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THE WORLD BANK

Washington, D.C.

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The World Bank

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Washington DC 20433

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PRDDR - Soviet (General)  
January, 1991

The World Bank Group  
**Archives**



**30382299**

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Soviet - General - January 1991

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The World Bank/IFC/MIGA  
O F F I C E M E M O R A N D U M

DECLASSIFIED

SEP 03 2019

WBG ARCHIVES

DATE: 24-Jan-1991 06:19pm EST

TO: See Distribution Below

FROM: Geoffrey B. Lamb, PRDPD

( GEOFFREY B. LAMB )

EXT.: 32544

SUBJECT: In confidence: Macnamara on Gorbachev

I was talking this afternoon to Macnamara (about military expenditure).

He spent an hour and a half with Gorbachev last week -- just after the Vilnius suppression and before the Riga action. I thought you might be interested in his views, bearing in mind this was a private conversation. I prompted him by telling him a little of what we'd been thinking about, but saying that recent events in the USSR and G7 reactions had put most things currently on hold. What did he think about prospects?

1. There is a frightening political and economic vacuum developing -- and it showed through in Gorbachev's demeanour and answers. There's no doubt that he's being boxed in by renewed conservative activism, disillusionment of the progressives who have nearly all deserted him or been pushed out, and popular bitterness and longing for order.

2. But Gorbachev remained convinced that there was no other course but to push ahead with ending the Cold War, and with economic reform (though he seemed to lack clarity on overall vision and timing of the latter, I gathered). He seemed to think G was in serious trouble, but had better than a trivial chance of coming through.

3. Macnamara himself was convinced by their conversation that G did not order the Vilnius crackdown, but has very limited freedom now about how to deal with the nationality issue.

4. There was an "absolutely fantastic" opportunity for the Bank to play a central role in Soviet reforms, because there was just no other institution which could put it all together in the way the Soviets desperately needed. There was a very strong parallel to our effort in China. He recommended that the Bank go straight to Gorbachev, and put the same question he had put to Deng Hsiao Ping: do you want the World Bank to play a central role in your reform effort, or not? He was absolutely confident that the answer would be a strong yes.

5. We should then establish a substantial team in Moscow, which could provide the integrating framework the Soviets badly

need and at the same time draw in Bank expertise from Washington as needed.

6. He could see that the political ups and downs in the Soviet Union would make continuity extremely difficult, and we wd just have to live with that -- but the West needed to realise that continuity of effort and technical support was "hugely in the West's interests", with the implication that we needed somehow to delink our efforts from day to day events.

7. He was recently invited to London for a consultation with Attali, to whom he'd given the advice that technical help was much more important than financial transfers.

8. The JSSE main report was, in his view "a superb piece of work" -- and should form the basis for the kind of major effort he thought was needed.

DISTRIBUTION:

TO: Wilfried Thalwitz	( WILFRIED P. THALWITZ )
TO: Paul Isenman	( PAUL ISENMAN )
TO: Alexander Shakow	( ALEXANDER SHAKOW )
CC: Costas Michalopoulos	( COSTAS MICHALOPOULOS )
CC: John A. Holsen	( JOHN A. HOLSEN )
CC: Alan Gelb	( ALAN GELB )



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SEP 03 2013

WBG ARCHIVES

The World Bank/IFC/MIGA  
OFFICE MEMORANDUM

DATE: 24-Jan-1991 06:19pm

TO: See Distribution Below

FROM: Geoffrey B. Lamb, PRDPD

( GEOFFREY B. LAMB )

EXT.: 32544

*SECRET*

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DISTRIBUTION:

TO: Wilfried Thalwitz  
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( WILFRIED P. THALWITZ )  
( PAUL ISENMAN )  
( ALEXANDER SHAKOW )  
( COSTAS MICHALOPOULOS )  
( JOHN A. HOLSEN )  
( ALAN GELB )

The World Bank/IFC/MIGA  
O F F I C E M E M O R A N D U M

DATE: 22-Jan-1991 06:48pm

TO: Wilfried Thalwitz  
TO: Paul Isenman

( WILFRIED P. THALWITZ )  
( PAUL ISENMAN )

FROM: Geoffrey B. Lamb, PRDPD

( GEOFFREY B. LAMB )

EXT.: 32544

SUBJECT: Bock's meeting today on Soviet TA

The meeting of Bock's working group on Soviet TA today took stock of where we stood in the light of the Baltic crackdown. Basil Kavalsky's draft board paper (latest version being copied to you) is on hold, and the US associate status proposal was described (by the US) as "shelved". The Bank will however respond as BBC promised (5 pages or so) to Geraschenko's request that we review the Soviet development bank proposal.

G7 and EC positions are generally toughening, with the ? partial exception of the Germans.

There are two specific things requiring Wilfried's decision:

# JSSE technical discussions in Moscow when the background papers are published. [PRD's view is yes to this, on grounds that we're finishing an agreed task.]

# EDI policy seminar on fiscal federalism in Moscow in early March, following back-to-back with the New Delhi seminar on the same issue. [PRD's view is no to this: it's new, and potentially highly visible.]

CC: Costas Michalopoulos  
CC: John A. Holsen  
CC: Alan Gelb

( COSTAS MICHALOPOULOS )  
( JOHN A. HOLSEN )  
( ALAN GELB )



*Duplicate*

FORM NO. 75  
(6-83)

THE WORLD BANK/IFC

ROUTING SLIP		DATE: January 22, 1991	
NAME		ROOM NO.	
Messrs. Isenman,			
Michalopoulos,			
Holsen, and			
Gelb			
APPROPRIATE DISPOSITION	NOTE AND RETURN		
APPROVAL	NOTE AND SEND ON		
CLEARANCE	PER OUR CONVERSATION		
COMMENT	PER YOUR REQUEST		
FOR ACTION	PREPARE REPLY		
INFORMATION	RECOMMENDATION		
INITIAL	SIGNATURE		
NOTE AND FILE	URGENT		
REMARKS:  This is the latest draft of Basil's Board paper, currently on hold.			
FROM: Geoff Lamb		ROOM NO.: S13-119	EXTENSION: 32544



## WORLD BANK GROUP TECHNICAL ASSISTANCE IN THE SOVIET UNION

1. The past six months have seen a major expansion in contacts between the Soviet Union and the World Bank Group. The starting point was the Joint Study of the Soviet Economy undertaken by the Bank, EBRD, IMF and OECD. The Study necessitated a number of visits and intensive follow-up discussions by senior Bank managers. The Soviet Union participated as a special invitee in the recent Annual Meetings and the delegation held further informal meetings at that time, exploring inter alia, the modalities of Bank membership. In late November, Mr. Conable visited the Soviet Union to discuss the evolving relationship between the Bank and the Soviet Union with senior members of the Government.
2. During that visit the Soviet authorities indicated that (a) they had made a decision in principle to apply for membership in the Bank and (b) they were interested in a technical assistance cooperation program as a way of taking advantage of the Bank's expertise in effecting the transition to a market economy and more fully integrating the Soviet Union into the global trading and finance system. Following that visit, the Deputy Chairman of the USSR Council of Ministers has written to the Bank requesting technical assistance in a number of specific areas. This request is attached.
3. While the Bank is well placed to provide assistance to the Soviet Union in the areas covered by the request, management is convinced that such a program should be mounted only if it can be done without impairing the Bank's ability to provide support to its current member countries. Before responding to this request, a determination must be made whether such a program of assistance to the Soviet Union meets the requirements of the Articles of Agreement. This memorandum also addresses the appropriate scope and phasing of such technical assistance, and how it should be financed.

### The Justification for Assistance to a Non-member Country

4. The Bank's response to this request must of course take into account the requirements of the Articles of Agreement and existing Bank policies. The Articles of Agreement of the Bank are clear in stating that the facilities and the resources of the Bank are to be used exclusively for the benefit of member countries.<sup>1/</sup> This means that any use must be justified exclusively on the grounds of the benefits which it conveys to members; it does not mean that a use which benefits a non-member is contrary to the Articles.
5. The attached memorandum issued by the Bank's Legal Department in February 1990 provides a legal analysis of the interpretation of this requirement of the Articles. In Para. 5 it is stated that "Providing Bank's technical assistance to a country which is not a member of the Bank and has not applied for such membership cannot be consistent with the . . . Articles in the absence of clear indications as to the benefits which will accrue to members from the use of the

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<sup>1/</sup> Article III, Section 1 (a) of the Articles of Agreement of the Bank provides as follows: The resources and the facilities of the Bank shall be used exclusively for the benefit of members with equitable consideration to projects for development and projects for reconstruction alike.



Bank's resources and facilities in such a situation. If such benefits are identified they should be explained to the Executive Directors before such assistance is provided. The Executive Directors are empowered by the Articles of Agreement (Article IX) to interpret the Articles and their concurrence with the provision of assistance to non-members in certain cases would confirm that such assistance is considered by them as beneficial to the Bank and its members . . . What the Articles require is that decisions on the use of the Bank's own resources and facilities be based exclusively on the benefits to be derived from such use by its members."

6. Management believes that the provision of the requested technical assistance will indeed benefit both the institution and its members. Particularly because the proposed technical assistance would support the integration of the Soviet Union into the world economy, a positive response to this request would, assuming the conditions for effective implementation are met, convey significant and tangible benefits to a large number of countries. The speed of implementation and scale of the proposed program would obviously depend on the evolving circumstances and policies of the Soviet Union about which there is at present considerable uncertainty.

7. The USSR covers the world's largest land area for any single country, has the world's third largest population and is among the world's largest producers and consumers of resource-based products such as oil, gas and a number of minerals. Even taking into account recent reappraisals of the size of the USSR economy which sharply reduce its GNP, it still accounts for a significant share of world output, trade, resource use and environmental impact. Moreover it is the most important trading partner for a number of Bank member countries in Eastern and Central Europe, accounting on average for a third of their trade. Other countries, such as India, also have sizeable trade shares with the Soviet Union. The significance of the USSR is, however, most apparent when seen in terms of its potential. Improving the efficiency of its economy and, in particular, of its production and consumption of resource intensive goods, can make a significant impact on the world economy and especially on global resource balances. The impact on the global and regional environment should also be an important benefit to the Bank's membership of improved efficiency of resource use in the Soviet Union. Finally, the analytical work on the USSR is likely to provide insights on issues of importance in other centrally planned economies in transition.

8. The precedents for Bank assistance to non-member countries all relate to cases where the assistance was preparatory to membership of the country concerned. In the view of the attached legal memorandum "If . . . the work was undertaken at a time when it was fully expected that the country in question would become a member, the benefits to present members and to the prospective member may be considered a reasonable justification for the use of Bank facilities." As indicated above, although the Soviet Union has not yet applied for membership, it is the avowed intention of the authorities - confirmed during Mr. Conable's recent visit - to seek membership in the IMF and the Bank in due course after appropriate bilateral consultation with existing members.

9. In all previous cases where the Bank has provided specific assistance to a non-member, a formal membership application had already been received. Nevertheless, given the size and complexity of the Soviet Union - it is by far the largest economy which is not yet a member of the Bank - the time and effort



needed to put the Bank in a position to respond effectively in the event membership does materialize will be much more substantial than for any other potential new member. Hence a further enlargement of past precedents in this particular case - that is, by allowing limited assistance prior to formal application for membership - would not expose the Bank to significant future claims from other non-members.

10. It should also be stressed that the Bank will not undertake such a program unless the interests of Bank member countries are reflected in the arrangements. Thus, an important criterion for choosing areas of involvement will be the extent to which they support systemic reform and the integration of the USSR into the international economy, which will benefit Bank membership worldwide and especially in Eastern Europe by making a contribution to international stability, economic growth and environmental sustainability. We would also insist on the right to disclosure of information. We would expect all economic and sector work undertaken as part of the program to be handled in the same way as economic and sector work on member countries, i.e. to be released to the Board of Directors and to be treated as the property of Bank membership generally.<sup>2/</sup> In addition we would require that the Soviet Union grant the usual privileges and immunities to Bank staff and consultants we may use in the course of our work.

11. As the legal memorandum indicates, it is for the Board to judge whether these arrangements, the objectives and content of the program, and the special circumstances described above, lead to a determination that use of Bank resources is justified exclusively on the basis of benefits likely to accrue to member countries.

#### The Scope and Phasing of the Program

12. Since the initial discussions with the Soviet authorities on a technical assistance program - both in the context of the Joint Study and in discussions with the special invitees to the Annual Meetings, it has been emphasized that Soviet economic reforms would have to be comprehensive in order to be effective and that Bank assistance should be an integrated package of policy advice and technical assistance, ranging from systemic reforms and economy-wide policy formulation through analysis of major sectoral problems. The broad objective would be to ensure that sectoral recommendations would be supportive of systemic reform and consistent with the medium-term balance of payments and fiscal situation, and would also be firmly related to investment strategy at the project level. Technical assistance would be provided mainly at the union level, but also selectively at the republic and local levels and the first step in structuring the program would have to be a satisfactory coordinating mechanism between the union and the participating republics. It was also emphasized that major institutional changes would be necessary along with extensive training in almost all sectors.

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<sup>2/</sup> While Bank country economic and sector work is not usually included in the concept of technical assistance, this is because in most developing member countries the Bank already has an ongoing program of country economic and sector work which provides the context for decisions on what technical assistance to undertake. In the Soviet Union, economic and sector work will be an indispensable part of the total technical assistance package.



13. The proposed program would begin modestly with traditional Bank activities such as a financial sector survey, an agricultural sector survey and advice on trade policy. An especially urgent element in trade policy will be the need to develop approaches that substitute for the demise of the CMEA arrangements with Eastern Europe. Training activities, already identified in the Joint Study, would begin early and would be the most flexible and expandable component in the technical assistance program.

14. This gradualist approach would permit the Bank to proceed as major policy and institutional issues are satisfactorily resolved - the most important of which is the Union's relationship with its constituent republics - with the built-in flexibility ranging from a minimal watching brief to being able to expand to a level of activities comparable to that provided by the Bank to its major borrowing members if the reforms make headway and the Soviet Union formally applies for membership. How quickly the program is built up will, of course, depend upon the interest of the Soviet authorities and the pace of implementation of economic reform. No activities will be undertaken until the Bank is satisfied that technical assistance can be effectively absorbed.

#### Financing

16. It is clear from the Joint Study that the depth and complexity of the reforms in the Soviet Union will exceed those in any similarly placed countries. If the Bank is to have an influence on the reform process, it will need to make sizeable investments in economic and sector work, as well as in direct technical assistance to the Soviet authorities at both the union and republic levels. Such a program of technical assistance could therefore be expected to build up to a level of activity similar to that provided by the Bank to its major borrowing members.

17. A program of this kind will require significant funding. For purposes of a decision on financing modalities, management believes that the program should be planned on the order of \$50 million over a three year period. It is proposed to set up a Trust Fund which would be empowered to receive contributions from the Bank and other donors and to handle the funding for this purpose. As with the recent proposal for African Capacity Building it is suggested that the World Bank make a catalytic contribution to the Trust Fund of \$15 million. This will allow the initial expenditures to be funded and the program to get off the ground quickly. The \$15 million is equivalent to the amount which would be required over a three year period to fund Bank country economic and sector work needed to prepare for Soviet membership and to support the proposed technical assistance.

18. It is proposed that this allocation of \$15 million be made from FY90 net income. Expenditure of Trust Fund resources would be managed on the basis of an overall work program which would be approved by the Bank as administrator. To the extent the expenditure of Trust Fund resources entails the use of the allocation \$15 million, these amounts would be shown as expenditures in the year in which they are incurred.

### Management Recommendations

19. The request from the Soviet Union is a unique opportunity for the Bank to contribute to a critical economic transformation which will have an impact on the global economy and environment for many years to come. In addition, it will make it possible to establish the foundations for expeditious assistance once the Soviet Union becomes a full member of the institution.

16. In light of the above Management recommends:

a). that it be authorised to respond positively to the Deputy Chairman's request for technical assistance;

b). that it should plan for a technical assistance program of \$50 million over a three year period;

c). that, subject to Board approval of the draft Technical Assistance Agreement, a Trust Fund be established to receive contributions from interested countries and agencies to fund this program; and

d). that the Executive Directors propose to the Board of Governors a transfer out of surplus of \$15 million to this Trust Fund, to be expensed as needed over the three years.

# OFFICE MEMORANDUM

DATE: January 18, 1991

TO: Distribution

FROM: Costas Michalopoulos, *MM* PRDDR

EXTENSION: 32738

SUBJECT: USSR TECHNICAL ASSISTANCE PROGRAM

RECEIVED

91 JAN 18 AM 11:30

PRDDR

As you know, the Soviet Union has requested the Bank to undertake a program of technical assistance and cooperation. At the request of Mr. Thalwitz, a Steering Committee was recently set up to provide overall direction to the PRE effort on a possible program for TA to the Soviet Union. A copy of the minutes of the first meeting held on January 14 and other background information are attached for your information.

I have been asked to initiate and chair a PRE Working Group on this subject, which would help coordinate PRE efforts on an ongoing basis. Would you please let me know as soon as possible which of your Division Chiefs you would like to nominate to represent your Department in this Working Group. We would like to hold the first meeting within the next ten days. While Soviet TA seems to be at least temporarily off the fast track, there are several points on guidelines and background that are well worth discussing now.

Attachments

Distribution:

Messrs/Mme. J. Linn, A. Golan, D.C. Rao, A. Shakow, A. Hamilton,  
K. Piddington, M. Petit, A. Churchill, L. Pouliquen,

cc: Messrs. Thalwitz, Rajagopalan, Summers, Isenman, Holsen, Colaco,  
Lamb, Gelb.



The World Bank/IFC/MIGA  
O F F I C E M E M O R A N D U M

DATE: 10-Jan-1991 04:28pm

TO: See Distribution Below

FROM: PAUL ISENMAN, PRDDR ( PAUL ISENMAN )

EXT.: 33957

SUBJECT: PRE STEERING COMMITTEE ON SOVIET T.A.

Wilfried Thalwitz has asked me to coordinate PRE work on Soviet TA, since it will cut across PRE. In that connection, I would like to ask you to be a member of PRE's Steering Committee on Soviet TA to provide overall directives to the PRE effort in this area. There would also be a PRE working group which would be chaired on my behalf by Costas Michalopoulos, which would help coordinate PRE efforts on an ongoing basis. Alan Gelb would be the secretary of these groups. Costas and Alan would also serve as members of the Steering Committee.

The Bank received a formal request from the Soviet Union to provide TA and is sending a generally positive response. While, at this point, there are many unanswered questions about various aspects of Bank TA, now is the time to begin planning our response. Management of the Bank-wide program will be with Operations. We expect PRE to play an important role. Among the issues for the Steering Committee to consider is how this can be done while minimizing the diversion to this "sexy" and important new program from other PRE work. We expect the program will be financed partly through the Bank's net income and partly through external sources, but this does not eliminate the issue of opportunity cost, either at the staff or managerial level. I am sending you separately copies of the official Soviet request and several memos on where things currently stand.

The first meeting of the Steering Group will be held on Monday, January 14 at 10:30 a.m. in Conference Room S-13-005. A draft agenda is attached.

PRE STEERING COMMITTEE ON T.A. TO THE SOVIET UNION  
DRAFT AGENDA FOR MEETING ON MONDAY, JANUARY 14,  
10:30 - 11:30 a.m., CONFERENCE ROOM S-13-005

1. The current situation regarding the TA Project.

- . Scale of program and its funding;
- . Mode of implementation, use of staff and consultant resources;
- . Probable areas of emphasis;
- . Management of the overall program.

2. Possible Modalities of PRE Involvement.

- (i) Support to the program (to be handled like Operational support?);
- (ii) Task management of components of the program.  
This could involve, for example, studies or seminars organized by EDI.
- (iii) Are other modes of involvement possible/desirable?

3. Substance of PRE Involvement.

Considering the probable areas of emphasis of the program, where should PRE be involved, in (i) offering support, and (ii) managing tasks?

The need for selectivity.  
Areas of comparative advantage.  
Maximising externalities with ongoing work.  
Staff versus consultant resources.

4. Managing and Monitoring PRE Involvement.

DISTRIBUTION:

TO: Johannes Linn	( JOHANNES LINN )
TO: John A. Holsen	( JOHN A. HOLSEN )
TO: Francis X. Colaco	( FRANCIS X. COLACO )
TO: Alan Gelb	( ALAN GELB )
TO: Amnon Golan	( AMNON GOLAN )
TO: Costas Michalopoulos	( COSTAS MICHALOPOULOS )
CC: Wilfried Thalwitz	( WILFRIED P. THALWITZ )
CC: Visvanathan Rajagopalan	( VISVANATHAN RAJAGOPALAN )
CC: Larry Summers	( LARRY SUMMERS )
CC: Geoffrey B. Lamb	( GEOFFREY B. LAMB )

The World Bank/IFC/MIGA  
O F F I C E M E M O R A N D U M

DATE: 15-Jan-1991 02:41pm

TO: See Distribution Below

FROM: Alan Gelb, CECSE ( ALAN GELB )

EXT.: 37667

SUBJECT: Minutes - PRE Steering Group on USSR TA Program

14 January, 1990

Minutes of PRE Steering Group on USSR TA Program

1. Paul Isenman, Johannes Linn, Amnon Golan, Francis Colaco, John Holsen, Costas Michalopoulos, and Alan Gelb met to consider PRE's response to the prospective Technical Assistance Program.
2. It was noted that the development of the Program was still ongoing, and that its leadership would be in Operations. No response to the Soviet letter officially requesting TA had yet been sent, and the details of the proposed program were not available. The likely size of the program was expected to be about \$50 million over a three-year term, and it had been proposed that the Bank advance \$15 million from its net income against pledges of funding by outside donors. However, there were uncertainties in these areas. Recent political developments in the USSR argued in favor of a phased approach to building up the TA effort. One EDI staff member was active on the committee headed by David Bock.
3. PRE would undoubtedly have a role to play in such a program, and discussion focused on the likely size of that role and the implications for PRE. If the program was motivated by the prospect of USSR membership, this would call for expertise on the country to be built up through long-term involvement of individuals, and on a reasonably large scale; the USSR was more like another China than a typical new entrant. Issues for PRE include:
  - (a) There was no prospect of substantially increasing work on the USSR without cutting work in other areas - already, there were too many "priorities." Working on the USSR would inevitably be seen as attractive, and there will be a tendency for the most experienced staff to shift priorities in this direction. This seems to have happened to some extent on Eastern Europe already. Many of the areas indicated as important for TA will draw on PRE staff.
  - (b) The reimbursement of the costs of staff and consultants by the program could not substitute for staff resources, because consultants would need to be managed and their work integrated by PRE staff. EDI, for example, was already at the limit of what could be done with available staff resources; the consultant/staff ratio could not rise indefinitely. Therefore, although funding would need to be assured before undertaking new work, cash was not the only requirement.



4. For the above reasons, a substantial PRE involvement would require more staff resources. Assuming that PRE were responsible for \$5 million of consultant TA, this would involve managing about 25 SYs; the burden of this would be shared between PRS, EDI, and CEC. Messrs Colaco, Golan, and Linn would consider the likely requirements and report back to Paul Isenman.

5. PRE's involvement would need to be managed in some integrated way. Messrs. Michalopoulos and Gelb would play some role in this respect for the Group.

6. It was agreed in principle that background work done for the Joint Soviet Study could be submitted for the PRE working papers, and that John Holsen would clear submissions.

ag/11/cgsa

DISTRIBUTION:

TO: Paul Isenman	( PAUL ISENMAN )
TO: Francis X. Colaco	( FRANCIS X. COLACO )
TO: Johannes Linn	( JOHANNES LINN )
TO: Amnon Golan	( AMNON GOLAN )
TO: John A. Holsen	( JOHN A. HOLSEN )
TO: Costas Michalopoulos	( COSTAS MICHALOPOULOS )

Office of the President

December 21, 1990

Members of the President's Council:

Technical Cooperation with USSR

This afternoon, Mr. Yuriy P. Khomenko (Minister-Counselor) and Mr. Vitaliy Y. Verzhbitskiy (Third Secretary, Economic Affairs) from the USSR Embassy delivered the attached letter to Mr. Conable.

I also attach a copy of a note from Mr. Qureshi on the same subject.

Happy Holidays!



Attachments

Dear Mr. President:

Your recent visit to the Soviet Union and the talks during this visit opened up real prospects for proceeding in the relations between the USSR and the World Bank toward specific mutually beneficial cooperation.

Now that the research by the World Bank, International Monetary Fund, Organization for Economic Cooperation and Development and European Bank for Reconstruction and Development into the state of the USSR economy is coming to an end we have noted with special satisfaction the readiness of the Bank to render consultative and technical assistance to the Soviet Union in coping with the problems concerning its transition to the market economy.

Bearing in mind that the World Bank has accumulated rich international experience in developing and regulating multifaceted processes taking place in the market economy, we would like to use this experience as well as the services of highly skilled experts of the Bank for consultative and technical assistance to facilitate the economic transformations in the Soviet Union.

In our view, the high priority areas of consultative and technical cooperation with the World Bank could be such as a reform of the banking system and improved finances, establishment of a market infrastructure and personnel training, implementation of destatization and privatization programs, a range of problems relating to the consumer market and social protection of the population. As to the specific sectors of the economy, it would be appropriate, I think, to focus on the issues of energy development, resource-saving technologies, agroindustrial complex, including transportation, storage of finished products, information technologies and telecommunications.

By regarding these sectors and areas of cooperation as reference points, the experts of both sides could formulate a long-



term program of consultative and technical cooperation between the USSR and the World Bank.

If the reaction of the Bank's leadership to the above ideas is positive, the Soviet side would be ready to discuss in the very near future the organizational and legal as well as financial and other issues of preparation and implementation of this program.

Sincerely,

I. ABALKIN

Deputy Chairman of the USSR  
Council of Ministers

World Bank/IFC/MIGA  
F I C E M E M O R A N D U M

DATE: 09-Jan-1991 01:57pm EST

TO: See Distribution Below

FROM: David R. Bock, OPNSV ( DAVID BOCK )

EXT.: 62856

SUBJECT: Next Steps on Financing

Last night, the President met with Messrs. Qureshi, Stern, Shihata, Wood and Linn to discuss how to proceed with the fundraising for the Soviet technical assistance program. It was decided that Finance (Mr. Wood) would prepare a draft memorandum to the Board proposing an allocation of IBRD net income to a trust fund for this purpose. The justification for such is to be anchored in Mr. Shihata's opinion on the use of Bank resources and facilities for this purpose.

This thus resolves one of the major issues we discussed on Monday. The draft memorandum to the Board which I circulated last week will be incorporated in some fashion into this proposed use of net income.

Before anything is sent to the Board, the President plans to consult with the Executive Directors. The present timetable envisaged is that nothing will be distributed prior to the seminar on JSSE next Friday. It is also possible that we will delay a discussion until after the visit of Mr. Pavlov, which might not now take place until the first week of February. Also, the sense of last night's meeting is that it may be some time before the political situation clarifies sufficiently in the Soviet Union to permit a launch of the technical assistance program. The objective should be to be prepared to get underway in three-four months time, perhaps earlier if the situation becomes clearer sooner. Work on the definition of a technical assistance program should continue apace in order to be in a position to send a technical mission to Moscow sometime after the first week of February at the earliest.

I have made contact with the Fund; a meeting was being held yesterday to discuss next steps and I will report separately as soon as I find something out.

DISTRIBUTION:

TO: Paul Isenman	( PAUL ISENMAN )
TO: Basil Kavalsky	( BASIL KAVALSKY )
TO: Fred Levy	( FRED LEVY )
TO: David M. Goldberg	( DAVID M. GOLDBERG )
TO: John A. Hulsan	( JOHN A. HULSAN )
TO: Farvez Hason	( FARVEZ HASAN )

PREs Current Work on the USSR

PRE has been involved in several aspects of the Joint Study of the USSR, including the areas of agriculture, housing, trade, macro, labor and training. Apart from this work, there appears to be very few activities specifically focussed on the USSR. One is a small study of Privatization Processes in the USSR (CECSE), another is a small study of Regional Issues in the USSR (PRDPD). A number of ongoing and planned activities do include the USSR as one of a set of countries. These include:

Agricultural Reform in Eastern Europe	AGRAP
Urban Industrial Pollution Management	ENVPR
Accounting for CPEs	IECSD
Factbook on Socialist Countries	IECSD and CECSE
Land Regulation and Supply	INURD
Conference on Natural Gas	IENGU
Costs and Benefits in Transforming CMEA	CECTP
Trade Patterns in Eastern Europe	CECTP
Predicting East European Trade Flows	CECTP.
Senior Policy Seminar on Fiscal Federalism	EDI



USSE 118

At 50112 - too fast.

Peretz - need effective  
gov't with some pop  
support for either  
centralized or decentralized  
gov't.  
Won't be implemented soon,  
but good yardstick.

TA -- should be broad --  
include private sector.  
TA & Fed aid now [??]


Do Orlov: Good comments at first,  
then much too long & slow.  
Can they go slower?

~~People should  
get comfort  
pay for  
anything over  
4 hrs or the  
board per  
week month.~~

→ March 17 referendum &  
Ukraine own currency.

Monetary reform  
not far enough.

Baril Keys & Ownership  
& legal system  
real basis of reform.

ROUTING SLIP		DATE: 1/17	
NAME		ROOM NO.	
Mr. Isenman			
APPROPRIATE DISPOSITION		NOTE AND RETURN	
APPROVAL		NOTE AND SEND ON	
CLEARANCE		PER OUR CONVERSATION	
COMMENT		PER YOUR REQUEST	
FOR ACTION		PREPARE REPLY	
INFORMATION		RECOMMENDATION	
INITIAL		SIGNATURE	
NOTE AND FILE		URGENT	
REMARKS: re Pre-Bd Patricia said that when Mr. Thaler is back this afternoon, he will decide when to have it			
FROM: 		ROOM NO.: EXTENSION:	

# THE WORLD BANK

ROUTING SLIP		DATE 1-16-91
FROM THE SENIOR VICE PRESIDENT, POLICY, RESEARCH AND EXTERNAL AFFAIRS		
NAME		ROOM NO.
Messrs. Isenman		
Michalopoulos		
Lamb		
APPROPRIATE DISPOSITION	NOTE AND RETURN	
APPROVAL	NOTE AND SEND ON	
COMMENT	PER OUR CONVERSATION	
FOR ACTION	PER YOUR REQUEST	
INFORMATION	PREPARE REPLY	
INITIAL	RECOMMENDATION	
NOTE AND FILE	SIGNATURE	
REMARKS		
<div style="position: relative; height: 200px;"> <div style="position: absolute; top: 0; left: 0; width: 100%; height: 100%; background-color: #e0e0e0; border: 1px solid #ccc;"></div> <div style="position: absolute; top: 50%; left: 50%; transform: translate(-50%, -50%); font-size: 2em; color: #000080; opacity: 0.5;"> RECEIVED 91 JAN 16 PM 5:02 PRDDR </div> </div>		
FROM: Wilfried P. Thalwitz/John Holsen		



P. When is  
pre-brand?  
P

FROM

TO

DATE

Notes for JAH's Presentation at  
Board Seminar on JSSE (18 January 1991):

- A. The "Summary and Recommendations" volume is only tip of the iceberg. Background papers will be published by the OECD in three or four volumes. Detailed analysis -- hopefully of interest to Soviet officials and, indeed, to all interested in problems of economic reform in socialist economies.
- B. Study is result of a genuine collaborative effort by four agencies. (Although EBRD's input necessarily from consultants, not staff.)

