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Folder Title: President Wolfensohn - Media Coverage and Interviews - Interview - Mr Andre Sitov - Tass - April 8, 1997

Folder ID: 30487792

Series: Media coverage and engagement

Dates: 03/17/1997 – 04/08/1997

Subfonds: Records of President James D. Wolfensohn

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ISAD Reference Code: WB IBRD/IDA EXC-13-12

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THE WORLD BANK

Washington, D.C.

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PUBLIC DISCLOSURE AUTHORIZED

Interview: Mr. Andre Sitov, Tass

Tuesday, April 8, 1997
9:10 - 9:30 a.m.
Room E1227

DECLASSIFIED
WBG Archives



R2002-036 Other #: 34 Box #: 186484B
President Wolfensohn - Briefings Books for Presidents Meetings - Meeting Materials
Interview - Mr Andre Sitov - Tass - April 8, 1997



30487782

Archive Management for the President's Office

Document Log

Reference # : Archive-01374 1128

Edit

Print

A. CLASSIFICATION

☒ Meeting Material
☐ Trips
☐ Speeches

☐ Annual Meetings
☐ Corporate Management
☐ Communications with Staff

☐ Phone Logs
☐ Calendar
☐ Press Clippings/Photos

☐ JDW Transcripts
☐ Social Events
☐ Other

B. SUBJECT: INTERVIEW: MR. ANDRE SITOV, TASS (N)
VENUE: E1227 (OFFICE)
IN ATTENDANCE: JDW, SITOV, KLAS
(N) SENT OUT BY CAROLINE
(B) IF ANY FROM KLAS BERGMAN
EXC: CA // ALI (4/7)
Brief Includes letter to JDW from Klas Bergman - April 7, 1997 "Interview with
ITAR-TASS" and tabs:
- Russia at-a-glance
- Trip Objectives
- Press Background

DATE: 04/08/97

C. VPU

Corporate

☐ CTR
☐ EXT
☐ LEG
☐ MPS
☐ OED
☐ SEC/Board
☐ TRE

Regional

☐ AFR
☐ EAP
☐ ECA
☐ LAC
☐ MNA
☐ SAS

Central

☐ CFS
☐ DEC
☐ ESD
☐ FPD
☐ FPR
☐ HRO

Affiliates

☐ GEF
☐ ICSID
☐ IFC
☐ Inspection Panel
☐ Kennedy Center
☐ MIGA

D. EXTERNAL PARTNER

☐ IMF
☐ UN
☐ MDB/Other IO
☐ NGO
☐ Private Sector

☐ Part I
☒ Part II
☐ Other

E. COMMENTS:

File Location ☒ EXC ☐ IISC ☒ Archives	Cleared By Caroline Anstey	Date: 05/02/97
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OFFICE MEMORANDUM

DATE: April 7, 1997

TO: Mr. James D. Wolfensohn, President, EXC

FROM: Klas Bergman, EXTME

EXTENSION: 37229

SUBJECT: **Interview with ITAR-TASS**

Andrei K. Sitov, the Bureau Chief of ITAR-TASS, the News Agency of Russia, will be interviewing you in your office on Tuesday, April 8. He has been informed that he will have 20 minutes for the interview between 9:10 a.m. and 9:30 a.m.

He has asked for the interview in connection with your visit to Russia and has submitted the following questions that he would like to raise with you.

- What is the primary goal of the visit? Whom do you plan to meet? What specific projects do you want to discuss with your Russian hosts?
- What is the Bank's vision of its current and future role in Russia?
- What type of projects would it like to support?
- Will the current emphasis on socially significant programs be further reinforced?
- Does the Bank plan to support the housing reform program that is widely anticipated in Russia under the direction of Mr. Nemtsov?
- The Russian government has suggested that with IMF programs in Russia nearing completion, the Bank's projects will grow in importance. What amounts of credit can Russia realistically expect from the Bank in the next few years?
- What makes the credits so attractive?
- Does the Bank plan to expand its guarantee operations in Russia?
- How successful in your view was the first coal credit? How soon can the second one be expected?
- What can Russia contribute to the work of the Bank? Are you satisfied with the current level of cooperation? How can it be improved?
- How will individual members like Russia and other NIS countries benefit from the new Strategic Compact?

