

**BLACK  
EXHIBIT 65**



# ASSISTING RUSSIA'S TRANSITION

An Unprecedented  
Challenge



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# Contents

vii	<b>Acknowledgments</b>
ix	<b>Executive Summary</b>
	ix Executive Summary
	ix Резюме
	xxi Résumé analytique
	xxi Resumen Ejecutivo
xxxi	<b>Abbreviations and Acronyms</b>
1	<b>1. Russia's Transition: from Plan to Market</b>
	1 An Extraordinary Challenge
	2 Institutional, Economic, and Social Performance
	4 Recent Achievements
5	<b>2. The Evolution of Bank Group Assistance</b>
	5 The Bank's Goals
	5 Early Phases
	7 The "Renewed Lending" Phase
	8 The "Crisis and Recovery" Phase
11	<b>3. Bank Products and Services</b>
	11 Analytical and Advisory Services
	13 Bank Lending Trends
	13 Closed Project Performance
	14 IFC and MIGA Interventions
	15 Portfolio Management
	16 Project Implementation Units (PIUs)
	17 Cost-Effectiveness
	18 Decentralization of Bank Operations
19	<b>4. Development Impact</b>
	19 Private Sector Development
	21 Financial Sector Development

	22	Public Sector Management and Financial Accountability
	23	Social Protection
	24	Energy Sector
	25	Overall Impact of Bank Assistance
<b>27</b>	<b>5.</b>	<b>Contributions to Effectiveness of Bank Assistance</b>
<b>33</b>	<b>6.</b>	<b>Lessons Learned and Recommendations</b>
	33	Key Development Challenges
	33	Lessons Learned
	34	Recommendations
<b>37</b>	<b>Annexes</b>	
	39	1: A Thematic Overview of Russia's Transition Challenges
	49	2: A Chronological Overview of Russia's Transition Challenges
	51	3: Evaluating Bank Assistance to the Transport Sector
	53	4: Evaluating Bank Assistance to the Agriculture Sector
	55	5: 1997 and 1999 CAS Objectives and Outcomes
	57	6: Bank Performance in Sectoral Development
	59	7: Discussion of Other Counterfactuals
	61	8: Bank Management Views
	63	9: Russia: IFB Country Impact Review
	69	10: Views of External Advisers and Others
	75	11: Russian Federation Government Views
	83	12: MIGA's Activities in Russia
	85	13: The World Bank Institute's Activities in Russia
	87	14: Russia's Chamber of Accounts' Views of World Bank-Funded Projects
	89	15: Lessons from External Evaluations
	91	16: Guide to OED's Country Evaluation Rating Methodology
	95	17: Background Papers Prepared for the Russia CAE
	97	18: Report from the Committee on Development Effectiveness (CODE)
	101	19: Reference Tables
<b>125</b>	<b>Endnotes</b>	
<b>131</b>	<b>Bibliography</b>	
	<b>Text Figures</b>	
	6	2.1 World Bank Gross Commitments, Disbursements, and Net Transfers
	13	3.1 Sectoral Composition of New Lending
	<b>Text Tables</b>	
	3	1.1 Selected Macroeconomic Indicators (1990–01)
	9	2.1 World Bank Commitments (US\$ million)
	14	3.1 OED Evaluation Ratings of Bank Projects
	<b>Text Boxes</b>	
	12	3.1 Good Analytical and Advisory Services
	15	3.2 IFC Country Program Strengths and Weaknesses
	16	3.3 Coal Sector Restructuring—Best Practice Bank-Supported Project
	17	3.4 Selected Government Officials' Views of Portfolio Management
	20	4.1 Trucking Privatization: A Bank Group Success (FY93–94)
	21	4.2 Boosting Russia's Comparative Advantage in Space Technology

- 24 4.3 Bank Assistance for Gender Equality
- 29 5.1 External Views of Bank Performance

**Annex Tables**

- 42 A.1 Selected Fiscal Indicators (1992-01)
- 64 A.2 Summary of the IFC's Strategic Priorities and Results
- 102 A.3 Russian Federation at a Glance
- 104 A.4 International Development Goals
- 105 A.5 IBRD OED Summary Ratings, FY95-01
- 106 A.6 Evaluation Ratings of Closed IBRD Projects, 1995-01
- 107 A.7.1 Bank-GEF Loans Guarantees and Grants by Fiscal Year, 1992-01
- 109 A.7.2 Bank-GEF Loans Guarantees and Grants by Sector, Fiscal Year 1991-01
- 111 A.8 Recipient-Executed Grants, as of November 1, 2001
- 112 A.9 IBRD Lending to Russian Federation (Exit/Approval FY92-01)
- 114 A.10 Russian Federation-World Bank Economic Sector Work and Research Papers, since FY90, by Sector
- 119 A.11 Assistance Program Annual Cost, FY92-01 (\$'000)
- 120 A.12 Assistance Program Cost Effectiveness, FY92-96 and FY97-01
- 121 A.13 Russian Federation-IBRD Portfolio Performance Indicators, FY93-01
- 122 A.14 Russian Federation-IBRD's Senior Management since Calendar Year 1991
- 123 A.15 International Finance Corporation
- 124 A.16 MIGA Guarantees Issued in the Russian Federation, FY92-01