Each of the four international organizations took responsibility for leading the work on a particular set of issues. (One organization would be in charge; others, however, usually contributed a part of the staff involved.)

As a result of extensive discussions -- in the field, in Paris and in Washington -- we reached a common understanding on, I believe, all of the major issues. Thus, the analysis and conclusions presented in the report are shared by all four organizations.

- C. The Bank led the task forces concerned with two sets of issues: (1) systemic reform and (2) three major sectors.

As part of systemic reform, we were concerned with

- the role of prices;
- privatization and commercialization of state enterprises;
- reform of the financial sector; and
- the legal framework for a market economy.

Regarding economic sectors, the Bank was responsible for

- agriculture;
- manufacturing industry; and
- housing

The work of the two task forces turned out to be intimately related. That is, in all three sectors, the sectoral work led to the conclusion that systemic reforms were essential if the sectoral problems were to be solved.

For example, our visits to manufacturing enterprises indicated a great deal of over-manning. Financial and managerial autonomy for state enterprises, if not full privatization, are probably necessary to eliminate this inefficient use of labor. And it will be important to have an adequate social safety net in effect when the "hard budget constraint" is introduced, as there may be



a good deal of labor shedding.

The agricultural sector provides illustrations of the need to radically revise to the present system of prices. For example, because of food subsidies, the wholesale price of milk is greater than the retail price. Under these circumstances, collective and state farms, often do not use their own milk to feed the calves they are raising. They sell all the milk they produce, and then buy back powdered milk to be reconstituted and fed to their calves.

D. Regarding the task forces led by other organizations,

- the IMF was basically concerned with the fiscal sector and the near-term macroeconomic outlook;
- the OECD led the work on energy and the environment, on foreign trade and capital flows, and on labor the "social safety net" and labor markets; and
- the EBRD worked primarily on transportation and telecommunications, and on distribution infrastructure.

E. Considerable interest has been expressed in the cost of the study. I am not able, as yet, to give you figures for the other three participating organizations -- but I can answer with respect to the Bank. We have had a budget of about \$750 thousand for the study. Our latest tally shows that we will keep our expenditures within this figure. This includes staff personnel costs, consultants fees, travel and subsistence for staff and consultants, and minor expenses such as translations and, in order to get the report out on schedule, overtime in the print shop.

F. I will not try to summarize the "Summary and Recommendations." However, it may be worth reading aloud what is said of page 47 about what would be a desirable reform program.

We would stress, in particular, the need for a significant and broad-based liberalization of prices in an environment of increased domestic and external competition, supported by a clarification of property rights and encouragement of private ownership along with the commercialization of the larger state enterprises. This, in turn, requires that the necessary legal framework and a judicial system be put in place as rapidly as possible. Initially, the development of a private sector should be fostered by the sale of small enterprises and the encouragement of small-scale market activities. The commercialization of large state-owned enterprises would bring them under the discipline of a hard budget constraint, and would be a step towards both more efficient management and privatization.



These efforts need to be buttressed by tighter financial policies and a more realistic exchange rate policy so as to contain inflationary pressures and prevent major external imbalances. To cushion the effects of the reforms on the poorest segments of the society, these measures should be supported by an incomes policy and by an effective social safety net (including an adequate system of unemployment compensation). Limited assistance in support of restructuring should also be provided to viable firms facing severe transitional problems.

This, as you can see, is a comprehensive program -- which, inevitably, will not be easy to implement. But, given the linkages between the various components of the reform program, we think that such a comprehensive program is essential. The case is quite different from some of our structural adjustment programs, where we usually can focus on ~~one or~~ a few policy issues as of fundamental importance. In the case of the Soviet Union, it is not a question of changing a few policies, but one of creating a whole new economic system. just

- G. I should say a little about some of the issues that proved to be both particularly difficult and important. One of these is the pace of reform. As you have no doubt seen, we came down in favor of what might be called a "modified big bang." It is "big bang" in that simultaneous action is proposed in a number of key areas -- of which price liberalization seems to be the one that gives the Soviets the most worry because of its social implications. But the big bang is "modified" in that we emphasize the importance of a number of "safety nets" or "cushions."

The emphasis on rapid price reform may seem surprising, given the lack of market infrastructure and any tradition of competitive markets in the Soviet Union. The key to understanding this emphasis ~~will be found on page 11 of the report where we quote~~ the economic reform guidelines that were approved by the Supreme Soviet on October 19. In looking at the present economic situation, the guidelines say:

"The volume of production is declining. Economic links are being broken. ... The old administrative system of management has been destroyed ..."

This description is correct. The disruption of the economy is of increasing concern. It threatens the whole process of glasnost and perestroika. Something must be done urgently. It does not seem possible to restore, even temporarily, the old system of administrative controls. In these circumstances our proposal for rapid price liberalization -- for moving rapidly to market clearing prices -- should be seen in large part as a short-term measure. The purpose is to bring an end



to the economic disruption resulting from increasing hoarding, barter, black marketing, dollarization, and restrictions on the free internal movement of goods. Using market clearing prices to allocate supplies seems to us the best way to restore supplies and get production and distribution functioning more effectively.

However, we recognize the problems that may result from the rapid adjustment of prices. For this reason we modify the approach by suggesting that:

- A rationed amount of a number of essential consumer goods continue to be made available at subsidized prices. (Any quantity beyond the ratio would have to be bought at the market price.)
- Also, in a limited number of cases, of which petroleum is a particularly important example, we recommend that temporary export and import taxes be used to smooth the transition to world prices. (Subject to these taxes, prices would still be market clearing prices.)

- H. Issues of economic reform cannot be totally separated from the domestic political situation. Both glasnost and perestroika involve the devolution or decentralization of political and economic power. These reforms, still partial but substantial, have taken place in an environment of strong ethnic and regional loyalties. The results are apparent in the daily papers.

In many respects, economic reform depends upon prior political decisions. For example, privatization and commercialization depend upon prior decisions on what level of government "owns" the property concerned. Problems of fiscal, and hence macroeconomic, policy can hardly be resolved until a "Union Treaty" has made clear the allocation of powers and responsibilities between different levels of government. More broadly, the necessary consensus on economic reform policies can hardly come into being unless there is a substantial consensus on political issues.

Participants in the Joint Study have spent many hours considering how the issues related to ethnic and regional independence should affect the recommendations of the report. We concluded that a substantial decentralization of political power is consistent with continuing economic interdependence. There is a serious danger, however, that policies of economic autarky at the republic or sub-republic levels will accompany the shifts in political power. The economy of the Soviet Union is in fact highly interdependent, in part because industrial production tends to be concentrated in a small number of plants.

As a result, any failure to maintain an "All Union" market is likely to be extremely costly in terms of economic welfare. Nonetheless, there is a real danger that - while most of the rest of the world is seeking greater economic integration - the republics of the Soviet Union may, at least for some time, seek to go in the opposite direction. It is my own view that the prompt implementation of a truly comprehensive economic reform program would be the most effective way to get out of what is admittedly a very difficult situation.

- I. With this introduction, I would like to open the floor for your questions and comments. Before doing so, however, I wish to introduce to you Mr. Fred Levy and Mr. Alan Gelb --who were the task managers of, respectively, the work on systemic reform and sectoral issues. They will join me in responding to your questions and comments.



<b>ROUTING SLIP</b>		<b>DATE:</b> 12/28/90	
NAME		ROOM NO.	
Mr. W. Thalwitz		S-13-131	
Mr. P. Isenman		S-13-131	
	APPROPRIATE DISPOSITION	NOTE AND RETURN	
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	CLEARANCE	PER OUR CONVERSATION	
	COMMENT	PER YOUR REQUEST	
	FOR ACTION	PREPARE REPLY	
XX	INFORMATION	RECOMMENDATION	
	INITIAL	SIGNATURE	
	NOTE AND FILE	URGENT	
REMARKS:			
<p>FROM: John A. Holsten</p> <p>ROOM NO.: S-9039</p> <p>EXTENSION: 33719</p>			

## THE SOVIET STUDY: QUESTIONS AND ANSWERS

RECEIVED

90 DEC 28 PM 4:17

PRDDR

1. What are the study's findings about the prospects for the Soviet economy?

Prospects for the Soviet economy in 1991 are uncertain. Economic policy remains in a state of flux as the debate between the union and the republics over the direction, pace and management of reforms continues. Whether or not political agreement between the union and the republics will be reached will bear on ensuring a unified economic space, with a single currency, free interrepublican trade, and clear and mutually accepted rules for the apportionment of revenues and expenditures among different levels of government.

On the external side, it is unclear whether the envisaged changes in CMEA trade and settlement will in whole or in part take place at the beginning of the year, and whether the price of oil in the world market remains unpredictable. Given the wide range of persistent uncertainties regarding price, incomes and financial policies for 1991, it is impossible to predict with confidence the outlook for output and inflation. But, it appears very likely that economic performance will worsen significantly on both counts next year.

The study quotes President Mikhail Gorbachev: "The position of the economy continues to deteriorate. The volume of production is declining. Economic links are being broken. Separatism is on the increase. The consumer market is in dire straits. The budget deficit and the solvency of the government are now at critical levels. Antisocial behavior and crime are increasing. People are finding life more and more difficult and are losing their interest in work and their belief in the future. The economy is in very great danger. The old administrative system of management has been destroyed but the impetus to work under a market system is lacking. Energetic measures must be taken, with the consent of the public, to stabilize the situation and to accelerate progress towards a market economy."

Depending on the extent of retail price liberalization, and/or their administrative increases, the rate of inflation could well rise to more than 40 percent a year. But a rise in the inflation rate in early 1991 would be in large part "corrective" of a system that has long repressed prices through controls, but which had led to shortages of consumer goods.

In addition to the uncertainties relating to the outlook for oil prices, energy production and the reform of the CMEA system, the prospects for the balance of payments for 1991 will be significantly affected by developments in the domestic economy, by the growing decentralization of foreign trade and by the recent changes in the exchange rate as well as other exchange arrangements. There is a great potential for domestic energy conservation, which would free up more oil for export.

Alternative scenarios have been prepared, based on a range of assumptions regarding, in particular the price of crude oil (\$20 or \$26 a barrel) and the decline in the volume of oil exports (17 percent or 25 percent). In both scenarios, foreign financing gaps are calculated assuming a decline in the volume of imports of 7 percent. Under these assumptions, the current-account deficit vis-a-vis the traditional convertible currency area



(excluding gold exports) would range between \$10.1 billion and \$14.7 billion. In addition, the Soviet authorities will face in 1991 large amortizations of medium- and long-term debt (amounting to about \$12 billion). Given the secured financing, amounting to \$17 billion, and assuming no further decline in interbank deposits, the financing gap in convertible currencies could range between \$5.6 billion and \$10.2 billion. But part of this gap will be filled by the prospective surplus vis-a-vis the CMEA area (estimated at between \$9.9 billion and \$6.6 billion under the two alternative scenarios) depending on the financing available to these countries and on the disposition of their accumulated claims in transferable rubles on the USSR.

## 2. What are the relationships between the Soviet Union and the union republics?

The union consists of 15 union republics which--according to the 1977 Constitution--have the right to secede and to enter into relations with foreign states. The second tier of government consists of 20 autonomous republics, all of which are directly responsible to their respective union republics. The third tier includes towns and villages. Ethnic differences are immense.

Despite the vast size of the country, the republics are highly dependent on trade with each other. The republics are less dependent on foreign trade; the export of raw materials is heavily concentrated in a few republics.

By December 1990, all 15 union republics had declared either independence or sovereignty. The trend towards autonomy and increased barter trade between the republics has recently been reflected in the establishment of border controls on trade, particularly for necessities such as food products.

## 3. What are the essential requirements for successful reform of the Soviet economy?

Transformation is bound to be extraordinarily complex and will take many years to complete. At the heart of this transformation lie three closely related elements: macroeconomic stabilization, price reform in an environment of increased domestic and external competition, and ownership reform. Attempts to restructure the economy coincide with a major decentralization of political authority and responsibility. Many aspects of the economic reform depend on prior, essentially political, decisions (see three elements above).

The Soviet Union's movement toward greater political decentralization and regional independence is consistent with continuing economic interdependence. Economic integration among sovereign states in other parts of the world has been increasing, as the benefits of wider markets for goods and factors of production are sought. The key recommendations for systemic reforms in the study take into account the special characteristics of the USSR, including important differences with other centrally planned economies in transition--namely the closed nature of its economy and its particularly distorted relative prices, a complete lack of experience with private ownership, little exposure to a market system, and unresolved constitutional questions. But the USSR is in a better position than several other economies in terms of rich natural endowment and smaller external indebtedness.



4. What are the differences between the conservative and radical approaches to reform?

In the conservative approach, reforms start with some tightening of fiscal policy, while structural reforms proceed on a slow track. In the initial stage, prices are adjusted, but remain to a large extent administratively controlled. Macroeconomic stabilization would be attained gradually with price decontrol taking place over a period of two to three years.

The radical scenario, in contrast, begins with a strong macroeconomic stabilization program, designed to reduce the budget deficit rapidly to or below the level of 2 percent to 3 percent of GDP, accompanied by immediate decontrol of most prices and the start of privatization of small-scale enterprises.

The study, which advocates the radical approach with certain safeguards, looks at three main concerns about this approach. First, the radical scenario might impose unnecessary hardships on consumers. For that reason, the study recommends programs that will mitigate the adverse effects of the transition on consumers. It further recommends that controls be kept temporarily on the prices of public utilities and housing rents.

Second, price decontrol in the face of macroeconomic imbalances, extreme concentration of economic power and supply shortages and inelasticities could lead to a serious wage inflation spiral and large monopoly profits. Therefore, macroeconomic stabilization must accompany price decontrol, all this in a climate of increased domestic and external competitiveness.

Third, there is a concern that undue burdens could be placed on enterprises that would be viable if given time to adjust. The study recommends cushioning the impact of the transition to world market prices for a selected groups of goods. Following a significant initial adjustment, the balance of the change to a world market price would be phased in over a two- to three-year period.

5. What would be the effect of price reform on the transition to a market economy?

Nothing will be more important to the achievement of a successful transition than the freeing of prices to guide the allocation of resources. Early and comprehensive price decontrol is essential to ending both the shortages and the macroeconomic imbalances that increasingly afflict the economy. Once resource allocation is based on market clearing prices, the ruble will become an effective medium of exchange; this should largely eliminate the economic disruption resulting from the growth of hoarding, barter, the black market, dollarization, and imposition of restrictions on the free internal movement of goods. As the integration of the economy into the world economy proceeds through trade liberalization and current-account convertibility, domestic relative prices for traded goods should be aligned with the structure of world market prices.

6. What are the study's recommendations on ownership reform?

While the ultimate goal of ownership reform is to privatize almost all enterprises in the USSR, an intermediate step of commercialization--moving



effective control away from the bureaucracy to a more commercially oriented management and control structure--will be necessary for most large firms. Privatization can be an important source of revenues for the public sector which could help finance other aspects of the economic reform program. In the case of larger firms, however, the process is likely to go more slowly for a variety of reasons. Some monopolistic enterprises should be restructured before privatization; the total value of the assets that can eventually be privatized far exceeds the savings in the hand of the private sector; and, it is difficult both to determine a reasonable price for state enterprises and to find qualified entrepreneurs to take them over. It is necessary to use a flexible approach that varies according to the type of activity and size of enterprise and, if necessary, the preferences of the different republics.

The study supports rapid privatization of small enterprises through outright sales to individuals, cooperatives and others. Assets should be sold through open and well-publicized auctions and as quickly as possible. One major barrier to the entry of new firms is the highly monopolized state supply system. The breakup and privatization of wholesale trade should thus be among the first priorities of economic reform.

#### 7. What are the prospects for foreign direct investment?

Notwithstanding the lackluster performance to date, foreign direct investment could potentially make a major contribution to the structural transformation of the economy through capital infusion, the transfer of technology and managerial skills, and, equally important, by exposing domestic enterprises to market competition. But a substantial increase in foreign direct investment can be expected only once fundamental improvements have been made to the political, economic, and regulatory environment. Reform efforts in this regard should concentrate on three main areas: the broad constitutional aspects and legal system, the economic setting, and the specific regulatory structure applying to foreign investment.

#### 8. Does the study recommend special measures to alleviate the potential effects of reforms on workers and other vulnerable groups?

Transitional policies must be concerned both with adapting labor market practices to a market economy and with creating an effective affordable social safety net. The new Employment Law presented to the Supreme Soviet provides some social protection to the unemployed by providing unemployment benefits, training and public works. This package of measures is similar to those offered in Western economies, though its implementation may give rise to difficulties simply because of the lack of previous experience with such programs. It is essential to have in place a workable system of unemployment benefits before hard budget constraints are imposed on state enterprises. A longer-term concern involves the need for a permanent social security system targeted towards specific vulnerable groups.

The impact of price increases for food and other basic consumer goods is a matter of particular concern. A possible approach would be to give each person ration coupons carrying the right to purchase a fixed quantity of certain essential goods at a specified price. Those wanting more of such goods would be able to purchase them at the unsubsidized market price. The study provides variants of this approach.



9. Do the proposed reforms take environmental protection in consideration?

Environmental concerns cut across all sectors. Many of the industrial and agricultural regions of the USSR are on the verge of ecological breakdown, posing an imminent threat to the health of present and future generations. Environmental health risks in some regions are up to 10 to 100 times greater than those accepted in most OECD countries. Well-functioning markets can contribute to improved environmental conditions by spurring efficiency in resource use, including a reduction of waste in production inputs (e.g., energy and other raw materials). Industrial restructuring should contribute to the closure of inefficient plants, and in so doing, have a favorable effect on the use of resources. It is important that environmental considerations be taken into account in designing the economic reform program.

10. What is the outlook for energy in the Soviet Union?

The USSR is generously endowed with energy resources. Oil and gas production accounts for 22 percent and 40 percent, respectively, of world production. Energy exports generate about 40 percent of Soviet hard-currency earnings. But the energy industries are presently in a precarious position. Coal and oil production is falling, the growth of gas output is decelerating and domestic energy shortages are developing. Outdated technologies, obsolete equipment, and poor maintenance are endemic in much of the fossil energy sector. Energy-related air pollution, water and land degradation have grown largely unchecked.

A two-stage approach to reform is needed. First, in the near term efforts are urgently required to restore oil production and exports to previous levels, giving particular emphasis to improving field management practices and secondary recovery techniques. Efforts are also urgently required to shore up the faltering electric utility system. Second, commercialization and price reform, coupled with investment in more advanced technology, are essential for development and energy conservation over the longer term.

11. What kind of conditions would be required before external assistance can be provided in support of the reform program?

The criteria should be the adequacy and mutual consistency of the major structural reforms and financial policies. The study emphasizes the need for a significant and broad-based liberalization of prices in an environment of increased domestic and external competition, supported by a clarification of property rights and encouragement of private ownership along with the commercialization of the larger state enterprises. This, in turn, requires that the necessary legal framework and a judicial system be put in place as rapidly as possible. These efforts need to be buttressed by tighter financial policies and a more realistic exchange-rate policy so as to contain inflationary pressures and prevent major external imbalances. To cushion the effects of the reforms on the poorest segments of the society, these measures should be supported by an incomes policy and by an effective social safety net.



12. What kind of external assistance will be provided in support of Soviet reforms?

During the reform program's preparatory period, a primary focus of aid would be technical assistance. Union, republican and municipal authorities all indicated their interest in technical cooperation and advice. Assistance is needed in the design of policies, the establishment of new institutions, the development of a legal framework, developing statistical and accounting systems, and drawing up fiscal and monetary policies. Expertise will also be needed in such sectors as labor markets, management and marketing. A large part of this technical assistance should be provided by the private sectors of Western countries with the role of public sectors being limited to filling any important gaps.

Food aid, if targeted and successfully delivered to the regions most affected, could alleviate present distress. An early implementation of economic reform would make the single largest contribution to alleviation of food shortages.

Project assistance will be most effective when it is financing increased investment as part of a comprehensive reform program which will help ensure the more efficient use of the additional resources. Energy and environment, however, are areas where immediate new investments could have a quick payoff for both the USSR and the rest of the world (in particular the modernization of existing nuclear plants, the improvement of oil-extraction technologies and capacities, and the updating of the gas pipeline and distribution systems so as to favor energy savings). Project lending to remove bottlenecks in economic infrastructure may also be justifiable.

The date on which far-reaching reforms will be introduced is not now known, and the requirements for a wider range of project assistance and for balance-of-payments assistance will have to be re-evaluated in the light of the prospects at that time. Such assistance might include consumer goods and food to increase supplies at the outset of price liberalization. Assistance through a stabilization fund could also provide important support for an early move towards the full convertibility of the ruble. It must be stressed that BOP assistance should accompany the introduction of a major and comprehensive reform program. Without such a reform, additional financial resources would be of little or no lasting value. With it, assistance could provide important support during a time of a difficult transition to integration of the Soviet economy into the world economy, with benefits for all partners.

# OFFICE MEMORANDUM

DATE: January 17, 1991

TO: Distribution

FROM: Costas Michalopoulos, PRDDR

EXTENSION: 32738

SUBJECT: USSR TECHNICAL ASSISTANCE PROGRAM

As you know, the Soviet Union has requested the Bank to undertake a program of technical assistance and cooperation. At the request of Mr. Thalwitz, a Steering Committee was recently set up to provide overall direction to the PRE effort on a possible program for TA to the Soviet Union. A copy of the minutes of the first meeting held on January 14 and other background information are attached for your information.

I have been asked to initiate and chair a PRE Working Group on this subject, which would help coordinate PRE efforts on an ongoing basis. Would you please let me know as soon as possible which of your Division Chiefs you would like to nominate to represent your Department in this Working Group. We would like to hold the first meeting within the next ten days.

*Soviet IT seems to be at least temporarily off the fast track, there are several points in guidelines and background that are well worth discussing now*

Attachments

Distribution:

Messrs/Mme. J. Linn, A. Golan, D.C. Rao, A. Shakow, A. Hamilton,  
K. Piddington, M. Petit, A. Churchill, L. Pouliquen,

cc: Messrs. Thalwitz, Rajagopalan, Summers, Isenman, Holsen, Colaco,  
Lamb, Gelb.



The World Bank/IFC/MIGA  
O F F I C E M E M O R A N D U M

DATE: 16-Jan-1991 10:08am

TO: See Distribution Below

FROM: Francis X. Colaco, PRSVP ( FRANCIS X. COLACO )

EXT.: 33422

SUBJECT: USSR TA Program

In the limited time available, based on already ongoing work in Eastern Europe and knowledge of the USSR through participation in the recent missions, we propose agriculture and energy as the two priority, (with transport as slightly lower priority) sectors to which the Bank could provide technical assistance. We are tailoring the nature of assistance to the resource limitations imposed during the discussions of the Steering Committee. The general sense is that the available resources will only make a minimal dent in the size and scope of problems faced by the USSR in these two priority sectors.

Agriculture

Two key areas for Bank TA, building on ongoing work in Eastern Europe are:

- o liberalization of retail food prices in the context of macroeconomic stabilization; and
- o redistribution of property rights and land use in agriculture.

It is estimated that to do some productive work on the USSR, 3-5 staff years of input costing \$300,000 - \$500,000 will be required (as part of the ongoing work). This would be used for additional staff, consultants and travel.

Energy

In Poland, the ESMAP Program financed a restructuring study of the coal and gas company (\$550,000); a natural gas pricing study (\$150,000) and a plan for the development of natural gas and an environmental assessment (\$650,000). So, in this case the total expenditure was \$1,450,000 in about one year (with commitments for the year of \$5 million).

There is an immediate need for an assessment type activity, as well as more specific studies of the declining productivity of the oil and gas fields.



Further, the environmental aspects of energy production and utilization need early and urgent attention.

A rough minimum estimate would be that about \$5,000,000 over the three year period would be needed to mount any kind of TA program for the energy sector. Of this amount about \$1,000,000 (or 7 staff years) would be accounted for by additional Bank staff. These resources would be used to support general sector work done by the Bank, and rely on bilateral and other sources for more detailed and expensive TA.

### Transport

There are a number of areas for institutional reform and technological modernization in the transport sector. The most notorious problem is the limited farm access during wet periods (which frequently are harvest periods). Areas where Bank could provide assistance include:

1. Railways modernization studies: (i) computerization in all facets; (ii) introduction of modern heavy freight trains (involving operating systems, traction, rolling stock, yards, and tracks); and (iii) railway demand forecasting and investment priorities. (Based on similar ongoing studies in China: (\$3 to 5 million);
2. Integrated inter-modal transport feasibility study and action plan: involving railways, roads, ports, customs, insurance, and banking, with particular attention to organizational aspects, computerized information systems, and telecommunications. (\$0.5 million);
3. Development of modern road data bank for planning and management of the roads sector: focus on a demonstration project in one republic. (\$1 million, including road inventory equipment);
4. Study of costs, user taxes, and tariffs for all modes: to begin to define more clearly the potential role of the different modes, providing a basis for intelligent regulation of tariffs in those modes (railways, aviation) where deregulation of prices cannot take place immediately, and establish financing mechanisms to meet the huge needs for modernization and expansion of the transport system. (\$0.5 million);
5. Institutional organization of the highways sector: to address the fact that present efforts to reorganize the roads ministries in various republics is badly misdirected and to introduce competitive tendering for procurement of public infrastructure, with appropriate institutional safeguards to protect the public interest in high quality works at reduced costs. (\$0.2 million);

and

6. Training (a long-term effort) in such areas as: role of pricing, cost accounting, financial management, investment planning, project analyses, information systems, marketing, the role of different modes, etc. This training program could be developed in collaboration with EDI.

The cost estimates shown in parentheses are notional; some portion of the TA may be provided by Operations staff.

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CC: Costas Michalopoulos  
CC: Visvanathan Rajagopalan  
CC: James P. Mullan  
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**THE WORLD BANK/IFC**

ROUTING SLIP		DATE: 01-15-91	
NAME		ROOM NO.	
Messrs: Thalwitz			
Holsen			
Linn			
APPROPRIATE DISPOSITION		NOTE AND RETURN	
APPROVAL		NOTE AND SEND ON	
CLEARANCE		PER OUR CONVERSATION	
COMMENT		PER YOUR REQUEST	
FOR ACTION		PREPARE REPLY	
INFORMATION		RECOMMENDATION	
INITIAL		SIGNATURE	
NOTE AND FILE		URGENT	
REMARKS:			
<p><i>Done 1/15</i></p>			
FROM: Paul Isenman		ROOM NO.:	EXTENSION:



## FAX MESSAGE

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91 JAN 15 PM 3:10

PRDDR

TO: Distribution

NO. PAGES: Two, including this page

FROM: Amnon Golan, Director, EDI

EXT: 36300

SUBJECT: FYI - Soviet T.A. Program

Please see attached.

Attachment

Distribution:

P. Isenman, Fax No. 70952

D. Bock, Fax No. 76869

P. Knight

done 1/15

CC: G. Lamb

C. Michalopoulos

cc 2 persons  
Encl  
Kight

Amnon Golan  
Director  
Economic Development Institute  
The World Bank  
1818 H Street, N.W.  
Washington, D.C. 20433

IX

Fax (202) 676-0959

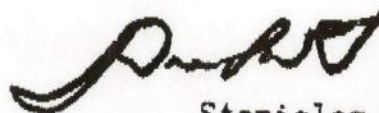
Dear Mr. Golan,

In order to facilitate our future collaboration with the World Bank and Economic Development Institute of the World Bank with regard to training part of proposed technical cooperation agreement between the Bank and the USSR, we designate Dr. Denis Kiselyov, currently affiliated with the Academy of National Economy, USSR as its representative in the USA, to maintain contacts with the Bank and EDI and represent State Commission on Economic Reform in elaboration of proposals and coordination of activities.

Dr. Kiselyov has our authority to draft preliminary proposals for the economic training part of the program and other activities, to maintain information exchange between the Bank and EDI and the Commission, to coordinate activities and discuss with institutions mentioned above, matters of mutual concern.

Dr. Kiselyov has an office in Midwest University Consortium for International Activities, Inc., (MUCIA) in Columbus, Ohio.

Sincerely,



Stanislav Assekritev

Deputy Chairman of State Commission  
on Economic Reform,  
USSR Council of Ministers



The World Bank/IFC/MIGA  
O F F I C E M E M O R A N D U M

DATE: 15-Jan-1991 11:19am

TO: See Distribution Below

FROM: Amnon Golan, EDIDR

( AMNON GOLAN )

EXT.: 36300

SUBJECT: EDI's Contribution to the Soviet Technical Assistance Program

When we met yesterday to discuss PRE's input to the Soviet Technical Assistance Program, you asked for a general outline of an EDI training program, its cost and implication for other EDI activities. Although we have recently discussed the contents of possible Senior Policy Seminars (SPSs) on Economic Policies of Transition and Fiscal Federalism (see Mr. King's memorandum of 12/14/90 [being faxed to you with this memo ]), these proposals do not constitute a program. If we are to launch a massive three-year training program in the Soviet Union, we would follow the model we are presently developing for our activities in China. Under this approach, EDI's activities will concentrate heavily on building a network of training institutes in selected sectors. Our assistance will focus on the identification of training needs, training of trainers (such training will mainly take place in the Soviet Union with the help of foreign experts though, subject to budget availability, it could also include training abroad), preparation of training material in Russian, pedagogical assistance to local training programs and organizing a few select SPSs with institutes belonging to the networks. A detailed list of sectors where we could organize networks will have to be prepared in consultation with the Soviets, but based on Mr. Abalkin's letter and the joint report on the Economy of the USSR, we should probably plan for collaboration in five areas.

The actual cost of such a program will have to await detailed field work, determination of the number of institutes to be included in their needs. Still based on our China experience, the foreign exchange cost of such a program will be approximately \$300,000 per network per year. At this time we have no way to estimate the associated local costs of the program.

If we are to launch this program without reducing our activities in other regions of the world, EDI will clearly need additional regular staff positions to manage such a program. A very rough estimate of staffing needs includes a senior level Program Coordinator plus 3-4 regular higher level and 2-3 support level staff positions. On this basis, the program's annual cost will be roughly as follows:



(a)	5 networks	x	\$300,000 =	\$1,500,000
(b)	4 HL staff	x	\$110,000 =	440,000
(c)	2 SL staff	x	\$30,000 =	<u>60,000</u>
TOTAL				\$2,000,000

Aside from the above direct annual costs, the addition of such a major program to our ongoing activities is bound to require considerable input from a wide range of EDI staff and managers. Realistically, this will inevitably have some impact on our other ongoing activities.

Attachment (To be faxed with this memo)

AG:dbw

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cc: WT  
J. Holsen  
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CM

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91 JAN 16 AM 8:41

PRDDR

15 January, 1991

To Johannes Linn, CECDR

From Alan Gelb, CECSE

Ext 37667

CECs Role in TA for USSR

While the details of the proposed TA program on the USSR are not clear yet, some general indications of its nature, together with the role played to date by the Department in support to East and Central Europe suggest several areas where CEC would be likely to have a direct and substantial involvement. To some extent, this can be effected through the use of consultants recruited for specific tasks. Yet, the management of elements of technical assistance plus the need for the Department to build up expertise in the USSR and so institutionalize this in the Bank requires that a part of the additional resources be used to effectively strengthen staffing.

