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Contents

$4.5 billion arrangement

IMF approves Stand-By to support Russia's fiscal and monetary program

In a press release issued on July 28, the IMF announced it has approved a 17-month Stand-By credit for Russia equivalent to SDR 3.3 billion (about $4.5 billion) to support the government's 1999–2000 economic program. There will be seven equal disbursements of SDR 471.4 million (about $640 million), with the first installment to be released immediately. Subsequent installments will depend on quarterly reviews being completed and performance criteria and structural benchmarks being met. At the conclusion of the IMF Executive Board meeting, IMF First Deputy Managing Director Stanley Fischer made the following statement.

"Directors found that the economic crisis that erupted in 1998 had been due mainly to the failure of the authorities to come to grips with long-standing fiscal problems and to implement structural reform. The deterioration of the external environment as a result of Asia's economic crisis had been only the immediate cause of the crisis in Russia. In light of this, Directors endorsed the focus in the authorities' new economic program on fiscal consolidation and the acceleration of structural reforms. In view of Russia's extremely difficult economic and financial situation, Directors underscored the need for full and timely implementation of the envisaged reform measures. To facilitate effective implementation of the program, Directors urged the authorities to promote broader support for, and understanding of, the program in Russia.

"Stressing the crucial role of fiscal consolidation in the adjustment effort, Directors found that the fiscal targets were appropriately *(Please turn to the following page)*

Russian Federation: macroeconomic indicators

	1996	1997	1998 Estimate	1999 Program
	(annual percent changes)			
Real GDP	–3.5	0.8	–4.6	–2.0
Change in consumer prices				
Annual average	47.6	14.6	27.8	92.5
12-month	21.8	11.0	84.4	50.0
	(percent of GDP)			
Federal government				
Overall balance	–8.4	–7.1	–5.9	–5.1
Primary balance	–2.5	–2.5	–1.3	2.0
	(months of imports of goods and services)			
Gross reserves coverage	2.0	2.2	2.0	2.6

Data: Russian authorities; and IMF staff estimates and projections

Economic Forum

Financial sector liberalization promises benefits, but appropriate sequencing of reforms is crucial

Financial sector liberalization can spur economic growth and development. But liberalization can also entail risks if reforms are not appropriately designed and implemented. Participants in a recent IMF Economic Forum, "Getting It Right: Sequencing Financial Sector Reforms," examined this issue from several angles, including the optimal speed of liberalization, the appropriate timing and sequencing of reforms, and the lessons learned from past *(Continued on page 244)*

Participants in the Economic Forum, from left: Anders Åslund, V. Sundararajan (moderator), R. Barry Johnston, and Gerard Caprio. The panel also included Nicolas Eyzaguirre (not shown).

IMF support for Russian economic program

(Continued from front page) ambitious. A main objective was to reverse the prolonged decline in revenues, which had led to an unsustainable compression of expenditures, including in the area of social spending. However, Directors warned that these targets would not be achieved without strong political support to enforce large enterprises' compliance with statutory tax obligations. They also urged the authorities to refrain from allowing tax arrears to be offset against current expenditures and emphasized that further cuts in tax rates should be delayed until measures to increase tax compliance had yielded significant results. Directors also urged Russia and the World Bank to work together on a public expenditure review that focused on social and poverty alleviation needs.

"Directors emphasized that Russia was best served by a flexible exchange rate policy under current circumstances and welcomed the tightening of monetary policy since early 1999. They urged the government to resist pressures to curtail the independence of the central bank.

"Directors noted that there had been little progress in structural reform since last August, with some reversal in important areas. While there was a need to advance across the full range of structural reforms, Directors argued that tackling the pervasive problems of barter and nonpayments and the acceleration of bank restructuring would be key to the sustainability of macroeconomic stabilization and growth. Directors noted that political resolve to advance bank restructuring would require the authorities to resist what undoubtedly would be fierce opposition from vested interests and would be a key test of the commitment to structural reform in general.

"Directors noted that the de facto default on GKOs and OFZs was a regrettable setback, and that a normalization of relations with domestic and external creditors should be a main objective. They urged the authorities to seek orderly and cooperative rescheduling agreements with creditors.

"Directors expressed strong disapproval of the finding that the channeling by the central bank of domestic transactions through FIMACO and, in 1996, the transfer of assets in the books of the central bank to FIMACO meant that the balance sheet of the central bank had given a misleading impression of the true state of reserves and monetary and exchange rate policies. Without these indirect transactions and the inaccurate reporting of foreign reserves, it is possible that one or more of the disbursements of IMF funds to Russia in 1996 would have been delayed. Directors urged the Russian authorities to take immediate steps to prevent a recurrence of these problems. Directors took note of the findings that the July 1998 tranche from the IMF had not been misappropriated."

Program summary

Russia's exchange-rate-based stabilization strategy, which had produced notable gains since 1995, was abandoned in August 1998. The timing owed much to Asia's economic crisis and the rapid fall in investor confidence; however, the root cause was the failure to tackle underlying fiscal problems that had made the stabilization achieved under the fixed exchange rate policy inherently unstable. Political turmoil from mid-May 1998 had intensified financial market pressures. In mid-July, a new modified economic program supported by the IMF temporarily eased pressures, but confidence weakened anew following the Duma's refusal to accept key fiscal measures in the government's program. On August 17,1998, the authorities announced a default on ruble-denominated treasury bills and bonds maturing before end-1999 and widened the exchange rate band. In early September, the ruble was floated. A large depreciation of the ruble, loss of access to international capital markets, and a virtual collapse of the banking sector ensued. Moreover, large external arrears began to accumulate.