**Annex Figure**

- 65 A.1 Russia: Institutional Investor Country Credit Rating (IICCR) and IFC Net Approvals





# Acknowledgments

This Country Assistance Evaluation (CAE) assesses the development effectiveness of the World Bank's lending and non-lending assistance to the Russian Federation since 1991, a 10-year period of tumultuous political, economic, and social change. The review focuses on four areas central to the transition agenda and to the Bank's assistance in Russia, accounting for more than 75 percent of the Bank's analytical work and lending commitments: (a) public sector management, (b) private and financial sector development, (c) social protection, and (d) energy. Sectoral reviews were conducted by OED staff and consultants, and by experts from two Eastern European policy research institutes (the Institute for Economics in Transition, EIT, in Moscow, and the Center for Economic and Social Research, in Warsaw). The CAE also drew on project performance assessment reviews of individual projects.

The Operations Evaluation Group (OEG) of the International Finance Corporation (IFC) conducted a parallel evaluation of IFC activities in Russia, which is being issued as a separate report (its executive summary appears as Annex 9). The Operations Evaluation Unit (OEU) of the Multilateral Investment Guarantee Agency (MIGA) contributed a review of MIGA's activities (reproduced in Annex 12).

Using OED's standard methodology, the CAE assesses the effectiveness of Bank assistance

from three angles. The products and services dimension applies evaluation criteria to major Bank activities (strategic and policy advice, economic and sector work, lending and resource mobilization, and aid coordination) and OEG and OEU criteria to the IFC and MIGA interventions. The development impact dimension assesses the overall results of the assistance program. The attribution dimension relates these results to the performance of the Bank, the client country, its aid partners, and exogenous factors (see Annex 16).

This report was prepared by Gianni Zanini (Task Manager). Major contributors of background papers, which are listed in Annex 17 and are available online at [http://www.worldbank.org/oed/russia\\_cae/](http://www.worldbank.org/oed/russia_cae/) upon request from the OED Working Paper Series, include Alexander Radygin, Marina Kolosnitsyna, and Yuri Bobylev (IET, Moscow); Barbara Blaszczyk, Jacek Cukrowski, Helena Goralska, and Irena Topinska (Center for Social and Economic Research, Warsaw); Vinod Saghal and Deepa Chakrapani (OED, World Bank); Saul Estrin and Alan Bevan (London Business School); and Fred Levy, Baran Tuncer, and Richard Berney (consultants, formerly World Bank staff). Other inputs were provided by Marek Dabrowski and Jan Anthony Vincent Rostowki (CASE, Warsaw), Vladimir Mau and Sergei Drobyshesky (IET, Moscow), Vittorio Corbo (Pontificia Universidad Catolica de

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A mission led by Mr. Zanini, including Ms. Blaszczyk; Messrs. Berney, Corbo, Dabrowski, and Thompson; and IET experts, visited Moscow, Tula, Tver, and Novokuznetsk in February 2001 to conduct field interviews with current and former federal, regional, and local government officials, policy advisers, and analysts.

OED received feedback on a preliminary CAE draft from the current Russia country team in the Bank Group, the Europe and Central Asia (ECA) Region's management, an International Monetary Fund (IMF) representative, and former Bank staff involved in the Russia program during an all-day discussion session held in July 2001. Formal comments on subsequent revised drafts were received from ECA, the World Bank Institute (WBI), and IMF management. Bank management views on past assistance and the CAE are reproduced in Annex 8. In July 2001, the government of the Russian Fed-

eration, through the Federal Center for Project Finance, provided comments on preliminary drafts of the sectoral background papers in private and financial sector development, energy, and social protection. Government comments on the CAE were provided in March 2002 and have been incorporated in the report and reproduced in Annex 11. The summary minutes of the discussion on the CAE (and on the OEG evaluation of IFC assistance) by representatives of the Bank's shareholders are reproduced in Annex 18.

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## Executive Summary

The Country Assistance Evaluation (CAE) for Russia, covering the period from 1992 to 2001, showed disappointing but improving results for the World Bank's activities in the Russian Federation. Although OED rated the outcome of World Bank assistance to Russia as unsatisfactory during 1992–98, with only a modest impact on institutional development, for the period 1998–01 it rated the outcome satisfactory and institutional development impact substantial.

The Russia CAE found that an assistance strategy oriented around analytical and advisory services (AAA) with limited financial support for Russia would have been more appropriate than one involving large volumes of adjustment lending, since such lending in 1996–97 may have delayed rather than accelerated needed reforms. Disbursements should have rewarded actions rather than promises. In support of its overall outcome rating through June 1998, OED highlighted the large size of quick-disbursing and investment loans, including SAL III, with unsatisfactory outcomes. It noted that research and evaluation findings confirmed that large amounts of lending could not be relied upon to ensure country ownership.