Substantial inputs are likely from at least two of CECs divisions:

Financial Sector Reform is highlighted as a major area in the request for TA, and it would be expected that a major part of the burden would fall on CECFP which has extensive experience in neighboring countries.

Reforming Public Enterprise Management and Privatization is likely to be another major focus, and CECPS provides an appropriate locus for such an initiative in the Bank.

In both of these areas experienced staff are already overstretched, so that an initiative will require at least one HL staffmember to be added in each area to put together, supervise and participate in the program if important work on other countries is not to be sacrificed.

There is also need to deepen institutional knowledge in the area of systemic reform and bring to bear the experiences of other countries that have advanced further along that route. A natural focus for such general Soviet expertise is CECSE, but this unit is already severely overstretched because of its small staff resources, especially considering the initiatives recently funded by the Japanese grant facility. Therefore, one HL position would be required to extend analysis to the USSR on more than the present ad hoc basis. Assuming a substantial role in the coordination of the program on behalf of PRE steering Group would require another position. The Unit is already underprovided with SL positions and one more would be needed.

Involvement of CEC divisions in other areas, notably macroeconomics and trade, is likely, but it is probable that some degree of involvement, at least on the research side, could be accommodated in current resources.



RECEIVED

cc: WT

CM

GL

J. Holten

91 JAN 16 AM 8:41

PRDDR

Done 1/16

The World Bank/IFC/MIGA  
OFFICE MEMORANDUM

DATE: 15-Jan-1991 11:19am

TO: See Distribution Below

FROM: Amnon Golan, EDIDR

( AMNON GOLAN )

EXT.: 36300

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Attachment (To be faxed with this memo)

AG:dbw

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( ALEXANDER H. TER WEELE )  
( HYUNG-KI KIM )



4 of 4

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION  
**OFFICE MEMORANDUM**

DATE: December 14, 1990

TO: Mr. Amnon Golan, Director

FROM: Timothy King, Chief, EDIST

EXTENSION: 36444

SUBJECT: SPS(s) for the USSR

Following, as I understand, a conversation between yourself and Mr. Wapenhans, Mr. ter Weele asked me to outline a potential SPS that would cover the most important topics on the economic agenda of Soviet policy makers, and could be held in Moscow in March or April 1991, drawing mainly on material that is readily to hand. Having talked to several people, including Mr. Holsen, there appears to be no dissent with the view that the list of topics must include:

1. Fiscal relationships among the different government authorities, and especially between Republican Governments and the Union Government;
2. Stabilisation, both immediate, and in the context of an increasingly open economy;
3. Price reform, including issues of the "social safety net" and indexation;
4. Issues of enterprise ownership and management, including questions of corporatization and privatisation; and
5. Reform of the Financial System. This also relates closely to items 2 and 4.

At the time your request was received, EDIEM was well on the way to preparing a separate Moscow seminar to discuss issues of fiscal federalism, to follow the SPS to be held on this topic in Delhi in late February. Very senior Soviet economist/technocrats have requested that this be a four-day rather than a three day affair. Subject only to a green light for EDI to start, it is expected that this will be held at the National Academy of Economics during the week of March 4.

Messrs Knight and Simon and I are therefore of the opinion that there is nothing to be gained and much to be lost by trying to convert this seminar into a multi-topic one. Instead we would propose a seminar to take up the other issues in a fairly integrated way. Together with Mr Denis Kiselyov, who is on the staff of the National Academy of Economics (though currently at Ohio State University) we have sketched out the attached note, and are in a position to prepare a seminar brief very quickly when it is clear that we can go ahead and make official contact with the Academy.

cc: Messrs. ter Weele, Knight, Kiselyov, Simon.

TKing:sch



RECEIVED

91 JAN 16 AM 8:41

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cc: WT

GL  
CM

J. Holten

The World Bank/IFC/MIGA  
OFFICE MEMORANDUM

DATE: 15-Jan-1991 12:58pm

TO: Alan Gelb

( ALAN GELB )

FROM: John OConnor, IECSE

( JOHN OCONNOR )

EXT.: 33805

SUBJECT: TA on Statistics for the USSR

D.C. has asked me to respond to you regarding Johannes' note on the PRE Steering Committee meeting on USSR TA. Ishrat hasn't yet had a chance to respond, so I'm winging it on debt even more than the rest, which is of course all highly conjectural. However, the model I'll explicate is one that I think is working elsewhere and could work well in the USSR, as soon as anything can.

IEC would almost certainly expect its TA in statistics to the USSR to become part of the work programs of existing units. While this will mostly mean IECSE and IECDI, my brief visit to Moscow last October convinced me that a significant role will also fall to IECSD, particularly in the early stages. A visit or two by IECAP and IECIT would probably be necessary to round out the operationally significant package.

I think \$0.9m over three years, Johannes' order of magnitude, is probably as good a guess as anyone can make just now. However, I am skeptical that anything meaningful can be accomplished in FY92. In my view, major changes will be required in the mindset at Goskomstat and other key government agencies and experience in Eastern Europe suggests that this will take at least a year after it begins in earnest (and I saw no signs that the change has begun). Nor do I think that the Soviets need all that much help in conventional statistical matters, e.g., how to do surveys, although that is the kind of piecemeal that other TA donors are eager to provide.

Hence, I recommend we proceed with a two-part strategy:

- \* assign FY92 priority to tasks that are most likely to accelerate the change in mindset; and

- \* aim our overall (three year) TA at making the Bank the key advisor to the government on statistical priorities.

The second point would of course be contentious if expressed too openly. However, my experience elsewhere (in places as disparate as CSFR and Angola) suggests that the other donors will in fact welcome the practice so long as we don't announce the principle. The Bank is very flexible (if not loose) in both form and content of TA on statistics, which has its disadvantages in normal

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conditions but is ideal for economies in transition.

The trick is to say that the Bank will be technical assistant "of last resort." We should accept those tasks that others reject but are still, in our view, raising operationally significant statistical issues. This channels the energies of other agencies into the pieces of work at which they are adept and minimizes prospects of turf battles - while putting the Bank on the moral high ground when it finds itself in such battles. It also means that we help the authorities identify what won't get done but is important to them for policy purposes.

The downside is that it requires a bit more faith that money will be well spent, because I don't think we should say the Bank is going to do "x" in topic "y." I can of course say that IECSE will have to give some fairly deep TA on national accounting and that we can't delegate all that to anyone else because it will have significance for things like estimating GNP per capita for operational guideline purposes; and IECDI will have to be equally deep into establishment of a debtor reporting system no matter who else wants to offer help in the area. If the Bank were to limit itself to such piecework statistical efforts, it would, in my view, quickly become a peripheral player in the wider game of policy advice.

That said, I don't see any point in explicating conventional statistical tasks that would be budgeted as piecework. Instead, I would like to give a thematic view of what I think TA money would purchase.

Probably the major tasks in early FY92 will be (i) getting-to-know-you visits, which should be reciprocal and (ii) keeping straight all the offers of help that the government will get from individual industrial countries, the IMF, the OECD, the European Communities, UNSO, and UN specialized agencies.

I would suggest that a few Goskomstat staff be invited to spend a few months in IEC. I would begin with a systems person and someone with a national accounting background.

We have already built some contacts via the International Comparison Program (ICP), via the Austrian Central Statistical Office. We should provide additional resources to this activity, particularly to move work forward in time (the formal exercise is limited to 1990 which means that it won't really touch on emerging issues of privatization of activities unless someone arranges for a more ambitious, annual, approach).

We should get the USSR deeply into our RPO-financed study of measuring growth and inflation in CPEs. We should also bring them in on the IECSE/CECSE Factbook on Economies in Transition.

I think we should take some very modest steps to encourage a metamorphosis in the technical "research institutes" that have



been appended to ministries, which have in fact done much of the detailed statistical work on prices and quantities. I see these as potential trade associations, in the U.S. sense of the term, representing the collective interests of enterprises in a progressively more market-oriented and fragmented industry (as the great combines are disassembled). While the substantive advantages ought to be even more significant, I see this as essential if Goskomstat is not to drown in data it cannot process, let alone evaluate, during the transitional years. The emerging trade associations, in my vision, will process enterprise returns into industry reports that satisfy the information requirements of central authorities (while providing some vestige of a veil of confidentiality, which will become increasingly important as privatization actually takes place).

We should expect to participate in an inter-secretariat group comprising the key donors of TA on statistics, which will involve travel additional to that which we will have to do on our own. My guess is that we will need to field four-person missions twice in FY91 to meet the Bank's "own" needs (with fairly senior staff going the first time and the second team with sleeves rolled up); and a three person mission as part of the inter-secretariat at least once to Moscow and once to Western Europe (making the rounds of ECE, OECD, and EC).

By the end of FY92, I would guess we could have, superficially, the usual minimum set of information (national accounts, BoP, debt, etc.). Since the economy will have been in turmoil, I doubt that this will mean much, analytically, except in terms of the infrastructure we will have been developing along the way.

This is my sense of the critical time to ensure that statistical activities in fact are connected to policy concerns. IECAP and IECIT would go to show their wares; IECDI might get into things like the Debt Strategy Module; and IECSE would probably be shifting from basic national accounting issues to social and environmental indicators. But most of all, the Bank's TA in statistics would be responding to specific and immediate concerns of policy-makers - basically taking over tasks that others had thought they could do but find they can't or won't do.

My guess is that we will find ourselves working more directly with TA donors from individual industrial countries at this stage, apart from the usual dependence on the IMF for balance of payments. The U.S. has the deepest hooks in thus far; IECSE is well connected with all of the key players in this regard and I would expect that FY93 will be a year for cofinancing activities in order to steer them where we wish them to go. This will probably give us even greater leverage with UN specialized agencies (including ECE). If we were to make clear that some of the FY93 money would be made available to support work of other agencies, we would find them eager, in FY92, to inform us of what they are doing and reluctant to view our actions as turf battles. I also happen to think it is the right way to go.



This is also the right time to ensure that there is an indigenous feedback mechanism to advise national decision-makers on statistical priorities. I do not believe that traditional approaches work even in industrial countries and I think they could be disastrous in the USSR. Hence, what I have in mind is Bank funding of some activities that help to define an indigenous process for bringing together users and compilers of policy-relevant indicators.

CC: D. C. Rao  
CC: Ishrat Husain  
CC: Shaida Badiie  
CC: Johannes Linn

( D. C. RAO )  
( ISHRAT HUSAIN )  
( SHAIDA BADIEE )  
( JOHANNES LINN )

1/15/91

*[Signature]*

1 of 4

FAX To Mr. Isenman 477-0952

From Amnon Golan 676-0858

4 pages (incl. this page)

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91 JAN 15 PM 12:40

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2 of 4

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91 JAN 15 PM 12:44

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The World Bank/IFC/MIGA  
OFFICE MEMORANDUM

DATE: 15-Jan-1991 11:19am

TO: See Distribution Below

FROM: Amnon Golan, EDIDR

( AMNON GOLAN )

EXT.: 36300

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CC Lant

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TOTAL					\$2,000,000
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Attachment (To be faxed with this memo)

AG:dbw

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CC: Alexander H. ter Weele	( ALEXANDER H. TER WEELE )
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The World Bank/IFC/MIGA  
O F F I C E M E M O R A N D U M

DATE: 15-Jan-1991 02:41pm

TO: See Distribution Below

FROM: Alan Gelb, CECSE

( ALAN GELB )

EXT.: 37667

SUBJECT: Minutes - PRE Steering Group on USSR TA Program

14 January, 1990

Minutes of PRE Steering Group on USSR TA Program

1. Paul Isenman, Johannes Linn, Amnon Golan, Francis Colaco, John Holsen, Costas Michalopoulos, and Alan Gelb met to consider PRE's response to the prospective Technical Assistance Program.
2. It was noted that the development of the Program was still ongoing, and that its leadership would be in Operations. No response to the Soviet letter officially requesting TA had yet been sent, and the details of the proposed program were not available. The likely size of the program was expected to be about \$50 million over a three-year term, and it had been proposed that the Bank advance \$15 million from its net income against pledges of funding by outside donors. However, there were uncertainties in these areas. Recent political developments in the USSR argued in favor of a phased approach to building up the TA effort. One EDI staff member was active on the committee headed by David Bock.
3. PRE would undoubtedly have a role to play in such a program, and discussion focused on the likely size of that role and the implications for PRE. If the program was motivated by the prospect of USSR membership, this would call for expertise on the country to be built up through long-term involvement of individuals, and on a reasonably large scale; the USSR was more like another China than a typical new entrant. Issues for PRE include:
  - (a) There was no prospect of substantially increasing work on the USSR without cutting work in other areas - already, there were too many "priorities." Working on the USSR would inevitably be seen as attractive, and there will be a tendency for the most experienced staff to shift priorities in this direction. This seems to have happened to some extent on Eastern Europe already. Many of the areas indicated as important for TA will draw on PRE staff.
  - (b) The reimbursement of the costs of staff and consultants by the program could not substitute for staff resources, because consultant would need to be managed and their work integrated by PRE staff. EDI, for example, was already at the limit of what could be done with available staff resources; the consultant/staff ratio could not rise indefinitely. Therefore, although funding would need to be assured before undertaking new work, cash was not the only requirement.

4. For the above reasons, a substantial PRE involvement would require more staff resources. Assuming that PRE were responsible for \$5 million of consultant TA, this would involve managing about 25 SYs; the burden of this would be shared between PRS, EDI, and CEC. Messrs Colaco, Golan, and Linn would consider the likely requirements and report back to Paul Isenman.

5. PRE's involvement would need to be managed in some integrated way. Messrs. Michalopoulos and Gelb would play some role in this respect for the Group.

6. It was agreed in principle that background work done for the Joint Soviet Study could be submitted for the PRE working papers, and that John Holsen would clear submissions.

ag/11/cgsa

DISTRIBUTION:

TO: Paul Isenman	( PAUL ISENMAN )
TO: Francis X. Colaco	( FRANCIS X. COLACO )
TO: Johannes Linn	( JOHANNES LINN )
TO: Amnon Golan	( AMNON GOLAN )
TO: John A. Holsen	( JOHN A. HOLSEN )
TO: Costas Michalopoulos	( COSTAS MICHALOPOULOS )



The World Bank/IFC/MIGA  
O F F I C E M E M O R A N D U M

DATE: 14-Jan-1991 10:21am

TO: See Distribution Below

FROM: Patricia Gallagher, PRESV

( PATRICIA GALLAGHER )

EXT.: 31018

SUBJECT: Continuation of Meeting on Colloquium

Mr. Thalwitz will continue the meeting on the board colloquium on the JSSE Study on Tuesday, January 15 at 3 pm in S13-131.

DISTRIBUTION:

TO: Johannes Linn  
TO: Larry Summers  
TO: Paul Isenman  
TO: Dennis de Tray  
TO: Geoffrey B. Lamb  
TO: D. C. Rao  
TO: Paul S. Armington  
TO: John A. Holsen  
CC: Rest of Distribution Suppressed

( JOHANNES LINN )  
( LARRY SUMMERS )  
( PAUL ISENMAN )  
( DENNIS DE TRAY )  
( GEOFFREY B. LAMB )  
( D. C. RAO )  
( PAUL S. ARMINGTON )  
( JOHN A. HOLSEN )

*Calander*

The World Bank/IFC/MIGA  
O F F I C E M E M O R A N D U M

DATE: 15-Jan-1991 03:47pm

TO: Prisce Daniel

( PRISCE DANIEL )

FROM: Paul Isenman, PRDDR

( PAUL ISENMAN )

EXT.: 33957

SUBJECT: for calendar



The World Bank/IFC/MIGA  
O F F I C E M E M O R A N D U M

DATE: 15-Jan-1991 03:51pm

TO: See Distribution Below

FROM: Patricia Gallagher, PRESV ( PATRICIA GALLAGHER )

EXT.: 31018

SUBJECT: Rescheduling Preparation Meeting on Colloquium

Sorry for all these changes but WT is stuck at the Board's mercy. He would like to have the meeting on the Colloquium at 5pm today in S13-131. Please let me know if you cannot make it.

DISTRIBUTION:

TO: Johannes Linn	( JOHANNES LINN )
TO: Larry Summers	( LARRY SUMMERS )
TO: Paul Isenman	( PAUL ISENMAN )
TO: Dennis de Tray	( DENNIS DE TRAY )
TO: Geoffrey B. Lamb	( GEOFFREY B. LAMB )
TO: D. C. Rao	( D. C. RAO )
TO: Paul S. Armington	( PAUL S. ARMINGTON )
CC: Penny Chokechaitanasin	( PENNY CHOKECHAITANASIN )
CC: Kate Oram	( KATE ORAM )
CC: Prisce Daniel	( PRISCE DANIEL )
CC: Lynette Alemar	( LYNETTE ALEMAR )
CC: Komola Ghose	( KOMOLA GHOSE )
CC: Keith Jay	( KEITH JAY )
CC: Patricia Gallagher	( PATRICIA GALLAGHER )

The World Bank/IFC/MIGA  
O F F I C E M E M O R A N D U M

DATE: 14-Jan-1991 10:21am

TO: See Distribution Below

FROM: Patricia Gallagher, PRESV

( PATRICIA GALLAGHER )

EXT.: 31018

SUBJECT: Continuation of Meeting on Colloquium ?

Mr. Thalwitz will continue the meeting on the board colloquium on the JSSE Study on Tuesday, January 15 at 3 pm in S13-131. ✓

DISTRIBUTION:

TO: Johannes Linn

( JOHANNES LINN )

TO: Larry Summers

( LARRY SUMMERS )

TO: Paul Isenman

( PAUL ISENMAN )

TO: Dennis de Tray

( DENNIS DE TRAY )

TO: Geoffrey B. Lamb

( GEOFFREY B. LAMB )

TO: D. C. Rao

( D. C. RAO )

TO: Paul S. Armington

( PAUL S. ARMINGTON )

TO: John A. Holsen

( JOHN A. HOLSEN )

CC: Penny Chokechaitanasin

( PENNY CHOKECHAITANASIN )

CC: Kate Oram

( KATE ORAM )

CC: Prisce Daniel

( PRISCE DANIEL )

CC: Lynette Alemar

( LYNETTE ALEMAR )

CC: Komola Ghose

( KOMOLA GHOSE )

CC: Daphne Minott

( DAPHNE MINOTT )

CC: Patricia Gallagher

( PATRICIA GALLAGHER )

FD's Colloquium  
J/WT

Tues. Jan. 15  
5:30



THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION  
OFFICE MEMORANDUM

cc: GL  
done 1/15

DATE: January 14, 1990

TO: Distribution

FROM: D.C. Rao, IECDR *DR*

EXT.: 33800

SUBJECT: ED's Colloquium

The attached note from Paul Armington could be the basis for discussion at tomorrow's meeting.

Attachment

Distribution

Messrs. Thalwitz, Summers, Isenman, Armington ✓

D.C. Rao:llt

RECEIVED  
91 JAN 15 AM 7:42  
PRDDR

Issues to be Considered in the PRE Colloquium for  
Executive Directors on Global Savings:  
Prospects for Supply and Demand<sup>1</sup>

The Problem

1. Worldwide, the new demands for funds now looming on the horizon are vast: the financing of a retooled and united Western Europe; the belated reconstruction and development of Eastern Europe, the Soviet Union, and China; the replacement and upgrading of infrastructure in the industrialized Far East and North America; the financing of the old war against extreme poverty; and the financing of the newer wars against threats to the global commons of land, sea, atmosphere, and space. In broad orders of magnitude, how much money are we talking about here? And who will come up with this sort of money? Looking around the world, we see an insufficiency of major players on the supply side.<sup>2</sup> The idea that "the cupboard is bare" is corroborated by interest rates: global rates, adjusted for inflation, are high by any standard.

The Risk of Crisis

2. Should we conclude, therefore, that we face a global crisis marked by shortage of savings, high real interest rates, and low economic growth in countries or sectors that are marginalized in the competition for

---

<sup>1</sup> Scheduled for 3:00 P.M. April 18 through lunch April 19.

<sup>2</sup> Historically, pre-OPEC I, the "industrial countries" were taking the lead in supply of development finance. After 1973, "petro-dollar" reflows and the bloom of international banking played a large role, sustaining debt-creating flows to developing oil importers until a debt crisis was precipitated in 1982. Obviously, that situation was not sustainable. By now, nine years later, the erstwhile "industrial countries" have assumed the role of the "developing countries" to some extent; OPEC is no longer a worldclass funder; and the banks are substantially out of the action. In the rich countries the capacity and willingness to raise taxes seems nearly exhausted, and some of the wellsprings of private savings have recently been dwindling, especially in Japan and the NIEs. Indeed, in recent years the "industrial countries" have been living in part off a real net inflow of resources from the poor countries, who are naturally aiming to stop this transfer when they can.



funds?<sup>3</sup> Will the world's banking sector be among the sectors that are damaged? More generally, on this last point, do we face a shortage of financial intermediation, perhaps both as a contributing cause and as an outcome of the crisis? Will the transition from debt-creating, mainly-public finance to other forms of finance involve a hiatus in global intermediation, aggravating an underlying savings shortage?

### The Policy Alternatives

3. What can or should be done by policy makers to deal with this risk of crisis, either by way of preventing the crisis or to deal with it as it unfolds in the 1990s? Here there are choices to be made:

a) Do nothing? Have faith in market solutions: trust that forward-looking households, businesses, and financial institutions will provide the needed bridging finance to the 21st century, at tolerable (if not sustainable) levels of interest rates?

b) Pursue policies to make "market solutions" work better? What are these policies? Is this approach mainly a matter of making international financial intermediation more cost-effective?

c) Define and prioritize the countries or country groups that are most likely to be hurt by the global crisis, and thus focus an aid effort on them? Such an approach may make sense if intermediation failure takes the form of geographically-definable shortages; is this likely to be the case? Is there a "regionalisation" problem in international finance, as there may be in international trade?

---

<sup>3</sup> This crisis could of course be overtaken and obviated by even starker ones that shift down the demand for funds, including protracted global recession and erosion of the institutional bases of creditworthiness. The Colloquium will address the savings issue in the actual context of present realities, not in the abstract context of equilibrium theory.

d) Is it possible to make such external aid complementary with additional internal mobilization of savings, rather than to forestall such mobilization? More generally, what are the key strategic links between a sensible global policy on savings and sensible domestic policies in developing countries? How should the developing countries respond to the crisis?

e) Instead of (or in addition to) focusing international policy responses on countries or groups of countries, is there a case for a response geared to types of finance? Surely, the world of finance is changing fundamentally in that new forms of finance and new styles of risk management must lead the way toward future development. To the extent that the global savings shortage can be identified by type of flow, a global policy response that is correspondingly tailored may be appropriate.

#### The World Bank Group

4. More specifically, what can or should the World Bank Group do to help? Ipsa facto, the Bank is part of the problem. Arguably, it needs to be part of the solution, too. Does the imbalance between global savings and investment now impinge on IBRD policies?

Bank's declining net transfer



Colloquium on Global Savings: Presenters and Discussants a/

Outside Presenters/Discussants (alphabetical order)

Fred Bergsten/John Williamson (IIE)  
 Richard Berner (Solomon Bros.)  
 Michael Boskin (CEA)  
 Barry Bosworth (Brookings)  
 Robert Eisner (Northwestern)  
 → Martin Feldstein (NBER)  
 Stanley Fischer (MIT)  
 Francisco Gel (Mexico)  
 Robert Heller (Visa Int'l)  
 David Henderson/Steven Englander/John Martin (OECD)  
 Ernesto Hernandez-Cata (IMF)  
 Lutz Hoffman (DIW, Berlin)  
 → Pedro-Pablo Kuczynski (First Boston Int'l)  
 Flemming Larsen (EC, Brussels)  
 Alexandre Lamfalussy\* (BIS)  
 Herb Levine (Penn)  
 Carlos Massad (ECLA, Chile)  
 Jacques Polak (IMF (retired))  
 Helmut Schmidt\* (Germany)  
 Paul Volcker\* (US)

*Barn Bush*

*Called with  
FIN*

*Roth- Wood*

*de la Rivecourt*

*→ Summers*

Bank Presenters/Discussants

Selected EDs, b/ Conable, Thalwitz, Summers, Rao, Holsen

\* Possible dinner speaker.

a/ List of suggestions only; no contacts have been made as of this date. Only a small fraction of this list could be accommodated within the time and budget parameters of the Colloquium.

b/ Selected EDs may be asked to chair sessions, and to moderate the discussion, making extensive comments if they wish.

PA:ka  
 (31)

- Use<sup>v</sup> / mobil. RESOURCES
- Interest in involvement
- Framework
- Hong Kong

Sessions chaired by ED,  
ED Commentators.

→ Agt. Res

GATT

Advt  
Case  
→ Use  
→ Res  
→ Res

→ Name  
come see



→ Sell them that they ought to be interested

Dist. Seminars  
Seminars  
Board  
Board

→ Review.

Urban  
Forestry  
Ann. Rpt Emv.

Purpose:

EDC Ann Rpt's Research

→ Discretionary List small.

→ Change of practice.

→ Road pricing

→ AWP Review → Policy Agenda.

→ Caw Japan Levy & Interest Rate



# Record Removal Notice

<b>File Title</b> Soviet - General - January 1991		<b>Barcode No.</b>  30382299		
<b>Document Date</b> December 18, 1990	<b>Document Type</b> Memorandum			
<b>Correspondents / Participants</b> To: Executive Directors From: T.T. Thahane, VPSEC				
<b>Subject / Title</b> Proposed PRE Colloquium for Executive Directors				
<b>Exception(s)</b>				
<b>Additional Comments</b> Declassification review of this record may be initiated upon request.		<p>The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information or other disclosure policies of the World Bank Group.</p> <table border="1"><tr><td><b>Withdrawn by</b> Shiri Alon</td><td><b>Date</b> September 05, 2019</td></tr></table>	<b>Withdrawn by</b> Shiri Alon	<b>Date</b> September 05, 2019
<b>Withdrawn by</b> Shiri Alon	<b>Date</b> September 05, 2019			





# Record Removal Notice

<b>File Title</b> Soviet - General - January 1991		<b>Barcode No.</b>  30382299		
<b>Document Date</b> December 19, 1990	<b>Document Type</b> Memorandum			
<b>Correspondents / Participants</b> To: Mr. Timothy T. Thahane, Vice President & Secretary From: E. Patrick Coady, U.S. Executive Director				
<b>Subject / Title</b> Proposed PRE Colloquium for Executive Directors				
<b>Exception(s)</b>				
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<b>Withdrawn by</b> Shiri Alon	<b>Date</b> September 05, 2019			

# OFFICE MEMORANDUM

DATE: December 17, 1990

TO: Mr. Timothy Thahane, Vice-President and Secretary, SECGE

FROM: Paul Isenman, Director, PRD

EXTENSION: 33957

SUBJECT: PRE Colloquium for EDs

1. PRE proposes that its colloquium for EDs, to be held at a suitable date in March or April, should address the critical question of who will finance development in the 1990s, and how. This will provide a good opportunity for Larry Summers to take the lead in discussing with EDs an issue of crucial importance to the Bank, and one which is central to his own concerns.

2. We see the colloquium focussing on three broad themes. First, the global supply of investment capital in the coming decade depends predominantly on the savings outturn and trends in the US, Japan and the EC -- and these have been changing markedly in recent years. Second, the colloquium would examine the global implications of investment trends and demand for external savings of key country groupings -- the different categories of developing countries, but also potential new claimants on the savings pool such as Eastern Europe and the Soviet Union. Third, a great deal depends on the form in which world savings are intermediated. The colloquium might therefore look at growth prospects for the main types of financing -- aid, foreign direct investment, commercial lending, non-concessional official lending, and portfolio investment -- and at what policy and institutional changes will be needed for enough savings to flow in the right forms to ensure adequate access by developing countries. Attached is a brief outline of questions to be covered.

3. We have appreciated the guidance given by EDs, and the opportunity for an interchange with the Board Steering Committee. On balance, we think the topic above is the right one, and promises an interesting discussion. Trade, the other topic we had proposed and in which some EDs had shown interest, may be less productive, given the fairly recent colloquium on the same topic, the continuing uncertain status of trade negotiations, and the fact that the Board will in any case in the coming months be receiving two papers discussing trade issues.

Attachment

GLamb:lisa

bcc: Messrs. Alexander Shakow and Andrew Steer

*Handwritten notes:*  
→ What's the outline?  
→ What's the topic?  
→ What's the agenda?  
→ What's the format?  
→ What's the timing?  
→ What's the location?  
→ What's the budget?



GLOBAL SAVINGS: PROSPECTS FOR SUPPLY AND DEMAND

or

WHO WILL FINANCE DEVELOPMENT IN THE 1990s?

Proposed Topic for Board Colloquium March/April, 1991

The colloquium would focus on the outlook for the supply and demand of savings for the 1990s and beyond. Particular emphasis would be placed upon the prospects for financial flows to developing countries and upon the intermediation process.

The Supply of World Savings

1. How large are total world savings? What are the trends? What are the determinants? Can we explain interest rates?
2. What are the prospects for net savings among the OECD country groupings (EC, Japan, USA)? What are the key uncertainties?

Investment and the Demand for Savings

1. What are investment trends and prospects in the key country groupings -- Africa, Highly Indebted Countries, Eastern Europe and the Soviet Union, Other Low Income, Other Medium Income?
2. To what extent can domestic savings finance investment needs?
3. What have been the recent trends in financial flows to these country groupings? What have been the determinants?

The Intermediation Process

1. What are the key features characterizing recent trends in international financial intermediation: aid, official non-concessional debt flows, commercial debt flows, foreign direct investment and portfolio investment?
2. What are the prospects for the 1990s? What forms of intermediation have the greatest prospects for growth? Where will competition for foreign savings be the stiffest?
3. What policy and institutional changes are required to facilitate the required flows?

The World Bank/IFC/MIGA  
O F F I C E   M E M O R A N D U M

DATE: 03-Jan-1991 05:23pm

TO: See Distribution Below

FROM: Geoffrey B. Lamb, PRDPD

( GEOFFREY B. LAMB )

EXT.: 32544

SUBJECT: EDs' colloquium again

I've just seen D.C.'s note to Paul of today's date proposing dates and arrangements for the colloquium, proving that my EM jogging your elbow this morning was indeed unnecessary, and that everything is in hand.

Al Watkins would be happy to offer the IECDI team some ideas on intermediation arising out of his current work, if that would be helpful.

I will also pass on to Paul (Armington) some material that Francisco Sagasti had commissioned last FY on resource mobilization for development in the 1990s. There may be something of interest here.

DISTRIBUTION:

TO: Dennis de Tray  
CC: Paul Isenman  
CC: Andrew Steer  
CC: D. C. Rao  
CC: Lynette Alemar  
CC: Alfred Watkins

( DENNIS DE TRAY )  
( PAUL ISENMAN )  
( ANDREW STEER )  
( D. C. RAO )  
( LYNETTE ALEMAR )  
( ALFRED WATKINS )



note to: Millard

subject: USSR Development Bank

from: Diana *DM*

date: January 11, 1990

*SM  
GL*

*done 1/28*

- 
1. I made comments on the technical aspects of the draft proposal for David Bock. (attached)
  2. The Bank could support this project by drafting detailed terms of reference for the development of a comprehensive proposal which would include a definition of:
    - \* corporate structure
    - \* legal structure
    - \* financial and capital structure
    - \* institutional role
    - \* activities
    - \* strategy
    - \* detailed business plan supported by pro forma financial statements
    - \* policies and procedures
    - \* staffing requirements
  3. We could recommend investment banks to carry out the development of the detailed proposal and finance the work.
  4. We could review proposed policies and procedures and arrange for training of staff.
  5. Supporting an IFC participation in such an institution would be far more interesting to me than the questionable Africa venture.