Attached are:

- 1) Russian Federation at a Glance
- 2) Trip objectives and themes from briefing book
- 3) Press backgrounder on Russian Economy

cc: Mmes. Anstey, Tsatsakis, Holden, Horiguchi, Assad, Messrs, MM Brown,
J. Pakulski, Crosby

Russian Federation

During 1995 the Russian economy showed real progress toward stabilization and the downward trend in output continued at a more moderate pace. The 4 percent fall in GDP during 1995 was much smaller than in previous years, and well below the decline of over 12 percent in 1994. Industrial production began to show signs of real growth during the middle of the year, but fell back in the last quarter to its lowest level in recent years, equal to half the level of industrial output in 1991. Domestic investment was similarly depressed, and fell by 13 percent as compared with the 1994 average. These numbers fail to fully capture activity taking place in the informal sector, and they likely underestimate production of services, the sector that has shown the most dynamic performance. The leveling out of the output decline and positive signs of growth in select subsectors and industries provide optimism that the economy is set to enter a period of recovery and positive growth.

Considerable progress was made during 1995 in reducing inflation. After starting the year at 18 percent in January, monthly inflation was reduced steadily to about 3 percent by December, and in February 1996 registered just 2.8 percent, the lowest rate since the pre-reform period. The annual year-on-year inflation rate was 190 percent in 1995, down from 300 percent the previous year. Stricter adherence to monetary targets was critical to this result, coupled with a stable exchange rate, growing confidence in the currency, and rising public demand for rubles. The government's ability to resist pressure to further expand the already substantial subsidies to special sectors, such as agriculture and coal, was an important factor in lowering inflation.

With very limited recourse to foreign or domestic financing, increasing the revenue effort while maintaining a cap on public expenditures is critical. Efforts to improve revenue collection in 1995, however, were not very successful. Some sectors of the economy remain under-taxed—natural gas in particular—and tax compliance, as reflected in tax arrears to government, remains a major problem. Outstanding tax arrears increased from 2 percent to 2.6 percent of GDP during 1995. Budget execution again resorted to the rather draconian practice of expenditure sequestration to maintain spending tar-

gets, pointing to the critical need for strengthening budget preparation and implementation practices.

Trade performance during the year was strong. The merchandise trade surplus increased to \$18 billion, with export growth of 17 percent boosting total merchandise exports to \$81 billion. Trade with countries outside the Commonwealth of Independent States accounted for all of this growth, while exports to those countries contracted, continuing the trend of recent years. Leading exports included petroleum, natural gas, and processed metals, such as copper, nickel and aluminum. Imports grew by 10 percent and totaled nearly \$64 billion.

Unemployment continues to rise in Russia, but remains below expectations in light of the massive decline in national output. During 1995 open unemployment worsened, rising to 8.2 percent of the labor force by end-December, and registered unemployment increased, but only to 3 percent of the work force. At the same time wage arrears are growing, leading to some increase (still negligible) in industrial action. As of mid-1995 wage arrears, including government arrears to civil servants, accounted for around 2 percent of GDP.

Poverty also remains a serious social problem on which little progress has been made in recent years. Almost a third of the population was estimated to be living on incomes below the official poverty line in 1993. The share of the population who are poor does not appear to have changed significantly since that time, although fully comparable figures are not available. Poverty is concentrated among the working poor, elderly living alone, families with many children, and in single-industry towns where factories have shed workers. The fall in real social transfers to the elderly and unemployed has exacerbated the hardships facing families.

Social Indicators

Social indicators suggest some modest improvements in 1995, although changes in the annual statistics must be interpreted cautiously. Preliminary indicators give grounds for optimism that the increase in mortality and morbidity rates has been arrested. After average life expectancy fell by about 5 years between 1991 and 1994, there has been some improvement in the 1995

figures, suggesting an increase in life expectancy by 1 year, mainly for women. But male life expectancy remains very low at around 58 years. Preliminary data indicate that infant mortality was 17.5 per 1,000 births in 1995, a significant improvement from the 19.9 per 1,000 recorded in 1993.