### A Decade of Rapid Political and Economic Transformation

When it joined the Bank in June 1992, soon after the dissolution of the Soviet Union, Russia was in the midst of a protracted and deep recession. Inflation was high and accelerating and the balance of payments was under severe pressure, compounded by the heavy external debt inherited from the Soviet Union and a disintegrating ruble zone. The dissolution of the institutional framework for most of Russia's trade exacerbated the extraordinary shifts required in relative prices. The Russian people were hesitant about the move toward capitalism, unsure of what this would entail for their livelihoods, and concerned about the risks of a possible political backlash. The obstacles to reforms included:

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## Резюме

Оценка результатов деятельности Группы организаций Всемирного банка в Российской Федерации (КАЭ), охватывающая период 1992–2001 годов, отражает неутешительные, хотя и улучшающиеся результаты деятельности Всемирного банка в Российской Федерации. ДООД оценивает результаты содействия Всемирного банка России в период 1992–1998 годов как неудовлетворительные ввиду их скромного воздействия на институциональное развитие, в то время как аналогичные результаты за период 1998–2001 годов характеризуются как удовлетворительные, учитывая их значительное воздействие на институциональное развитие.

В КАЭ содержится вывод о том, что для России была бы более уместна стратегия содействия, ориентированная на оказание аналитических и консультационных услуг (АКД) при ограниченном финансовом содействии, по сравнению со стратегией, предполагающей значительные объемы кредитования на структурные преобразования, поскольку в период 1996–1997 годов предоставление такого рода кредитования скорее сдерживало, чем ускоряло проведение необходимых реформ. Кредитные средства должны предоставляться в обмен на действия, а не обещания. В подтверждение своей оценки общих результатов деятельности в период по июнь 1998 года включительно ДООД особо подчеркивает большой объем быстро используемых и инвестиционных займов, в том числе Третьего займа на цели структурных преобразований, представление которых принесло неудовлетворительные результаты. В КАЭ отмечается, что результаты исследований и оценок подтверждают тот факт, что значительный объем кредитования не может гарантировать заинтересованное участие страны в реализации проектов и программ.

## ENGLISH

- State institutions designed for command and control of economic activity instead of regulation and oversight
- An economic structure based on central planning rather than incentives and comparative advantage
- Production and distribution systems dominated by large, state-owned enterprises that

also delivered social services and provided social protection

- A newly created, poorly regulated financial sector
- A nonfunctional payment system
- Weakening authority in a central, complex federal system.

The Russian transition has been more difficult than expected by the international community. Successive Russian governments launched stabilization and adjustment programs in the early to mid-1990s, with assistance from the International Monetary Fund (IMF) and the Bank, and encouragement from the international community. Most of these programs were only partially implemented because of weak institutional capacity and insufficient political will. In August 1998, a year-long stabilization and structural adjustment program collapsed because of external shocks and inadequate fiscal adjustment. Russia defaulted on its debt, the ruble was floated (depreciating by over 60 percent), and output dropped by more than 5 percent.

Asset and income inequality have increased, partly through a process initiated in the 1980s, when enterprise managers and senior government and party officials began to take over state enterprises and their assets in what is referred to as "spontaneous privatization." But some aspects of the formal privatization process also contributed. Poverty has increased and indicators of social and human development have declined, social services have deteriorated, and "market-type" social protection mechanisms have been slow to develop. Macroeconomic stability has been difficult to achieve, partly because the authorities lacked the instruments for indirect control of the economy, but also because there was no consensus on how to spread the costs of adjustment. Small and medium-size enterprise (SME) has been discouraged by high costs of entry and of doing business, including weak rule of law and bureaucratic harassment.

## РУССКИЙ

### Десятилетие быстрых политических и экономических перемен

В момент вступления в члены Банка в июне 1992 года, вскоре после распада Советского Союза, Россия находилась в середине затянувшегося и глубокого спада. Высокий уровень инфляции продолжал расти быстрыми темпами, а платежный баланс

испытывал серьезное давление, усугублявшееся большим внешним долгом, доставшимся России в наследство от Советского Союза, и распадом рублевой зоны. Развал институциональной структуры основной части российской торговли обострил необходимость принятия чрезвычайных мер по изменению относительных цен. Население России испытывало сомнения относительно целесообразности перехода страны к капитализму, не будучи уверенным в том, как это повлияет на его уровень жизни, и испытывая обеспокоенность по поводу возможного возврата к прежней политической системе. Препятствия в проведении реформ включали:

- государственные институты, предназначенные для управления и контроля за экономической деятельностью, а не для осуществления регулирования и надзора;
- экономическую структуру, основанную на централизованном планировании, а не на стимулах и сравнительных преимуществах;
- систему производства и распределения, в которой доминировали крупные государственные предприятия, которые также оказывали социальные услуги и предоставляли социальную защиту;
- недавно созданный и плохо регулируемый финансовый сектор;
- не работающую систему платежей;
- ослабление власти в централизованной сложной федеральной системе.

Переход России к рыночной экономике оказался более сложным, чем ожидало международное сообщество. В период с начала до середины 1990-х годов сменявшие друг друга правительства России приступили к реализации программ стабилизации и структурных преобразований при содействии Международного валютного фонда (МВФ) и Банка и поддержке со стороны международного

ENGLISH

Yet, there have been no major policy reversals and the economy has finally begun to recover. The rapid privatization, dismantling of controls, and price and trade reforms carried out through the mid-1990s have made the process irreversible, although it is unclear whether an easier transition path could have been found given the initial conditions and the political realities. The 1998 crisis was a turning point in Russia's transition. Over the past three years, the government has made significant progress in fiscal adjustment, the incentive regime, legislation approvals for structural reforms, the strengthening of public institutions, and the restoration of public trust in its ability to conduct policies. Aided by a positive terms of trade shock and the effects of the devaluation, growth recovered and inflation has been reduced.

