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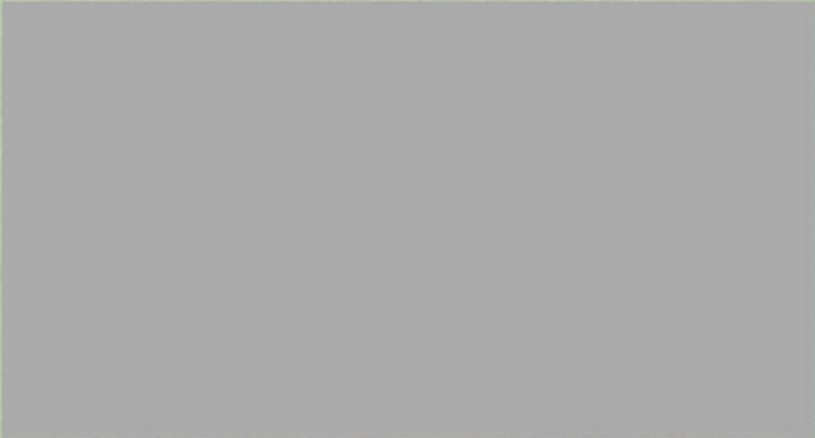
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 Paris Club - 93-03 (Apr. 8, 1993 meeting)

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M. Law
 J. ...
 D. ...

DATE: April 9, 1993

TO: Mr. D. C. Rao, Acting Vice President, DEC

FROM: Michael Lay, Economic Adviser, DPG

93 APR 12 AM 9:39
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EXTENSION: 35092

SUBJECT: Paris Club: Russia - Back-to-Office Report

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Introduction

1. The meeting between Russia and the Paris Club creditor countries was held on April 1 to 2. 1/ The resulting agreement provides Russia with a substantial amount of debt relief, on the order of \$15 billion for 1993. Should other creditors grant terms no less favorable, as Russia is now obligated to seek, this would allow Russia a debt service ratio of less than 10% during 1993, somewhat less than called for by Paris Club agreements even with "IDA only" countries. However, creditors accepted the arrangement on the grounds that external resources were urgently needed to support the Russian Federation's reform program. And the delegation from Russia did note that each \$1 billion represented 1% of Russia's GDP.

2. The agreed rescheduling did not turn on a rigorous analysis of balance of payments requirements, in part because the balance of payments numbers were so uncertain and there was no IMF arrangement (which normally defines the financing gap to be filled by the rescheduling), as well as other considerations. Rather, the premise of the rescheduling was that Russia could afford to pay a maximum of \$3.5 billion of debt service during 1993, of which on a pro rata basis the creditor countries represented at the Paris Club were due about \$2 billion.

3. The agreement covers:

- (a) a rescheduling for arrears on short term debt of 100% of the amounts of principal and interest (including late interest) due and not paid as of December 31, 1992, under which payments will be made beginning January 1, 1995, and ending July 1, 1999;
- (b) a rescheduling for short term debt liabilities falling due during the consolidation period of 100% of principal and interest due during 1993 to be paid in equal installments beginning 1996 and ending in 2000;

1/ The essential features of the agreement were transmitted to EC4 at that time.

- (c) a "catch-up" and rescheduling clause for amounts of principal and interest originally due during 1992 which were previously rolled over, under which Russia agrees to pay at least 50% of amounts due to each creditor by September 30, 1993 2/, with the balance to be paid in equal installments from 1995 to 1999;
- (d) a rescheduling of 100% of principal and interest on MLT debt falling due during 1993, with payments of equal installments to begin in 1996 and end in 2000; and
- (e) while 40% of interest accruing during 1993 on consolidated amounts will be paid on due dates, 60% will be paid in 10 equal payments from 1996 to 2000.

4. The unusual features of this agreement include a rescheduling of both short term arrears as well as short term obligations falling due during the consolidation period, and the "catch-up" clause on post cut-off date debt.

5. Negotiations between Russia and the creditor countries were made possible by an agreement between Ukraine and Russia which was achieved during March and which is the last of a series of such agreements between Russia and other republics of the former Soviet Union (FSU) 3/. This agreement allowed Russia to negotiate on behalf of Ukraine pending a final agreement between Russia and Ukraine. Of the other republics, Belarus, Turkmenistan, Uzbekistan 4/ and Kyrgyzstan have relinquished claims on foreign assets while Russia has accepted their share of the FSU's foreign debt liability. Armenia, Kazakhstan, Tadjikistan, and Moldova have reached agreements under which Russia would be responsible for managing their FSU debt liabilities. Therefore, in view of this array of agreements, Russia and the creditors could negotiate concerning the entire amount of FSU debt.

6. While the agreement is not based on an IMF program, it does have a pullback clause under which the provisions of the agreement cease to apply if there is no upper credit tranche arrangement by October 1, 1993. The agreement commits the Government of the Russian Federation not to accord any external creditors repayment terms more favorable than those accorded to the participating creditor countries. Of course, bilateral agreements between Russia and each of the creditor countries will be needed and these will have legal standing and serve as the implementing documents for the agreement.

7. The agreement calls for a subsequent meeting between Russia and the creditors to consider the matter of Russia's debt service obligations falling due during 1994, provided that an upper credit

2/ This was an important feature allowing Russia a requested 6 month breathing space in effecting payments.

3/ Technically, there are still no agreements between Russia and the republics of Azerbaijan and Georgia, but these republics would be liable for very small percentages of the FSU debt.