Structural Reform

Following the major structural reforms introduced over 1991-93, the past two years have been periods of consolidation with few new initiatives. Private retailers now account for nearly 90 percent of retail trade and domestic prices of most traded goods have largely converged to world levels, although oil stands out as an important exception. But progress in structural reforms has been uneven, with some sectors showing rapid transformation and others proving very resistant to change. Industry privatization, which was dramatic and made rapid early progress between 1992 and 1994, has slowed in its second phase and there is concern over its lack of transparency. Agricultural reform remains very controversial in Russia, and has not been widely embraced by the agricultural sector itself.

The financial sector, which underwent rapid liberalization sparking a proliferation of private banks, faced a liquidity crisis in August 1995 that exposed the weaknesses of many banks and underscored the need for development of government regulatory and monitoring capacity and more stringent implementation of prudential banking regulations. In the area of social safety nets, few initiatives have been made and the weakness of the current system has come to a fore as growing demands have been placed on diminishing social funds. Land reform has also seen little progress. The rights of land owners to lease or rent land have been stated several times since the new constitution was passed guaranteeing private land ownership, but legislation protecting rights to buy, sell, mortgage, or lease land has been absent.

Progress in privatization has long been the centerpiece of the government's achievements in structural reform. The first stage of Russian voucher-based privatization, completed in October 1994, was very impressive. Over two-thirds of large and medium enterprises and 80 percent of small enterprises were either completely or partially privatized. The new phase, which began in late-1994, has been based on cash sales and investment tenders, and the controversial "loans-for-shares" scheme selling government equity as collateral in return for budget loans. While the magnitude of the task and of progress has been enormous, both phases of reform have raised questions about quality. Evidence drawn from enterprises privatized during the first phase indicate that ownership is quite concentrated, and that

insiders hold the majority of shares, raising the question of how innovative or reform-minded the new managers are. Implementation of the second phase, particularly the loans-for-shares arrangements, has been non-transparent, giving the appearance of special benefits to insiders and a poor return on public assets.

Since the former mono-banking system was dismantled and private banks authorized to operate, around 2,500 independent commercial banks have begun operation, most created within the last few years. The Russian securities market also began in 1992 and now includes over 60 licensed exchanges. Reform of the legal and regulatory environment, however, has lagged far behind liberalization of the sector, resulting in poor information disclosure, underdeveloped supervision, and shallow and illiquid markets. Most of the banks are small, undercapitalized, and suffer weak management. Moreover, government intervention is still strong through pressure to lend to specific entities. In August 1995 several banks defaulted on overnight obligations, triggering a crisis of confidence in the system. Quick action by the central bank to inject liquidity into markets helped restore confidence.

The social transfer programs financed by extra-budgetary funds set up in fiscal 1992, including pensions, unemployment insurance, and cash transfers for children, continue to be the main social safety nets for the population. Local governments also maintain some poverty prevention programs, providing targeted assistance. During 1995 no major changes to these programs were introduced, but a crisis in pension financing drew attention to the need for basic reform. For the first time since the pay-as-you go pension system was initiated, the pension fund was unable to meet its obligations, and required transfers from the federal budget. High inflation combined with less regular and complete indexation in 1995, also led to an erosion of real pension benefits, and the year ended with the average pension equal to only the minimum elderly subsistence requirements. This experience has moved pension reform to the fore of the social protection restructuring agenda for 1996.

Significant progress has been made in the oil sector. Oil prices have moved from 10 percent of world levels to 70 percent in three years and, for the last few months of 1995 and early 1996, have been essentially at international parity after adjustment for export duties. The government has decided to eliminate export duties by July 1. Oil export volumes to countries outside the Commonwealth of Independent States have increased substantially.