#### From Investment to Adjustment Lending

The Bank, the IMF, and the European Bank for Reconstruction and Development (EBRD) were asked by their shareholders to work together in providing advice and financial assistance to facilitate the transition. The Bank was entrusted with the responsibility of encouraging and overseeing structural reforms. This was an unprecedented challenge for the Bank since it lacked country knowledge and historical precedent for this type of process. A series of strategy documents established that, beyond its complementary assistance in support for IMF-funded stabilization efforts, the Bank's focus would be on helping build the institutions of a market economy, developing the private sector, and mitigating the social costs of the transition. To this end, the Bank committed 55 loans for \$12.6 billion through end-FY01, of which US\$7.8 billion has been disbursed and US\$2.4 billion cancelled. Through FY96 lending focused on rehabilitation and investment (with a heavy involvement in energy). Thereafter, most lending was directed to adjustment operations. Policy advice was provided through economic and sector work, technical assistance, and design and implementation of lending operations.

At the behest of the international community, the Bank rushed the processing of many projects, both for investment and general budget support, even though the prospects for their success were highly

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сообщества. Большинство этих программ были выполнены лишь частично в связи со слабым институциональным потенциалом и недостаточной политической волей. В августе 1998 года осуществлявшаяся уже в течение целого года программа стабилизации и структурных преобразований рухнула под воздействием неблагоприятных внешних факторов и неадекватной реформы бюджетно-налоговой сферы. Россия объявила дефолт по своим долгам, курс рубля стал плавающим (обесценившись при этом более чем на 60 процентов), а объем производства сократился более чем на 5 процентов.

Имущественное неравенство и неравенство в уровне доходов увеличилось, отчасти в результате начатых в 1980-е годы преобразований, когда руководство предприятий и высшие правительственные и партийные чиновники начали брать под свой контроль государственные предприятия и их активы в рамках так называемой Тстихийной приватизацииТ. Определенную роль в этом процессе сыграли также некоторые особенности официальной приватизации. Масштабы бедности увеличились, показатели социального развития и развития людских ресурсов снизились, качество социальных услуг ухудшилось, а механизмы социальной защиты Трыночного типаТ развивались достаточно медленно. Достичь макроэкономической стабильности было сложно, отчасти из-за того, что у властей не было инструментов косвенного контроля над экономикой, а также в связи с отсутствием согласия в вопросе распределения издержек структурных преобразований. Развитию малых и средних предприятий (МСП) препятствовали высокие затраты, связанные с вхождением в рынок и осуществлением коммерческой деятельности, в том числе слабый правопорядок и бюрократические препоны.

Тем не менее, принципиального изменения политического курса не произошло, и экономика в конце концов начала восстанавливаться. Стремительная приватизация, устранение системы контроля, реформы в области ценообразования и торговли, осуществленные в середине 1990-х годов, сделали процесс необратимым, хотя остается

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uncertain. These high-risk/high-payoff operations did not succeed, as the Bank did not command the resources or the influence to overcome the unprecedented constraints described above. Results were better in operations dealing with privatization and social protection than those dealing with stabilization, the financial sector, and oil restructuring. Bank advice and lending played a positive but marginal role in the design of policies and in their implementation until 1998. Since then,

however, many of the lessons drawn out of Bank operations and analytical advice have been put to work. This helps explain why the sustainability ratings of Bank-financed operations are higher than the outcome ratings. Their modest but cumulative benefits, together with the positive impact of Bank advice, contributed to building the foundations for Russia's recent turnaround.

After the August 1998 financial crisis, both the relevance and efficacy of assistance improved significantly. The Bank has been cautious in new lending, which has been focused on long-term social and institutional development. The continued policy dialogue on structural reforms and the Bank's outreach activities played a role in preventing policy reversals, in formulating the current reform program, and in strengthening client ownership. The Bank has become the main external interlocutor on the micro-economic and social reform agenda, and the government has adopted many of the policies that the Bank had recommended. Achievements supported by Bank interventions include the improvement in fiscal management, the targeting of social assistance programs, and the restructuring of the coal sector. Portfolio performance has also improved since 1999, partly through the cancellation of troubled projects and partly through joint Russia-Bank efforts to speed up implementation. An open question is the resilience of these achievements to external shocks, in particular to a significant drop in the prices of oil or other export commodities.

### **IFC and MIGA Activities in Private Sector Development**

An in-depth evaluation of the activities of the *International Finance Corporation* (IFC), the private

## РУССКИЕ

неясным, можно ли было найти более простой путь перехода к рыночной экономике, учитывая стартовые условия и политические реалии. Кризис 1998 года явился поворотным моментом в переходе России к рыночной экономике. За последние три года правительство добилось существенных успехов в реформировании бюджетно-налоговой сферы, формировании системы стимулов, законодательном оформлении структурных реформ, укреплении государственных институтов, а также смогло восстановить веру общества в свою способность проводить разумную политику. Благодаря положительному эффекту от резких перемен в области торговли и девальвации рубля возобновился рост экономики, а инфляция снизилась.