4/ Although the agreement with Uzbekistan apparently needs further clarification.

tranche arrangement has been concluded with the IMF and that bilateral agreements have been reached between Russia and the creditor countries.

8. The status of one category of debt remains to be clarified. This concerns debt contracted after October 28, 1991, the date on which the "Memorandum of Understanding of the Debt to Foreign Creditors of the Union of Soviet Socialist Republics and its Successors" was signed, and debt contracted before March 31, 1993, which was disbursed in FSU successor states apart from Russia. Russia is not responsible for this debt under the agreement, but further work is apparently needed to identify precisely the amounts concerned.

] What is the
nature of
instruments
of this
debt?

9. During the brief formal discussion prior to the negotiations, the creditor countries uniformly supported the reform program but also emphasized the need for a tighter monetary policy to stabilize the economy, and for reduced subsidies. Addressing the problem of monetary policy, Deputy Prime Minister Shohkin stated that the Governor of the Central Bank is now a member of the Presidium, and that this and the recognized concern about this problem should be reassuring to the creditors.

10. The cost of the agreement to Germany was cited as \$5 billion, and to Austria, \$1 billion, a sizeable per capita burden.

11. Mr. Trichet chaired the meeting for the creditors. Deputy Prime Minister Shohkin led the delegation of the Russian Federation.

12. Attached are the statements made by Deputy Prime Minister Shohkin, the IMF and the World Bank, a copy of the agreement, the press release, and, finally, a list showing the status of debt agreements between Russia and the other FSU republics.

cc: without attachments

Messrs./

Mmes. Karaosmanoglu; Sandstrom; Stern; Linn; Kashiwaya; Selowsky; Ray, McCarthy; Birdsall, Gelb, Ahmed; Nishimizu, Bhattacharya; Pfeffermann; Shakow.
Wyss, Handwerker, Paris Office.
Institutional ISC.

cc: with attachments

Messrs. Cheetham, Huang, Toft, Nielsen, Vieira Da Cunha, EC3
Kavalsky, Graiss, EC4

MLav:vl

Speech to the Paris Club on 1 April 1993

Introduction

I would like to begin today by thanking you for your invitation to the Paris Club. This is the first time I have had the opportunity to attend a Paris Club meeting in person. I come here with the hope that we can together find a realistic solution to the problems of the external debts of the former Soviet Union.

I know full well how much time and effort has been spent in trying to reach a Paris Club agreement. I can only say that this effort reflects the importance my Government attaches to a successful rescheduling of our external debt.

A Paris Club agreement is important to us for two reasons. The Government's economic reform programme is at a crossroads. Either we go forward to economic stabilisation or, I fear, the present opportunity for fundamental economic change will be lost. A central feature of the reform programme is the need to relieve pressure on the budget. This pressure comes from many sources, including the claims of our creditors. A realistic rescheduling would reduce this pressure since every \$1 billion of debt service increases our budget deficit by more than 1% of GDP.

A Paris Club agreement would also have important political consequences for our reform Government as it would serve as an important public display of support for the Government at a time when it is criticised for relying on financial assistance from the West.

Our discussions today take place against the background of a profound constitutional struggle over the distribution of political authority that has disrupted the implementation of our reform programme. One issue in this debate that has been seized upon by the Government's political opponents is our inability to reach a Paris Club agreement and, more generally, what is perceived as the failure of the West to deliver its promised financial assistance. Not agreeing a rescheduling today can only strengthen the hands of the enemies of political reform.

These dramatic political developments are in part the result of a more fundamental deterioration in social conditions. The living standards of our people have fallen dramatically over the past year. Nearly half of all Russians now live close to or below the poverty line. Excessive inflation has destroyed savings. Unemployment - currently at a low level - threatens to become a serious problem as our economic reform programme is implemented.

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It would be easy for me to come here today and agree to an unrealistic rescheduling. That would not be in our interest or your interest. The premature payment of excessive debt service would only increase the risk of hyperinflation and exacerbate social tensions. The result, in either case, would be to delay further the day when Russia is able timely to pay its debts.

Economic background

Turning to our economic situation, when we embarked upon our radical economic reform programme last year, our objective was to transform the centrally planned economy to a market economy. This is still the Government's overriding objective.

We have made considerable progress in spite of a number of setbacks. The budgetary deficit was reduced to less than 6% of GDP last year compared with 20% in 1991. Prices and foreign trade have been liberalised. Over 46,000 firms have been privatised and nearly all the population have received privatisation vouchers.

Our difficulties have been well-publicised and I do not intend to minimise them. Suffice it to say that a number of important reform measures were not implemented due to compromises and inconsistent policies, caused mainly by three factors: 1) our internal political situation, 2) the policy of the Central Bank, and 3) pressure from the military-industrial complex. This led to a deterioration in our economic situation, which is now extremely unstable. We are facing a severe monetary and budgetary crisis caused mainly by the enormous internal pressures to support our industries as they make the transition to a market economy. This has resulted in a rapid increase in the pace of inflation, now running at 25% - 30% per month. Hyperinflation is close at hand.

On top of this, our industrial output fell by approximately 19% last year as a result principally of the disruption in trade with our traditional partners and a dramatic fall in demand. Output continued to fall in the first months of this year at a comparable rate.

New reform measures

To combat this situation, the Government is considering a comprehensive package of reform measures to be implemented in 1993. Our objective is to stabilise the economy based on market principles.