DATE: December 14, 1990

TO: David Bock, Director, OPNSV

FROM: Diana McNaughton, Acting Chief, CECFP

EXTENSION: 37480

SUBJECT: USSR Development and Project Finance Bank

### Introduction

Development banks have come under severe criticism both at the World Bank and among lenders in international capital markets. Though launched with laudable objectives and, in many cases, high professional standards, a number of them have deteriorated into insolvent and poorly managed government institutions financing non-viable enterprises, largely in the public sector. We therefore look upon proposals such as the one for a USSR Development and Project Finance Bank with considerable caution. Nonetheless, the concept paper appears to have well defined objectives and to follow sound financial management precepts which, if adhered to, should protect the bank from the pitfalls of traditional development banking.

The concept paper for the USSR Development and Project Finance Bank takes cognizance of many of the critical problems and issues of development banking and places emphasis on commercial viability as an overriding objective which sets the framework for the establishment of a strategy supported by sound and prudent financial policies and control procedures. Some comments on specific aspects of the proposed institution are offered below.

Range of Activities and Conflict of Interest -- The range of anticipated activities is very broad. The contemplated list includes participation in joint stock companies, exploitation of natural resources, and possibly providing legal services. Clearly, there are many areas of opportunity in the emerging financial market of the USSR. However, for a new institution having limited access to skilled human resources, it might be preferable to begin with a narrowly defined strategy and to diversify selectively as skills and experience develop. The definition of a realistic role and strategy contribute significantly to success in banking. A related issue is the potential for conflict of interest and abuse when a financial institution invests in, and lends, to the same company. A similar risk occurs when a financial institution lends to its shareholders. The World Bank is wary on this point. We note however, that it is possible to mitigate this risk through the implementation of prudent policy and sound controls.



Financial Aspects -- The proposed institution would lend primarily to new ventures. New ventures with no proven track record are, by definition, uncertain and of higher than normal commercial credit risk. Such loans and investments are undertaken largely on the basis of projections which ultimately are a best estimate, often an overly hopeful one, of future outcomes. Given the high risk profile of its activities, the proposed bank should have a high level of capital (30%-40%) to serve as a cushion against losses. Appropriate lending policies will also be of considerable importance. The bank should require a substantial equity contribution from project promoters (in the range of 30%). Expertise needed to elaborate such policies based on international experience would be provided by the foreign partners.

Institutional Aspects -- The selection of suitable foreign partners will be extremely important because of the bank's considerable reliance on the expertise they will provide as well as on their market reputation. The EBRD is a new and untested institution. However, this type of activity is one of their priorities and they are likely to have access to high levels of financial expertise.

Skills Development -- The paper refers to a brief training effort lasting about a year. This is an appropriate length of time for formal training but for professional development it is quite short, for it is generally recognized that it takes approximately five years to develop a mid-level professional banker. Skilled human resources have been properly identified as a factor critical to the success of the bank. In that context, we would also emphasize the importance of building credit skills at the earliest possible time, not as the bank gains clients, as stated in the concept paper. New hires should receive credit training immediately, and, those who speak the languages of well developed banking centers, should be sent to those countries for an apprenticeship in credit.

Funding -- The paper correctly states that funding would be difficult without the State guarantee, but envisions its phasing out. Clearly funding issues are critical and require careful consideration. The plan to take deposits, for example, needs to be examined carefully. If the bank is principally providing project financing for new ventures, there is a real question as to whether deposits are an appropriate source of funds, and if so, up to what percentage of total funding sources. The risk profile of assets financed will be high, placing depositors funds at a risk which is perhaps excessive. In addition, the use of short term deposits to fund investment projects would engender term transformation and interest rate risk which would have to be carefully managed.

Capitalization -- The ownership structure described in section three is feasible (and probably desirable) but it is doubtful that it will achieve as much "democratic management and independence" of the Bank as the proposal suggests. In practice ownership soon becomes divorced from management.

The paper appears to confuse the capital and the assets of the Bank. For example in 4.1 stock-holder assets (capital) are to include valuable



services etc. Section 4.2.2 is relevant--it talks about obtaining shares by payment in kind rather than currency but whether these payments can be included as a "capital" or "assets" or both is a moot point.

Capital requirements are here specified as \$US 400m. with an initial 290m subscribed by persons taking up shares. The remainder apparently would be built up rapidly from accumulated profits. High earnings retention might diminish the dividend stream and make the shares relatively less attractive to many investors--in particular the 50% of investors assumed to be Soviet individuals.

This unattractiveness is compounded by the concept of limiting Soviet individuals in the first instance to holding convertible subordinated stock which will be eligible for full participation only after some considerable time. On the other hand, it may be an attractive gamble to put in 60 rubles now in the hope of \$US100 or more sometime in the future.

The limitation on geographic origin of Soviet citizen subscribers and the threatened alteration to voting rights spelt out in 4.2.1 are unwieldy and will lead to immediate circumvention if there is a financial benefit to be gained.

The three paragraphs about full subscription to quotas at the end of 4.2.1 are not clear.

Section 4.2.2 is headed "Transfer of Stocks" but is really about the primary issue and placement. There are brief mentions of secondary markets for the stock in other paragraphs but the topic is nowhere explicitly dealt with. It must be given attention early because transfer of stock through trading will soon arise bringing big problems in relation to the various quotas and restrictions on voting blocks that are envisaged.

The program of implementation is ambitious. Given that the shares in the Bank have to be attractive for investors to wait to put their money in, very substantial institutional development would have to be done.

Financial Projections -- The financial projections could be assessed thoughtfully if they included a full pro forma balance sheet and income statement which would provide a basis on which to ascertain the strength of the proposed financial structure. Attachment 1 is a financial projection format which could be useful. A lotus program for this format is available. It does not appear that the projections have taken into account provisions for possible loan losses.

### Summary

Certainly a number of these issues would be covered in a comprehensive project proposal and financing plan. The general orientation of the project, the specific plans to bring in consultants to develop a comprehensive business plan, the plan to bring in foreign investors under joint stock ownership, the objectives of achieving a targeted return on investment and publishing reliable financial information, are all



fundamentally sound and desirable. The proposal would need to be further elaborated to include a definition of:

- . the institution's role in the financial market
- . a strategy and business plan establishing both qualitative and quantitative objectives
- . a clear statement on autonomy in lending and personnel decisions
- . financial structure and financial performance indicators
- . management and organizational structure
- . staffing levels and skills requirements
- . lending and investment policies, criteria and control procedures
- . a "Negative Pledge" on lending at the behest of government
- . financial management parameters
- . financial products and services to be offered
- . funding sources
- . accounting and operating systems

At the risk of emphasizing the obvious, no matter how well designed the plan for a new financial institution, the key to success is implementation. "The devil is in the details." The following section provides some discussion of what we have learned from observing successful development banks.

### The Lessons of Experience

As noted in the introduction many development banks have failed in their objectives and are now insolvent, representing an implicit financial drain on the economies in which they operate. Nevertheless, some have succeeded in contributing to economic development while maintaining financial viability. The following paragraphs attempt to distill the lessons of their experience.

Development banks have contributed to economic reconstruction and industrial development in a number of developed countries by providing a source of scarce long term financing as well as financial expertise. Most of these development banks are still in existence. Some have diversified the financial services they offer in order to meet the needs of the more sophisticated markets within which they now operate. Some continue to offer a narrow range of banking services concentrating primarily on providing long term project finance.

These institutions have played a developmental role while maintaining a stable earnings stream and financial viability. In contrast, a number of development banks in developing countries established for a similar purpose, to provide long term loans for project finance, have demonstrated an unstable earnings stream and have had their financial viability undermined by weak loan portfolios evidenced by poor loan collection, sometimes running as low as 5%. While recognizing that the economic context in which a banking institution operates has significant bearing on its financial viability and performance, we nevertheless can learn some useful lessons from the policies and banking practices of industrialized country development banks.

A recent study done by the U.S. Comptroller of the Currency entitled; "An Evaluation of the Factors Contributing to the Failure of National Banks (June 1988)", concludes that management is the most important factor in averting insolvency and consequent bank failure, particularly in cases where banks operate in adverse economic conditions. An evaluation of World Bank operations with development banks also singles out management failure as the most prevalent cause of poor development bank performance. With this in mind, we have attempted to describe the management practices of successful development banks. The banks we chose for review are; The Development Bank of Japan, Industrial Bank of Japan, Istituto Mobiliare Italiano, Credit National.

The financial strength of these institutions obviously has a great deal to do with the economic health of the countries within which they operate. However, there are some important similarities among them in terms of management which, I believe, may contribute to their successful financial performance. These practices are only infrequently followed by government owned financial institutions in developing countries. They are;

- . Autonomous Lending Decisions The choice of bank borrowers is determined by the bank itself based on criteria of project viability, credit history and financial strength of the borrower.
- . Competitive Salary Structure These institutions are not governed by the civil service in terms of pay scale or personnel policies and practices. Personnel policies of these institutions are similar to those in the commercial banking system at large of the countries within which they operate. They compete for the highest caliber financial staff and are viewed as desirable places in which to work.
- . Management In most instances, executive management is appointed by government. Executive management may consist of one or more individuals. The degree to which executive management becomes involved in day to day management varies. In all cases there is a strong cadre of professional senior management.
- . Financial Performance Balance sheet soundness and profitability are key objectives for these institutions. Bonuses and other incentive schemes relate to institutional performance. In



addition, since they rely on capital markets for their funding these factors are critical.

- . Directed Lending All of these institutions have, at one time or another, lent to disadvantaged groups or to priority economic sectors at the behest of government. Such lending has almost always been done on a managed funds basis or with government guarantee.

# OFFICE MEMORANDUM

DATE January 11, 1991  
TO Distribution below  
FROM R. Chander, DECV  
EXTENSION 311314  
SUBJECT EUROSTAT -- USSR Agreement

RECEIVED

91 JAN 14 AM 11:06

PRDDR

*SCM*  
*Done 1/15*

Attached please see a copy of an agreement signed between EUROSTAT and the USSR on technical cooperation on statistical issues. This may be relevant to the Bank as it begins to explore technical assistance to the USSR.

Distribution:

Messrs Isenman, Linn, Rao, Gelb, O'Connor, Dhanji, Shakow, Lamb



DG 34/C

2216

23. XI. 1990

C5

SP/gf

THE WORLD BANK  
Mr. R. CHANDER  
Statistical Adviser  
1818 H Street, N.W.  
WASHINGTON D.C. 20433

Subject :      Memorandum signed by Eurostat and Goscomstat

Please find enclosed the translation of the Russian text presented by Goscomstat on 31.8.1990 and signed by Messrs. FRANCHET and KIRICHENKO.

I trust you will find this of interest.

Yours sincerely,



J.A. GIRA  
Director,  
Statistics on International and Intra-Community  
Transactions; Relations with third Countries.

Annex

Translation of the amended Russian text supplied by Goskomstat  
on 31 August 90 and signed by Messrs Franchet and Kirichenko

M E M O R A N D U M

Under the Trade and Economic Cooperation Agreement concluded between the USSR and the European Economic Community, negotiations took place from 28 to 31 August 1990 between the State Statistical Committee of the USSR (Goskomstat) and a delegation from the Statistical Office of the European Communities (Eurostat) comprising the Director General, Yves Franchet, and the official responsible, Richard Kuhner.

Participating in the discussions were the President of Goskomstat, V.N. Kirichenko, his principal deputies, I.A. Pogossoy and N.G. Belov, and other leading members of Goskomstat.

During the discussions, the legal, organizational, technical, methodological and other aspects of the cooperation between Goskomstat and Eurostat were examined. The two parties exchanged information on a large number of questions linked to the transition of the country to a market economy, including questions relating to the statistical study of inflationary processes, and to employment, unemployment, the social protection of the population and other areas.

Goskomstat expressed an interest in learning about the organization of statistics in the EC Member States, the methodology of calculating consumer price indices and the compilation of national accounts, external trade statistics including customs statistics, experience in the organization of international comparisons etc. Particular attention was devoted to the need to compile price statistics in order to trace the impact of price changes on living standards.

During this exchange of views, a high opinion was expressed of Eurostat's experience in drafting and applying international standards for the activity of the statistical bodies of EC Member States; in this context it was mentioned that while based on UN principles the EC statistical system was more far-reaching and detailed due to the similarity between EC countries.

In the course of the negotiations, the practical value was recognized of the bilateral international comparisons of gross national product and of the real parities of the currencies of the USSR and of the Federal Republic of Germany which are being carried out according to UN methodology with the financial assistance of the European Communities.

Agreement was reached on various forms of cooperation between Eurostat and Goskomstat, including the exchange of specialists, the organization of joint seminars, and the exchange of methodological documentation, publications and other material.

Both parties agreed that before the end of 1990, as an initial step in this direction, a delegation of leading members of Goskomstat, comprising 4 or 5 persons, would visit Luxembourg to study Eurostat's work in drafting the legal texts which govern statistical work and in making recommendations in the statistical field. It was stated that during this visit, the Goskomstat delegation would have the possibility of finding out about the organizational activities of Eurostat, the problems it faces, the statistical standards applied in Community countries and other issues. Before the visit began, Goskomstat would forward to Eurostat a list of questions to be studied. The provisional date for this visit was the beginning of December 1990. For its part, the Eurostat delegation informed Goskomstat that it would be sent an official invitation.

It was also agreed that before the end of the year a visit to Paris by four or five Goskomstat specialists would be organized to study problems related to the compiling of price indices, including the price indices of consumer goods. Before this visit began, Goskomstat would also send a list of questions for study. Goskomstat would receive an official invitation setting out the conditions of the visit. It was also stated that Eurostat would bear the costs of the above delegation's stay in Luxembourg and Paris.

Mr Franchet confirmed his intention of examining the possibility of organizing a visit by a Goskomstat delegation to one of the Community countries which have wide experience in compiling and implementing the system of national accounts, in particular in the area of GNP accounts and household accounts.



The Goskomstat delegation took note of the information regarding the organization by Eurostat and other international organizations of seminars on various statistical subjects. For its part, Goskomstat expressed an interest, in principle, in the participation of Soviet statisticians in such seminars.

The two parties recognized the usefulness of the contacts established between their two organizations. In the course of the discussions, guidelines for subsequent cooperation were examined.

Yves Franchet

Director General of the  
Statistical Office of the  
European Communities

Vadim N. Kirichenko

President of the State Committee  
for Statistics of the USSR

Moscow, 30 August 1990

The World Bank/IFC/MIGA  
O F F I C E M E M O R A N D U M

DATE: 09-Jan-1991 12:05pm

TO: See Distribution Below

FROM: Peter Knight, EDIEM

EXT.: 36313

SUBJECT: IIASA Report: The Soviet Economic Crisis

By interoffice mail I am sending you copies of the report prepared by the heads of working groups in IIASA's Economic Reform and Integration Project and a few others (names and positions in footnote one to the report). It is entitled: The Soviet Economic Crisis: Steps to Avert Collapse, and has figured in several recent articles in the press.

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( AMNON GOLAN )

*Talked to Dulce  
& reg. direct mail*

*Pls send him  
Contact*

Sov. TA 1/14/91

Fancy

→ Abalkin Letter When  
→ Org. | Decided?  
→ Ops | Conditional

---

→ Pressure -- even with more \$,  
More stress.

OPS - new managers  
PRE - no " " "

EEU -- big shift  
Segregation of resources

→ Research distortion

→ Needs long-term commitment

→ Cream off best people

→ Units -- mgt.

Ca 25 \$/yr. for PRE to  
manage.

IE -- Data

CE -- Alan Millard Mary

Support:  
Res +  
TA

WT to see  
VPs



The World Bank/IFC/MIGA  
O F F I C E M E M O R A N D U M

DATE: 14-Jan-1991 03:10pm

TO: See Distribution Below

FROM: Costas Michalopoulos, PRDDR ( COSTAS MICHALOPOULOS )

EXT.: 32738

SUBJECT: DRAFT BOARD PAPER ON SOVIET T.A.

In response to your request, here are some comments reflecting PRE views on your Draft Board Paper.

1. As I indicated to you on Friday, we would want to review the "Annex" that describes the TA program before the whole paper goes to PC.
2. We believe that irrespective of what the Annex says in this regard, the cover paper must indicate explicitly the need for institutional and policy readiness on the part of the USSR before we go ahead with the program. These factors will also affect the phasing and speed of implementation.
3. If the program is to be truly supplemental, it would be desirable to have three year funding for it. Otherwise, the second and third years of the program may not be incremental.

In addition to these general points, we have a number of specific drafting suggestions as follows:

- Para 4. We would redraft more positively as follows:  
"This means that any use must be justified exclusively on the grounds of the benefits it conveys to members; it does not mean etc..."
- The link to the Joint Study might be strengthened by making the TA the next stage of the collaboration.
- An additional argument for the TA is that analytical work on the USSR might indirectly throw insights on issues of importance in other centrally planned economies in transition.
- In Para 7, we would explicitly mention India in the third sentence as a country with close trade ties to the USSR.
- In Para 12, we would add at the end the phrase "and the cost to other programs would be more direct."

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The World Bank/IFC/MIGA  
O F F I C E M E M O R A N D U M

DATE: 14-Jan-1991 04:33pm

TO: See Distribution Below

FROM: David R. Bock, OPNSV ( DAVID BOCK )

EXT.: 82856

SUBJECT: RE: World Bank Group Technical Assistance in the Soviet Union

Basil,

Here are some comments on your Friday afternoon draft.

In para. 2, I would delete the last sentence. The better place for reference to the Abalkin letter is at the start of para. 12 (although we should think about whether it is appropriate to attach the rather scruffy piece of paper that we received).

On para. 3, see the wholesome comments with which I agree. On para. 12, the notion here should be a basis for planning rather than an estimated cost of a program which at this stage would appear excessive to most observers, given the developments over the last week in the Soviet Union. Instead, I would phrase this in the following general terms:

"As described in the annex to the paper, the scope of Bank technical assistance to the Soviet Union could eventually be very broad. It is clear from the joint study that the depth and complexity of the reforms in the Soviet Union will exceed those in any similarly placed countries. If the Bank is to have an influence on the reform process, it will need to make major investments in economic and sector work, as well as in direct technical assistance to the Soviet authorities at both the union and republic levels. Such a program of technical assistance could therefore be expected to build up to a level of activity similar to that provided by the Bank to its major borrowing members. At the present time, work programs for the major countries range between 80-115 staffyears on an annual basis. As the Soviet Union would not be a borrower during the initial phase of technical assistance, the level of resource input might be expected to be about 75 staffyears in the first full year of the program. The pace with which the program is built up will, of course, depend upon the interest of the Soviet authorities, and the pace of implementation of economic reform.

For purposes of a decision on financing modalities, management believes that the program should be planned on the order of up to \$40-50 million over a three-year period. Not all of these costs should be borne by the Bank by any means and it is



thus proposed to set up a trust fund to handle the funding for this purpose....."

Sorry to be relatively brief in these comments. I have seen Bob Picciotto's memo to you as well. I am not certain that the idea of an advance against the future technical assistance loan works particularly well and it is not clear to me why the net income approach won't work.

Finally, as I said before, the PC doesn't need the annex today since the key issue is whether we have sufficient justification for the use of Bank resources. I think the PC members have a fairly good idea what the program would entail. Also, everyone recognizes that it will need to be built up in accordance with the Soviet's absorptive capacity and the willingness of ourselves and our stockholders to get involved in this country while the reform process seems to be under considerable attack, if not backsliding.

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( DAVID M. GOLDBERG )  
( FRED LEVY )  
( PAUL ISENMAN )

The World Bank/IFC/MIGA  
O F F I C E M E M O R A N D U M

DATE: 10-Jan-1991 04:28pm

TO: See Distribution Below

FROM: PAUL ISENMAN, PRDDR

( PAUL ISENMAN )

EXT.: 33957

SUBJECT: PRE STEERING COMMITTEE ON SOVIET T.A.

Wilfried Thalwitz has asked me to coordinate PRE work on Soviet TA, since it will cut across PRE. In that connection, I would like to ask you to be a member of PRE's Steering Committee on Soviet TA to provide overall directives to the PRE effort in this area. There would also be a PRE working group which would be chaired on my behalf by Costas Michalopoulos, which would help coordinate PRE efforts on an ongoing basis. Alan Gelb would be the secretary of these groups. Costas and Alan would also serve as members of the Steering Committee.

The Bank received a formal request from the Soviet Union to provide TA and is sending a generally positive response. While, at this point, there are many unanswered questions about various aspects of Bank TA, now is the time to begin planning our response. Management of the Bank-wide program will be with Operations. We expect PRE to play an important role. Among the issues for the Steering Committee to consider is how this can be done while minimizing the diversion to this "sexy" and important new program from other PRE work. We expect the program will be financed partly through the Bank's net income and partly through external sources, but this does not eliminate the issue of opportunity cost, either at the staff or managerial level. I am sending you separately copies of the official Soviet request and several memos on where things currently stand.

The first meeting of the Steering Group will be held on Monday, January 14 at 10:30 a.m. in Conference Room S-13-005. A draft agenda is attached.

*Hear your views concerns*

PRE STEERING COMMITTEE ON T.A. TO THE SOVIET UNION  
DRAFT AGENDA FOR MEETING ON MONDAY, JANUARY 14,  
10:30 - 11:30 a.m., CONFERENCE ROOM S-13-005

1. The current situation regarding the TA Project.

- Use Costas memo*
- . Scale of program and its funding;
  - . Mode of implementation, use of staff and consultant resources;
  - . Probable areas of emphasis;
  - . Management of the overall program.

2. Possible Modalities of PRE Involvement.

- Clearance*
- (i) Support to the program (to be handled like Operational support?);
  - (ii) Task management of components of the program. This could involve, for example, studies or seminars organized by EDI.
  - (iii) Are other modes of involvement possible/desirable?

3. Substance of PRE Involvement.

Considering the probable areas of emphasis of the program, where should PRE be involved, in (i) offering support, and (ii) managing tasks?

The need for selectivity.  
Areas of comparative advantage.  
Maximising externalities with ongoing work.  
Staff versus consultant resources.

4. Managing and Monitoring PRE Involvement.

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TO: John A. Holsen  
TO: Francis X. Colaco  
TO: Alan Gelb  
TO: Amnon Golan  
TO: Costas Michalopoulos  
CC: Wilfried Thalwitz

( JOHANNES LINN )  
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( WILFRIED P. THALWITZ )



CC: Visvanathan Rajagopalan  
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( VISVANATHAN RAJAGOPALAN )

# OFFICE MEMORANDUM

- PI - chen  
- file ✓

DATE: January 10, 1991

TO: Distribution

FROM: Paul Iserman, PRDDR

EXTENSION: 33957

SUBJECT: SOVIET T.A. - PRE STEERING COMMITTEE

In preparation for our first Steering Committee meeting on Monday, January 14, 10:30 - 11:30 a.m. in Conference Room S-13-005, attached are the following background documents.

- Official letter of request from Mr. Abalkin;
- David Bock's draft (EM dated 1/08) of Mr. Conable's reply to Mr. Abalkin's letter.
- Moeen Qureshi's note to Mr. Conable dated 12/21 on Next Steps on Soviet TA;
- David Bock's EM on Next Steps on Financing dated 1/09;
- List of PRE's activities which involve, in part, the USSR.

Attachments

Distribution:

Messrs. J. Linn, J. Holsen, F. Colaco, A. Gelb, A. Golan, C. Michalopoulos.

Office of the President

December 21, 1990

Members of the President's Council:

Technical Cooperation with USSR

This afternoon, Mr. Yuriy P. Khomenko (Minister-Counselor) and Mr. Vitaliy Y. Verzhbitskiy (Third Secretary, Economic Affairs) from the USSR Embassy delivered the attached letter to Mr. Conable.

I also attach a copy of a note from Mr. Qureshi on the same subject.

Happy Holidays!



Attachments



Dear Mr. President:

Your recent visit to the Soviet Union and the talks during this visit opened up real prospects for proceeding in the relations between the USSR and the World Bank toward specific mutually beneficial cooperation.

Now that the research by the World Bank, International Monetary Fund, Organization for Economic Cooperation and Development and European Bank for Reconstruction and Development into the state of the USSR economy is coming to an end we have noted with special satisfaction the readiness of the Bank to render consultative and technical assistance to the Soviet Union in coping with the problems concerning its transition to the market economy.

Bearing in mind that the World Bank has accumulated rich international experience in developing and regulating multifaceted processes taking place in the market economy, we would like to use this experience as well as the services of highly skilled experts of the Bank for consultative and technical assistance to facilitate the economic transformations in the Soviet Union.

In our view, the high priority areas of consultative and technical cooperation with the World Bank could be such as a reform of the banking system and improved finances, establishment of a market infrastructure and personnel training, implementation of destatization and privatization programs, a range of problems relating to the consumer market and social protection of the population. As to the specific sectors of the economy, it would be appropriate, I think, to focus on the issues of energy development, resource-saving technologies, agroindustrial complex, including transportation, storage of finished products, information technologies and telecommunications.

By regarding these sectors and areas of cooperation as reference points, the experts of both sides could formulate a long-

term program of consultative and technical cooperation between the USSR and the World Bank.

If the reaction of the Bank's leadership to the above ideas is positive, the Soviet side would be ready to discuss in the very near future the organizational and legal as well as financial and other issues of preparation and implementation of this program.

Sincerely,

I. ABALKIN

Deputy Chairman of the USSR  
Council of Ministers

World Bank/IFC/MIGA  
O F F I C E   M E M O R A N D U M

DATE: 08-Jan-1991 11:11am EST

TO: See Distribution Below

FROM: David R. Bock, OPNSV ( DAVID BOCK )

EXT.: 82856

SUBJECT: USSR: Mr. Conable's draft reply to Mr. Abalkin

May I have your comments by the end of the day.

---

Dear Mr. Deputy Chairman,

Thank you for your letter indicating your interest in pursuing discussions on a program of technical cooperation between the USSR and the World Bank. I would like to confirm that we are indeed interested in extending these discussions. I will be raising this issue with the Bank's executive directors shortly and we expect to be sending a technical mission to Moscow in the near future to define the scope of such a technical cooperation program.

I have taken note of the priorities for such a technical cooperation that you yourself have defined. This agrees very closely with our own assessment of where we might be of most assistance to the USSR in the near term.

Please accept my personal best wishes for the New Year.

Barber B24HK24H;1mKNew ALL-IN-1



MOEEN A. QURESHI  
Senior Vice President, Operations

December 21, 1990

Mr. Conable

*Barber*

Next Steps on Soviet Technical Assistance

I promised to let you know what I think we should do next regarding the development of a technical assistance program for the USSR. I think we all recognize the need to move carefully with this program, given the political uncertainties in the Soviet Union coupled with the impetus now provided by the U.S. "associate status" initiative. My own view is that this political uncertainty is likely to continue for some time. We thus need to think in terms of an approach that allows us to start up the program in the near future while retaining flexibility in how we build it up thereafter.

There are two immediate steps that we need to take: asking the Board for authority to undertake the TA program and approaching donor governments for funding. As you know, we have been waiting for a formal request from the Soviet authorities before taking this issue up with the Board. I do not expect to receive such a request until the new administration at the Union level is appointed. Even then, we may need to send a technical mission to Moscow to discuss the program again before going to the Board and also to assure ourselves that the Soviets' proposed administrative structure for the program is generally satisfactory.

We should wait a few weeks before deciding whether to send such a mission, at least until a new administration is in place. In the meantime, we are drafting a Board paper setting out the likely content and cost of the program. This will be ready for your review in the first week of January.

On the fundraising effort, I believe that we need to start some informal consultations with key donors. We should keep this exercise simple, focussed on the G-7, and structured similarly to other special purpose trust funds. It will greatly simplify this process if we can get the U.S. to take the lead, and I would suggest that you talk to the U.S. as soon as convenient. If the U.S. will commit to (say) one-third of the cost -- about \$15 million over three years -- it should be easy to raise the rest from the other donors quickly and without a lot of discussion about burden-sharing, etc.

I would like to have completed the initial soundings of donors by the time this subject is taken up in the Board -- perhaps in the latter part of January.

In terms of organization, I propose to link the Soviet program with a restructuring of the existing EMENA Department that deals with Eastern Europe. This department is clearly overloaded with the addition of new members and a renewed relationship with Romania. PBD is in the process of completing a study of organizational options. At this stage, my inclination is to set up a new department to deal with "new programs", i.e. the Soviet Union, Bulgaria, Romania, and eventually Albania. I might choose to put Czechoslovakia in the new department also, depending on a closer look at likely workload with the Soviet program over the near term. Willi and I will prepare soon a proposal for your consideration.

Linking the Soviet program to these other countries will enable us to gradually build up the program based on Soviet receptiveness and our own resource availabilities without having to create an entirely separate management structure. Also, with two departments covering Eastern Europe and the Soviet Union, we can adjust the workload on each management group according to how rapidly various country programs take off.

While it is uncertain at this time how fast we should move with the Soviet program, I believe that we should position ourselves to start staffing up the program in February-March. I thus want to take a decision on restructuring EMENA CD4 in January, and to make it effective as soon as possible.

*Green*



World Bank/IFC/MIGA  
F I C E M E M O R A N D U M

DATE: 09-Jan-1991 01:57pm EST

TO: See Distribution Below

FROM: David R. Bock, OPNSV ( DAVID BOCK )

EXT.: 82856

SUBJECT: Next Steps on Financing

Last night, the President met with Messrs. Qureshi, Stern, Shihata, Wood and Linn to discuss how to proceed with the fundraising for the Soviet technical assistance program. It was decided that Finance (Mr. Wood) would prepare a draft memorandum to the Board proposing an allocation of IBRD net income to a trust fund for this purpose. The justification for such is to be anchored in Mr. Shihata's opinion on the use of Bank resources and facilities for this purpose.

This thus resolves one of the major issues we discussed on Monday. The draft memorandum to the Board which I circulated last week will be incorporated in some fashion into this proposed use of net income.

Before anything is sent to the Board, the President plans to consult with the Executive Directors. The present timetable envisaged is that nothing will be distributed prior to the seminar on JSSE next Friday. It is also possible that we will delay a discussion until after the visit of Mr. Pavlov, which might not now take place until the first week of February. Also, the sense of last night's meeting is that it may be some time before the political situation clarifies sufficiently in the Soviet Union to permit a launch of the technical assistance program. The objective should be to be prepared to get underway in three-four months time, perhaps earlier if the situation becomes clearer sooner. Work on the definition of a technical assistance program should continue apace in order to be in a position to send a technical mission to Moscow sometime after the first week of February at the earliest.

I have made contact with the Fund; a meeting was being held yesterday to discuss next steps and I will report separately as soon as I find something out.