In the short span of five years since the dissolution of the Soviet Union thousands of laws and decrees have been issued to erect a legal framework appropriate to a market-oriented democratic society. In 1995 and early 1996 the government completed work on the new code

of civil law that has been four years in the making. It sets out laws fundamental to the market economy: guaranteeing the legal right to buy, sell, or lease property; establishing the role of contracts, insurance, torts, and liability under the law, and protects consumer rights by, for example, requiring truth in advertising. However, application of the law remains weak and will take many years to develop. Absence of an efficient court system continues to impede economic activity and reduce productive investment flows. Poor contract enforcement results in high risks, and hence higher costs of business in Russia, while also discouraging foreign investors.

Medium-Term Prospects

The government has made major progress in financial stabilization over the past year. The program of monthly

monitoring under Russia's IMF program and ongoing discussions with the Paris Club on a possible multi-year debt rescheduling arrangement, provide some assurance that future governments will follow consistent and reasonably sound macroeconomic policies.

External Debt

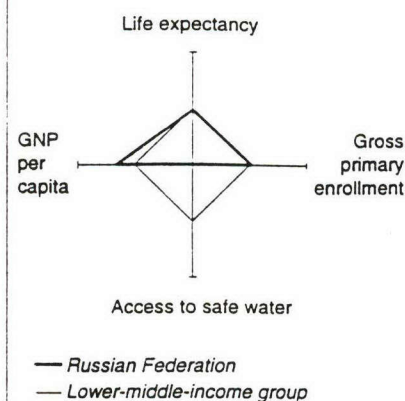
In November 1995 Russia won very favorable terms for rescheduling of the approximately \$26 billion in London Club debt held by private creditors. A multi-year arrangement has spread the repayment schedule out over a 25-year period. The Paris Club also extended its rescheduling arrangements with Russia for another year, adopting terms similar to those used in 1994. Adoption of a multi-year arrangement with the Paris Club is anticipated during 1996.

Russian Federation at a glance

POVERTY and SOCIAL

	Russian Federation	Europe & Central Asia	Lower-middle-income
Population mid-1995 (millions)	147.3	488	1,154
GNP per capita 1995 (US\$)	2,230	2,240	1,700
GNP 1995 (billions US\$)	328.4	1,093	1,962
Average annual growth, 1990-95			
Population (%)	-0.1	0.4	1.4
Labor force (%)	0.0	0.6	1.8
Most recent estimate (latest year available since 1989)			
Poverty: headcount index (% of population)	31	..	..
Urban population (% of total population)	73	66	56
Life expectancy at birth (years)	65	68	67
Infant mortality (per 1,000 live births)	18	23	36
Child malnutrition (% of children under 5)	..	..	..
Access to safe water (% of population)	..	..	78
Illiteracy (% of population age 15+)	2	..	..
Gross primary enrollment (% of school-age population)	107	97	104
Male	107	97	105
Female	107	97	101

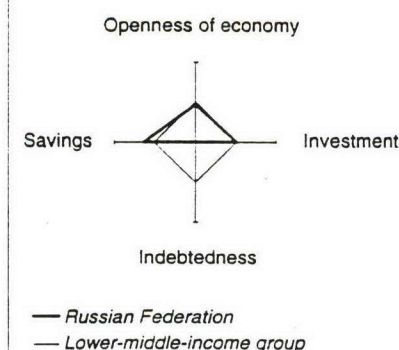
Development diamond*



KEY ECONOMIC RATIOS and LONG-TERM TRENDS

	1975	1985	1994	1995
GDP (billions US\$)	..	..	277.1	363.7
Gross domestic investment/GDP	..	..	28.9	28.0
Exports of goods and non-factor services/GDP	..	..	27.7	25.8
Gross domestic savings/GDP	..	..	31.6	30.7
Gross national savings/GDP	..	..	30.1	29.5
Current account balance/GDP	..	..	1.1	1.5
Interest payments/GDP a/	..	..	1.8	1.7
Total debt/GDP	..	..	34.0	28.5
Total debt service/exports a/	..	..	26.2	19.5
Present value of debt/GDP	..	..	..	..
Present value of debt/exports	..	..	..	..
(average annual growth)				
GDP	..	..	-12.6	-4.0
GNP per capita	..	..	-12.6	-4.1
Exports of goods and non-factor services	..	..	11.8	3.6