### **От инвестиционного кредитования к кредитованию структурных преобразований**

Акционеры Банка, МВФ и Европейского банка реконструкции и развития (ЕБРР) обратились с просьбой к этим организациям об осуществлении совместной деятельности по предоставлению консультаций и оказанию финансового содействия в целях облегчения перехода России к рыночной экономике. Банку было поручено заниматься вопросами стимулирования структурных реформ и надзора за их осуществлением. Это оказалось небывалой по своей сложности задачей для Банка, поскольку он не обладал необходимым объемом знаний о стране, а разворачивающиеся в стране процессы не имели исторического прецедента. В целом ряде стратегических документов было определено, что, помимо оказания дополнительного содействия финансируемым МВФ усилиям по стабилизации, основное внимание Банка должно быть сосредоточено на содействии в создании институтов рыночной экономики, развитии частного сектора и снижении социальных издержек перехода к рыночной экономике. В этих целях Банк взял на себя обязательства по предоставлению 55 займов на общую сумму 12,6 млрд. долл. США до конца 2001 финансового года, из которых 7,8 млрд. долл. США были использованы, а 2,4 млрд. долл. США

## ENGLISH

sector financing arm of the World Bank Group, was undertaken by the IFC's independent Operations Evaluation Group (OEG). Through the end of 2001, IFC devoted the bulk of its efforts to technical assistance. This strategy reflected Russia's needs during the first half of the 1990s, the availability of ample investment financing from the EBRD, and IFC's continuing concern with the high risks of investment operations in the country. Commitments for loans and equity investments in 48 financial sector, manufacturing, and retail private enterprises amounted to US\$ 0.71 billion (US\$ 0.51 billion in 34 companies, net of cancellations). This was about one-seventh the scale of funding by the EBRD. IFC's caution in making investments was prudent in the circumstances and reflected a successful and laudable resistance to external pressure and internal approvals incentives.

OEG found that the IFC had an impressive record of technical assistance operations; they addressed strategic needs and contributed materially to Russia's transition process. But along with other development finance institutions, IFC ramped up its investments in 1993-98 ahead of the reform process, with attendant disappointing outcomes. Mainly as a result of the 1998 crisis and the generally difficult business environment that led to losses for most private companies, particularly in the financial sector, only 35 percent of the IFC's investment projects achieved satisfactory development outcomes. By contrast, 96 percent of the donors' grants channeled through IFC for technical assistance achieved satisfactory development outcomes. Nonetheless, despite the success of 1,100 privatization auctions the IFC helped conduct for SMEs in the early 1990s, IFC had not yet established a sustainable wholesale channel for investments in SMEs. Looking forward, OEG's evaluation supported the planned expansion of IFC activities in response to the improving investment climate in the past two years.

According to a desk review by its Operations Evaluation Unit (OEU), the Multilateral Investment Guarantee Agency's (MIGA) guarantee program met prudently and selectively the demands from private foreign investors for political risk insurance. As a result, it has not suffered any claims losses in Russia,

## РУССКИЙ

аннулированы. По 1996 финансовый год основная часть кредитных средств направлялась на восстановительную деятельность и инвестиции (в основном в области энергетики). После этого кредитование главным образом направлялось на структурные преобразования. Консультации в отношении мер политики предоставлялись в рамках экономической и отраслевой деятельности, технического содействия, а также разработки и реализации кредитных операций.

В соответствии с волей международного сообщества Банк ускорил рассмотрение многих проектов как в области осуществления инвестиций, так и в сфере общей бюджетной поддержки, даже несмотря на то, что перспективы успешной реализации этих проектов были весьма неопределенными. Эти операции, связанные с высокой степенью риска, могли дать существенные результаты в случае их успешной реализации, но оказались неудачными, поскольку Банк не имел возможности распоряжаться ресурсами и не обладал достаточным влиянием для преодоления беспрецедентных трудностей, описанных выше. Результаты операций в области приватизации и социальной защиты были лучше, чем в областях стабилизации, финансов и реструктуризации нефтяной отрасли. Вплоть до 1998 года деятельность Банка по оказанию консультационных услуг и кредитованию играла положительную, но весьма незначительную роль в разработке и реализации мер политики. Однако впоследствии многие из уроков, извлеченных из операций и аналитических консультаций Банка, нашли свое воплощение в практической деятельности. Это помогает понять, почему рейтинг устойчивости финансируемых Банком операций превышает рейтинг результативности операций. Скромный, но кумулятивный эффект этих операций наряду с положительным воздействием консультаций, предоставленных Банком, помогли заложить основу для недавнего изменения ситуации в России в лучшую сторону.