DISTRIBUTION:

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TO: John A. Holsen	( JOHN A. HOLSEN )
TO: Parvez Hasan	( PARVEZ HASAN )



### PREs Current Work on the USSR

PRE has been involved in several aspects of the Joint Study of the USSR, including the areas of agriculture, housing, trade, macro, labor and training. Apart from this work, there appears to be very few activities specifically focussed on the USSR. One is a small study of Privatization Processes in the USSR (CECSE), another is a small study of Regional Issues in the USSR (PRDPD). A number of ongoing and planned activities do include the USSR as one of a set of countries. These include:

Agricultural Reform in Eastern Europe	AGRAP
Urban Industrial Pollution Management	ENVPR
Accounting for CPEs	IECSD
Factbook on Socialist Countries	IECSD and CECSE
Land Regulation and Supply	INURD
Conference on Natural Gas	IENGU
Costs and Benefits in Transforming CMEA	CECTP
Trade Patterns in Eastern Europe	CECTP
Predicting East European Trade Flows	CECTP.
Senior Policy Seminar on Fiscal Federalism	EDI

The World Bank/IFC/MIGA  
O F F I C E   M E M O R A N D U M

DATE: 10-Jan-1991 05:20pm EST

TO: Basil Kavalsky ( BASIL KAVALSKY )

FROM: David R. Bock, OPNSV ( DAVID BOCK )

EXT.: 82856

SUBJECT: USSR Board Memorandum

Basil,

Your "flash draft" has all the right points in it. However, I think it needs a different introduction and should be organized into three sections (apart from the introduction): justification for the program, financing options, and management recommendations.

I think you need to be very careful in how you set out the issue for Board consideration. The title of the memorandum should be "Financing for a Technical Assistance Program in the Soviet Union." The lead-in should be a summary of the expansion of contacts with the Soviet Union over the last several months mentioning the G7 study, the invitation to the Soviets to attend the Annual Meetings and culminating in the visit of the President to Moscow.

The justification would then run something like this. "During that visit the Soviet authorities indicated that (a) they had made a decision in principle to apply for membership in the Bank and (b) they were interested in a technical assistance cooperation program as a way of taking advantage of the Bank's expertise in effecting the transition to a market economy and more fully integrating the Soviet Union into the global trading and finance system. Subsequent to that visit, Soviet authorities have made a formal request to the Bank for a technical assistance cooperation program."

"As a technical matter, the Bank clearly has the capacity to provide assistance to the Soviet authorities in the areas that are of primary interest to them. Moreover, provided that additional budgetary resources are made available and that the build up of the program is phased in an appropriate fashion, management is convinced that such a program can be mounted without adverse effects on the Bank's ability to provide support to its borrowing member countries. The critical questions, however, are whether such a program of assistance to the Soviet Union can be justified in terms of the Articles of Agreement and how it would be financed."

The memorandum should then proceed to lay out the



justification for the program starting with a statement of what the Articles require (based on Ibrahim's opinion which could be attached as an annex). The test should be framed as narrowly as possible, e.g. is it worth \$15 million of the Bank's money to influence the transition in the Soviet Union?

I would continue to avoid, as you have, arguing about primary and secondary benefits to the technical assistance. This section should also stress that the Bank would not undertake such a program unless the Soviet Union agreed to certain conditions, in particular, the disclosure of information -- since most of the ESW will be released to the Board of Directors and be treated as the property of the Bank membership generally rather than just for the Soviets. Also, the Soviets would need to agree on the privileges and immunities point.

The next section should lay out the financing question in whatever form you think is best. I query whether the auditors would accept a trust fund controlled by the Bank, but there are lots of people to advise you on this issue.

In the recommendation section, I would simply state that management believes that it is in the interest of the Bank to undertake this program and that the benefits exclusively accruing to the member countries offer sufficient justification to allocate \$15 million to the program.

As you will see from the above, I do not think it is necessary to describe the technical assistance program in the text of this memorandum. We will provide you an annex which gives a broad overview of the program but we do not want the Board involved at this stage in reviewing the content of the program. This annex could also provide justification on the overall budget figures. The best place to insert a reference to the annex would be at the start of the section on financing. I suggest that you circulate the memorandum as soon as ready and not wait for the annex which will take us a little time to prepare.

David

CC: D. Joseph Wood  
CC: Johannes Linn  
CC: Sven Sandstrom

( JOE WOOD )  
( JOHANNES LINN )  
( SVEN SANDSTROM )



The World Bank/IFC/MIGA  
O F F I C E M E M O R A N D U M

DATE: 10-Jan-1991 08:38am

TO: See Distribution Below

FROM: David R. Bock, OPNSV

( DAVID BOCK )

EXT.: 82856

SUBJECT: IMF Plans re Soviet TA

1. I spoke to Jack Boorman last night re the Fund's plans vis a vis Soviet TA. As of now, they are not planning to send anything to their Board on TA and the Associate Status issue until after Pavlov's visit (being planned for 1/23-24) at which time he is expected to see the MD. The seminar next Friday will be exclusively on the JSSE. In the meantime, the European Department, which will be in charge of TA to the USSR, is drafting a Board paper.

2. Despite the fact that there are fewer legal problems with Fund TA to nonmembers and ample precedents for TA to prospective members once they have applied, Fund management are anticipating some of the same problems over resources that we are. The Fund's administrative budget is perhaps more clearly linked to charges on resource-using members than is the Bank's. Also, the Fund is already unable to meet all of the requests for TA from present members. A program of TA to the USSR will increase the "number of negatives" for others. No decisions have been made about how to fund a TA program. An approach to donors is quite possible.

3. I told Jack that this timetable for approaching the Board with a formal proposal fit well with our own plans, and I gave him an overview of the next steps on the side of the Bank. I also filled him in on the resistance of the US to making contributions to our respective financing requirements.

DISTRIBUTION:

TO: Paul Isenman  
TO: Basil Kavalsky  
TO: Andrew N. Vorkink  
TO: Peter Knight  
TO: Parvez Hasan  
TO: Dale R. Weigel  
TO: Fred Levy  
CC: Moeen A. Qureshi  
CC: Rest of Distribution Suppressed

( PAUL ISENMAN )  
( BASIL KAVALSKY )  
( ANDREW VORKINK )  
( PETER KNIGHT )  
( PARVEZ HASAN )  
( DALE R. WEIGEL )  
( FRED LEVY )  
( MOEEN QURESHI )

The World Bank/IFC/MIGA  
O F F I C E M E M O R A N D U M

DATE: 09-Jan-1991 01:57pm

TO: See Distribution Below

FROM: David R. Bock, OPNSV

( DAVID BOCK )

EXT.: 82856

SUBJECT: Next Steps on Financing

Last night, the President met with Messrs. Qureshi, Stern, Shihata, Wood and Linn to discuss how to proceed with the fundraising for the Soviet technical assistance program. It was decided that Finance (Mr. Wood) would prepare a draft memorandum to the Board proposing an allocation of IBRD net income to a trust fund for this purpose. The justification for such is to be anchored in Mr. Shihata's opinion on the use of Bank resources and facilities for this purpose.

This thus resolves one of the major issues we discussed on Monday. The draft memorandum to the Board which I circulated last week will be incorporated in some fashion into this proposed use of net income.

Before anything is sent to the Board, the President plans to consult with the Executive Directors. The present timetable envisaged is that nothing will be distributed prior to the seminar on JSSE next Friday. It is also possible that we will delay a discussion until after the visit of Mr. Pavlov, which might not now take place until the first week of February. Also, the sense of last night's meeting is that it may be some time before the political situation clarifies sufficiently in the Soviet Union to permit a launch of the technical assistance program. The objective should be to be prepared to get underway in three-four months time, perhaps earlier if the situation becomes clearer sooner. Work on the definition of a technical assistance program should continue apace in order to be in a position to send a technical mission to Moscow sometime after the first week of February at the earliest.

I have made contact with the Fund; a meeting was being held yesterday to discuss next steps and I will report separately as soon as I find something out.

DISTRIBUTION:

TO: Paul Isenman  
TO: Basil Kavalsky  
TO: Fred Levy  
TO: David M. Goldberg  
TO: John A. Holsen  
TO: Parvez Hasan

( PAUL ISENMAN )  
( BASIL KAVALSKY )  
( FRED LEVY )  
( DAVID M. GOLDBERG )  
( JOHN A. HOLSEN )  
( PARVEZ HASAN )



The World Bank/IFC/MIGA  
O F F I C E M E M O R A N D U M

DATE: 09-Jan-1991 01:57pm

TO: See Distribution Below

FROM: David R. Bock, OPNSV

( DAVID BOCK )

EXT.: 82856

SUBJECT: Next Steps on Financing

Last night, the President met with Messrs. Qureshi, Stern, Shihata, Wood and Li24HK24H;1mKNew ALL-IN-1 mail for PAUL ISENMAN from fundraising for the Soviet technical assistance program. It was decided that Finance (Mr. Wood) would prepare a draft memorandum to the Board proposing an allocation of IBRD net income to a trust fund for this purpose. The justification for such is to be anchored in Mr. Shihata's opinion on the use of Bank resources and facilities for this purpose.

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I have made contact with the Fund; a meeting was being held yesterday to discuss next steps and I will report separately as soon as I find something out.

DISTRIBUTION:

TO: Paul Isenman

( PAUL ISENMAN )

TO: Basil Kavalsky

( BASIL KAVALSKY )

TO: Fred Levy

( FRED LEVY )

TO: David M. Goldberg

( DAVID M. GOLDBERG )

TO: John A. Holsen

( JOHN A. HOLSEN )

TO: Parvez Hasan

( PARVEZ HASAN )



TO: Peter Knight  
TO: Dale R. Weigel  
TO: Rest of Distribution Suppressed

( PETER KNIGHT )  
( DALE R. WEIGEL )

Reduced PC --- USSR TA 1/4/2 Rules

→ Fund.

→ Assoc. Membership

Next Income

UNDP

Bilat. donors - US?

→ Stewardship

More - need big down-payment  
on financing.

(Brasim - going out of its  
way for a non-member  
& not a low-income  
country.

Ernie - Timing - don't rush.

Raise trust fund - use them.

→ Timing: when send ~~mission~~ prep.  
mission. Re  
Board.

JL - Don't go overboard. Don't  
overpromise

Will discuss on effectiveness  
~~Don't know off after~~  
beyond min. criterion.

→ Amit. & Max right - Min. stds  
→ Coord w/ Fund

Ibrahim

→ Do paper

Not

→ Consultations over next 2 weeks

→ No separate agreement

→ TA agreement <sup>needs to be approved by</sup> ~~for~~ board, but won't get back for specific perm,

Consult after next Fin.  
Joe (PRE) (David) --

← after have paper.  
Meet w/ Fund.



273

# OFFICE MEMORANDUM

DATE: January 8, 1991

TO: Mr. Paul Isenman, PRDDR

FROM: Costas Michalopoulos *dm*

EXTENSION: 32738

SUBJECT: DRAFT BOARD PAPER ON SOVIET T.A.

RECEIVED

91 JAN -8 PM 4:23

PRDDR

The paper contains the main elements of an approach to TA to the Soviet Union that we need to discuss with the Board. However, there are a number of points of emphasis on which we would like to see the paper modified. The main substantive points are as follows.

1. The paper needs to state explicitly that we favor a phased approach which starts slowly and permits us the flexibility to increase our involvement over time. This idea should be spelled out in a recast paragraph 5, which should focus on modalities and phasing.

2. Para 5 needs to be recast on a number of other points as well. The first sentence is an overstatement. Moreover, we should not be talking about "picking" the right level of government. This gives the wrong tone to the relationship. The key issue is how to develop a set of priorities for which to provide TA among the vast Soviet needs for TA. We believe that a key criterion should be the extent to which the TA supports systemic reform.

3. The \$40-50 million three year total is an appropriate upper limit for which to seek approval from the Board in principle; but we should indicate that we will be flexible in how much we do depending on the evolving circumstances and policies of the Soviet Union about which there is at present considerable uncertainty.

4. Regarding financing, we believe that the preferred option should be a trust fund with an up-front contribution by the Bank from net income. The TA program should be started when the Bank contribution is matched by at least some outside funding. In the meantime, the Bank could use some net income for preparing the TA program.

5. We should seek approval in principle for a resident team in Moscow, but not commit or expect any immediate start-up on the scale envisaged in para 5, which we consider over ambitious and premature. We should start modestly, perhaps with one resident coordinator.

6. The introduction to the Board paper (Para 1) needs to be recast in order to place TA in the context of the evolving links of the Soviet Union with the World Bank, starting with the participation of USSR observers at the meetings and the undertaking of the JSSE Study, the visit of Mr. Conable and finally the request for TA, which we must indicate was the Soviet's idea.

7. In keeping with this view of TA as part of the evolving links with the Bank, we continue to feel that, if at all possible, it will be useful to have the Board discuss JSSE and TA together.

*Am't depends*

*Get money saved on Net Inc.*

*Tim - overall relationship*

393

In addition to these comments, we have a number of specific drafting suggestions, as follows.

- In para 2, consideration #3, it would be better to say "the Bank has, in certain areas, comparative advantages in the ...". And in consideration #5, it might be better to say "the entry of the Soviet Union into the world economy, which would be supported by the proposed TA, should lead to ...".
- In para 3, the paper should say, "Summary and Recommendations", not "Executive Summary". And the Board got it on December 21, not December 20.
- In para 4, point 3, "de-statization" will not be clear to many. It would be better to say "commercialization of state enterprises." The phrase "de-statization" refers to financial and managerial autonomy from central government ministries; it does not necessarily mean full private ownership and management.
- On para 6, yes, the reform program should be comprehensive. But this does not mean that the Bank's TA needs to be comprehensive. There will be lots of other actors. This is said in para 2, consideration #2, but should be repeated here so the need for comprehensive reform is not misunderstood. Also, it is unclear whether the TA hinges on the adoption of a comprehensive reform. We believe that both the scale and nature of TA should be conditioned on progress in Soviet reforms.
- In the "Next Steps" we may wish to avoid any promises of "specifying a detailed three year program of technical assistance." The magnitude should be no more than "indicative" and content should be kept flexible given the unclear and changing circumstances.

Finally, an issue not considered and which we should not raise in the Board paper now, but which we must address later, is the extent to which a Bank-managed Trust Fund for USSR TA would finance activities done by others. I refer not to our hiring consultants for things we plan and manage, but to activities which, while requested by the USSR, are basically planned and managed by others. This affects both the needed size and management of the Trust Fund.

## MESSAGE CONFIRMATION REPORT

SESS.	MODE	DATE/TIME	TIME	DISTANT STATION ID	PAGES	DIAL	RESULT
879	G3S	01/08 16:54	01'40"	202 477 1245	003/003	01	O K 6000

*Sent to D B  
I received by him*



THE WORLD BANK  
INTERNATIONAL FINANCE CORPORATION  
MULTILATERAL INVESTMENT GUARANTEE AGENCY

FAX 71245

FAX to Mr. David Bock  
# 71245

1/8<sup>3</sup>

David, 1/8

Here are the  
PRE VIEWS on  
your draft,  
taking account  
of contributions  
from Johannes,  
John, Graft,  
Costas & me.

Paul

The World Bank/IFC/MIGA  
O F F I C E M E M O R A N D U M

DATE: 08-Jan-1991 11:26am

TO: See Distribution Below

FROM: Peter Knight, EDIEM ( PETER KNIGHT )

EXT.: 36313

SUBJECT: RE: USSR: Mr. Conable's draft reply to Mr. Abalkin

Looks OK to me. Some news: The US is not likely to receive Pavlov next week. Most likely date -- first week in February. This suggests that we may wish to proceed with a memo to the Board this week. It is my understanding that the US is still opposed to proceeding toward full membership at this time. But they would like the Bank to proceed with fairly large-scale TA ASAP. I would not anticipate any change in this in the near future, but if developments merit at a later state the opposition would be dropped, and the membership processed normally (nevertheless it could take some time -- remember Japan!). I believe this position will be pushed with the G7.

Regarding the IMF. My understanding is that the European Department is preparing a paper on the Associate Status question. Some TA has already taken place. Areas of expected TA (to be discussed with the Pavlov mission): central banking, statistics (BOP and financial), fiscal measures (expenditure, taxation, tax administration), participation in IMF institute courses (some already taken place), possible seminars in Moscow on financial programming later this year.

DISTRIBUTION:

TO: David R. Bock	( DAVID BOCK )
CC: Dale R. Weigel	( DALE R. WEIGEL )
CC: Parvez Hasan	( PARVEZ HASAN )
CC: John A. Holsen	( JOHN A. HOLSEN )
CC: David M. Goldberg	( DAVID M. GOLDBERG )
CC: Fred Levy	( FRED LEVY )
CC: Basil Kavalsky	( BASIL KAVALSKY )
CC: Paul Isenman	( PAUL ISENMAN )



ROUTING SLIP		Date Jan. 8, 1990	
NAME		ROOM NO.	
Messrs. Qureshi, Stern,			
Thalwitz, Shihata, Bock,			
Sandstrom			
<input type="checkbox"/> URGENT	<input type="checkbox"/> For Action/Comment	<input type="checkbox"/> Per Your Request	
<input type="checkbox"/> Appropriate Disposition	<input type="checkbox"/> Information/Discard	<input type="checkbox"/> Returned	
<input type="checkbox"/> Approval/Clearance	<input type="checkbox"/> Note And Return	<input type="checkbox"/> See My E-Mail	
<input type="checkbox"/> File	<input type="checkbox"/> Per Our Conversation	<input type="checkbox"/> Signature/Initial	
<b>RE:</b> Financing Technical Assistance to the USSR			
<b>REMARKS</b>  <p>The attached is for today's meeting with Mr. Conable at 5.30.</p> <p>cc: Messrs Linn            Isenman            Holser            Michalopoulos</p>			
<b>From</b> R. Picciotto		<b>Room No.</b> N7055	<b>Ext.</b> 30202

P-1862

RECEIVED  
 91 JAN -8 PM 3:04  
 PRDDR

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION  
**OFFICE MEMORANDUM**

DATE: January 8, 1991  
TO: Mr. Barber B. Conable  
FROM: R. Picciotto, CPBVP  
EXT: 30202  
SUBJECT: **Financing Technical Assistance to the USSR**

**A. Background**

1. The provision of technical assistance to the USSR is undoubtedly in the institutional interest. It will bring the Bank close to being the universal body the founders intended. The USSR was represented at Bretton Woods. It did not become a member at the time because it did not wish to comply with the requirements of membership. Now that it wishes to become a member in good standing, it makes good sense to facilitate this historic transition through policy advice and technical cooperation activities.

2. Quite apart from eventual membership, an economically productive, stable USSR (the ultimate objective of the technical assistance the Bank would provide) would be in the interest of all Bank member countries. More effective integration of the USSR in the global economy would help the international economy in general—and Eastern Europe in particular. A new international order which would include the USSR as an economic partner of the industrial democracies would greatly facilitate the handling of global environment, trade and development problems and create conditions more suitable to peaceful development worldwide.

**B. Possible Approach**

3. This being said, we should find a financing formula to provide technical assistance to the USSR which is in line with Bank policies and which meets legal requirements.

4. First, we should abstain from considering the regular budget as a potential source of funding. We have recently determined that we should not use the regular administrative budget for providing grants. The provision of technical assistance to the USSR out of the regular budget would open up a Pandora's box as members and non-members alike will scramble to the trough for their fair share of "free" technical assistance. Neither should we consider a Special Grant approach since, among other things, the "arm's length" criterion would not hold.

5. Second, we should stick to our policies for the provision of services to non-members. This means that we should segregate all our costs related to technical assistance activities in the USSR and recover them fully with outside funds—according to our normal reimbursable program policies and procedures.

6. Third, we should do what we normally do when faced with the need to deliver technical services which are consistent with our development mandate but are not part of our regular operations and require grant funding: we should consider



approaching the United Nations Development Program and find out whether they have the resources to put at our disposal as Executive Agency of a UNDP scheme or, if they cannot meet the whole bill (the likely scenario here) whether they can contribute to a cost sharing arrangement together with the Bank and other donors.

7. It is likely that the UNDP will not be able to put up more than a fraction of the resources needed. But they must have lots of rubles to spare and perhaps a few million dollars of seed money to help us get going until we can get funding from other sources. Even if UNDP has only a small amount to contribute we could make a grant out of net income to the UNDP and set up a joint trust fund into which other donors would be asked to contribute. A joint trust fund would provide us with a ready made administrative model and a UN umbrella may come in handy if the political winds change. (It may even be argued that not to approach the UNDP for a technical assistance program would conflict with the normal division of labor in the international system) If, however, the UNDP route is ruled out on policy grounds (or if UNDP has no money at all to contribute) can we set up a Bank trust fund with net income funding?

### C. Compliance with Bank Policies

8. We have checked a trust fund approach against the net income allocation criteria (adopted in 1983 by the Board), the opinions of the General Counsel on the scope of the Bank's power to make grants, and the Price Waterhouse views on the accounting treatment of grants. Our tentative conclusions follow.

#### Net Income Allocation Criteria

9. The four relevant criteria are: (i) broad and significant development impact; (ii) catalytic impact in terms of additional capital flows; (iii) building upon the Bank's experience and comparative strengths; (iv) non-impairment of the Bank's discretion to allocate its net income in future. Provided the Bank is not intended to be the major contributor to the fund, a TA grant for a USSR trust fund would meet these criteria.

#### Bank's Power to Make Grants

10. There seems to be no getting around the fact that we are talking about a grant for technical assistance. Past opinions of General Counsel have clearly stated that the Bank has the power to make grants out of its gross or net income. However, this opinion was rendered in the context of Article I of the Articles of Agreement which states the purpose of the Bank as: "to assist in the reconstruction and development of territories of members...". Therefore, the Legal Department should rule on whether the Bank's power to make grants extends to a non-member given the special circumstances listed above (paras 1 and 2) and the USSR's stated interest in becoming a member.

#### Accounting Treatment

11. The two conditions for net income funding are that the transfer of funds is: (i) made to an entity with substantially same membership as the Bank; and (ii) is not subject to stringent conditionality regarding the use of the funds. The first condition would obviously be met if the trust fund is controlled by the UNDP or Bank/UNDP or the Bank. Whether the second criteria is satisfied depends upon how the purpose of the trust fund is defined. In the event the criteria is not fully met, the question of whether net income treatment is proper from an accounting viewpoint will depend upon the



materiality of the grant amount in relation to other income and expenditure items (e.g., net income, administrative budget, etc.). As we saw in the case of the Gulf Crisis discussions, Price Waterhouse is likely to live with even a fairly sizeable figure (in the Gulf case, \$20-30 million in my recollection) on the grounds that it is not material. But this must, of course, be confirmed.

cc: Messrs. M. Qureshi  
E. Stern  
W. Thalwitz  
I. Shihata  
D. Bock  
R. Lynn  
S. Sandstrom

The World Bank/IFC/MIGA  
O F F I C E M E M O R A N D U M

DATE: 08-Jan-1991 11:11am

TO: See Distribution Below

FROM: David R. Bock, OPNSV

( DAVID BOCK )

EXT.: 82856

SUBJECT: USSR: Mr. Conable's draft reply to Mr. Abalkin

May I have your comments by the end of the day.

-----  
Dear Mr. Deputy Chairman,

Thank you for your letter indicating your interest in pursuing discussions on a program of technical cooperation between the USSR and the World Bank. I would like to confirm that we are indeed interested in extending these discussions. I will be raising this issue with the Bank's executive directors shortly and we expect to be sending a technical mission to Moscow in the near future to define the scope of such a technical cooperation program.

I have taken note of the priorities for such a technical cooperation that you yourself have defined. This agrees very closely with our own assessment of where we might be of most assistance to the USSR in the near term.

Please accept my personal best wishes for the New Year.

Barber B. Conable

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TO: Basil Kavalsky  
TO: Fred Levy  
TO: David M. Goldberg  
TO: John A. Holsen  
TO: Parvez Hasan  
TO: Peter Knight  
TO: Dale R. Weigel

( PAUL ISENMAN )  
( BASIL KAVALSKY )  
( FRED LEVY )  
( DAVID M. GOLDBERG )  
( JOHN A. HOLSEN )  
( PARVEZ HASAN )  
( PETER KNIGHT )  
( DALE R. WEIGEL )

The World Bank/IFC/MIGA  
O F F I C E M E M O R A N D U M

DATE: 08-Jan-1991 01:33pm

TO: See Distribution Below

FROM: David R. Bock, OPNSV ( DAVID BOCK )

EXT.: 82856

SUBJECT: DRAFT Letter to Mr. Gerashchenko

This should also have been sent to you for comments.

DISTRIBUTION:

TO: Paul Isenman	( PAUL ISENMAN )
TO: Basil Kavalsky	( BASIL KAVALSKY )
TO: Fred Levy	( FRED LEVY )
TO: David M. Goldberg	( DAVID M. GOLDBERG )
TO: John A. Holsen	( JOHN A. HOLSEN )
TO: Parvez Hasan	( PARVEZ HASAN )
TO: Peter Knight	( PETER KNIGHT )
TO: Dale R. Weigel	( DALE R. WEIGEL )



DRAFT

January 8, 1991

Mr. Viktor V. Gerashchenko  
Chairman of the Board  
State Bank of the USSR  
12 Neglinnaya  
Moscow 103016  
Union of Soviet Socialist Republics

Dear Mr. Gerashchenko:

Thank you for sending me the concept paper on the creation of a USSR development and project finance bank. I will be happy to have Bank staff to review this proposal and give you detailed comments on the possibility of financing a technical assistance in assessing the feasibility, we will of course need to take this up in the context of a broader technical cooperation program that we discussed with you. We will be reviewing this matter with our Board of Directors.

Thank you again for your warm hospitality during my visit to Moscow. I look forward to seeing you again soon.

Sincerely,

Barber B. Conable

The World Bank/IFC/MIGA  
O F F I C E M E M O R A N D U M

DATE: 08-Jan-1991 11:15am

TO: Johannes Linn  
TO: Paul Isenman

( JOHANNES LINN )  
( PAUL ISENMAN )

FROM: John A. Holsen, PADSS

( JOHN A. HOLSEN )

EXT.: 33719

SUBJECT: USSR TA: Comments on Bock Draft

As you may have noted, I did not copy my comments on the Bock draft to David and colleagues. I thought the two of you should look at them first. However, if you are broadly in agreement, I would appreciate your forwarding my E-mail to Bock.

I understand that the JSSE seminar is definitely set for 2:30 on Friday afternoon, January 18. Choi tells me that a notice is being sent out this afternoon. So, Wilfried's desire to have a joint discussion of JSSE and TA seems out of the question. I share the view that the JSSE is an appropriate subject for a seminar, while the TA proposal should be discussed at a regular Board meeting (preferably with a paper distributed in advance). So the immediate issue seems to be reduced to what should we tell the Board at the seminar on the 18th. Perhaps a comment on the Pavlov meetings and the promise of a paper within a few days.

DECLASSIFIED

SEP 03 2019

WBG ARCHIVES

The World Bank/IFC/MIGA  
OFFICE MEMORANDUM

DATE: 07-Jan-1991 10:10pm

TO: See Distribution Below

FROM: Johannes Linn, CECDR

( JOHANNES LINN )

EXT.: 37458

SUBJECT: CONFIDENTIAL--USSR: Conversation with Wilfried

I spoke with Wilfried and briefed him on the current state of events. Here are the major points:

1. He wants to stick with a joint Board discussion of JSSE and TA proposal if at all possible. Reason 1: They are critically linked in substance. Reason 2: It's the only way we (PRE) remain a central player in the unfolding events which he thinks will be critical for the effective development of a TA program. He realizes we may have missed the boat on this one, because of prior commitment and parallelism with the IMF, but wants us to try to recontract anyway, provided the joint discussion can be scheduled within the next two weeks or so.
2. In any case, he believes we need to prepare carefully for the Board discussion of JSSE--with prepared statement to Board (John to present), Alan and Fred as back-ups, agreed division of labor on areas of responsibility for addressing questions, agreed position on how we will handle the areas for which the Fund was responsible, etc..
3. On funding, his preferred option is trust fund with up front payment by Bank from net income complemented by external funding; second best is purely external trust fund; least attractive/unacceptable: admin. budget.
4. On scale, nature of commitment, etc.: he believes strongly in a phased, flexible build-up of our involvement, most likely starting slowly. He thinks the \$40-50 m three year total may not be an inappropriate upper limit for which to seek approval from the Board, and believes we should seek approval in principle for resident team in Moscow (he thinks it'll be necessary for effective functioning and inevitable, eventually), but not commit or expect immediate start-up of a resident mission.
5. We will have to coordinate closely with the Fund, although separation from OECD/EBRD at this stage is appropriate.

Let's talk tomorrow. Best regards.

*Tom -  
Jacob  
Linn  
on  
9/1/91*

*Some  
minimal  
co-financing*



DISTRIBUTION:

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TO: Costas Michalopoulos  
TO: Geoffrey B. Lamb  
TO: John A. Holsen  
CC: Penny Chokeychaitanasin  
CC: Alan Gelb  
CC: Patricia Gallagher

( PAUL ISENMAN )  
( COSTAS MICHALOPOULOS )  
( GEOFFREY B. LAMB )  
( JOHN A. HOLSEN )  
( PENNY CHOKECHAITANASIN )  
( ALAN GELB )  
( PATRICIA GALLAGHER )

The World Bank/IFC/MIGA  
O F F I C E   M E M O R A N D U M

DATE: 07-Jan-1991 00:07am

TO: Paul Isenman ( PAUL ISENMAN )

FROM: Sven Sandstrom, EXC ( SVEN SANDSTROM )

EXT.: 81138

SUBJECT: RE: Soviet TA

Paul,

Thanks for copy of your em to David last Friday. I will see if Barber wants to meet with the principals early this week (hopefully already today Monday) to discuss next steps -- in particular what route to go on the financing of the program and an approach for consultation with the EDs individually.

I'm not sure from your em whether you have seen all the recent letters and notes concerning the Soviet Union (they have all been copied to Wilfried), including:

- formal request for TC from Abalkin delivered 12/21
- copy of letter from the Soviets to Brady dated 1/2 (and delivered to us 1/4) indicating that a delegation from Moscow led by Pavlov would be here the week of the 14th to discuss TC and membership (with the US?!)
- note from Ernie to Barber dated 1/4 re the financing of a TC program.

In addition, David and his group are working on a draft note intended for the Board.

Sven

cc: Lamb

Michalopoulos -

done 1/9

ROUTING SLIP		DATE 1/7/91	
OFFICE OF THE SENIOR VICE PRESIDENT, OPERATIONS			
NAME		ROOM NO.	
Members of the USSR TA			
Informal Working Group			
(Messrs. Isenman, Kavalsky, Levy,			
Goldberg, Holsen, Hasan, Knight)			
	To Handle		Note and File
	Appropriate Disposition		Note and Return
	Approval		Prepare Reply
	Comment		Per Our Conversation
	Full Report		Recommendation
	Information		Signature
	Initial		Send On
REMARKS			
FROM David R. Bock			

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CREATION OF A  
USSR DEVELOPMENT AND PROJECT FINANCE BANK

Concept Paper

Moscow  
December 1990

ORGANISATIONAL COMMITTEE FOR THE  
ESTABLISHMENT OF THE USSR DEVELOPMENT  
AND PROJECT FINANCE BANK

S.D.KONYCHEV  
CHAIRMAN OF THE COMMITTEE

Tel:246-25-67

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# STATE BANK OF THE USSR

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103016, Moscow, Neglinnaya, 12,

Victor V. GERASHCHENKO  
Chairman of the Board

14 December 1990

Mr. Barber B. Conable  
President  
The World Bank  
Washington, D.C. 20433 U.S.A.