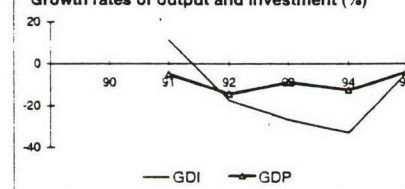
Economic ratios*



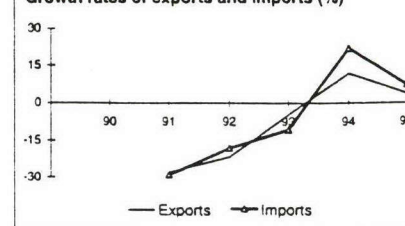
STRUCTURE of the ECONOMY

	1975	1985	1994	1995
(% of GDP)				
Agriculture	..	..	7.8	9.4
Industry	..	..	34.8	33.9
Manufacturing	..	..	..	..
Services	..	..	57.4	56.7
Private consumption	..	..	47.5	..
General government consumption	..	..	20.9	..
Imports of goods and non-factor services	..	..	25.0	23.1
(average annual growth)				
Agriculture	..	..	-6.0	-6.0
Industry	..	..	-25.1	-4.7
Manufacturing	..	..	..	..
Services	..	..	-2.9	-4.0
Private consumption	..	..	..	..
Total consumption	..	..	2.2	-2.8
Gross domestic investment	..	..	-33.1	-4.5
Imports of goods and non-factor services	..	..	22.0	7.1
Gross national product	..	..	-12.7	-4.2

Growth rates of output and investment (%)



Growth rates of exports and imports (%)

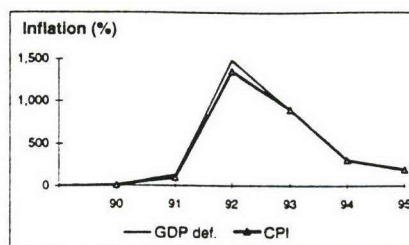


Note: 1995 data are preliminary estimates.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

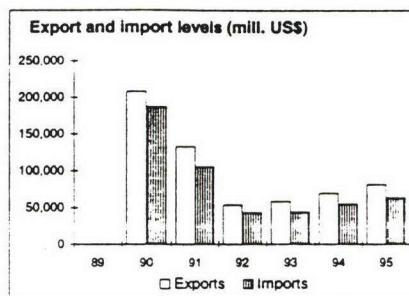
PRICES and GOVERNMENT FINANCE

	1975	1985	1994	1995
Domestic prices				
(% change)				
Consumer prices	..	..	303.2	189.2
Implicit GDP deflator	..	..	307.6	182.8
Government finance				
(% of GDP)				
Current revenue	..	..	37.7	29.8
Current budget balance	..	..	..	..
Overall surplus/deficit	..	..	-10.0	-4.8



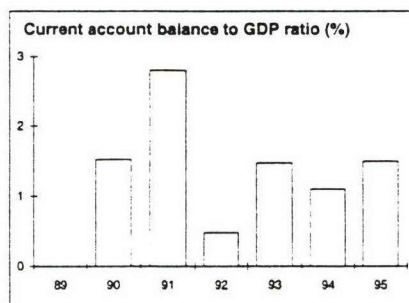
TRADE

	1975	1985	1994	1995
(millions US\$)				
Total exports (fob)	..	..	69,400	81,400
Petroleum, crude and processed	..	..	16,454	18,162
Natural gas	..	..	12,632	13,834
Manufactures	..	..	..	..
Total imports (fob)	..	..	55,200	63,500
Food	..	..	..	..
Fuel and energy	..	..	..	..
Capital goods	..	..	..	..
Export price index (1987=100)	..	..	..	..
Import price index (1987=100)	..	..	..	..
Terms of trade (1987=100)	..	..	..	..