После финансового кризиса августа 1998 года как актуальность, так и эффективность операций Банка по оказанию содействия России существенно

## ENGLISH

which is ranked in the top five countries in the Agency's portfolio. Before the outbreak of the financial crisis, MIGA covered transfer risks but did not offer coverage for currency convertibility. MIGA continued to support projects after the country's default on foreign debt. Although there was relatively low demand for MIGA's products, its \$549 million in coverage issued for 18 projects—mainly in agribusiness, food processing and beverages, finance, and extractive industries—nonetheless facilitated an estimated \$1.3 billion of foreign direct investment in Russia (see Annex 12). In investment marketing services, the Web-based PrivatizationLink Russia was launched in October 2000, providing important and timely information to potential foreign investors. OEU suggested that in the future the Agency should strive to maximize the amount of foreign direct investment it facilitates while diversifying its portfolio and minimizing net exposure in Russia.

### Next Steps

Bank management agreed with the OED's recommendations that the Bank should focus its assistance even more sharply on areas with strong government commitment to reform and relative social consensus. Public sector management, legal and judicial reform, investment and business climate, pension reform, land markets, and coal and electricity sector restructuring now offer high-potential development rewards. The ongoing policy dialogue and technical advisory program on banking sector reform should continue. Responding to client demand, Bank assistance should provide for an expanded program of good practice advice and strengthen the public debate on reforms. Policy-based lending should be designed to ensure a tight linkage between progress of reform and actual disbursements. The Bank should also consider targeting part of its assistance to selected regions committed to reform.

### Lessons Learned

The key generic lesson of the Bank's experience in Russia is that country ownership is crucial to the success of assistance. Thus, it is important for the Bank to pay close attention to the political and institutional aspects of reforms and consult with all relevant units

## РУССКИЙ

повысились. Банк проявлял осторожность в предоставлении нового кредитования, основная часть которого была направлена на достижение долгосрочных целей социального и институционального развития. Продолжающийся диалог по структурным реформам, а также пропагандистская деятельность Банка сыграли свою роль в предотвращении возврата к прежней экономической политике, в формулировании текущей программы реформ и повышении степени заинтересованности страны-клиента в осуществлении этих реформ. Банк стал основным внешним партнером в деле проведения микроэкономических и социальных реформ, а правительство взяло курс на осуществление многих мер политики, рекомендованных Банком. Трени, достигнутые благодаря участию Банка, включают совершенствование управления бюджетно-налоговой сферой, повышение адресности программ социальной помощи и реструктуризацию угольной отрасли. Результаты реализации портфеля проектов также улучшились после 1999 года, как за счет аннулирования проблемных проектов, так и благодаря совместным усилиям России и Банка по ускорению реализации проектов. Открытым остается вопрос устойчивости этих достижений перед лицом внешних потрясений, в частности, резкого снижения цен на нефть или на другие экспортные товары.

### Деятельность МФК и МИГА в области развития частного сектора

Независимая Группа оценки операционной деятельности (ГООД) Международной финансовой корпорации (МФК) – структуры Всемирного банка, занимающейся финансированием развития частного сектора – провела углубленную оценку деятельности МФК. По конец 2001 года МФК направляла основную часть своих усилий на оказание технического содействия. Эта стратегия отражала потребности России в течение первой половины 1990-х годов, наличие значительного объема инвестиционного финансирования со стороны ЕБРР, а также сохраняющуюся обеспокоенность МФК в отношении высокой степени риска инвестиционных операций в стране.

## ENGLISH

of government and civil society, to improve the relevance and design of its activities and avoid operations where commitment is weak. There are a number of other general lessons:

- In the face of a poor track record and narrow country ownership of reform, a large adjustment lending program (especially one with front-loaded disbursements) risks delaying rather than accelerating reform.
- In the presence of a poor track record and new consensus on a reform program, adjustment lending should be offered after the government has publicly adopted the necessary reforms or has begun implementing them, as was the case for the Coal Sectoral Adjustment Loans (SECALs). Disbursements should be backloaded and carefully modulated on the basis of solid progress in implementation.
- Adequate analytical work should be available upstream of lending. AAA should be funded to the extent commensurate with the role the Bank is expected to play.
- Timetables for implementation should be realistic.
- For physical rehabilitation and investment projects to achieve their development objectives, progress on policy and institutional reform is necessary.

### Management and Government Response

Bank management disagrees that the shift from investment lending to structural adjustment lending was a misguided response to the systemic reform challenges that Russia faced in 1996. In their view, restricting assistance to AAA and small loans as the OED's counterfactual suggests would have meant a perpetuation of the Bank's limited impact on policy formulation. The 1997 Structural Adjustment Loans (SAL I and II) and Social Protection Adjustment Loan (SPAL) were necessary to influence the design of the structural reform agenda. These operations, Bank management further argues, provided the right tools and built the necessary trust to help prevent economic policy reversals, improve Bank-Russia relations, and sowed the seeds of the reform program first endorsed by the government in 2000 and currently under implementation.

The Russian authorities found that the CAE "presents a sufficiently objective picture of developments

## РУССКИЙ

Объем обязательств по предоставлению займов и осуществлению инвестиций в акционерный капитал 48 частных предприятий, действующих в финансовом секторе, обрабатывающей промышленности и розничной торговли, составил 0,71 млрд. долл. США (0,51 млрд. долл. США для 34 компаний за вычетом аннулированных). Это

составило около одной седьмой части объема финансирования ЕБРР. В данных обстоятельствах осмотрительность, проявленная МФК в отношении капиталовложений, была разумным шагом и отражала успешное противодействие внешнему давлению и порядку утверждения решений – и достойна одобрения.