We aim to achieve this goal, first, by reducing monthly inflation to 5% by year-end through strict curbs on the issue of new credits, and secondly, by reducing Central Bank financing of the budget deficit, with overall domestic financing limited to acceptable levels to take into account our inflationary objective.

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An important element of the programme will be to stabilise the Rouble. A strong currency will serve as an important public symbol of the success of the reform programme. Maintenance of a more stable exchange rate will also act to discipline monetary policy.

The principal components of the package will be quantified in consultation with the IMF. The components we are currently discussing include :-

- significantly increasing interest rates on savings banks deposits;
- increasing the Central Bank's official lending rate to market determined levels;
- issuing an official decree setting goals for monetary policy and strict quarterly limits on the growth rate of new Rouble credits issued by the Central Bank;
- reducing import subsidies and exemptions from export taxes and customs duties;
- issuing government securities to finance up to 30% of the budget deficit.
- strengthening of foreign exchange controls;
- severely reducing the issue of credits to enterprises and other republics of the former Soviet Union;
- introducing a strict process for allocating credits from the budget;
- including all interest rate subsidies in the budget.

We believe substantial international financial assistance can play a crucial role in contributing to the success of our reform effort. We would like to determine the amount of the assistance together with Western governments. In requesting this assistance, we recognise that it would be conditional on Russia's meeting agreed performance targets

The main objective of the assistance package would be to provide:

- special budgetary financing, to assist in raising funds from sources other than the Central Bank;
- long-term investment funds for restructuring priority sectors of the economy - energy, military conversion and agroindustry - and funding a loan programme for small businesses;

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- the Rouble stabilisation fund announced in 1992;
- an IMF standby loan to increase reserves; and
- a rescheduling of our external debt, which I will discuss in more detail shortly

Balance of Payments

Turning to our balance of payments, we have recently reported the results of 1992 to the IMF and discussions are in progress concerning the final data. Only a few differences remain. We expect these to be resolved next week in Washington. We are also discussing 1993 balance of payments projections. I would only like to report today that preliminary discussions indicate the worsening economic situation is expected to result in a widening of the financing gap this year.

Foreign Exchange Mobilisation

I would like now to make a few comments on our plans for mobilising our foreign exchange resources.

As we discussed with you last year, we have been actively examining ways to improve the system of mobilising foreign exchange so as to increase our debt servicing capacity. In the second half of 1992, we implemented a system under which exporters were obliged to sell a portion of their foreign exchange earnings to the Central Bank or to authorised banks. The Government then purchased foreign exchange from the Central Bank for debt service payments.

The main problems with this system have been inconsistent compliance by exporters and the strain which the purchase of foreign exchange puts on the budget at a time at time when our budgetary position is under extreme pressure. We are therefore implementing measures to address these problems. The first is to allow payment of export and import levies to be made in foreign exchange as well as Roubles. The second is to require that certain products (principally oil and gas) be exported directly for the Government's account. The results of these initiatives are shown in the presentation we have circulated to you. While it is still too early to know whether this arrangement will prove satisfactory, I wish to assure you that achieving positive results in this area is one of my highest priorities.

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IMF and World Bank

Turning to our relations with the IMF and the World Bank, the Government wishes to conclude negotiations with the IMF as soon as possible. We expect within the next few months to complete discussions on a programme that contains the conditions for the successful stabilisation of the economy. I want to emphasise that we welcome calls for tough - but realistic - policies from the IMF since these are the goals of our Government as well.

We have already agreed on the major elements of a programme of cooperation with the World Bank. This programme envisages loans of approximately \$8 billion to be disbursed before 1997. During 1992, we have drawn down \$60 million under a \$600 million rehabilitation loan. In 1993, we expect that \$1.3 billion will be drawn down under various World Bank facilities.

Request for amendments to proposed rescheduling terms

I would now like to turn to the first of the issues that we must resolve - the financial terms and conditions of debt relief. I should like to make two preliminary points. First, the Government appreciates that the terms proposed to us already represent a generous and exceptional offer. Secondly, the Government is strongly committed to servicing debts not eligible for deferral and has no arrears on debts contracted in 1992.

We have carefully examined the financial terms proposed by our official creditors and our Bank Advisory Committee. We calculate that debt service to all creditors in 1993 arising from these proposals would amount to some \$5.1 billion.

The foreign exchange required in 1993 to meet this payment would lead to a substantial increase in the budgetary deficit and impose an intolerable burden upon the country at this critical time. To put this matter in perspective, our 1992 debt service payments, while small in dollar terms, represented one-half of the budget deficit and one-quarter of our social expenditure. For 1993, as I have said, each \$1 billion of debt service payments would increase the budget deficit by more than 1% - and this at a time when the deficit is already too large and the need for a social safety net is even more pressing than last year.

We have previously stated that a maximum of \$3.5 billion could be allocated to debt service to all creditors in 1993. Even this amount would severely strain our budgetary resources and heighten social tensions. We both run the risk of derailing economic reform if we do not leave some flexibility in our rescheduling. We will therefore be seeking in our discussions with you today ways in which the figure of \$3.5 billion might be reduced.

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Looking at the medium term, I would like to emphasise that the objective of the Government is to arrive at a debt servicing requirement that corresponds to the country's expected debt servicing capacity. The Government is concerned by the high level of payments due in later years under the proposed rescheduling terms.

To remedy the situation, we are asking the Paris Club to consider making some limited amendments to the proposed rescheduling package. In suggesting these amendments, I wish to emphasise the Government is not seeking any interest forgiveness or change in the cut-off date.

