Board Meeting of June 5, 1997
Statement by Juan L. Cariaga


We welcome this excellent CAS. It is well grounded on Bank lessons and cross-country experience, and proposes a clear pro-active strategy for reform that places the Bank in a leading role in Russian transformation. Also, it is well written and in particular, the executive summary and the summary matrix of actions, instruments and performance criteria, give an excellent global view of the main issues Russia faces at this time.

We commend the Russian authorities on the progress made in the fight against inflation and we are very pleased for the progress reported in project implementation.

As we fully agree with the overall strategy, our comments aim mainly at clarifying the proposed strategy.

The main challenge for Russia today is how to resume growth. Resumption of growth is the fastest way to reduce shallow poverty in a significant fashion and at the same time, the most effective manner of validating and thereafter consolidating the on-going reform program.

The reform of the tax system and tax administration is crucial to recuperate revenues and permit more sustainable fiscal equilibrium. It is essential in this respect, to focus on the design of a simple tax system with no exemptions to facilitate tax administration. This would also broaden the tax base, permit lower tax rates, and consequently allow a rapid supply response.

We fully agree with the emphasis on a deep and at the same time flexible structural adjustment program. In Russia, as opposed to other countries that have initial conditions closer to a competitive market economy, structural reforms are complex and time consuming. This is the main reason why the resumption of growth is taking so much time to occur. In this context, we welcome flexibility in designing adjustment operations and, in particular, the use of single, multiple or floating tranche operations.

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Accelerating the pace of structural reforms and broadening their scope are crucial for rapid supply response. Lessons learnt on results of structural reform elsewhere, show that when there is strong political commitment, broad and rapid reform has the highest pay-off. The CAS clearly states that there is a window of opportunity to accelerate and broaden reforms that should be used to produce rapid supply response.

It is also commendable that the Bank is taking the lead in supporting structural reform where it has a clear comparative advantage. It seems to us that SALs are more appropriate vehicles than EFFs to implement a wide and complex structural adjustment program as the one that needs to be implemented in Russia. Normally the primary focus of the EFFs is financial stabilization despite the fact that they also intend to address structural issues. In retrospect, it would have been a more effective strategy for the Bank to enter earlier with independent structural adjustment loans in parallel to the EFF, instead of playing a subsidiary role in the initial phases of structural adjustment. This could have accelerated the expected resumption of growth.

It is also important to point out that the low or intermediate scenarios are riskier than the proposed strategy. This is so because the slow progress in the structural reform program in the low and medium scenarios places the resumption of growth at risk. This in return, increases the probability of a swift policy reversal, that could raise serious reservations on the viability of the overall development program.

Finally, a couple of comments on the diagnosis part of the CAS. First, para. 14 attributes the slow growth in foreign investment to deficiencies in the policy framework for foreign investment. We believe that the main cause of the slow growth in foreign investment lies not so much in the deficiencies in the policy framework but, in the absence of a stable macroeconomic framework. Several studies on direct investment clearly point out that a necessary condition for private investment to flourish, is the existence of an appropriate macroeconomic framework. Second, on dollarization (para. 9), we believe that dollarization is not the issue that prevents the economy from achieving monetary deepening. In our view, dollarization is a rational way of protecting personal wealth in a macroeconomic environment that until recently has been highly unstable.

To close, let me congratulate again the staff for an excellent work and wish them and the Government of the Russian Federation good luck in the implementation of this historic strategy.