ГООД пришла к выводу, что МФК достигла впечатляющих успехов в проведении операций технического содействия, которые отвечали стратегическим потребностям России и внесли существенный вклад в переход России к рыночной экономике. Однако объем инвестиций, осуществляемых МФК, так же как и другими учреждениями, занимающимися проблемами финансирования развития, в течение 1993-1998 годов опережал процесс реформ, что привело к соответствующим разочаровывающим результатам. В основном из-за кризиса 1998 года и сложных условий осуществления коммерческой деятельности в целом, приведших к убыткам для большинства частных компаний, преимущественно в финансовом секторе, только по 35-ти процентам инвестиционных проектов МФК были получены удовлетворительные результаты в области развития. В противоположность этому 96 процентов грантов доноров, направленных через МФК на оказание технического содействия, достигли удовлетворительных результатов в области развития. Тем не менее, несмотря на успех 1100 аукционов по приватизации МСП, проведенных при содействии МФК в начале 1990-х годов, МФК по настоящее время не создала устойчивого канала для осуществления крупных инвестиций в МСП. Оценивая перспективы на будущее, ГООД поддерживает планируемое расширение деятельности МФК в ответ на улучшение инвестиционного климата в последние два года.

## ENGLISH

in Russia over the past decade and outlines the factors behind the Bank's successes and setbacks." While they "for the most part agree with the [CAE's] assessments of the results of the Bank's activity in individual sectors," they assessed its overall outcome as satisfactory, as the process of transition has been "very rapid" and the positive developments post-1998 resulted from efforts made in the previous period and the important role played by the Bank and Fund. Regarding the relatively high share of problem projects in the past, they pointed to shared responsibility with the Bank, as many operations "did not rely on a thorough understanding of the existing problems." Finally, they found OED's recommendations to "coincide to a greater extent with the provision of the Program for Russia's Cooperation with the Bank recently approved by the government."

### Executive Directors' Perspective

The Executive Board's Subcommittee of the Committee on Development Effectiveness (CODE) discussed both the OED and OEG reports on May 8, 2002. They broadly supported the evaluations' recommendations and noted management's assurances that they will be incorporated into the Country Assistance Strategy scheduled to be considered by the full Board in June 2002. Members urged greater coherence, coordination, and information sharing between the Bank and the IFC. The chairman concluded by underlining the importance of country ownership of reforms and capacity to implement them; the need for the Bank to work in partnership with other donors; and the vital role of Bank engagement in building ownership and strengthening institutions early in the process of transition.

In the course of the discussion, some Subcommittee members wondered whether the large amount of adjustment lending in the early years might not have retarded reforms by postponing the need to deal with critical structural issues. They felt that an assistance strategy oriented around AAA with limited financial support for Russia would have been more appropriate than one involving large volumes of adjustment lending. Others, however, felt that the leverage provided by lending had been critical to the Bank's dialogue with the Russian authorities and

## РУССКИЙ

В соответствии с аналитическим исследованием своего Отдела оценки операционной деятельности (ОООД) программа гарантий Международного агентства по инвестиционным гарантиям (МИГА) осторожно и избирательно удовлетворяла спрос иностранных частных инвесторов на страхование от политических рисков. В результате МИГА не понесло убытков по страховым требованиям в России, которая входит в число пяти основных стран в портфеле Агентства. До финансового кризиса в России МИГА предоставляло гарантии по рискам, связанным с переводом средств, но не гарантировало от рисков, которые были обусловлены нестабильностью курса национальной валюты. После отказа России от погашения своей внешней задолженности МИГА продолжало финансирование проектов. Несмотря на относительно невысокий спрос на продукты МИГА, покрытие инвестиционных рисков в размере 549 млн. долл. США в рамках 18 проектов – преимущественно в таких секторах, как сельское хозяйство, пищевая промышленность, финансы и горнодобывающая промышленность – позволило России получить около 1,3 млрд. долл. США прямых иностранных инвестиций (см. приложение КАЭ 12), которые, в противном случае, вряд ли поступили бы в страну из-за моратория на выплату долгов. В октябре 2002 года было начато предоставление услуг по инвестиционному маркетингу с использованием Веб-страницы "PrivatizationLink Russia", на которой представлена важная и своевременная информация для потенциальных иностранных инвесторов. ОООД рекомендует Агентству в будущем максимально увеличить объем прямых иностранных инвестиций, притоку которых оно способствует, диверсифицируя при этом свой портфель и сводя к минимуму чистую сумму рисков в России.

### Последующие действия

Руководство Банка согласилось с рекомендациями ДООД в отношении того, что Банк должен еще более сконцентрировать свое содействие на областях, в которых правительство привержено реформам и в которых достигнуто относительное согласие. В настоящее время перспективными с

## ENGLISH

that AAA alone would likely not have captured the government's attention. Thus, they argued that it could be difficult to wait to build broad consensus, especially when faced with crisis situations. In such circumstances, the Bank might have to accept greater risks in acting—particularly when it has relatively less understanding of the economy—and try to build ownership through its engagement, even though there might be divided views in the country.