Dear Mr. Conable,

In the course of our meetings in Washington and Moscow we discussed inter alia the importance of institutional changes, especially in the financial system for the success of the economic reforms initiated in the USSR.

We believe that already at this early stage of consultations on the 1991 the programme of technical assistance we can identify a project which could be treated as a priority in terms of the new situation in the USSR's collaboration with Western economies.

The project we are bearing in mind is that of the proposed creation in the USSR of a specialized development bank which can satisfy both soviet and western needs.

The respective concept paper describing the project had been prepared by a group of Soviet experts in the field of international banking and was positively assessed by specialists within the State Bank.

The proposed development bank is seen as an essential means of identifying and evaluating viable, primarily export oriented investment opportunities in the USSR and channelling and controlling the effective utilization and repayment of Western capital and finance. This does not mean that the Bank would have an exclusive or monopoly position in such matters, rather it would act as a centre of excellence and catalyst in the mobilization of various sources of finance and the creation of the necessary institutional framework.

Moreover, although an element of state sponsorship would be required to launch the institution, it is envisaged that the Bank will be essentially a commercial, private sector company from the outset, operating in many aspects of its activities as a merchant or investment bank and employing Western standards, procedures and techniques.

In particular, the Bank is seen as having the following main characteristics:

1. Incorporated as a joint stock company with majority non-state sector ownership. Shares to be offered to both Soviet and foreign investors, including individual Soviet citizens.

2. Profitability and maximization of return on shareholders' equity as the main objective and *raison d'être* of its activities.

3. Managed and operated along commercial lines, with assured autonomy and independence from state ownership and management structures and systems.

4. Modelled and structured along the lines of similar Western organizations, which are familiar and acceptable to foreign investors and lenders alike, including multilateral institutions such as the European Bank for Reconstruction and Development.

5. Employment of high quality foreign expertise and management both during the initial start-up phase and, probably on a consulting basis, fully operational stage.

6. Adoption of an active *banque d'affaires* role to financed investments, with direct shareholdings in industrial and commercial companies and the provision of corporate finance and managerial advice and assistance to ensure that they can operate effectively and profitably in an open market economy.

We are aware that the World Bank group has contributed in many ways to the establishment of similar development banking institutions in a number of countries and that it possesses unique experience and expertise in this area. In view of this fact and without undermining the importance of other programs which can be implemented in the USSR by the World Bank we consider that the establishment of the proposed Development Bank could form an appropriate pilot project for your group in the commencement of its activities in the Soviet Union.

Consequently, we felt it appropriate to bring the proposed Development Bank to your attention and to solicit your views as to



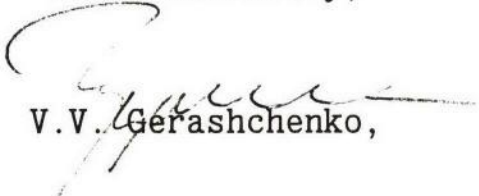
its feasibility and the possible involvement of the World Bank in supporting its establishment and subsequent operation. Initially, we would be seeking financial and technical assistance in fully investigating the Bank's feasibility, defining its appropriate corporate structure, carrying out its incorporation and putting it into operation. An active involvement of the World Bank in the new Development Bank would considerably add to its status and credibility, inspiring the confidence which will attract other interested parties, particularly private sector investors.

The concept paper describing the proposed Development Bank, its feasibility, structure and operations has been translated into English for presentation to yourselves, with a view to subsequent meetings of experts being held in Washington or Moscow to discuss it.

In the meantime I would appreciate receiving your initial reaction to the proposed Development Bank and, hopefully, an expression of the World Bank's in-principle support for its creation as well as your views regarding possible ways of provision of financial and technical assistance to the project in the year 1991.

Encl. Concept paper.

Yours sincerely,

  
V.V. Gerashchenko,

## CONTENTS

1. Rationale for Creation
  2. Operating Criteria
  3. Ownership
  4. Structure
    - 4.1 Financing
    - 4.2 Capital (Charter Fund)
      - 4.2.1 Stockholding Structure
      - 4.2.2 Transfer of Stocks
      - 4.2.3 Attraction of Foreign Investors
    - 4.3 Attraction of Capital and Loans
    - 4.4 State Guarantee
    - 4.5 Exploitation of Natural Resources
  5. Normative Base (Legal Framework)
  6. Corporate Structure
  7. Strategy for Development of Operations
  8. Profitability Projections
  9. Development of Expertise
  10. Personnel Policy
  11. Control Over Activities
  12. Conclusions: Programme for Future Activities
- Annex I: Profitability Projections



## 1. Rationale for Creation

The development of export is a major strategic task of the Soviet economy. The accent is to be upon exporting; i.e., knowing how to sell in foreign markets (and not the abstract "development of foreign economic relations") in order to accelerate the transition of the USSR to a healthy market economy.

The existing Soviet economic machinery continues to rely upon rigid foreign currency regulation when the greater portion of hard currency resources are being taken from producer-exporters and centrally distributed through the hard-currency plan. A significant portion of hard currency assets is being directed in this way towards the development and maintenance of export production (the extraction and transport of oil, gas, gold, and the like). The need for this system will last for a long time, especially because of the large external State debt and the necessity to import foodstuffs.

While acknowledging the need to retain this system for the said tasks, one can hardly contend that it gives priority to the development of export production and ensures an efficient investment cycle, that is, generates the maximum hard currency receipts with the minimum of hard currency expenditures.

In light of these considerations, it is essential to commence the creation of a parallel investment structure based on other, commercial, principles for mobilising hard currency resources from internal and external sources and investing them in the most profitable export projects. It is envisaged that the USSR Development and Project Finance Bank (DPFB) would become the principal link of such a structure.

## 2. Operating Criteria

The principal task of the DPFB would be to maximise profitability; that is, to obtain maximum profit in freely-convertible currency for the stockholder units of investment.

In performing this role, the DPFB will endeavour to mobilise as many resources as possible in freely-convertible currency and, when necessary, in rubles. It will invest in those projects which offer the greatest export receipts per unit of investment. On the basis of this approach the DPFB could continue to replenish its resource base, increase revenues and profit from its activities, and repay its loans. The DPFB will be thus be economically (that is, objectively), rather than administratively, interested in export development.

It would be fundamentally wrong to choose and give priority to some sort of general political or macroeconomic task such as the "development of export" as the principal objective of the DPFB rather than a purely financial objective. The name "USSR



Development and Project Finance Bank" suggested is essential in order to assure clients and creditors that the DPFB has the requisite powers to carry on operations in freely-convertible currency and a special interest in the specified domain of business activity.

When the principal task of the new Bank is properly formulated, it will be a commercial bank not merely in words, but in fact. There lies the principal distinction between it and the existing specialised banks, above all Vneshekonombank SSSR.

### 3. Ownership

The DPFB can become a true commercial bank only if its owners are organisations and persons who are interested in receiving maximum return on the assets they invest in the capital of the Bank. It is thus advisable to organise the DPFB as a joint-stock company with a mixed form of ownership. The basis must be the principle that any juridical or natural person in the USSR and abroad may become a stockholder thereof. Having regard to the distinctive features of mobilising capital for the DPFB, the following principal groups of stockholders could be formed:

- Soviet juridical persons: including State enterprises, joint-stock societies, collective enterprises, joint enterprises, partnerships, cooperatives, and other subjects provided for by the Law on Ownership;
- Soviet natural persons: any citizen of the USSR who acquires Bank stocks. The personnel of the Bank itself would be part of this group;
- Foreign juridical and natural persons;
- Soviet social security fund.

This broad composition of stockholders would ensure the democratic management and independence of the Bank.

### 4. Structure

#### 4.1 Financing

It is expected that the DPFB would be financed as follows:

- stockholder assets (capital) in foreign currency as well as partially in kind and in the form of providing services;
- attracted assets (deposits, credits, and loans obtained from Soviet and foreign juridical and natural persons);
- natural resources and existing production capacities by leasing them from the State and other subjects of ownership.

It is proposed that the DPFB borrowings be secured on the basis of appropriate All-Union and republic guarantees.

#### 4.2 Capital

Having regard to the business orientation of the Bank, its capital must be mobilised in freely-convertible currency. The task at the first stage is to ensure financing of not less than



400 million United States dollars (or equivalent in ECU). It is evident that the Soviet Government has neither the assets to invest as capital nor is it able to grant a subordinated credit at the initial stage.

Thus it is essential that assets be attracted partially from other sources and partially be accumulated from Bank profits according to an acceleration formula. The issuance of stocks should be the principal measure. For each of the aforementioned groups of stockholders a certain subscription quota would be established for the initial capital of the Bank:

- US\$40 million for Soviet juridical persons, foreign juridical persons, and foreign natural persons (12.5%);
- US\$165 million for Soviet natural persons (50%);
- US\$85 million for the Soviet Social Security Fund (25%).

Given the diverse nature of the proposed stockholders, a suitable structure must be developed to accommodate them. The initial approach for achieving this might be that the stocks for all four groups would be common and carry the right to one vote and to receive dividends; each would have a par value of US\$100. However, at the first stage the Soviet natural persons and Soviet Social Security Fund would be issued so-called "original" stocks in rubles which would contain a provision for subsequent conversion into common stocks and have different provisions for the distribution of profit (limited voting rights and use of distributed profits for capitalisation of the companies).

#### 4.2.1 Stockholding Structure

The subscription to capital by Soviet juridical persons and by foreign juridical and natural persons will be by paying-in the stocks at par in hard currency without limitation as to amount for individual purchasers but within the established group quotas, with priority given to applications in the sequence of their registration. Stock subscribed in this manner would be known as common stock.

The subscription to capital by Soviet natural persons will be in two stages. Initially "original" stocks will be issued with a par of 60 rubles each for the total sum of 100 million rubles, and these will be acquired for rubles. Only citizens of union republics which support the DPFb with their guarantee at the initial stage of activities (see 4.3 below) will be granted the right to acquire original stock. As is done in the West when denationalising companies, a maximum number of stocks will be established to be sold to a single investor (possibly even one per person). In this case the number of Bank stockholders might number 1.5 million Soviet citizens. Later, when the stocks would circulate freely in the market, an additional limitation might be introduced to limit the number of votes per each Soviet investor.

It is suggested that the State Social Security Fund be allocated original stock in return for the provision of all-union and union republic guarantees.

The "original" stocks would contain a provision concerning



their conversion into common stocks once certain criteria were met.

The criteria proposed are that original stockholders "buy" their way into becoming common stockholders. To achieve this result, it is suggested that no dividends be paid to Soviet natural persons, and that the State Social Security Fund only receive 50% of its entitlement. Rather, dividends that would have been paid are retained in the DPFB. Only when these retained earnings reach US\$250 million, the par value of the original stock, would the original stock be converted into common stock.

If stocks within a separate quota, or even if all the quotas (except the Soviet Social Security Fund) are not fully subscribed, the paying-in thereof shall continue as follows:

- by offering them to new investors on the original conditions;
- from profit relating to the unpurchased share of stocks not paid in, distributing pro rata the additionally paid-in stocks (separately for each quota) to the investors who already own stocks.

This provision regarding capitalisation will create the requisite additional advantages for those stockholders who purchase stocks at the earliest stage and who have assumed the greatest risk.

#### 4.2.2 Transfer of Stocks

A specified share of the stocks of the first three groups (for example, up to 10% of the total amount of the quota) and all the stocks of the Soviet Social Security Fund might be transferred without paying-in under the following events:

- when Soviet juridical persons transfer resources of vital importance so that the DPFB may commence activities; for example, right to use a land plot, buildings, communications, and organisational technology, or the performance of specific services;
- to Soviet natural person as part of the remuneration package as employees of the DPFB;
- to foreign juridical and natural persons for consultancy (legal, accounting, management, etc.) services and to banks for the provision of services to the DPFB;
- stocks of the quota for the State Social Security Fund will be transferred to this specially established Fund as payment for the use of the State guarantee (see 4.3). The Fund will at the outset be issued "original" stocks, with a provision for their conversion into common hard currency stocks after the capitalisation is completed; i.e., similar to the stocks of Soviet natural persons. However, unlike the stocks of Soviet natural persons, those held by the Fund will be paid dividends in an amount of 50% of the profit due that particular quota. This means that the rate of compulsory capitalisation of profit for this quota will be two times less than that for Soviet natural persons while the conversion of stocks will be simultaneous and pro-rata for both groups.

Dividends received by the Social Security Fund will be



directed to rendering material support to the less protected strata of the populace, indigent pensioners especially. The utilisation of dividends would be under the direction of the Social Security Fund Management, an independent Board composed of public figures. Obviously this means of payment for use of a guarantee of the USSR State Bank would be more socially just than simply crediting the funds to the State budget. Having regard to the character of the Fund, it might be appropriate for the Social Security Fund to be refunded that proportion of the tax paid by the DPFb on the profits accrued to the Social Security Fund.

#### 4.2.3 Attraction of Foreign Investors

There are many potential investors in the DPFb. Attracting the European Bank of Reconstruction and Development (EBRD) as a stockholder would be of great importance, for according to its Charter up to 40% of its capital may be invested in such companies. The DPFb would meet one of the principal criteria of the EBRD as it would fall into the category of companies with a mixed but majority private ownership. The participation of the EBRD would be a catalyst for attracting other investors and would also facilitate future borrowing from the EBRD itself.

To attract investors it is essential that the DPFb have a comprehensible financial and legal structure. This in turn requires that its charter, other normative acts, and financial projections be worked out with the participation of Western specialists. At the first stage it would be advisable to select a limited number of leading consultants for the project: a law firm, accounting firm, and investment bank. The draft charter and financial projections must be sent for the opinion of central banks, export finance bodies, reconstruction and development banks and agencies, investment and commercial banks, investment funds and companies, as well as accounting firms. The comments made must be fully taken into account, and the foundation documents should be referred for the consideration and confirmation of the Governments of the USSR and the RSFSR only after being reworked.

#### 4.3 Attraction of Capital and Loans

In the long run the Bank's potential industrial and commercial clients in the USSR are the principal source for attracting external financing. These foundations also will be reinforced, as indicated above, by appropriate residual guarantees.

The development of export production will lead to an increase in foreign exchange receipts, which will be deposited in the Bank for various periods or invested in projects financed by the Bank in the form of share participation.

In order to attract finance from its clients, the DPFb must offer a broad range of financial, account, and advisory services. Obviously in the early years the DPFb will be in a position to attract part of the hard currency funds of enterprises which are presently deposited with Vneshekonombank.



The DPFB must also develop a programme for mobilising the resources, both medium and long-term, from foreign sources. The principal emphasis should be on various types of export credits granted under guarantee or insurance of the governments of developed countries. At present a Soviet State guarantee is essential for such credits to be obtained. In the longer term, as the DPFB operations expand and it publishes audited balance sheets for a number of years, the export and import banks and agencies of Western countries will be able to conduct an independent credit analysis of its financial position and offer credits without those guarantees.

As already noted, it is of the greatest importance that the DPFB obtain financing from the EBRD and, at a later stage, perhaps also from the International Financial Corporation. Substantial assets might be mobilised by the DPFB in the capital markets from private sources. However, this is possible only with the regular publication of reliable information about the financial position of the Bank.

It also would be advisable to link individual loans with specific export projects that have proven hard currency self-sufficiency. As Soviet legislation becomes more sophisticated, collateral security can be organised for credits in the form of a pledge of a land lease, property, receipts, and various rights. One specialisation of the Bank will become the domain of business activity known in the West as "project financing."

#### 4.4 State Guarantee

It is proposed to provide such a guarantee only to cover the obligations of The Bank to foreign creditors. Of all the types of resources needed to create the DPFB, the State guarantee is of vital significance at the beginning stage. There is no doubt that if the guarantee is not available, foreign investors and export credit agencies will take a cautious position vis-a-vis the DPFB, and this would delay capitalisation for many years.

The rapid creation of a bank with a mixed form of ownership and operating upon Western lines is impossible without the assistance of the State at the early stages as the hard currency domain has been completely centralised. The guarantee would be provided for a limited period to cover only those obligations which the DPFB would assume with regard to foreign creditors until the capitalisation is completed.

It should be stressed that the guarantee would be provided in return for payment in the form, for example, of participation of the State Social Security Fund in the profits of the Bank without the purchase of stocks. This form of providing credit would in essence become a lease of one of the State resources, for foreign creditors still have confidence in obligations of the Government of the USSR.

Unlike a credit which the Government cannot give at the moment because of the complex financial and currency situation, such a guarantee would not divert real hard currency resources, including those mobilised in the form of foreign loans, from



financing other social and investment programmes.

Taking a sober view of the state of affairs, it must be said that the possibilities of new borrowings abroad without the guarantee of Vneshekonombank SSSR have been virtually exhausted. Leaving aside the "political" aid credits (Federal Republic of Germany and elsewhere), new borrowings can be obtained only when linked with viable self-sufficient export projects. It is precisely these which the DPFb proposes to undertake.

Taking into account that at present the existence of a State guarantee of the USSR will not in and of itself attract foreign credits, granting the guarantee with regard to obligations of the Bank will not reduce the opportunities for Vneshekonombank SSSR to attract assets in the traditional forms.

In addition to the conditions already noted, it is proposed that the general State guarantee would be limited to a maximum sum of three billion rubles, roughly equal to the size of the balance which it is envisaged that the DPFb requires for capitalisation over seven to nine years. Given the expected changes in the Treaty of the Union on the basis of union republic sovereignty, they will form their own independent balances of payments.

When formalising the State guarantee for Bank obligations it is essential to avoid the situation where future legislative changes might undermine confidence in the Bank just when it is being capitalised. Under these circumstances the guarantee of the USSR needs to be backed up by union republic guarantees.

Given present conditions, the following scheme would be vital:

(a) two identical general State guarantees regarding Bank obligations would be provided, the USSR and the RSFSR, for the amount of three billion rubles by the respective governments;

(b) the Bank Board and perhaps the State Bank of the USSR would have recourse to the governments of the other union republics for support for the creation of the DPFb by providing analogous general guarantees. Having regard to the amount of hard currency balances of the individual republics, the amounts of their State guarantees might be somewhat less than that of the RSFSR;

(c) at the capitalisation stage, the Bank would finance projects primarily on the territory of the RSFSR and those union republics which support the Bank with their own State guarantees. The initial subscription to stocks by Soviet natural persons also would be from the population of the RSFSR and those other republics, and the disbursements from the State Social Security Fund would be limited to those territories.

During this period, the financing of projects on the territories of other union republics by the Bank would be only on condition of their governments providing guarantees for Bank obligations within the framework of the projects. After the general State guarantees had lapsed, this limitation would be removed.



#### 4.5 Exploitation of Natural Resources

The DPFB should be given the right to exploit natural resources and organise export production on the basis of the leasing of objects of all-union, republic, and municipal ownership (land, minerals, operating enterprises, and infrastructure), having regard to the limitations established by the Government.

In carrying out its functions under this heading, the DPFB should endeavour to create subsidiary companies on a share basis with State and other enterprises, with the participation, when necessary, of foreign partners. It also would be possible to lease and purchase enterprises from the State on a share basis with the labour collective.

The share participation of the DPFB in such joint-stock companies would vary from minimal to a controlling holding. This approach would enable the weakest link in Soviet project financing to be strengthened: management and control over its realisation. When necessary, foreign specialists could be recruited to manage subsidiaries.

The DPFB would endeavour to achieve extensive collaboration with territories and local agencies of power. On the other hand, it would compete for resources with ministries and State organisations and thereby reduce monopolistic practices.

#### 5. Normative Base (Legal Framework)

Given the distinctive aspects of forming joint-stock capital of the DPFB, the use of a State guarantee by the Bank at the capitalisation stage and other aspects which are not regulated by hard currency legislation in force, the foundation documents (charters) must be confirmed by special decrees of the governments of the USSR and the RSFSR.

When drafting the foundation documents maximum use must be made of new Soviet legislation and recent decrees of the Government of the USSR on ownership, lease, joint-stock societies, and joint enterprises. The said documents must be so drawn that draft legislation on banks, joint entrepreneurship, foreign investment, and others are used with respect to the Financial Corporation and Bank after being adopted without changing their charters.

When necessary, exceptions from legislation in force must be made. Above all, the Bank must be outside the scheme for hard currency licensing administered by Vneshekonombank SSSR, as control over Bank activities will be effected in other forms (see point 10 below).

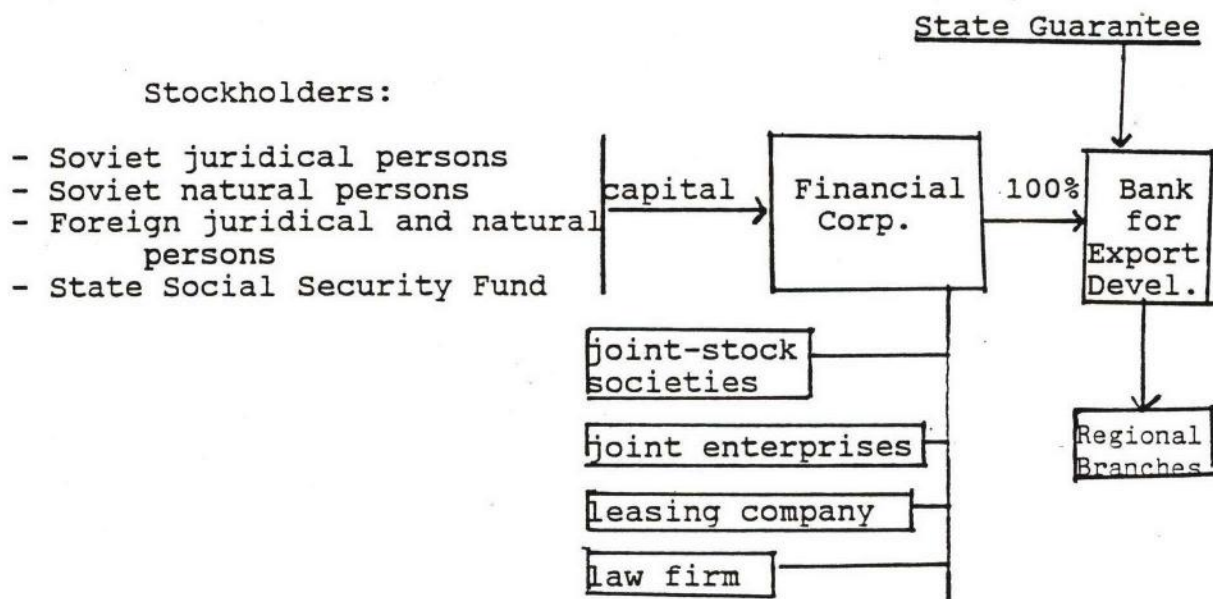
#### 6. Corporate Structure

The corporate structure must be as flexible as possible and ensure:

- (a) the independence of the DPFB;
- (b) the possibility of the DPFB participating in project

management and control through subsidiary companies;

(c) obtaining the maximum financial advantages from highly profitable projects with a small share of the Charter fund in the total amount of investment.



## 7. Strategy for Development of Operations

The DPFEB must be completely independent of the Government or its agencies in its choice of strategy and day-to-day operations. Above all this applies to the choice of projects to finance and conditions thereof, and to relations with clients in both the State and other sectors of the economy. The sole criterion for developing and financing projects is to be their profitability for the DPFEB and their soundness from the standpoint of hard currency self-sufficiency.

The choice of specific projects must be preceded by macroeconomic research, on the basis of which a strategy for the development of operations is to be devised which would determine the priority orientations of investments and sufficient diversification by branch and client with regard to credit risk.

The following may be priority areas:

- tourism
- timber processing
- transport services (sea and air transport)
- agrarian sector
- mineral extraction ("tailings" of operating entities, temporarily closed and unused State deposits)
- production of construction materials
- utilisation of wastes
- export of intellectual property
- chemical and oil refining
- metallurgy
- machine-building

## 8. Profitability Projections



The preliminary calculations set out in Annex 1 show that the capitalisation of the Financial Corporation and Bank may be done in seven to nine years. In this event the foreign and Soviet investors would be ensured a rather high rate of return on their investments: up to 35%.

The calculations appended proceed from the basic positions and proportions which foreign banks used for revenues and expenditures, on the basis of a "conservative" approach to valuing them. Accordingly, the nine-year period for capitalisation may be regarded as the maximum. The calculation of ruble cash flows shows that a fund in the amount of 100 million rubles obtained through the purchase of stocks by Soviet natural persons would be sufficient to finance the Financial Corporation and Bank for eleven years. Thereafter such expenditures would be covered by converting into rubles part of the revenues received in foreign hard currency.

#### 9. Development of Expertise

The DPFB should become a leading centre of economic, financial, and legal expertise in the Soviet Union.

Western methods of analysing the economic efficiency of projects, financial self-sufficiency, and risks will be mastered. As the client base develops, a credit analysis of clients will be perfected in the forms which Western banks use.

In order to prepare or analyse feasibility studies, Soviet scholarly organisations will be used extensively, including institutes of the Section for Economics and other sections of the USSR Academy of Sciences and branch scientific research institutes. This analysis will be backed up by Western expertise, including that of investment banks, as well as other firms specialising in the analysis of markets and technical aspects of projects.

Of major interest are the approaches and methods used by international and national agencies for programme assistance to developing countries, such as the International Finance Corporation, and regional banks of reconstruction and development. Excellent contacts with the EBRD are essential in this connection.

Among the issues of legal expertise, priority will be devoted to working out the conditions for securing credits. Having regard to changes being made in Soviet legislation, agreements and contracts not previously used in the USSR need to be worked out on the pledge of property and assets of borrowers, stocks, lease of land, and other property rights.

In individual instances materials may need to be prepared on this matters concerning initiatives to amend legislation in force.

Having created a strong legal service (perhaps as a subsidiary law firm), the DPFB will provide the entire complex of



legal services to clients and sister companies, including the formation of joint-stock societies, joint enterprises, leases of land and other natural resources, and the leasing and purchase of enterprises.

There also will be extensive involvement by leading Soviet jurists (especially from the Institute of State and Law of the USSR Academy of Sciences), as well as foreign lawyers who are specialists in Soviet law and international and comparative law (Professor W. E. Butler, and others).

To establish economic and legal expertise the Bank will use to the maximum extent the funds of governments and private foundations already created in the West, the tasks of which include assistance to socialist countries in forming a market economy structure.

#### 10. Personnel Policy

The personnel problem is amongst the most complex in the Soviet Union, both in the domain of banking and in foreign economic relations. The following approach seems to be justified:

1. To form a founding group of organisations, both foreign and local, who would appoint individuals to develop the concept of the DPFB.

2. Obtain funding for, and subsequently commission, an independent study on the DPFB.

3. Launch the DPFB, based on appropriate foundation documents and reflecting the findings of the study.

4. The number of personnel of the DPFB during the first two years would be on the order of 30 to 50 persons. At least half must be persons who have some experience with international banking operations or accounts.

5. Thereafter, as the client base grows, the personnel would grow gradually to 500-1000 persons. To train this number of specialists it would be necessary to have a one-year basic training programme in international operations and accounts.

The principal source of personnel for the DPFB must be students and graduates of relevant institutions of higher education, particularly the faculties of economics and finance. Possibly graduates in other disciplines might be retrained (this is widely practiced in the West by accounting firms when they hire personnel).

The DPFB also will hire foreign specialists. At the early stage it would be advisable to recruit a number of such specialists who have experience in organising internal management and operations systems of a Bank (bookkeeping, credit analysis, balance sheet management, and the like). Such specialists might be seconded by foreign stockholders for two or three years, with compensation of their expenses through the issuance of additional stocks.



In addition to hiring and training highly qualified permanent personnel, the DPFb will extensively recruit both Soviet and foreign specialist consultants to fulfil specific work or projects on a one-off basis.

When developing the system of remuneration, great accent will be placed upon bonuses for the realisation of specific programmes, conducting profitable operations, and the annual financial results. The distribution of stocks of the DPFb among their personnel within quotas allotted by the Board from the stocks of Soviet natural persons will be developed as an important form of remuneration; this will give personnel an additional financial interest in the final performance results of the DPFb.

#### **11. Control Over Activities**

Methods of financial control which have recommended themselves in international practice with respect to public joint-stock companies will be used with respect to the DPFb. Among them are the publication of an annual financial balance sheet certified by external auditors.

For all its independence from external factors (the Government, etc.), the Board can act only within the framework of the general strategy approved by the stockholders and must regularly report to them at the general stockholders meeting. As regards the Bank, the control system is more stringent: it is supplemented by elements of purely bank regulation and control on the part of the USSR State Bank as the central bank.

In the interests of foreign investors, the indicators and principles of such control must be as close as possible to the unified rules applied in developed countries and perhaps even more stringent than those now used in the USSR with respect to new commercial banks.

Such measures would include a monthly report on the basic balance sheet accounts, liquidity, and the credit and other positions. When the Bank departs from the normative indicators, it must immediately inform the State Bank of the USSR about measures taken to eliminate such. Further, the DPFb must agree with the USSR State Bank a general system for internal control, the permissible size of large exposures, and other indicators.

When necessary, the State Bank of the USSR may demand continuous audits in addition to the annual selective audit by outside auditors.

#### **12. Conclusions: Programme for Future Activities**

The creation of the DPFb is a complex and unusual project requiring a high level of coordination of effort in various directions.

However, this project is realistic and feasible, as the political, economic, and legislative conditions for implementing it have been fully determined in the USSR in principle. The following action programme is suggested at the first stage:

1. Refer the present Concept Paper by the USSR State Bank to the USSR and RSFSR councils of ministers for approval in principle;

2. If such approval is obtained, create an initiative group under the aegis of the USSR State Bank and the RSFSR State Bank of Soviet specialists appointed by the project leader and select a group of foreign consultants;

3. Develop the Concept Paper and work out draft charters and other normative acts;

4. Send the said materials to potential stockholders abroad and in the USSR;

5. Collect comments and proposals, rework the Concept Paper, charters, and normative acts;

6. Submit the reworked materials for the consideration and confirmation of the Governments of the USSR and RSFSR and adopt necessary normative acts;

7. Approach the governments of the other union republics;

8. Organise the issuance of and subscription to stocks amongst foreign investors;

9. Issue stocks and the subscription thereto in the USSR.

If the project is promoted by all the interested organisations, the programme might be realised within a period not exceeding eight to ten months.

Subsequent steps relating principally to the creation of the infrastructure and commencement of activity by the Financial Corporation and Bank might be worked out during the first stage.



**PROFITABILITY PROJECTION**  
for USSR Development and Project Finance Bank

Page 1.