The full details of the amendments are contained in a term sheet which will be circulated to you shortly. I would like to comment on the principal changes.

We have framed our request on the basis that the consolidation period should start on 1 January 1993. We acknowledge payments will need to be made to creditors on account of post cut-off date arrears. We also acknowledge that moratorium interest payments will need to be made. We propose that the timing of the both these payments during 1993 should be negotiated with you within the overall cash constraint which I have referred to earlier.

After much thought, we have decided to request that the period over which our rescheduled debt should be repaid is limited to 10 years with 5 years grace. This decision has been a particularly difficult one to reach. We believe that, in the present uncertain conditions, a much longer grace period and final maturity would be needed to give us the necessary confidence that we will be able to meet the payments on the rescheduled debt as well as the debt service on the substantial new debt which we shall have to assume in the next few years. In accepting that the Paris Club cannot agree to any longer rescheduling terms, I must point out that, in the medium term, the debt service payments which we will have to be made may prove impossible for us and may need to be reconsidered.

In requesting these amendments, we are seeking to achieve, first, a realistic medium term debt servicing requirement that we are confident we can honour, and, secondly, a breathing space of at least 6 months in which no payments are made on the external debt of the former Soviet Union. This would have the important benefit of alleviating the debt service burden during a critical period in which the Government will implement further reform measures. We believe both elements are crucial to the success of our reforms.

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Legal Framework

I will now turn to the legal framework. There are two issues that need to be discussed here: joint and several liability and the definition of the debts of the former Soviet Union for which the Government will be responsible.

With respect to joint and several liability, our position remains that the only realistic legal framework for the repayment of the debts of the former Soviet Union is one in which Russia alone has sole responsibility for managing and servicing those debts. The reasons for this have already been discussed at great length and I do not propose to review them here.

I have received a copy of the 26 March correspondence exchanged by Mr. Trichet and Prime Minister Kuchma, in which it was agreed that the Creditor Countries would not ask Ukraine for payments on the debt of the former Soviet Union which will be covered by a rescheduling agreement with Russia, until Ukraine and Russia reach an agreement on the debts and assets of the former Soviet Union.

I believe that all parties would have preferred a definitive solution to this matter prior to our meeting. That has, unfortunately, not been possible. My Government is nevertheless prepared to go forward with a Paris Club agreement on the basis of the provisional agreement reached by Mr. Trichet and Prime Minister Kuchma. We expect to resume negotiations with Ukraine shortly, and I am confident that we will be able to negotiate an accord under which Russia will become solely responsible for the external debt of the former Soviet Union.

In order to clarify the present position of the Creditor Countries in advance of the resumption of our negotiations with Ukraine, I would like to have confirmation that the Creditor Countries will release those MOU signatories that have already signed Zero Option Agreements with Russia from joint and several liability, and if Russia and Ukraine are able to reach such an agreement, the Creditor Countries will release Ukraine as well.

As to the second issue, the definition of debts, we will distribute the text of a Declaration that the Government proposes to issues shortly on this subject. At the request of our Paris Club creditors, the Declaration would expand the definition of former Soviet debts for which the Russian Government is responsible to include certain debts not covered by the Memorandum of Understanding signed on 28 October 1991.

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The expanded definition adds three new categories of debts. The first is debts contracted by the Government of the former Soviet Union before 28 October 1991 but disbursed after that date to a legally authorised entity. The only exception is for debts demonstrably disbursed to a former Soviet State other than Russia. As I am sure you can understand, my Government cannot accept responsibility for debts disbursed to another State after the MOU had put creditors on notice that Russia would be liable only for Soviet debts outstanding as of 28 October 1991. Because of the difficulties in tracing the proceeds of many of these loans, Russia has agreed to bear the burden of demonstrating that a particular loan was in fact disbursed to another former Soviet State.

The second important new category would consist of arrears arising out of the delivery of goods or the provision of services to the Government of the former Soviet Union after 28 October 1991. These arrears arose largely, but not entirely, from the delivery of goods to Russia. For the reasons I just mentioned, the Declaration makes an exception for goods and services demonstrably delivered after 28 October 1991 to another former Soviet State.

The third new category consists of guarantees issued by the Government of the former Soviet Union or by entities legally authorized to borrow on behalf of the Government of the former Soviet Union which were not called prior to 28 October 1991. As you know, the MOU covered only outstanding debts. Issued but uncalled guarantees were thus not included in the MOU. This category covers principally supplier credits guaranteed by VEB.

The Declaration also clarifies that my Government, in stepping into the shoes of the Government of the former Soviet Union, will be responsible for those debts for which that Government would have been responsible, but will not be liable for private debts unrelated to Governmental activity. An example of the type of debts I have in mind here are the debts of joint venture companies involving foreign partners, where the borrowing was not undertaken at the request of the Government, but for wholly private purposes. It would be inconsistent with international practice for my Government to assume responsibility for these debts. I am sure your own Governments would be similarly unwilling to assume responsibility for the debts of private enterprises within your territory.

Conclusion

I would like to conclude by reminding you that what is at issue here is not just Russia's debt service for 1993, but the future of Russia's reform programme. As I said at the beginning, a Paris Club agreement is of great importance to us as it will provide tangible evidence of the West's support for our reform policies, and will enable us to move forward to the next phase of the reform

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programme. This is especially important now when the Government is under enormous pressure to compromise on its economic policies.

