that ongoing consultations between the shareholders and the Management of the Bank will result in a mutually acceptable and effective solution to the problem of strengthening the Bank’s financial capacity and capital adequacy.

**New Approaches to Development**

The Bank is a living and complex organism. Like any organism, it never stops developing, without however losing its unique identity. We appreciate the extraordinary adaptability that the Bank has repeatedly displayed while always remaining at the forefront of assistance to developing countries and transition economies.

We welcome the Comprehensive Development Framework with great enthusiasm and believe that the Bank must strengthen its role as coordinator of bilateral and multilateral efforts to provide effective assistance to developing countries. The most important condition for implementing this framework is maintaining the Bank’s leading and influential role within the international division of labor and financial architecture—the role of providing credit resources for development.

We cannot allow this key function of the Bank to erode or be pushed aside. For us the Bank is above all a lending institution, an instrument for the transfer of financial resources to developing countries, and only in that capacity can and should it perform its analytical, advisory and coordinating functions.