Annex # 1

Basic Assumptions in mln. roubles

- 1 Stocks issued in the amount of including paid up in:  
hard currency  
roubles  
transferred without payment
- 2 State Guarantee

200  
50  
100  
50  
3000

**HARD CURRENCY SECTION**

**I. REVENUES:**

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
1 Capital (Hard Currency)	25.00	51.28	55.01	62.34	74.31	91.37	113.12	140.08	172.76	200.00	200.00	200.00
2 Fixed Assets	5.00	10.00	20.00	30.00	40.00	50.00	50.00	50.00	50.00	50.00	50.00	50.00
3 Revenue from Interest Free - Funds	1.40	2.89	2.45	2.26	2.40	2.90	4.42	6.31	8.59	10.50	10.50	10.50
4 Credit Agreements Concluded	100.00	200.00	500.00	600.00	700.00	700.00	700.00	700.00	700.00	700.00	700.00	700.00
5 Credit Exposure and Guarantees Issued	20.00	80.00	250.00	500.00	1,000.00	1,500.00	2,000.00	2,500.00	3,000.00	3,100.00	3,200.00	3,300.00
6 Revenue from Credit Portfolio	.20	.80	2.50	5.00	10.00	15.00	20.00	25.00	30.00	31.00	32.00	33.00
7 Commitment Commissions	.20	.53	1.29	2.04	2.29	2.41	2.41	2.29	2.04	2.76	3.46	4.14
8 Front - End Commissions	1.00	2.00	5.00	6.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00
9 Investments			5.00	10.00	15.00	20.00	25.00	30.00	35.00	35.00	35.00	35.00
10 Profit distribution			.25	.50	.75	1.00	1.25	1.50	1.75	1.75	1.75	1.75
11 Commissions for Trade Operations Documentation	.10	.25	.25	.25	.50	.50	.50	1.00	1.00	1.00	1.00	1.00
12 Other Revenues	.10	.25	.50	1.00	1.25	1.50	1.75	2.00	2.00	2.00	2.00	2.00
13 Client Deposits	10.00	50.00	100.00	300.00	400.00	500.00	600.00	700.00	800.00	800.00	900.00	900.00
14 Revenues from Temporarily Free Client Deposits	.15	.75	1.50	4.50	6.00	7.50	9.00	10.50	12.00	12.00	13.50	13.50
15 Total Revenues	3.15	7.46	13.74	21.55	30.19	37.81	46.33	55.59	64.38	68.01	71.21	72.89

**II. EXPENSES:**

Page 2.

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
16 Amortisation	.30	.60	1.00	1.30	1.60	1.60	1.60	1.60	1.60	1.60	1.60	1.60
17 Wages and Expenses for Foreign Specialists	.30	.30	.40	.50	.60	.70	.80	.90	1.00	1.10	1.20	1.30
18 Payment for Consultant Services	.10	.10	.10	.10	.10	.10	.10	.10	.10	.10	.10	.10
19 Current Administrative Expenses	.10	.20	.20	.20	.20	.20	.30	.30	.30	.30	.30	.30
20 Foreign Travel Expenses	.10	.10	.10	.10	.10	.10	.10	.10	.10	.10	.10	.10
21 Outside Auditors	.10	.10	.10	.10	.10	.10	.10	.10	.10	.10	.10	.10
22 Personnel Training	.10	.10	.10	.10	.20	.20	.20	.20	.20	.20	.20	.20
23 Total Expenses	1.10	1.50	2.00	2.40	2.90	3.00	3.20	3.30	3.40	3.50	3.60	3.70

**III. PROFIT:**

24 Gross profit	2.05	5.96	11.74	19.15	27.29	34.81	43.13	52.29	60.98	64.51	67.61	69.19
25 Capitalised Profit	1.28	3.73	7.34	11.97	17.06	21.76	26.96	32.68	27.24			
26 Profit for distribution ( A,B,C and G)	.77	2.24	4.40	7.18	10.23	13.05	16.17	19.61	33.74	64.51	67.61	69.19
27 Dividends Payable to Stockholders	.51	1.49	2.93	4.79	6.82	8.70	10.78	13.07	15.25	16.13	16.90	17.30
28 Dividends Payable to Social Security Fund	.26	.75	1.47	2.39	3.41	4.35	5.39	6.54	7.62	16.13	16.90	17.30
29 Dividends Payable to Soviet Natural Persons										32.26	33.81	34.59
30 Profitability of Investment for Shareholders	2.05%	2.98%	5.87%	9.58%	13.64%	17.40%	21.57%	26.15%	30.49%	32.26%	33.81%	34.59%

## ROUBLE SECTION

Page 3.

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
--	------	------	------	------	------	------	------	------	------	------	------	------

## I. REVENUES:

31 Ruble fund for Purchase of Stocks	100.00	98.98	96.00	90.13	80.55	66.91	49.50	27.94	1.79			
32 Fixed Assets	10.00	20.00	30.00	40.00	40.00	40.00	40.00	40.00	40.00	40.00	40.00	40.00
33 Revenue from Interest - Free Funds	1.80	1.58	1.32	1.00	.81	.54	.19 (	.24) (	.76) (	.80) (	.80) (	.80)
34 Consultancy Revenues	.05	.10	.20	.30	.30	.30	.30	.30	.30	.30	.30	.30
35 Total revenues	1.85	1.68	1.52	1.30	1.11	.84	.49	.06 (	.46) (	.50) (	.50) (	.50)

## II. EXPENSES:

36 Amortization				1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
37 Operational and Administrative Expenses	.30	.30	.30	.50	.50	.50	.50	.50	.50	.50	.50	.50
38 Wages of Personnel	.12	.15	.20	1.00	2.00	3.00	4.00	5.00	5.00	6.00	6.00	6.00
39 Payments of Consultants under Contract	.10	.10	.10	.15	.15	.15	.15	.20	.20	.20	.20	.20
40 Total Expenses	.52	.55	.60	3.15	4.15	5.15	6.15	7.20	7.20	8.20	8.20	8.20

## III. PROFIT.

41 Pretax Profit in Roubles	1.33	1.13	.92 (	1.85) (	3.04) (	4.31) (	5.66) (	7.14) (	7.66) (	8.70) (	8.70) (	8.70)
42 Profit Tax in Roubles	.40	.34	.28 (	.55) (	.91) (	1.29) (	1.70) (	2.14) (	2.30) (	2.61) (	2.61) (	2.61)
43 Profit Tax in Hard Currency	.23	.67	1.32	2.15	3.07	3.92	4.85	5.88	10.12	19.35	20.28	20.76
44 Total Tax Paid	.63	1.01	1.60	1.60	2.16	2.62	3.15	3.74	7.82	16.74	17.67	18.15
45 Profit After Tax	.70	.12 (	.68) (	3.45) (	5.20) (	6.93) (	8.81) (	10.88) (	15.49) (	25.44) (	26.37) (	26.85)
46 Profit in Roubles After Conversion of Stocks into Hard Currency	1.02	2.98	5.87	9.58	13.64	17.40	21.57	26.15	21.79			
47 Profit Carried Over	1.72	4.83	10.02	16.15	24.59	35.06	47.81	63.08	69.38	43.94	17.56 (	9.28)



## NOTES

1. From stocks issued to Soviet juridical persons and to foreign juridical and natural persons paid up in 1991 (25 million rubles) and in 1992 (25 million rubles).
2. Includes cost of construction or repair of building, equipping of offices, computers, communications, and other equipment paid for in hard currency.
3. Assuming 7% annual interest rate.
5. The share of credits used initially shall be 25% and increase as operations develop up to 75%, depending upon the average and long-term character of those investments. This correlation is based on international banking practice.
6. Average margin is 1% per annum.
7. Recovered from the unused credits at the rate of 0.25% per annum.
8. Recovered from the bank arranging the credit when signing the agreement from the total amount of the credit. The accepted rate is 1%.
9. Investments are shown only for those subsidiary companies which have profit for distribution.
10. The profit on such investments is higher than on credits and amounts to about 5% per annum of the funding cost.
11. Includes commissions for confirming and accepting letters of credit, payment thereof, and others. The commission is about 0.25% of the amount of operations.
12. Includes arbitrage, trade in securities, a'farfait, and other assets.
13. Balances of current account and demand deposits.
14. Difference between rates for placing and rates paid by client, ca. 1.5% per annum.
17. From three to ten persons at 100,000 rubles per person per annum.
18. Ten man-days per month at 1,000 rubles per man-day. Only expenses paid by the Bank are included. The principal portion of these expenses will be paid by the client. Part of the expenses relating directly to the DPFb would be paid insofar as possible from the specialised funds (see point 9 above) or, at the outset, by the transfer of stocks.
19. Communications, subscriptions to computer information, office supplies, and the like.
20. Most business trips are at client expense. Only those expenses are taken into account which would be paid by the

DPFB itself (at 5 man-months, based on 20,000 rubles per business trip).

21. Rates are based on the experience of Soviet banks abroad.
22. From 10 to 20 persons per year at 10,000 rubles per person.
25. 5/8 of the amount of annual gross profit until the capital base of 200 million rubles is achieved.
26. See entries 24 and 25.
27. 25% according to the stocks belonging to them, including during the period of capitalisation.
28. 12.5% (i.e., 1/2) during capitalisation and 25% in subsequent years.
29. 50%, beginning from the year following the year in which capitalisation is completed.
30. Entry 27: 25 million rubles in 1991 and Entry 27: 50 million rubles thereafter.
31. Reduced as the DPFB is capitalised in hard currency.
32. Cost of buildings and equipment.
33. Based on 2% per annum.
36. Amortisation over 30 years.
37. Communications services, office supplies, electricity, gas, heating, water, and the like.
38. From 100 to 600 persons at 1000 rubles per annum.
39. Legal and tax advice not connected with projects (i.e., not attributable to clients).
41. Paid in rubles.
42. Only the actual amount in rubles is taken into account received from the purchase of stocks by Soviet natural persons.

fund

→ Mtd on  
Assoc. status

→ What's going  
on.

Timing of  
discussions.

Commitments.

→ Instruments  
past  
will be ok.



Jan 7

0550 17

Board  
seminar  
→ JSSE

Fri. 18th

Assoc. status  
TA  
may change...

→ Admin w/in PRE  
" PRD

Republics  
municipalities

→ Briefing Johannes:

→ Timing: 14th

→ Financing

→ Fund / Assoc. memb.

→ Whitings...

→ Content.

Johann-  
Net income

Unclear.

Russ.

Net  
income  
OK

David  
L. Guen

→ Draft paper on Soviet TA.

→ Awalkin

→ Geraschenko letter.

→ TA Portunk - lawyer

→ OK if Soviets apply,

→ Disorganization

→ Give

Who's ~~going~~ coord. w/ Fund

→ Concordat - [Macro]

5:30

Enis

VerMassian

Boormann

→ Tim talked with them.

Send pre-forma letter to  
Awalkin.



In parallel, go do work  
prn + raise money.

---

Let vol + press our  
response.

→ Techn. mission - Moscow

~~Hardware~~ + infra vs. macro  
side

Shavardnadze



~~Have~~ → have to go back to Board  
at least on funding

→ Need <sup>Seminars</sup> ~~work~~ + board paper/mtg.

ROUTING SLIP		DATE 1/7/91
FROM THE SENIOR VICE PRESIDENT POLICY, PLANNING AND RESEARCH		
NAME		ROOM NO.
Messrs. Linn		
✓ Isenman		
Holsen		
	APPROPRIATE DISPOSITION	NOTE AND RETURN
	APPROVAL	NOTE AND SEND ON
	COMMENT	PER OUR CONVERSATION
	FOR ACTION	PER YOUR REQUEST
XX	INFORMATION	PREPARE REPLY
	INITIAL	RECOMMENDATION
	NOTE AND FILE	SIGNATURE
REMARKS  URGENT		
FROM Patricia Gallagher		

Mr. Thaler  
WORLD BANK OFFICE TRACKING SYSTEM  
OFFICE OF THE PRESIDENT  
Routing and Action Transmittal Sheet

TO: Mr. B. Conable (E-1227) DATE: 1/04/91

SUBJECT:

Document From: Alexander Bessmertnykh

To: bbc (original addressed to Secretary Brady)

Dated: 1/02/91

Reference No.: EXC910104013

Topic: Re inv. to visit Wash. for discussions on the status of the  
assoc. with the IMF/WB for the Soviet Union.

ACTION INSTRUCTIONS:

DUE DATE:

HANDLE

REVIEW AND RECOMMEND

XXX FOR YOUR INFORMATION

DISCUSS WITH

AS WE DISCUSSED

PREPARE RESPONSE FOR SIGNATURE

FOR YOUR FILES

RETURN TO

OTHER:

Remarks: NOTE: This was hand-delivered to the Bank on Friday, Jan. 4

@ 12 noon.

cc: Members of the President's Council



AMBASSADOR OF THE  
UNION OF SOVIET SOCIALIST REPUBLICS  
1125 SIXTEENTH STREET, N. W.  
WASHINGTON, D. C. 20036

January 2, 1991

Dear Mr. Secretary:

I would like to thank you on behalf of Minister of Finance of the USSR Valentin S. Pavlov for your kind invitation to visit Washington, D.C. for discussions on the status of association with the IMF and the World Bank for the Soviet Union.

Minister Pavlov has just informed me that he is prepared to arrive in the United States on the week of January 14, 1991, together with a group of officials from the State Bank of the USSR, Soviet Ministries of Foreign Affairs and Finance.

The Soviet side would tentatively suggest to have discussions on the following issues:

- Financial-economic and organizational-legislative aspects of the status of association of the USSR with the IMF and the World Bank, including the form of representation of the Soviet Union at these institutions;

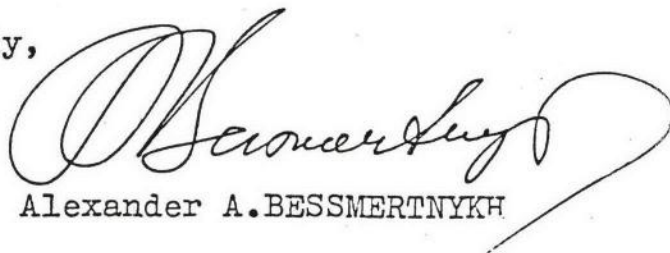
- Scale and forms of technical economic and other assistance by the Fund and the Bank during the period of special association of the USSR with these organizations;

- Correlation between the status of observer and the practical steps toward full membership of the Soviet Union in the IMF and the World Bank.

The Embassy would greatly appreciate an early advice from your office on the acceptability of the specified time for Minister Pavlov's visit and the proposed agenda, which could, of course, accommodate further suggestions by the American side.

Wishing you all the best in the New Year,

Sincerely,

A handwritten signature in dark ink, appearing to read 'Alexander A. Bessmertnykh', with a large, sweeping flourish at the end.

Alexander A. BESSMERTNYKH

cc. Mr. Michel Camdessus  
Mr. Barber B. Conable

The Honorable  
Nicholas F. BRADY  
The Secretary of the Treasury

cc: Mr. Linn  
Mr. Isenmon  
Mr. Kolsen

ERNEST STERN  
Senior Vice President  
Finance

January 4, 1991

Mr. Conable

Barber -

Financial Technical Assistance to the Soviet Union

I agree with Moeen's note of December 21 on the technical assistance to the Soviet Union in that we should wait until the constitutional arrangements in the Soviet Union are clarified and the administrative mechanism is again functioning. At the moment, the disarray is so extensive that any technical assistance could not reasonably be expected to serve any purpose other than as a political signal of support. This, I agree, should not be our intention.

However, I believe that we need to discuss the proposed approach to the financing of the technical assistance.

I understand the U.S. proposal for a special relationship has support, and we need to take it into account. As you know, the U.S. initially spoke of some kind of an associate membership, but I believe we have been successful in clarifying---with the U.S. and to the public---that there is no associate membership status and that the U.S. announcement describes a special relationship. There are three components to that relationship: attendance at the Annual Meetings; technical assistance; and the establishment of an office in Moscow. The first poses no problem. The second can be arranged, but the question is how it might best be financed. The third will, presumably, depend on the timing and volume of the technical assistance.

One approach to financing technical assistance is to contact the G-7 donors; another is to contact a wider set of donors and, a third is to fund an initial allocation out of FY90 net income.

I do not believe that it is wise to approach the G-7 at this point for yet another contribution at a time when we are about to consult with them on contributions of concessional assistance for IDA and low middle-income countries affected by the Gulf crisis. In addition, we know that the U.S. concept for a special relationship for the USSR involves some financial contribution from the Bank. The U.S. is opposed to G-7 funding at least in part, I suspect, because they wish to avoid questions of burden-sharing or concerted action. In light of the U.S. position, this approach is likely to involve difficult discussions and acrimony.



The second alternative is even less desirable. For the G-7, we at least have the rationale of their having requested the joint report on the Soviet Union. There is no similar rationale for approaching a wider group for a contribution in the absence of a burden-sharing framework. It would, of course, equally conflict with our efforts to raise concessional assistance.

The third approach rests on the premise that it is in the interest of all Bank members to assist the USSR in a successful transition to a more efficient, market-oriented economy and integration in the world economic system. If the premise is correct -- I think there are few other events which can have so major an impact on the welfare of our members -- we would be best served by proposing to the Board a modest allocation out of FY90 income to a trust fund, which would be open for contribution by others, to finance advisory services by Bank staff or consultants. An allocation out of net income is possible if it is in the interest of all the members. A paper to the Board proposing such an action based on the global interest in supporting the USSR, if agreed, would meet this requirement. The amount involved could be modest, on the order of \$10-15 million. This would finance something like 30-50 staff years of assistance. This is more than is likely to be utilized before the end of this fiscal year. The ultimate scale of technical assistance to the Soviet Union is difficult to assess, but it would not seem appropriate, in any event, for the Bank to be the sole provider. While we could add to the trust fund next fiscal year, we should also put a limit on the scale of our contribution and seek to supplement it from other sources over time.

Establishing such a trust fund has the advantage of demonstrating that the World Bank recognizes the importance of a successful transition in the Soviet Union and is willing to assist directly -- rather than only as an administrator of the funds of others. It would enable us to act soon without actually having to make any commitments, or incur any expenditures, before conditions are appropriate. It also enables us to delay consultation with potential donors until we have some sense of the scale of requests and the likely time at which we will need additional resources. It would also allow interested donors to plan for contributions in their next budget cycle rather than facing them with requests in the middle of that cycle. Finally, it avoids the difficulty of having to organize a concerted G-7 action on contributions, allowing us to raise the relatively modest amount involved in a low key manner from those who are interested in making contributions.

The risks to this approach are the possible difficulty of persuading the Board and of having funds in place before conditions will support an effective technical assistance effort. Of course, the latter problem would also exist if our consultations with the G-7 were unexpectedly smooth and expeditious.

In any event, we have the capacity to withstand such pressure and to initiate technical assistance only when we have concluded that conditions will make such support fruitful.

The Board reaction can only be determined after consultation.

What we need to decide in our discussion is (i) which of these approaches we wish to take, and (ii) who should be responsible for the mobilization of resources. The latter is important, since the issue is delicate and comes at a time when we are in the market for many different kinds of funds, which puts a premium on avoiding confusion. Since the issue is likely to arise in the course of the seminar on the Soviet Study, we should reach a conclusion before then.

Our response to Mr. Geraschenko's request for assistance of December 26, 1990 should be guided by the conclusion reached on the general issue. Setting up a specialized bank to circumvent rigidities in the current system does not, in any event, strike me as something that can be supported effectively.



Ernest Stern

cc: Mr. Qureshi  
Mr. Thalwitz  
Mr. Wapenhans  
Mr. Shihata

# THE WORLD BANK

## ROUTING SLIP

DATE  
1-4-91

FROM THE SENIOR VICE PRESIDENT,  
POLICY, RESEARCH AND EXTERNAL AFFAIRS

NAME

ROOM NO.

Messrs. Isenman ✓

Holsen

Mink

Jan. 1/10

Handwritten initials and arrows pointing to the routing slip entries.

APPROPRIATE DISPOSITION

NOTE AND RETURN

APPROVAL

NOTE AND SEND ON

COMMENT

PER OUR CONVERSATION

FOR ACTION

PER YOUR REQUEST

Y INFORMATION

PREPARE REPLY

INITIAL

RECOMMENDATION

NOTE AND FILE

SIGNATURE

REMARKS

FROM:

Patricia M. Gallagher





## Office Memorandum

To: Mr. S. Zecchini

January 3, 1991

From: L.A. Whittome

Subject: Publication of Background Paper of USSR Study

Thank you for your fax.

I certainly agree on the need to publish the papers as soon as possible and that publication should take place before the end of February; hopefully earlier. The editorial group is working with the target that its work should be completed by the beginning of February, although we may have to allow for the possibility of a few days' slippage. To speed the process, I would ask that each institution send us, as soon as possible, copies of the diskettes containing their revised versions of the background papers. We hope to send each institution edited versions of their papers by January 25 and would at that point ask for their agreement to proceed with publication or for final comments--which we would hope would be minor--by January 30. With the help of the World Bank we shall seek to send you the final texts by electronic mail as you suggest.

With the best will in the world I doubt that a January 10 deadline for sending all tables and graphs to you is feasible. That is also the agreed deadline for the circulation of comments on the revised background papers, and it is already clear that some of these comments will deal with the tables and charts (whether they overlap with or contradict those in other papers, comments regarding their clarity, and so forth). I think therefore that we have to accept a somewhat later deadline, say January 20.

Regarding the length of the volume(s), I am certain that we all agree that small is beautiful. I would therefore assume that each institution will carefully consider suggestions from the others for shortening. Realistically, our self-imposed deadlines will limit the scope for major revision and cutting but we must do what we can.

We found that with the summary report, it was essential to proof the galleys most carefully for even with the best system various errors in typesetting or formatting seem bound to intrude. I would suggest that one or possibly two members of our editorial group take on the responsibility for a final proofing and stand ready to fly to Paris for that purpose immediately you tell us that the galleys are available.

- 2 -

Finally, may I remind each institution to be sure to send to the Fund copies of its comments on each paper by January 9-10, so that the editorial group can have the benefit of all suggestions before the final editing phase.

cc: Mr. Flemming  
Mr. Thalwitz  
Mr. Holsen

# THE WORLD BANK

<b>ROUTING SLIP</b>		DATE 1/4/91	
<b>FROM THE OFFICE OF THE SENIOR VICE PRESIDENT POLICY, PLANNING AND RESEARCH</b>			
NAME		ROOM NO.	
Messrs. Isenman ✓			
Holsen			
	APPROPRIATE DISPOSITION		NOTE AND RETURN
	APPROVAL		NOTE AND SEND ON
	COMMENT		PER OUR CONVERSATION
	FOR ACTION		PER YOUR REQUEST
x	INFORMATION		PREPARE REPLY
	INITIAL		RECOMMENDATION
	NOTE AND FILE		SIGNATURE
REMARKS			
FROM			
Patricia Gallagher			



SS

WORLD BANK OFFICE TRACKING SYSTEM  
OFFICE OF THE PRESIDENT  
Routing and Action Transmittal Sheet

=====

TO: Mr. M. Qureshi (E-1241)	DATE: 1/02/91
--------------------------------	------------------

=====

=====

SUBJECT: |

Document From: Jeffrey Gates; Powell, Goldstein, Frazer & Murphy

To: BBC

Dated: 12/18/90

Reference No.: EXC910102006

Topic: Req. mtg. w/BBC to discuss Soviet interest in ESOP financing  
concept

=====

=====

ACTION INSTRUCTIONS:

| DUE DATE: |

1/15/91

\_\_\_\_XXX\_\_\_\_ HANDLE  
\_\_\_\_ REVIEW AND RECOMMEND  
\_\_\_\_ FOR YOUR INFORMATION  
\_\_\_\_ DISCUSS WITH \_\_\_\_\_  
\_\_\_\_ AS WE DISCUSSED  
\_\_\_\_ PREPARE RESPONSE FOR \_\_\_\_\_ SIGNATURE  
\_\_\_\_ FOR YOUR FILES  
\_\_\_\_ RETURN TO \_\_\_\_\_  
\_\_\_\_ OTHER: \_\_\_\_\_

Remarks: Please provide copy of response to EXC  
cc: Mr. Thalwitz

=====

POWELL, GOLDSTEIN, FRAZER & MURPHY

ATTORNEYS AT LAW

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900 CIRCLE 75 PARKWAY  
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404 951-5800

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TELEX 650 2510 330  
TELECOPIER 202 624-7222

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400 PERIMETER CENTER TERRACE  
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404 399-2800

ELEVENTH FLOOR  
THE CITIZENS & SOUTHERN NATIONAL BANK BUILDING  
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ATLANTA, GEORGIA 30335  
404 572-6600

December 18, 1990

Mr. Barber Conable  
President  
International Bank for  
Reconstruction and Development  
1818 H Street, N.W.  
Washington, D.C. 20433

Re: Soviet Interest in ESOP Concept

Dear Mr. Conable:

Now that we are poised to provide technical assistance to economic reform efforts underway in the Soviet Union, I am writing to request a meeting to share with you the steadily increasing interest that the Soviets are showing in the use of the ESOP financing concept in their reform efforts.

For example, during my most recent trip to the Soviet Union (September) as part of an ESOP Association delegation, we signed protocols to develop centers for privatization in conjunction with both the U.S.S.R. Commission on Economic Reform and the Russian Federation Commission on Economic Reform and Ownership. We also signed protocols with the Moscow City Council, the Leningrad City Council, the Prime Minister of Lithuania and the Prime Minister of Latvia. I believe that in each case these were the first protocols signed in the privatization area.

During Stanislav Shatalin's recent 12-day visit to the United States, I spent 4 days with him (we also spent time together in Moscow in February). For your information, enclosed is a "summary overview" memo I provided to Shatalin indicating how this ownership-expanding financing concept can be used to address a variety of issues facing privatization policy makers.

Interest is also shown by Leonid Abalkin (Chairman of the Economic Reform Commission) who sees ESOP financing as a way to balance the three competing concerns of social justice, economic efficiency and revenue. Great interest was also expressed by Andrei Orlov (Deputy Chairman of the Commission) and also by "radicals" such as Gavriil Popov (Mayor of the Moscow City

Mr. Barber Conable  
December 18, 1990  
Page 2

Council) with whom I did a television show on ESOPs in Moscow in February and who signed a protocol with us in September.


Note also the enclosed article from this past week's New York Times indicating how stock ownership by employees was the key motivational ingredient in turning around a previously inefficient enterprise in Moscow.

With 56 nations now actively interested in adapting the ESOP financing concept to their economies, the World Bank seems long overdue in offering expertise in techniques of finance that can create a broad base of stock ownership--as an alternative to those techniques which (as history has shown) concentrate ownership in the government or in a few private hands.

I will call to see if we might find a convenient time to discuss this in more length.

With best wishes for an enjoyable holiday seson, I remain,

Sincerely,

  
Jeffrey R. Gates  
Partner

Enclosures



M E M O R A N D U M

TO: Stanislav Shatalin  
FROM: Jeff Gates  
DATE: November 18, 1990  
RE: ESOP-Type Financing and Privatization

---

Variations of ESOP-type financing can assist in addressing a variety of issues confronting those shaping privatization policy. For example:

1. Whose Privatization? Use of the ESOP/CSOP financing concept can help make investors of those without the funds to invest. Without this financing technique, only those citizens presently holding rubles will become owners of assets now owned by all citizens.
2. Social/Economic/Revenue Balance. ESOP-type financing helps balance the three competing concerns of social justice, economic efficiency and revenue.
3. Ruble Overhang. Use of this financing mechanism provides a way to extract excess rubles from circulation -- as the enterprise is acquired from the government (at least partly) with the future earnings of the enterprise.
4. Support Capital Market Creation. Using ESOPs as a "grass roots" way to start a capital market. For example, with employees trading stock among one another within a company as well as between ESOP companies.
5. Enhancing Appeal to Foreign Investors. Offering an ESOP as an exit vehicle for foreign investors makes the entry of foreign capital more attractive -- for example, by pledging hard currency to guarantee an ESOP loan to the enterprise as a future market for a foreign investors' interest. This may be particularly useful in the early years when a truly liquid capital market cannot be assured.

Memorandum to Stanislav Shatalin  
November 18, 1990  
Page 2

6. Phase-down of Foreign Investment. Helps balance the economic need for foreign investment with the political distaste for permanent foreign ownership--for example, by negotiating a phased reduction in that interest as you approach the investment horizon (such as by selling to an ESOP).

7. Valuation Insurance/Social Success Sharing. Using dedicated warrants can help protect against the possibility that assets will be sold for too little while also providing a way to spread the benefits of privatization. For example, have the government take warrants in the privatized company with the eventual proceeds dedicated to projects designed to support private sector development. An ESOP might provide a market for some of those warrants (again pulling rubles from circulation).

8. Support Bond Market. For example, have the government accept bonds of privatized companies in return for an agreement that those bonds will convert to equity at term, thereby extracting rubles from currency in the form of interest payments. The government might then offer for sale to the public diversified portfolios of these bonds, thereby extracting more rubles from circulation (less the interest). Given the history of government paper values in the U.S.S.R., some type of private sector bonds may provide a more realistic route for extracting rubles from circulation.

9. Private Participation in Public Enterprise. The ESOP could provide a "first step" privatization mechanism. For example, the U.S. government-owned railroad, Conrail, was for many years 85% government owned and 15% ESOP owned. Conversely, 15% of the stock of a privatized company could be held in escrow by the government with an agreement to sell those shares to the company's ESOP at a future date at today's value.

10. Essential to Get It Right the First Time. Once privatization transfers ownership out of government hands, it becomes very difficult thereafter to influence the pattern of ownership because practically all corporate funds are generated within a "closed system of finance" consisting of only three sources:

- (a) earnings and profits -- which create no new owners
- (b) tax benefits (primarily depreciation) -- creating no new owners, and
- (c) debt -- which (except for ESOP-type debt) creates no new owners.



Memorandum to Stanislav Shatalin  
November 18, 1990  
Page 3

The sale of new equities is not a significant source of new corporate funds in any market economy. Plus, it is primarily the current beneficiaries of this "closed system" who have the discretionary income (from their assets) to buy those equities.

This is the primary reason a "capitalist" economy's asset base expands while its ownership base remains unchanged or contracts. Providing investment incentives to this closed system (as the U.S. did during the 1980s with its "supply-side", deficit-financed shortening of depreciation schedules) only accelerates this system's natural tendency to concentrate ownership. With the exception of ESOP-type finance, corporate financing techniques are not designed to create new stockholders; rather, they are designed to create more capital for existing stockholders.

ESOP financing focuses on the employment relationship as the most cost effective locale to begin the implementation of this ownership-expanding technique of finance -- due partly to the potential effect on the company (and the economy) of increased motivation, productivity, profitability, etc. (along with an accompanying increase in tax revenues).

Because employees have modest personal savings and earning power relative to the value of the enterprise for which they work, they can acquire a significant ownership stake only when financed, at least in part, with "self financing" -- allowing their ownership stake to be paid for not with their personal savings or their wages but largely out of the future earnings of the enterprise.

The ESOP concept does not suggest a competency by employees to manage. Professional management is considered desirable and is the norm in ESOP companies.

The ESOP financing concept could also enable consumers and other cash-poor citizens to participate in privatizations. For example, if the government were to accept "ownership transfer bonds" in a privatized company in return for some portion of the company, the government could have a steady stream of income from the bonds (say for 10 years) with which to meet its fiscal needs (including extracting rubles from circulation). At the end of this period, those bonds could then convert to citizen-owned stock.