Last steps are often the most difficult. In our discussions today and tomorrow, all parties must remember that without a Paris Club agreement, economic reform in Russia is likely to take a very different path. I am confident that at this session of the Paris Club we can finally reach a realistic rescheduling that gives us the breathing space we need to put in place policies that will lead to sustained economic growth and improved social conditions for the Russian people. That after all is the best assurance that the current government will have the support it needs to pursue economic and political reform.

Rescheduling Terms Proposed by Russia

- | | | |
|----|---|---|
| 1) | Cut-off date | 1/1/91 |
| 2) | Consolidation Period | 1/1/93 - 31/12/93 |
| 3) | Medium and long term pre cut-off date debt (including loans signed prior to the cut-off date and since re-assigned to Russia and individual loans forming part of a protocol or framework agreement signed before the cut-off date) | 100% of principal and interest to be consolidated on arrears and current maturities
5 year grace period
5 year repayment period |
| 4) | Late interest and interest on 1991/2 deferral | To be consolidated and included in the rescheduling of pre cut-off date debt, or post cut-off date debt, as appropriate |
| 5) | Medium and long term post cut-off date debt contracted between 1/1/91 and 1/1/92 (including loans of the type described in 3) above signed between 1/1/91 and 1/1/92) | |
| | a) Current Maturities and Arrears Arising in Fourth Quarter 1992 | 100% of principal and interest to be consolidated
5 year grace period
5 year repayment period |
| | b) Arrears outstanding on 30/9/92 | Payment schedule to be agreed within limit set by Russia's short term cash constraints |

- 2 -

- | | | |
|-----|--|---|
| 6) | Loans contracted on behalf of Russia since 1/1/92 | To be paid on due dates |
| 7) | Arrears of principal and interest on short term debt contracted before 4/1/92 | 100% to be rescheduled
5 year repayment period |
| 8) | Moratorium interest payment on 1993 maturities of medium and short term debt eligible for deferral | Payment schedule to be agreed within limit set by Russia's short term cash constraint |
| 9) | Pull back clause | To be discussed |
| 10) | Goodwill clause | 1994 maturities |
| 11) | De minimis | SDR 1,000,000 |
| 12) | Date by which bilateral implementing agreements to be signed | 31/12/93 |
| 13) | Debt conversion option | To be discussed |
| 14) | Special account for payments | To be created at VEB |

INTERNATIONAL MONETARY FUND

Meeting of the Group of Official Creditor Countries
with the Russian Federation

Staff Statement

April 1, 1993

The economic situation in Russia continues to be very difficult. GDP and industrial production dropped by almost 20 percent in 1992, oil extraction declined by 15 percent and agricultural output by 8 percent. Both exports and imports fell sharply for the second consecutive year.

The rate of inflation has increased sharply since mid-1992, and in the first three months of this year it has averaged well above 1,000 percent at an annual rate. This has reflected loose financial policies and, in particular, excessive credit expansion by the Central Bank of the Russian Federation (CBR), mainly in the form of heavily subsidized loans to specific sectors, regions and enterprises. Coupled with a central bank lending rate that has remained unchanged at 80 percent per annum since May 1992, this policy has brought the entire structure of interest rates to highly negative levels in real terms, leading to large capital outflows and a sharp depreciation of the ruble since mid-1992. The CBR also extended large amounts of credit to other states of the former Soviet Union (FSU).

As regards the budget, the cash deficit of the enlarged government sector is estimated to have exceeded 20 percent of GDP in 1992, of which an estimated 6 1/2 percent of GDP was financed by the domestic banking system

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and most of the remainder by external financing. Revenue performance strengthened considerably during the course of the year, reflecting mainly improvements in tax administration, but this was more than offset by a large increase in expenditure, particularly in the form of subsidies and transfers to the state enterprise sector.

Substantial progress has been achieved in corporatization and privatization of state enterprises and other assets. At the end of 1992, some 20 percent of state enterprises, mainly small-scale establishments in retail trade and services, had been privatized. The distribution of privatization vouchers has now been completed, medium- and large-scale enterprises are being auctioned in exchange for cash and vouchers, and apartments are being privatized largely by transferring them to their tenants.

The principal task confronting the Russian authorities at this juncture is to deal with the problem of inflation before it reaches the point where the entire direction of the reform program is threatened. This assessment is accepted by the Russian Government, which has adopted an inflation target of 5 percent per month by the end of this year--an objective which the Fund staff considers to be both feasible and appropriate. However, achievement of this target will require a sharp reduction in the growth of central bank credit to the budget, to the commercial banks, and to other central banks in the ruble area. It will also require that the responsibility for directed loans to specific sectors

- 3 -

and enterprises be transferred from the CBR to the budget, and that central bank credits to all borrowers be extended at market-related terms.

On fiscal policy, the staff's latest estimates suggests that, in the absence of policy changes, domestic financing of the budget deficit in 1993 could reach 7 percent of GDP, or as high as in 1992. In our view, a domestic financing requirement of this magnitude is not consistent with the planned reduction in inflation, and therefore additional deficit reduction measures will be needed. These measures could include a more rapid convergence to world market prices for domestic energy, cuts in subsidies, and reductions in tax exemptions. In addition, the various extrabudgetary funds will need to be brought under the supervision of the Government.