In the aftermath of the August crisis, little progress was made in bank restructuring, and there was a standstill in other areas of structural reform. Output contracted, government revenues fell, and inflation accelerated during the fourth quarter of 1998. The situation has, however, turned around recently. Policies have been tightened and inflation has come down to below 2 percent on a monthly basis in June. Industrial output has recovered. With regard to structural policies, some restrictive foreign exchange control measures introduced in the aftermath of the August crisis have been revoked and some progress has recently been made in bank restructuring.

1999–2000 economic program

The main focus is on fiscal adjustment and the acceleration of structural reforms, which are highly interrelated and must be tackled in tandem. The *fiscal program* targets a primary surplus at the level of the federal government of 2 percent of GDP in 1999. This represents an adjustment of about 3½ percentage points of GDP, compared to 1998. The program targets an inflation rate of 50 percent in 1999 (December to December), compared with 84.5 percent in 1998. Net international reserves are targeted to increase by $2.2 billion in 1999, with an increase in gross reserves of $1.7 billion during the last three quarters of the year. Real GDP is assumed to decline by 2 percent in 1999.

Monetary policy will be conducted in the framework of a flexible exchange rate policy. The authorities will intervene to smooth exchange rate fluctuations but will not resist fundamental changes in the balance of payments. The 1999 program assumes a rescheduling of nearly all obligations on Soviet-era debt falling due in

1999–2000, as well as the provision of additional exceptional balance of payments support from the IMF, the World Bank, and Japan. It assumes that all Russian-era debt will continue to be serviced as scheduled.

The authorities' strategy to raise revenues involves introducing new taxes and raising other tax rates to capture windfall gains from the large ruble depreciation and increase taxation of consumption. Also, a wide range of measures aim to improve tax compliance. In addition to avoiding recourse to tax offsets, the program calls for cutting the oil pipeline access of tax-delinquent oil companies and increasing compliance of enterprises with respect to their statutory tax obligations. On the expenditure side, the authorities aim to further prioritize spending and control commitments by line ministries, in particular in the context of a planned comprehensive expenditure review.

Structural reforms under the program fall into four broad categories: financial sector reform, including bank restructuring; private sector development, industrial restructuring, and liberalization of foreign direct investment and international trade; enhancement of fiscal management; and improvements in the competitiveness, transparency, and accountability of infrastructure monopolies. Measures within each of these categories will address the problems of nonpayments. Measures to improve transparency of the Central Bank of Russia's own operations and the relations between the authorities and commercial banks are also an important part of the program.

Russia joined the IMF on June 1, 1992, and its quota is SDR 5.9 billion (about $8 billion). Its outstanding use of IMF financing currently totals SDR 12 billion (about $16 billion).

The full text of Press Release No. 99/35 is available on the IMF's website (www.imf.org).

Summers outlines urgent agenda for debt relief, poverty reduction

In a day-long meeting on July 26 sponsored by the U.S. Executive Directors of the IMF and the World Bank—Karin Lissakers and Jan Piercy, respectively—senior IMF, World Bank, and U.S. officials, and representatives of leading nongovernmental organizations convened for a "nuts and bolts" discussion on debt relief. The conference's goal, noted Piercy, was to lay out a framework that would ensure that debt relief achieved its intended effect—namely, strong and durable growth and poverty reduction.

Opening the discussion, U.S. Treasury Secretary Lawrence Summers outlined an urgent agenda for changing the way the world approaches debt relief for the heavily indebted poor countries (HIPCs). The United States, he said, viewed three steps as critical imperatives: reassessing the proper scale of relief, finding appropriate financing, and revamping the way the international financial institutions approach poverty reduction and sustainable development and how their assistance is targeted. He underscored that debt relief was not an end in itself but a means to create successful development. The process could work, he said, only if national policies and institutions were right and if the right kind of support were available from the international community.

According to Summers, IMF and World Bank support for the poorest countries must feature a more integrated approach to adjustment that puts growth, poverty reduction, and good governance at the center of program design and strengthens the protection of core social priorities. A new mechanism must also be developed to ensure that the benefits of debt relief flow into increased national efforts to combat poverty, invest in people, and address AIDs and environmental degradation. In addition, a more explicit recognition was needed of the importance of transparent policymaking, good governance, and effective anticorruption efforts and of the need for a greater emphasis on building national ownership of policies and programs, with concrete steps to broaden participation and understanding. Finally, he stressed that the IMF's Enhanced Structural Adjustment Facility (ESAF) must be transformed, and the capacity of the IMF and the World Bank to support the poverty reduction and long-term growth must be strengthened.

Summers: A new, reformed approach to the IMF's and the World Bank's support for the poorest countries should be a goal of the September Annual Meetings.

These are ambitious goals, Summers acknowledged, but it is important to seize the momentum from the Cologne summit (see *IMF Survey*, July 5, page 209) and accelerate and integrate debt-relief efforts into a single package for consideration at the September Annual Meetings of the IMF and the World Bank. He also pointed to the crucial balance that must be struck between international and national interests as the debt-relief initiative moves forward. Three questions would be key—namely:

- how to target support for social objectives while enhancing national ownership and participation;
- how to accelerate the flow of debt relief within the HIPC Initiative while also strengthening the link between relief and lasting poverty reduction; and
- how to design effective economic adjustment policies while also protecting and advancing core social priorities.

The right answer may differ from country to country, Summers observed, but it is critical to take advantage of this historic opportunity for positive change and reach broad international agreement between now and September on an enhanced framework for debt relief and poverty reduction.