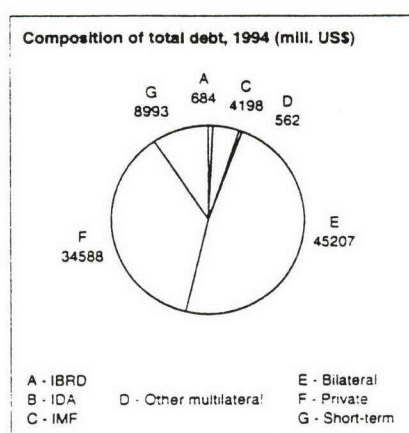
BALANCE of PAYMENTS

	1975	1985	1994	1995
(millions US\$)				
Exports of goods and non-factor services	..	..	76,900	93,800
Imports of goods and non-factor services	..	..	69,400	84,000
Resource balance	..	..	7,500	9,800
Net factor income	..	..	-4,300	-4,900
Net current transfers	..	..	-100	500
Current account balance,				
before capital transfers	..	..	3,100	5,400
Financing items (net)	..	..	-7,000	0
Changes in net reserves	..	..	3,900	-5,400
Memo:				
Reserves including gold (mill. US\$)	..	..	6,475	17,275
Conversion rate (local/US\$)	..	..	2,204.7	4,561.6



EXTERNAL DEBT and RESOURCE FLOWS

	1975	1985	1994	1995
(millions US\$)				
Total debt outstanding and disbursed b/	..	..	94,232	103,800
IBRD	..	..	684	..
IDA	..	..	0	0
Total debt service paid	..	..	3,661	..
IBRD	..	..	38	..
IDA	..	..	0	0
Composition of net resource flows	..	..	..	..
Capital transfers, net	..	..	800	-600
Official creditors	..	..	..	..
Private creditors	..	..	..	..
Foreign direct investment	..	..	600	1,956
Portfolio equity	..	..	-200	-1,434
World Bank program	..	..	..	..
Commitments	..	..	1,590	..
Disbursements	..	..	283	..
Principal repayments	..	..	0	..
Net flows	..	..	283	..
Interest payments	..	..	38	..
Net transfers	..	..	245	..



World Bank International Economics Department, September 1996

Note: Estimates for economies of the former Soviet republics are subject to more than the usual range of uncertainty.

a. Scheduled payments before debt relief. b. Debt owed to China, former Yugoslavia, and the members of ex-CMEA is excluded.

TRIP OBJECTIVES AND THEMES

KEY MESSAGES

- 1) **Reform:** Importance of structural reforms to revive growth and sustain macroeconomic stabilization; more attention needed to social issues to mitigate hardships on population.
- 2) **CAS:** Bank willing to expand program to \$2-3 billion per year if the government accelerates reforms.
- 3) **Coal:** Implementation of reforms under Coal-I significantly behind schedule; Bank willing to proceed with Coal-II only if concrete actions taken.
- 4) **New Adjustment Loans:** Need to reach final agreements on SAL-I (\$600 million) and Social Protection Adjustment Loan (\$500 million).
- 5) **Sea Launch:** All issues on the Bank side are resolved and we are willing to proceed as soon as the GoR and commercial sponsors come to agreement on remaining details.
- 6) **Portfolio Performance:** Big improvements over the last year; proportion of satisfactory projects has risen from 39% to 65%, and we are aiming for 80% by end-FY97.

This will be your third visit to Russia as President of the World Bank (your previous trips were in October 1995 and May 1996). This visit gives you the opportunity to meet President Yeltsin's new reform team and to gauge first-hand how the Bank can best support the new Government's reform agenda. Your visit is especially timely given that the Country Assistance Strategy (CAS) for Russia is scheduled to be presented to the Board in June.

Your last visit to Moscow was at the height of the campaign season in Russia, just prior to the June 1996 Presidential elections. Since that time, the Government has been in a constant state of political flux due in part to Mr. Yeltsin's illness. Nevertheless, the Bank continued to carry through with its program of support, and fielded two senior-level visits, in October 1996 (Mr. Koch-Weser) and March 1997 (Mr. Linn's visit for the 1997 CPPR).

Very recently President Yeltsin undertook to radically reorganize the Government, reappointing Mr. Chubais to head up the reform effort in the Government, as well as bringing in reformers from the regions—former Governor Nemtsov among them. Although all the senior appointments have not been finalized, and most of Moscow has yet to settle down to get back to work following the excitement, there is clearly a sense of a window of opportunity for the Government to move forward more rapidly with critical structural reforms.