The Russian authorities have expressed concern about the fall in the value of the ruble and the volatility of the exchange rate in the past several months. Recently, proposals have been made to fix the exchange rate, or to limit its variability by introducing a maximum spread between buying and selling rates. The Fund staff has cautioned that an attempt to fix the exchange rate before a strong anti-inflationary monetary policy has been introduced probably would be unsuccessful and would result in the loss of scarce foreign exchange reserves.

The balance of payments situation is expected to remain difficult in 1993 even on the assumption that financial policies are tightened around mid-year. The current account deficit with non-FSU states is expected to

- 4 -

widen, reflecting both a deterioration in the trade balance and a rise in net service payments. Exports would increase only slightly in 1993, in part because any improvement in policies during the course of this year probably would not affect energy exports until after 1993. Imports would need to rise significantly to avoid adverse effects on domestic production. On the capital account, the tightening of monetary policy is assumed to result in a turnaround of private flows during the course of the year. Gross official international reserves rose somewhat during 1992, but they remain low in relation to merchandise imports, and a further increase is required in 1993.

The external debt service obligations of the FSU are already very high (over 50 percent of Russia's merchandise exports in 1993) and these obligations will remain substantial for a number of years, partly because of the short maturities of new financing extended over the past few years.

Important steps in the transition to a market economy have been taken, including price liberalization and exchange rate unification, and in other areas, such as privatization, the direction of policy is clearly right. The continuation of structural reforms should set the stage for a reversal of the fall in output and exports, and bring back the Russian economy on a sustainable growth path. But this will require both decisive action to deal with domestic financial instability and an adequate level of external assistance.

PARIS CLUB MEETING - RUSSIAN FEDERATION

STATEMENT TO CREDITORS BY THE WORLD BANK REPRESENTATIVE
April 1, 1993

The Russian reform effort today is at a crossroads. A new political consensus must be forged if it is to proceed, and substantial external assistance will be required to regain the momentum for change. Early in 1992, tight fiscal and monetary policies spearheaded the shift in the policy regime, but macroeconomic stabilization in Russia is now lagging the structural reform process. There is no alternative to a credible program of stabilization.

The shift in policy course last summer led to a soaring budget deficit and rampant credit expansion in the third quarter of 1992. Although the tightening of fiscal and monetary policies in the fourth quarter averted the onset of hyperinflation, the threat not only remains but has increased in 1993. The fundamental problem continues to be rapid money creation to finance an unsustainable fiscal and quasi-fiscal imbalance. Macroeconomic instability adds to the uncertainties in the transition and may soon paralyze the pace of change which, despite the setbacks, has been impressive.

With the implementation of the Government's Mass Privatization Program, privatization picked up speed towards the end of 1992. There is evidence of significant adjustment in the enterprise sector, notably among the small and medium-sized enterprises. The responses of enterprises are far from uniform, however. Small scale privatization has lagged. Worse, some of the large enterprises are resisting adjustment; though they are also forced to adjust at the margin, they strive to maintain obsolete output compositions and inter-enterprise linkages. They support and even expand employment and increase wages; they continue to increase inventories despite the falling demand for their products. The results are a damaging build up in payment arrears and continued pressure for cheap credits and Government subsidies.

- 2 -

Explicit budgetary subsidies are nearly 30 percent of GDP. Many, if not most of them, go to state-owned enterprises. In addition, the equivalent of 23 percent of GDP is steered to enterprises through directed credits from the Central Bank of Russia and the Ministry of Finance. These directed credits have a substantial subsidy component. The size of these transfers is inconsistent with the attainment of macroeconomic stability, and far exceeds the volume required to produce an orderly transition to a market-based economy. The continuation of such large, non-market-based transfers to the SOE sector reduces resources available to the private sector and adversely affects the development of a market-based commercial banking system. Moreover, they shield the SOE sector from the necessary adjustment and hinder structural reform.

The international ramifications of the success or failure of the Russian reform program are unmatched in recent history. Russia's reform program is faltering and it will take decisive political leadership to implement measures which avoid hyperinflation and restore the momentum of reform. Building the political consensus for reform is fundamentally the responsibility of the Russian leadership and people. External assistance can help by easing the hardship of adjustment, contributing to a sustainable reform effort. Presently, debt service obligations are a heavy burden on the economy and debt rescheduling will liberate resources which are critically needed to finance the domestic transition.

External assistance can help by providing support for stabilization; support for a social safety net, which will buffer the impact of reforms and help reduce political opposition and social tensions; support for privatization and for private sector development; support for state enterprise reform and divestiture and, support to critical production sectors (especially energy and agriculture) to

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elicit a quick supply response. In the near term (up to 1994) the Bank's work in Russia focuses on these areas which are indispensable for the success of the reform effort.

With a renewed impetus to reform and satisfactory progress on macroeconomic stabilization, the Bank's lending program could expand quickly with a sizeable component of quick-disbursing assistance. Conversely, lack of progress on stabilization and sectoral reforms would constrain Bank lending. In the current fiscal year, the Bank has approved three loans to Russia totalling US\$ 760 million. A US\$500 million operation in support of sectoral reforms and new investments in oil production is in advanced stage of preparation and should be sent soon to the Bank's Board for consideration.