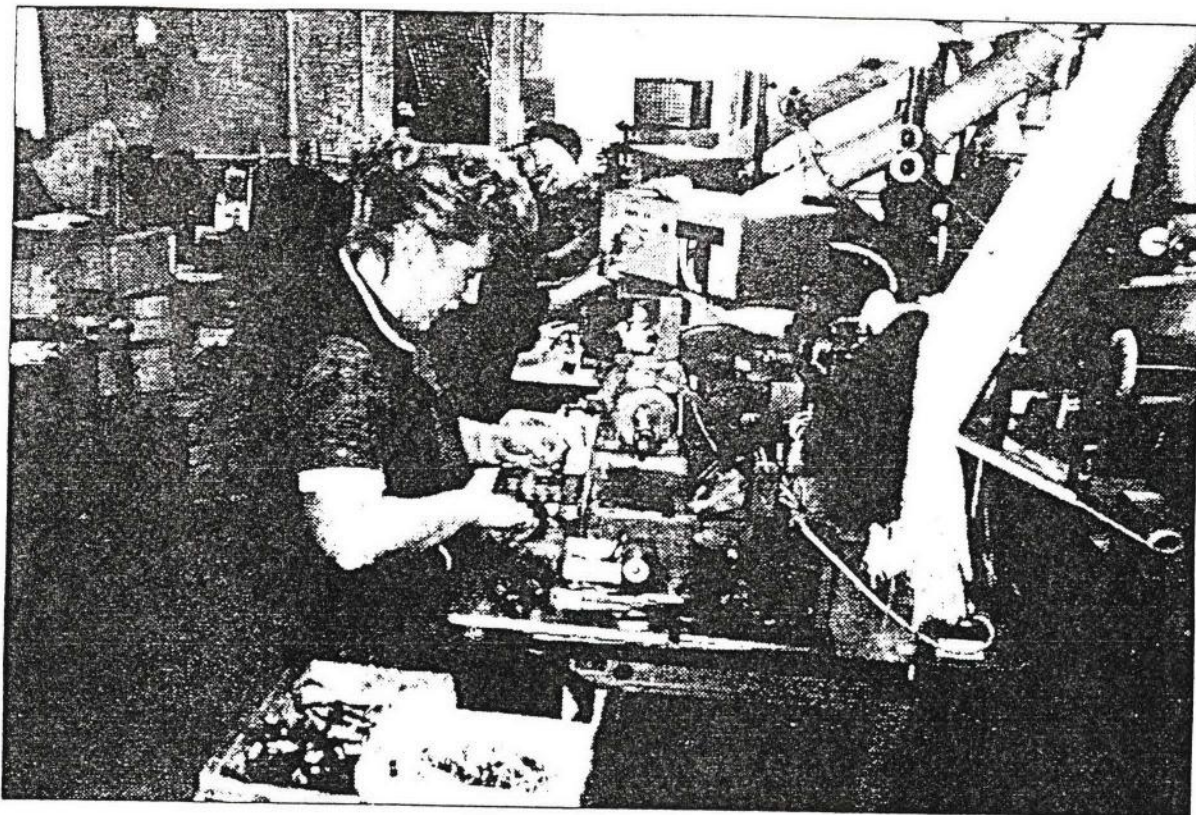
Memorandum to Stanislav Shatalin  
November 18, 1990  
Page 4

This "CSOP" (citizen or consumer stock ownership plan) financing could be organized as a mutual fund in which consumers and other citizens participate in an initial privatization and then diversify their investment via future privatizations.

I hope these thoughts are useful to you. I would be honored to be of assistance in whatever way you think most appropriate.

The New York Times

## A Rare Success Story in Moscow



Workers winding copper wire onto electrical components with converted sewing machines at the Moscow Low Voltage Equipment Factory, one of the Soviet Union's first shareholding companies. Steven Greenhouse/The New York Times

By STEVEN GREENHOUSE

*Special to The New York Times*

MOSCOW — In many ways the Moscow Low Voltage Equipment Factory seems locked in the 1950's. Inside the dirty yellow-brick building men hunch over cramped workbenches using old soldering guns, while women sit at converted sewing machines that wind copper wire onto electrical components.

This plant is the raw material, the clay, that Yuri Sergeevich Korolyov has been given to mold into an efficient, modern factory, and despite all the obstacles erected by the Soviet

system, he has made this low-tech factory something to brag about.

The electrical equipment factory is one of the nation's first shareholding companies; it has stopped losing money, developed a host of new products and raised wages by a colossal 65 percent since 1988.

The story of this Moscow plant offers a glimmer of hope in a nation where the economy is in a frightening downward spiral and where business successes are few and far between. Indeed, economists say it is unfortunate that there are not more entrepreneurial managers like Mr. Korolyov and more schools to teach such skills.

How did Mr. Korolyov manage this success? First, he was permitted to turn his company, in parlous condition, into a worker-owned cooperative. This allowed him to finally put his entrepreneurial vision to use. But perhaps most important, lackadaisical workers now felt motivated — they had a chance to share in the profits.

So while politicians endlessly debate the next step of perestroika and most citizens await the outcome, Mr. Korolyov and his workers are well along in restructuring their little cor-



# A Rare Success Story in the Soviet Union's Sliding Economy

Continued From First Business Page

ner of the Soviet economy.

"The most important thing was to change the attitude of the workers toward their job and toward the equipment they work with," said Mr. Korolyov, a harried, hard-working man who is experimenting with Western-style management from an office dominated by the obligatory portrait of Lenin. A drafty, three-story jumble of stairs and rooms, the factory produces many kinds of devices, including engines for washing machines, timers for microwave ovens and controls for small electric engines.

Mr. Korolyov, a 49-year-old electrical engineer, said that in 1986, when he was brought in to head the factory, he was appalled that the workers blithely ignored basic maintenance procedures needed to keep their machines from breaking down. There was little reason for them to care, he acknowledged, since even when their negligence contributed to a breakdown they continued to receive full salaries.

## Cooperative a First Step

One of the first things Mr. Korolyov did upon becoming chairman was to seek Government permission to turn the factory into an employee-owned cooperative. The Ministry of Electro-Technical Industry gave him the green light, and soon the factory had new owners, its 1,600 workers had a new attitude and the machinery was treated with respect.

"We're more interested in the results of our work now," said Valentina Molakova, a worker who assembles electronic controls. "We're also earning more money, and money is important."

Average wages have jumped to 380 rubles a month, far more than the nationwide average of 260. Two years ago, the national average was 230 rubles.

Thanks to increased productivity, the factory's revenues soared from 30 million rubles in 1986 to 44 million last year, even as the work force shrank



Steven Greenhouse/The New York Times

Yuri Sergeyevich Korolyov was one of the few Soviet managers to move quickly to take advantage of freedoms offered by reforms.

and most of the Soviet economy deteriorated. Once a chronic money loser, the factory posted a profit of about 4 million rubles last year.

What's in it for Mr. Korolyov? He is visibly excited by the idea of improving his company and being in the forefront of Soviet change. And the fact that his salary is rather high — three times that of the workers — is also a stimulant. "What I've done with the company is very similar to what is done in the West," he said.

Seeking further gains, Mr. Korolyov is in the midst of turning the cooperative into one of the handful of Soviet shareholding companies. The workers now own 25 percent of the shares, and the rest is being sold to other investors including a bank, a Soviet-Italian joint venture and the local Moscow district government committee. The move from a cooperative to a shareholder-owned struc-

ture is intended to make profits, productivity and modernization the factory's guiding principles. These goals differ from those of the factory as an employee-owned cooperative: preserving the workers' jobs and salaries at any cost.

Indeed, even though old-guard Communists are struggling to prevent change, the invisible hand is replacing the heavy hand on many fronts here. While President Mikhail S. Gorbachev vacillates about how fast to move toward a market economy, commodity exchanges are opening, private shops are flourishing, farmers' markets are everywhere, and managers like Mr. Korolyov are struggling to turn sluggish state-owned enterprises into dynamic shareholding corporations.

## Economic Uncertainties

To be sure, much remains uncertain about the Soviet economy and the political landscape. But without a striking reversal, the drift toward a market economy seems irreversible.

Mr. Korolyov and his workers are trying to move forward as the economic ground underneath them seems to be crumbling. The ruble is increasingly worthless, and economic regulations seem to change every three days. The centrifugal tug of the 15 republics is making it hard for Moscow enterprises to obtain needed components. What is more, with Communist power in decline, Mr. Korolyov can no longer rely on the party apparatus to bully suppliers into sending his factory components. Now he has to browbeat them himself.

When some visitors were in his office recently, he received a phone call from a factory manager who said he could not supply parts the Moscow factory desperately needed. After 10 minutes of shouting, thumping and turning crimson, Mr. Korolyov hung up and said, triumphantly, that the parts would be arriving after all. Business Soviet-style is a series of such little, hard-won triumphs.

Mr. Korolyov said he had originally hoped to increase revenues to 50 million rubles this year, from 44 million last year. But because components are in short supply, he will have to settle for 45 million this year.

## Advantages of New Climate

However many difficulties the withering away of the command economy may create, Mr. Korolyov is happy to see the old structure die. He did not like ministries telling him what or how much to produce. Nor did he like having to grope for excuses when the goals of over-optimistic plans were not fulfilled.

"The state enterprises lived in lies up to their ears," he said. "This new situation won't lead to duplicity. I recognize I can be dismissed if I do not manage this enterprise well, but now it's up to me. Now everyone is capable of having self-esteem and proving himself."



**'My people pay much more attention to quality these days.'**

Mr. Korolyov, a deep-voiced, husky man who wore a gray sweater vest inside his frayed charcoal suit, is not an ideologue. He does not preach against Communism or for capitalism. He just pursues whatever policies his instincts tell him are efficient.

#### Un-Marxist Incentive Method

He has introduced an un-Marxist incentive method to coax ideas from his 50 engineers, promising large bonuses to engineers who develop promising products.

Vadim Polosukhin, the factory's chief engineer, said, "An engineer who really believes in himself can say, 'I'll shoot to do this,' knowing he'll get 10 times his monthly salary if he achieves it."

Borrowing a popular Western idea, one engineer developed a timer that can be set to tell bakers, for instance, when 30 or 45 minutes has elapsed. He received a 4,000-ruble bonus. With such basic products, the factory satisfies consumer desires and increases production.

To bolster productivity, the factory has instituted a piecework system. To improve quality, the workers responsible for defective products have to go through the time-consuming, bonus-

reducing process of repairing the defects themselves.

"My people pay much more attention to quality nowadays," said Aleksei Lavrukhin, a foreman.

#### Navigating an Obstacle Course

Despite such motivational techniques, the factory remains far less productive than similar ones in the West. In the United States, factories making such equipment are often in one hangar-size room, where carts effortlessly distribute components and where products move smoothly from one stage to the next.

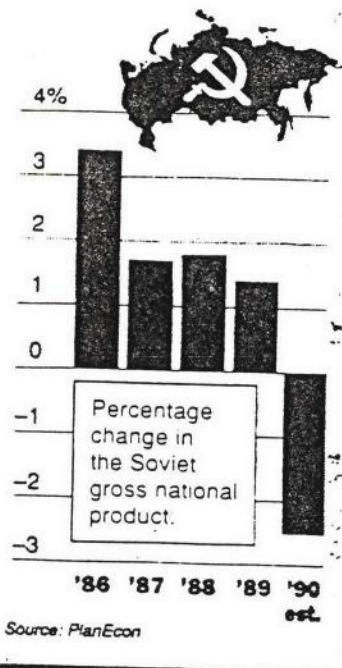
By contrast, the Moscow factory is divided into dozens of rooms, and parts are strewn in bins far from each worker. Transferring products from room to room is like navigating an obstacle course.

Still, the factory was in far worse shape when Mr. Korolyov took over. "It was a disaster," he said. "It couldn't pay its debts. One and a half million rubles was missing and couldn't be found."

He applied for the factory to become a cooperative two years ago, shortly after a law was approved allowing this new employee-owned structure. Most cooperatives involve agriculture or commercial middlemen; few involve existing state-owned factories.

The employees put up 500 rubles each for the plant, which cost 9 million rubles. Mr. Korolyov could pay the workers more with a cooperative structure because of big improvements in productivity, and regulations allowing cooperatives to have profit-sharing programs and pay lower taxes. Now Mr. Korolyov is es-

## Troubling Times



The New York Times

establishing what he thinks is an even better structure: a Western-style shareholding corporation.

Although he is excited about the new structure, Mr. Korolyov recognizes that managing it could be harder than under the old system.

"Before, when you headed a state enterprise, if things went wrong you could always blame the ministry," he said. "Now when things don't work out, people may start calling you a good-for-nothing."

# THE WORLD BANK

## ROUTING SLIP

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1-4-91

FROM THE SENIOR VICE PRESIDENT,  
POLICY, RESEARCH AND EXTERNAL AFFAIRS

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REMARKS

FROM:

Patricia M. Gallagher

Centre pour la Coopération avec les Économies Européennes en Transition  
Centre for Co operation with the European Economies in TransitionLe Secrétaire général suppléant  
Directeur du CentreThe Assistant Secretary-General  
Director of the Centre

SZ/90.02

cc: MM. J-P. Fitoussi  
J. Holsen  
Ms. T. Ter-MinassianTo: MM. J. Flemming  
W.P. Thalwitz  
A. Whittome

3rd January, 1991

From: Salvatore Zecchini

Subject: Publication of Background Papers of USSR Study

Once we have circulated the drafts of the background papers among our institutions, we need to specify a few points concerning their publication. We all agreed that the importance of these papers declines relatively fast and it is consequently essential to have them printed and published before the end of February. To speed up matters, I suggest the following:

- I would like to receive all tables and graphs in their final format by 10th January. As to the graphs, for printing reasons, it is necessary to have the data plotted;
- The final text of the papers, once edited, should be transmitted to us electronically through the link with the World Bank. This will speed up the photo-composition;
- The finalisation of the edited texts should take place before the end of this month.

I would also suggest that we try to reduce, to the extent possible, the number of pages of this volume. The bigger the volume, the longer it takes to print, the higher is the cost, the higher is the selling price and the fewer are the copies that can be sold. In this respect, I would like to remind that the four participating institutions agreed to share the cost or the profits of this operation.



ORGANISATION DE COOPÉRATION ET DE DÉVELOPPEMENT ÉCONOMIQUES  
ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

Centre pour la Coopération avec les Economies Européennes en Transition  
Centre for Co-operation with the European Economies in Transition

2, rue André-Pascal, 75775 PARIS Cedex 16

Téléfax : (33.1) 45.24.91.77

Téléphone : (33.1) 45.24.93.36

DESTINATAIRE/ADDRESSEE : Messrs. W.P. Thalwitz and J.A. Holsen

FAX NO. : (1.202) 477.0549

DE/FROM : Mr. S. Zecchini

ENVOYÉ PAR/SENT BY : S. Milowski

NOMBRE DE PAGES/NUMBER OF PAGES : 2 (y compris cette page/including this page)

DATE: 3rd January 1991

The World Bank/IFC/MIGA  
O F F I C E M E M O R A N D U M

DATE: 04-Jan-1991 12:37pm

TO: See Distribution Below

FROM: Sven Sandstrom, EXC

( SVEN SANDSTROM )

EXT.: 81138

SUBJECT: RE: Participation of Soviet Officials in EDI Seminars

Amnon,

As I told Peter Knight over the phone yesterday, the Soviet participation in the Delhi seminar is ok (no direct Bank costs). However, you cannot invite the Soviets to the seminar in Poland unless either (a) all costs are covered by non-Bank sources, or (b) we get Board approval to proceed with a Technical Cooperation program (including EDI) with the Soviet Union. We are right now trying to work out the next steps to seek Board approval but I doubt that we will have such an approval before February..

As you know we are at a difficult stage vis-a-vis the Board on the subject of assistance to the Soviet Union as a non-member and we are trying to avoid anything that would reduce the chances of getting a broad agreement on a TC program. And as far as the study of the Soviet economy is concerned, there was a full Board discussion before we went ahead.

I attach an EM from Ibrahim which gives his clear view. Ernie, as acting President, feels equally strongly.

Sven

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<b>File Title</b> Soviet - General - January 1991		<b>Barcode No.</b>  30382299		
<b>Document Date</b> January 2, 1991	<b>Document Type</b> Memorandum			
<b>Correspondents / Participants</b> To: Sven Sandstrom From: Ibrahim Shihata, LEGVP				
<b>Subject / Title</b> Participation of Soviet Officials in EDI Seminars				
<b>Exception(s)</b> Attorney-Client Privilege				
<b>Additional Comments</b>		<p>The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information or other disclosure policies of the World Bank Group.</p> <table border="1"><tr><td><b>Withdrawn by</b> Shiri Alon</td><td><b>Date</b> September 05, 2019</td></tr></table>	<b>Withdrawn by</b> Shiri Alon	<b>Date</b> September 05, 2019
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WORLD BANK OFFICE TRACKING SYSTEM  
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Mr. Thalmitz  
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TO: Mr. B. Conable (E-1227) DATE: 1/04/91

SUBJECT:

Document From: Alexander Bessmertnykh

To: bbc (original addressed to Secretary Brady)

Dated: 1/02/91

Reference No.: EXC910104013

Topic: Re inv. to visit Wash. for discussions on the status of the  
assoc. with the IMF/WB for the Soviet Union.

ACTION INSTRUCTIONS:

DUE DATE:

HANDLE  
REVIEW AND RECOMMEND  
XXX FOR YOUR INFORMATION  
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PREPARE RESPONSE FOR SIGNATURE  
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OTHER:

Remarks: NOTE: This was hand-delivered to the Bank on Friday, Jan. 4  
@ 12 noon.

cc: Members of the President's Council

Wright

Linn  
Isenmor  
Helen  
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AMBASSADOR OF THE  
UNION OF SOVIET SOCIALIST REPUBLICS  
1125 SIXTEENTH STREET, N. W.  
WASHINGTON, D. C. 20036

January 2, 1991

Dear Mr. Secretary:

I would like to thank you on behalf of Minister of Finance of the USSR Valentin S. Pavlov for your kind invitation to visit Washington, D.C. for discussions on the status of association with the IMF and the World Bank for the Soviet Union.

Minister Pavlov has just informed me that he is prepared to arrive in the United States on the week of January 14, 1991, together with a group of officials from the State Bank of the USSR, Soviet Ministries of Foreign Affairs and Finance.

The Soviet side would tentatively suggest to have discussions on the following issues:

- Financial-economic and organizational-legislative aspects of the status of association of the USSR with the IMF and the World Bank, including the form of representation of the Soviet Union at these institutions;

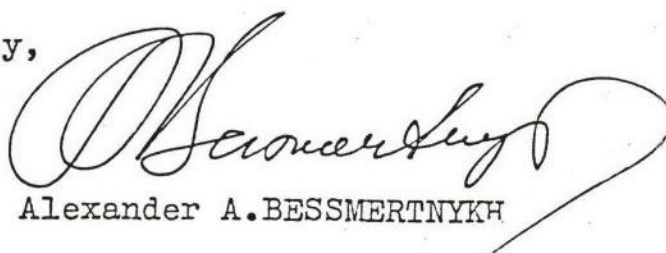
- Scale and forms of technical economic and other assistance by the Fund and the Bank during the period of special association of the USSR with these organizations;

- Correlation between the status of observer and the practical steps toward full membership of the Soviet Union in the IMF and the World Bank.

The Embassy would greatly appreciate an early advice from your office on the acceptability of the specified time for Minister Pavlov's visit and the proposed agenda, which could, of course, accommodate further suggestions by the American side.

Wishing you all the best in the New Year,

Sincerely,



Alexander A. BESSMERTNYKH

cc. Mr. Michel Camdessus  
Mr. Barber B. Conable

The Honorable  
Nicholas F. BRADY  
The Secretary of the Treasury



334-0476

cc: Mr. Linn  
Mr. Isenman  
Mrs. Folsom

The World Bank  
Washington, D.C. 20433  
U.S.A.

ERNEST STERN  
Senior Vice President  
Finance

January 4, 1991

Mr. Conable

Barber -

Financial Technical Assistance to the Soviet Union

I agree with Moeen's note of December 21 on the technical assistance to the Soviet Union in that we should wait until the constitutional arrangements in the Soviet Union are clarified and the administrative mechanism is again functioning. At the moment, the disarray is so extensive that any technical assistance could not reasonably be expected to serve any purpose other than as a political signal of support. This, I agree, should not be our intention.

However, I believe that we need to discuss the proposed approach to the financing of the technical assistance.

I understand the U.S. proposal for a special relationship has support, and we need to take it into account. As you know, the U.S. initially spoke of some kind of an associate membership, but I believe we have been successful in clarifying---with the U.S. and to the public---that there is no associate membership status and that the U.S. announcement describes a special relationship. There are three components to that relationship: attendance at the Annual Meetings; technical assistance; and the establishment of an office in Moscow. The first poses no problem. The second can be arranged, but the question is how it might best be financed. The third will, presumably, depend on the timing and volume of the technical assistance.

One approach to financing technical assistance is to contact the G-7 donors; another is to contact a wider set of donors and, a third is to fund an initial allocation out of FY90 net income.

I do not believe that it is wise to approach the G-7 at this point for yet another contribution at a time when we are about to consult with them on contributions of concessional assistance for IDA and low middle-income countries affected by the Gulf crisis. In addition, we know that the U.S. concept for a special relationship for the USSR involves some financial contribution from the Bank. The U.S. is opposed to G-7 funding at least in part, I suspect, because they wish to avoid questions of burden-sharing or concerted action. In light of the U.S. position, this approach is likely to involve difficult discussions and acrimony.



The second alternative is even less desirable. For the G-7, we at least have the rationale of their having requested the joint report on the Soviet Union. There is no similar rationale for approaching a wider group for a contribution in the absence of a burden-sharing framework. It would, of course, equally conflict with our efforts to raise concessional assistance.

The third approach rests on the premise that it is in the interest of all Bank members to assist the USSR in a successful transition to a more efficient, market-oriented economy and integration in the world economic system. If the premise is correct -- I think there are few other events which can have so major an impact on the welfare of our members -- we would be best served by proposing to the Board a modest allocation out of FY90 income to a trust fund, which would be open for contribution by others, to finance advisory services by Bank staff or consultants. An allocation out of net income is possible if it is in the interest of all the members. A paper to the Board proposing such an action based on the global interest in supporting the USSR, if agreed, would meet this requirement. The amount involved could be modest, on the order of \$10-15 million. This would finance something like 30-50 staff years of assistance. This is more than is likely to be utilized before the end of this fiscal year. The ultimate scale of technical assistance to the Soviet Union is difficult to assess, but it would not seem appropriate, in any event, for the Bank to be the sole provider. While we could add to the trust fund next fiscal year, we should also put a limit on the scale of our contribution and seek to supplement it from other sources over time.

Establishing such a trust fund has the advantage of demonstrating that the World Bank recognizes the importance of a successful transition in the Soviet Union and is willing to assist directly -- rather than only as an administrator of the funds of others. It would enable us to act soon without actually having to make any commitments, or incur any expenditures, before conditions are appropriate. It also enables us to delay consultation with potential donors until we have some sense of the scale of requests and the likely time at which we will need additional resources. It would also allow interested donors to plan for contributions in their next budget cycle rather than facing them with requests in the middle of that cycle. Finally, it avoids the difficulty of having to organize a concerted G-7 action on contributions, allowing us to raise the relatively modest amount involved in a low key manner from those who are interested in making contributions.

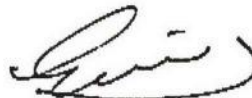
The risks to this approach are the possible difficulty of persuading the Board and of having funds in place before conditions will support an effective technical assistance effort. Of course, the latter problem would also exist if our consultations with the G-7 were unexpectedly smooth and expeditious.

In any event, we have the capacity to withstand such pressure and to initiate technical assistance only when we have concluded that conditions will make such support fruitful.

The Board reaction can only be determined after consultation.

What we need to decide in our discussion is (i) which of these approaches we wish to take, and (ii) who should be responsible for the mobilization of resources. The latter is important, since the issue is delicate and comes at a time when we are in the market for many different kinds of funds, which puts a premium on avoiding confusion. Since the issue is likely to arise in the course of the seminar on the Soviet Study, we should reach a conclusion before then.

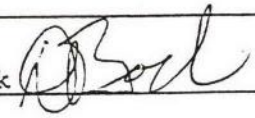
Our response to Mr. Geraschenko's request for assistance of December 26, 1990 should be guided by the conclusion reached on the general issue. Setting up a specialized bank to circumvent rigidities in the current system does not, in any event, strike me as something that can be supported effectively.



Ernest Stern

cc: Mr. Qureshi  
✓ Mr. Thalwitz  
Mr. Wapenhans  
Mr. Shihata



ROUTING SLIP		DATE Jan. 3, 1991	
OFFICE OF THE SENIOR VICE PRESIDENT, OPERATIONS			
NAME		ROOM NO.	
Members of the USSR TA			
Informal Working Group			
(Messrs. Isenman, Kavalsky, Levy,			
Goldberg, Holsen, Hasan, Knight)			
	To Handle		Note and File
	Appropriate Disposition		Note and Return
	Approval		Prepare Reply
	Comment		Per Our Conversation
	Full Report		Recommendation
	Information		Signature
	Initial		Send On
REMARKS			
<p>Could we have a meeting to discuss the attached on Monday, Jan. 7, at 10:00 AM in my office (Room F1220).</p>			
FROM			
David R. Bock 			

## TECHNICAL ASSISTANCE TO THE SOVIET UNION

1. The provision of technical assistance to the Soviet Union has been under consideration for several months. An Aide Memoire sent to the Soviet authorities outlined the Bank's capabilities and pointed out that "any such program will require the approval of the Bank's Board of Directors. Moreover, since the Bank's charter stipulates that its resources and facilities are to be used exclusively for the benefit of its members, this program will need to be funded in the near term by contributions from third parties or by reimbursements."

2. Bearing in mind the G-7's initiative in calling for the Joint Study of the Soviet Economy and the recent proposal by the President of the United States for "associate status" for the Soviet Union in the World Bank and the IMF, the justification for Bank technical assistance to the Soviet Union would seem to rest on the following considerations:

- the Soviet Union is undertaking basic policy reforms to create a market-based economy and has requested assistance from the Bank to help achieve this objective;
- the G-7 countries, the Common Market and other bilateral and multi-lateral donors, including the IMF, have initiated or are preparing technical assistance programs to the Soviet Union and the Bank should play an appropriate role;
- the Bank has certain comparative advantages in the provision of technical assistance that would be of benefit to the Soviets;
- the Soviet Union has decided in principle to apply for membership in the Bank and the Fund; a balanced program of policy advice and technical assistance would be a constructive way to prepare for that eventuality; and
- the entry of the Soviet Union into the world economy should lead to greater international stability and economic growth, and thus to long-term benefits for the Bank's member countries.

### Soviet Needs and Bank Approach

3. The Executive Summary of the Joint Study of the Soviet Economy was made available to Directors on December 20. The full Study makes clear that the Soviet Union can use substantial



technical assistance in almost all sectors of the economy. In order not to dissipate the Bank's technical assistance, an effort is being made to define mutually satisfactory areas where the Bank's expertise and the Soviet priorities coincide.

4. The formal Soviet request specifies the following priority areas:

- reform of the banking and financial systems
- developing the infrastructure necessary for a market system and related training
- implementation of de-statization and privatization programs
- a range of problems relating to the consumer market and social protection of the population
- and with respect to specific economic sectors, emphasis on energy development, resource saving technologies, agroindustry (including transportation and storage), information technologies and telecommunications.

5. As to the modalities of a technical assistance program, the Joint Study team found Soviet counterparts to be technically competent and did not experience serious communication problems, although logistical problems in the Soviet Union can be formidable. Care must be exercised in picking the right level of government for a given activity -- union, republic, region or municipality -- and in picking the counterpart organization(s). This will vary according to subject matter, although there should be one overall, high-level coordinating mechanism and a prominent economic institute as the principal Soviet counterpart organization. Because of the size of the Soviet economy, the complexity of Union-Republic relationships, the logistical difficulties of operating there and the large number of Soviet counterparts to be used, it would be necessary to have a coordinator and several key advisors together with supporting services located in Moscow. These matters need to be discussed in detail and management is preparing a technical mission to Moscow for the second half of January.

6. It is critical that the Soviet economic reforms be comprehensive -- policy reform, institutional changes (including training), appropriate investment strategies aimed at early, sustainable increases in production and a carefully designed social safety net that should be coordinated with price liberalization. Strong linkages would be established between macroeconomic policy work and the sectoral and investment strategies in order to have an early impact on the real economy.



7. Training cuts across all sectors and Soviet requirements are enormous. The Economic Development Institute (EDI) would work with Soviet institutions to mount policy seminars and help to design training programs to be run by Soviet institutions. EDI could provide materials and guide training programs in the techniques of investment analysis and project appraisal. Most of these programs would be done in the Soviet Union and be managed by Soviet institutions, with EDI playing an important role in setting standards.

### Risks

8. A technical assistance program, if carefully structured and prudently managed, should not have a major short-term impact or long-term negative effects on the Bank's member countries. The required funds would be raised externally; the core Bank staff necessary to manage and participate in the various studies will be limited; and close-down costs will be minimal if major political disorder ensues or the program must be closed down for other reasons.

9. The Soviet Union's relationships to its fifteen Constituent Republics are in a state of uncertainty and potential change. Nevertheless, a considerable degree of economic interdependence is likely to continue because of the structure of the Soviet economy and the geographical location of productive assets and raw materials. Whatever the merits of independence for any particular republic might be, the economic price to be paid for complete severance from an All-Union market without trade barriers would probably be very high.

10. In the event of extreme political disorder or military activity, as has happened from time to time in the case of a number of member countries, technical assistance activities might have to be suspended or even terminated. The associated risks are quantifiable, limited to funds already expended and the re-assignment of a small staff contingent. On balance, however, it is expected that the value of external assistance provided from multiple quarters, including the Bank and the Fund, is likely to exert a moderating influence through the rationalization of the underlying economic inter-relationships.

### Next Steps

11. For planning purposes it seems prudent to consider a three year program. A reasonable level of effort covering the outlined activities is preliminarily estimated to be in the range of \$40 to \$50 Million for foreign-exchange costs. The Soviet Union, the individual Republics and participating local authorities would share local costs, which will be estimated

during the proposed technical mission.

12. At this stage, Directors' approval is sought for the following: first, specifying a detailed three year program of technical assistance to the Soviet Union along the lines and order of magnitude indicated above, and secondly, exploring the funding sources for such program. I would then return to you in February or March to seek your approval of a specific technical assistance program for the Soviet Union.

The World Bank/IFC/MIGA  
O F F I C E M E M O R A N D U M

DATE: 02-Jan-1991 04:35pm

TO: Paul Isenman

( PAUL ISENMAN )

FROM: Geoffrey B. Lamb, PRDPD

( GEOFFREY B. LAMB )

EXT.: 32544

SUBJECT: Soviet TA

[We wd have been delighted if Lisa and her chap had come on New Year's Eve--pl apologise to her that everyone was so feeble, so that by 3.30 the household was quietly sipping tea and nursing sore feet...]

Costas will no doubt be getting back to you, if he hasn't already, about the Soviet TA memo etc. In essence, we thought a Steering Ctee plus an implementation group plus Alan doing it day to day was a bit too much of a good thing: we might profitably cut out a layer.

I was somewhat breathtaken to be so pointedly excluded from the arrangements you propose. It's rather odd -- and very unwelcome -- to go from being as closely involved as I was in Oct/Nov, to zero role in the disposition you now propose. It seems odd, too, not to have had any discussion.

Hope you're having a good break, despite being on-line.

*Spoke with Gray  
1/4,  
for discussion with him*

*Self*