Your visit affords you the chance to meet with members of the new Government and to pledge the Bank's commitment to accelerating its program of assistance under an enhanced lending scenario, provided the Government is committed to accelerating the pace of reforms in key sectors. You should congratulate the Government on its commitment to reform and reiterate that the Bank will be there over the long haul to help implement the structural reforms necessary to sustain macro stabilization, revive growth, and strengthen the social safety net.

Several major operations are currently in their advanced stages of preparation and are scheduled to be presented to the Board within the next few weeks, including: the Structural Adjustment Loan (SAL), the Sea Launch Guarantee Operation, and the Bureau of Economic Analysis Project. Key operations in health and education and possibly a \$500 million social protection adjustment loan are also scheduled for this fiscal year. The Government is likely to ask us to consider Coal II within the calendar year. However, processing of this operation can begin only after the Government takes steps to conclude preparatory activities so that these operations can be negotiated and begin to be implemented.

Press Background

The World Bank

Europe and Central Asia Region



Contacts: Phil Hay (202) 473-1796
Sevda Eris (202) 473-3847

RUSSIA'S ECONOMY: WORLD BANK SAYS GROWTH MAY BEGIN IN 1998 BUT REFORMS ARE KEY.

March 17, 1997—On the eve of the US-Russian Summit in Helsinki, the World Bank says that Russia is slowly emerging from deep recession and can now look forward to economic growth. However, significant reforms are still needed before Russia's new direction can be assured.

*"Over the past year, economic reform has been a hesitant process," says **Michael Carter, Director of the World Bank's Moscow Office.** "Inflation has fallen in a big way and that is a major success for the Government because it lays a lot of the groundwork for economic recovery. But at the same time you also have to overhaul the taxation system and make far-reaching reforms to capital markets, pensions, housing, regulation of natural monopolies, and privatization, if Russia is to see its potential for rapid growth come true."*

The Bank believes that while Russia is likely to record zero-growth in 1997—a forecast based on evidence that most Russian enterprises are still in the early stages of restructuring—information derived from current monthly trends in the economy suggests that the country's overall economic prospects may have reached a turning point. Annual growth is expected to turn positive in 1998 and could reach 6 percent as a medium term trend, driven by further expansion in services, export-oriented industries such as oil, gas, and metals, and power and telecommunications sectors.

Russia's growth, however, is by no means assured. While recent economic results suggest compelling signs of progress, an improved economic performance will depend on solidifying existing reforms and undertaking new structural adjustment aimed at energizing the private sector and addressing social concerns.

Groundwork in Place

The past five years have produced profound changes in Russia. Prices and trade have been liberalized, over 70 percent of GDP is now generated in the private sector, and despite initial problems, economic stability is within reach. A major achievement has been curbing the rate of inflation which has fallen from 1,354 percent in 1992 to 22 percent in 1996. In the process, the domestic currency has become stronger.

As the political environment has become more certain since the presidential elections last year, capital flight appears to have declined - a good sign for recovery in investment. On the Russian stock market, share prices surged upwards by 156 per cent in 1996, and were up by a further 42 percent since January of this year. Also last year, Russia recorded an estimated \$24 billion trade surplus with exports up 5 per cent and imports staying flat. In November, shortly after receiving an internationally recognized credit rating, Russia made its debut in the Eurobond market, successfully placing a five-year bond issue for \$1 billion.

Of special note in 1996 was Russia's agreement with the Paris and London Clubs to re-schedule payments of roughly \$72 billion which represents about 70 percent of the country's total external debt.

"These developments are highly welcome," says Michael Carter. "Especially, if you consider that Russia has been going through a major transition from its old state-planned system to a new market-oriented economy, at the same as struggling through a severe recession. Now the challenge is to create the right conditions for a big surge in investment."

Challenges Ahead

- **Tax Reform**

The biggest challenge to keeping the Russian economy stabilized is the need to control the size of the fiscal deficit. The deficit is driven by collapsing federal tax revenues which fell to 10 percent of GDP during 1996. According to the Bank, there are two main reasons for this downward trend: first, serious distortions in the overall tax structure with too many taxes, a narrow tax base, and high marginal rates; and second, weak tax administration, reflected in the widespread use of discretionary tax exemptions and growing arrears. The result has been increased budgetary shortfalls, including the non-payment of public sector wages and pensions.