Record Removal Notice

File Title Paris Club - 93-03 (Apr. 8, 1993 meeting)		Barcode No. 1183104		
Document Date Apr 2, 1993	Document Type Agreement			
Correspondents / Participants The Chairman of the Group of Participating Creditor Countries, The Head of the Delegation of the Government of the Russian Federation				
Subject / Title Agreement with the Government of the Russian Federation on the Debt Due to Foreign Official Creditors				
Exception No(s). <input type="checkbox"/> 1 <input type="checkbox"/> 2 <input type="checkbox"/> 3 <input type="checkbox"/> 4 <input type="checkbox"/> 5 <input type="checkbox"/> 6 <input checked="" type="checkbox"/> 7 <input type="checkbox"/> 8 <input type="checkbox"/> 9 <input type="checkbox"/> 10 A-C <input type="checkbox"/> 10 D <input type="checkbox"/> Prerogative to Restrict				
Reason for Removal Information Provided by Member Countries or Third Parties in Confidence				
Additional Comments		<p>The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information. This Policy can be found on the World Bank Access to Information website.</p> <table border="1"> <tr> <td>Withdrawn by Sherrine M. Thompson</td> <td>Date Mar 28, 2014</td> </tr> </table>	Withdrawn by Sherrine M. Thompson	Date Mar 28, 2014
Withdrawn by Sherrine M. Thompson	Date Mar 28, 2014			

PRESS RELEASE

Representatives of the Governments of Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, the United Kingdom and the United States of America, referred to as "Participating Creditor Countries", met in Paris on April 1 and 2, 1993 with the representatives of the Government of the Russian Federation, in order to examine the request to alleviate that country's external debt service obligations.

The delegation of the Russian Federation was headed by Mr Alexander SHOKHIN, Vice Prime Minister of the Russian Federation. The meeting was chaired by Mr. Jean-Claude TRICHET, Chairman of the Group of Creditor Countries.

Mr Alexander SHOKHIN signed in Paris on April 2, 1993 a Declaration acknowledging and confirming the continued validity of the foreign debt of the former Soviet Union and reaffirming the Government of the Russian Federation's liability for such foreign debt.

The Representatives of the Participating Creditor Countries took note of this Declaration and welcomed the efforts at economic recovery undertaken by the Government of the Russian Federation. They stressed their continuing support for the Russian reform process launched and guided by President YELTSIN.

In this context, they further stressed the importance of accelerating the process leading to a program supported by an upper credit tranche arrangement approved by the Executive Board of the International Monetary Fund.

In this spirit, the representatives of the Participating Creditor Countries agreed to recommend to their respective Governments a major reorganization of the external obligations of the Russian Federation, resulting from loans and guaranteed credits extended by Participating Creditor Countries.

This rescheduling represents a support of over US\$ 15 b in 1993 to Russia's economic reform efforts.

Debt alleviation on comparable terms is expected from other creditors.

The Participating Creditor Countries indicated their willingness to pursue an active economic and financial relationship with the Russian Federation in 1993 and agreed in principle to consider the matter of the Russian's Federation debt service obligations falling due in 1994.

The delegation of the Russian Federation expressed its thanks to the Participating Creditor Countries for their efforts in assisting the Russian Federation to achieve a sound economic and financial situation.

OFFICE MEMORANDUM

PARIS CLUB

1. ~~1993~~

2. ~~1993~~

3. ISC Files

DATE: March 30, 1993

TO: Mr. D. C. Rao, Acting Vice President, DEC
Michael Lav

FROM: Michael Lav, Economic Adviser, DPG

EXTENSION: 35092

SUBJECT: Paris Club Meeting - March 22 to 25, 1993

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WBG ARCHIVES

Introduction

1. The principal business during the Paris Club's March meeting was the negotiation of new rescheduling agreements for Mozambique and Guatemala. The Club also received the Finance Minister of Nigeria for an exchange of views. In addition, the Club held its normal tour d'horizon during which Mr. Trichet discussed further initiatives to address the issue of Russia's external debt.

Mozambique Rescheduling

2. Mozambique received enhanced Toronto terms for its rescheduling. Interestingly, the Paris Club rescheduled previously rescheduled debt from all three Paris Club agreements, while the IMF program had only envisaged rescheduling debt previously rescheduled under the first two agreements. This was justified on the basis of a closer review of balance of payments needs. Since enhanced Toronto terms are framed in a 3-year context, and Mozambique is already in the third year of an ESAF program, there are two trigger clauses in the agreement: year 2 would be activated by a fourth year ESAF program (and appropriate relations with the creditors), while year 3 of the Paris Club agreement would be activated by an appropriate (but unspecified) program with the Fund (and appropriate relations with the creditors).

3. Creditors were clearly interested to provide the best possible support for Mozambique. In this regard, there was some discussion of how the national reconstruction plan could be better defined, its funding costs better appreciated and how these costs could be met. Further work in this area is awaited with interest.

Guatemala Rescheduling

4. Guatemala received debt rescheduling terms accorded to heavily indebted lower middle income countries. While on statistical grounds, the case for this was not clear cut, creditors agreed with the improved treatment to facilitate a return to creditworthiness and in the expectation that Guatemala would not then need to revisit the Paris Club. The rescheduling encompasses arrears, and is dominated by the question of debt owed to Spain and Canada. Both Spain and Canada claim that this debt is duly guaranteed by the government of Guatemala. The government of Guatemala claims that according to the constitution, all guarantees need to be approved by the parliament, which was not done in

these cases. There appears to merit on both sides, and I am not qualified to make a determination of legality. The Paris Club agreement calls for the issue to be resolved through bilateral negotiations by the end of 1993, or else the agreement lapses.

Nigeria

5. The Minister of Finance of Nigeria led a delegation to a special meeting of the Paris Club. The Minister reviewed Nigeria's Medium Term Plan, his government's hopes for close work with the World Bank and the IMF to further refine this plan, and his expectation to implement a sound program to the extent possible, given that elections will be held in June and a new government inaugurated in August. The Minister saw progress in this task as an important basis for the new government's policies. He clearly wants to work as quickly as possible to achieve a program supported by the IMF and the World Bank. Further details are presented in the Minister's statement in the Nigeria annex.

6. Creditors were concerned about Nigeria's poor payment record in the recent past, including unequal treatment between the London Club and the Paris Club. They were also concerned about aspects of fiscal policy, including subsidies for fertilizer and petroleum products, which had been so problematic in the past. The Minister stated that the government intended to privatize the fertilizer trade. The expectation is that this would be part of the program to remove subsidies. Further, an education program was being initiated to explain to the population the problems caused by petroleum subsidies.

7. In response to a question the Minister stated that a Fund program was seen in terms of both policy and financial support. Although Nigeria had not accepted funding from the IMF previously, the Minister felt that this would be desirable in the future.

Tour d'Horizon

8. The main item on the tour d'horizon was the question of Russia's debt. A visit to Ukraine by Mr. Trichet was foreseen for March 26th. Russia and Ukraine had still not reached an agreement on responsibility for assets and liabilities. I later learned that this visit was successful in that Ukraine agreed to allow Russia to negotiate with creditors on behalf of all FSU debt pending a future agreement between Ukraine and Russia. Paris Club negotiations with Russia were subsequently scheduled to begin April 1.

9. A second item of interest on the tour was the discussion concerning Peru, the first of a set of countries which would come to the Paris Club for negotiations which were not "IDA only" countries but which might qualify for enhanced Toronto terms. The secretariat is to prepare a paper on this for discussion at the next Paris Club meeting just before the Peru negotiations.

10. The tour d'horizon encompassed 19 countries as follows:
- LAC Brazil, Costa Rica, Dominican Republic, Ecuador, Guyana, Nicaragua, Peru, Venezuela.
- MNA: Egypt, Iran.
- EAP: Philippines.
- ECA etc.: Bulgaria, Russia and Ukraine.
- AFR: Benin, Burkina Faso, Gabon, Madagascar, Nigeria, Tanzania.

Aside from the discussion of Russia and Peru, there were no items of general interest.

Next Steps

11. After the negotiations with Russia mentioned above, the next Paris Club meeting will be held from May 3rd, for which Burkina Faso, Guyana, and Peru will be invited for negotiations, with the methodology session on Peru to immediately precede negotiations. Another Paris Club meeting will be held at the end of May. At that time Benin would be invited for negotiations, perhaps Ecuador (if there is sufficient progress with the IMF, and Costa Rica. A rescheduling for the Philippines is now foreseen for June.

Messrs./

Mmes. Karaosmanoglu; Sandstrom; Stern; Husain, Jaycox, Kaji, Koch-Weser, Thalwitz, Wood; Linn; Kashiwaya; Hicks, I. Husain, Thomas, Nankani, Selowsky, Squire; Walton; McCarthy; Birdsall, Gelb, Ahmed; Yap, Nishimizu, Bhattacharya; Pfeffermann; Shakow. Wyss, Handwerger, Paris Office. Institutional ISC.

Messrs./Mmes.

Guerard (African Countries)
Lafourcade, Derbez, AF1 (Benin, Gabon)
Colaco, Carter, AF2 (Tanzania)
Aguirre-Sacasa, Gorjestani, AF3 (Madagascar)
Lim, Salop, AF4 (Nigeria)
Marshall, Sarbib, AF5 (Burkina Faso)
Denning, Patel, AF6 (Mozambique)
Hamilton, Kilby, SA1
Vergin, Khalilzadeh-Shirazi, SA2
Isenman, Penalver-Quesada, SA3
Madavo, Ikram, EA1 (Philippines)
Burki, Pearce, EA2
Haug, Shilling, EA3
Wiehen, Levy, EC1 (Bulgaria)
Dervis, Noel, EC2
Cheetham, Huang, Yurukoglu, Toft, EC3 (Russia)
Kavalsky, Kanaan, Grais, EC4 (Ukraine)
Kholi, Ayub, MN1

Chopra, Voyadzis, MN2 (Egypt, Iran)
Steckhan, Papageorgiou, LA1 (Brazil, Peru, Venezuela)
Segura, de Ferranti, LA2C1
Segura, Lacey, LA2C2 (Costa Rica, Guatemala, Nicaragua)
Abe, de Tray, LA3C1 (Dominican Republic)
Abe, Delvoie, LA3C2 (Guyana)
Loh, Dowsett-Coirolo, LA4 (Ecuador)

MLav:vl



Record Removal Notice

File Title Paris Club - 93-03 (Apr. 8, 1993 meeting)		Barcode No. 1183104		
Document Date Mar 22, 1993	Document Type Report			
Correspondents / Participants				
Subject / Title Summaries of Paris Club meeting discussions				
Exception No(s). <input type="checkbox"/> 1 <input type="checkbox"/> 2 <input type="checkbox"/> 3 <input type="checkbox"/> 4 <input type="checkbox"/> 5 <input type="checkbox"/> 6 <input checked="" type="checkbox"/> 7 <input type="checkbox"/> 8 <input type="checkbox"/> 9 <input type="checkbox"/> 10 A-C <input type="checkbox"/> 10 D <input type="checkbox"/> Prerogative to Restrict				
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