"Russia really has to reform its complicated tax system because if this problem of tax collection remains unsolved, it is going to frustrate efforts to get growth moving forward," says Michael Carter.

- **Interest Rates**

Most of Russia's budget deficit (7.7 percent of GAP in 1996) is financed domestically, which, coupled with strict monetary policy and declining inflation, has produced sharp rises in real interest rates and the cost of domestic debt service. Recent declines in nominal interest rates have been a positive sign, but the Government will need to contain domestic borrowing to continue this trend - to place public finances on a sounder footing and to create a better business climate for domestic investment.

- **Private Sector**

Russia now has a dynamic private sector which is poised to be the main source of growth in the economy. Reducing interest rates will certainly spur recovery but private business is also hampered by uncertain property rights and legal and regulatory systems. Addressing these issues will encourage foreign as well as domestic investment. Foreign investment could play

an extremely helpful role in Russia but at the moment it is only a third of the per capita amount flowing into Poland, and less than one-tenth of the amount invested in Hungary.

- **Poverty**

One of the biggest results of Russia's transition towards a market economy has been a growing incidence of poverty among its population. In 1996, 32 million people were classified as living below the poverty line while many other households experienced financial insecurity because of late payment of public sector wages and pensions. The World Bank believes that Russia must engineer a strong but affordable safety net to move people out of poverty and to ease social tensions at a time when the country needs to push ahead with greater structural reforms.

"It looks like a daunting list of things for the Russians to do," says Michael Carter. "But if Russia manages to sustain reforms there is no reason why Russia could not be one of the world's booming economies at the beginning of the next century."

The World Bank and Russia

The World Bank today is Russia's largest single foreign source of long-term financing for public sector investments. It also provides important funding for the private sector. Since August 1992, when the Bank made its first loan to Russia, 28 loans have been approved with a total value of \$6.4 billion, making Russia the Bank's third largest borrower after China and India.

Loans have been provided for the oil industry; transport, including road and bridge repairs; improving bus services in more than a dozen Russian cities; strengthening the banking sector and developing capital markets; supporting agricultural and land reform; promoting better health care, education, water supply and sanitation; and for protecting the environment.

Reflecting the Bank's commitment to safeguarding the environment, it responded quickly to finance the clean-up of the Komi oil spill in Northern Russia in April 1995 with a loan of \$99 million. In addition to funding other projects, the Bank has also backed a \$110 million Environment Management Project, part of which provided a \$5 million emergency loan in the summer of 1996 to deal with a disastrous outbreak of silkworms in the forests of Krasnoyarsk Kray in Siberia.

Review of Bank Projects

By 1995, the Russian portfolio of projects was one of the most troubled in the Bank. In late 1995, Russian Prime Minister, Victor Chernomyrdin and World Bank Group President, James Wolfensohn agreed that a major joint effort was needed to improve the performance of Russian projects financed by the World Bank.

In the last twelve months there has been substantial progress. In early 1996 a joint Government/World Bank review of the country's portfolio noted that disbursements of Bank loans to Russia's projects were averaging only \$25 million a month, and only 39 percent of projects were considered to be performing satisfactorily. At a similar annual review, concluded in March 1997, the portfolio's satisfactory performance rating has now jumped to 73 percent and

monthly disbursements are running at about \$70 million. The review agreed on an even more ambitious target—a satisfactory rating of 80 percent of projects by June 1997.

In a keynote speech to Russian government officials in Moscow earlier this month, the **World Bank's Vice President for Europe and Central Asia, Johannes Linn**, described the significance of this improvement:

"After twelve months, we all can take pride in the significant changes that our hard work has produced. Many projects are beginning to yield substantial benefits for the economy and the people of Russia. The art of successful communication is not just what is said but what is heard. The achievements recorded during this portfolio review show that we have been listening to each other. Let us now hear our clients and remove the remaining obstacles to serving them better."

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