## РУССКИЙ

точки зрения достижения целей в области развития являются управление государственным сектором, проведение юридической и судебной реформ, совершенствование инвестиционного и делового климата, осуществление пенсионной реформы, упорядочение деятельности земельных рынков, а также реструктуризация угледобычи и электроэнергетики. Необходимо продолжить текущий диалог по осуществлению экономических реформ, а также программу предоставления консультаций по техническим вопросам в области реформирования банковского сектора. В соответствии с запросами клиента, содействие со стороны Банка должно обеспечить расширение программы консультаций по вопросам передового опыта и совершенствование практики публичных дебатов по поводу проводимых реформ. Кредитование на проведение экономических реформ должно обеспечивать тесную увязку между реальным продвижением реформ и объемом фактически предоставленных средств. Банк также должен изучить возможность направления части своей помощи в избранные регионы страны, приверженные курсу на проведение реформ.

**Полученный опыт**

Главный характерный урок, извлеченный из деятельности Банка в России, заключается в том, что заинтересованность страны в реализации реформ играет решающую роль в обеспечении успеха содействия Банка. В связи с этим Банку необходимо уделять пристальное внимание политическим и институциональным аспектам реформ, проводить консультации с соответствующими правительственными структурами и гражданским обществом, чтобы повысить значимость и улучшить планирование своей деятельности и избегать операций, не подкрепленных в необходимых объемах соответствующими обязательствами. Имеется также целый ряд других общих уроков:

- Тчитывая слабые результаты в прошлом и недостаточную заинтересованность страны в осуществлении реформ, обширная программа кредитования на структурные преобразования

РУССКИИ

особенно если она предполагает предоставление большей части кредитных средств до выполнения правительством принятых обязательств в соответствии с соглашением о займе) может замедлить, а не ускорить проведение реформ.

Учитывая слабые результаты в прошлом и недавно сформировавшийся консенсус по программе реформ кредитование на структурные преобразования должно предоставляться после того, как правительство официально примет программу необходимых реформ или начнет их реализацию, как это было в случае отраслевых займов на структурные преобразования в угольной промышленности (ОЗСП). Предоставление кредитных средств должно быть обусловлено выполнением обязательств, принятых правительством в соответствии с соглашением о займе, и тщательно модулироваться на основе реальных достижений в осуществлении реформ.

- Необходимая аналитическая работа должна предшествовать кредитованию. АКД должна финансироваться в объеме, соразмерном предполагаемой роли Банка.
- График реализации должен быть реалистичным.
- Для того, чтобы реабилитационные и инвестиционные проекты достигли своих целей в области развития, необходим прогресс в проведении политических и институциональных реформ.

### Реакция руководства Банка и правительства

Руководство Банка не согласно с тем, что переход от кредитования на инвестиционные цели к кредитованию структурных преобразований явился ошибочной реакцией на трудности в проведении системных реформ, с которыми Россия столкнулась в 1996 году. По мнению руководства, ограничение содействия рамками АКД и предоставлением небольших займов, как это предлагает ДООД в разделе «Рассмотрение альтернативных вариантов», означало бы сохранение ограниченного воздействия Банка на

РУССКИИ

формирование экономической политики. Предоставленные в 1997 году Займы на структурные преобразования (ЗСП I и II и Заем на структурные преобразования в социальной сфере (ЗСПСС)) были необходимы для оказания влияния на разработку программы структурных реформ. По мнению руководства Банка, эти операции

явились действенным механизмом в деле создания необходимого кредита доверия, позволившего избежать возврата к прежней экономической политике, улучшить отношения между Банком и Россией и заложить основу программы реформ, впервые утвержденной правительством в 2000 году и реализуемой в настоящее время.

Российские власти считают, что КАЭ «представляет достаточно объективную картину развития событий в России в последнее десятилетие и помогает определить факторы, лежащие в основе успехов и неудач Банка». При том, что российские власти «в целом согласны с [содержащейся в КАЭ] оценкой результатов деятельности Банка в отдельных отраслях», они оценивают общие результаты деятельности как удовлетворительные, поскольку процесс перехода к рыночной экономике был «очень быстрым» и позитивное развитие событий после 1998 года явилось результатом усилий, предпринятых во время предшествующего периода, и важной роли Банка и Фонда. Что касается относительно высокой доли проблемных проектов в прошлом, то руководство России отметило, что оно разделяет ответственность с Банком, поскольку большое число операций «не основывалось на ясном понимании существующих проблем». Наконец, российские власти заявили, что рекомендации ДООД в большей мере соответствуют положениям Программы сотрудничества России с Банком, недавно одобренной правительством Т.

**Точка зрения Исполнительных директоров**  
Подкомитет Комитета по эффективности развития (КЭР) Совета исполнительных директоров рассмотрел отчеты ДООД и ГООД 8 мая 2002 года. Исполнительные директора в целом поддержали рекомендации, содержащиеся в оценках, и приняли к сведению заверения

РУССКИМ

оводства о том, что они будут включены в стратегию содействия стране, которую планируется рассмотреть на заседании Совета директоров в июне 2002 года. Члены Совета выразили к большей слаженности и координации деятельности между Банком и МФК, а также к более активному обмену информацией.

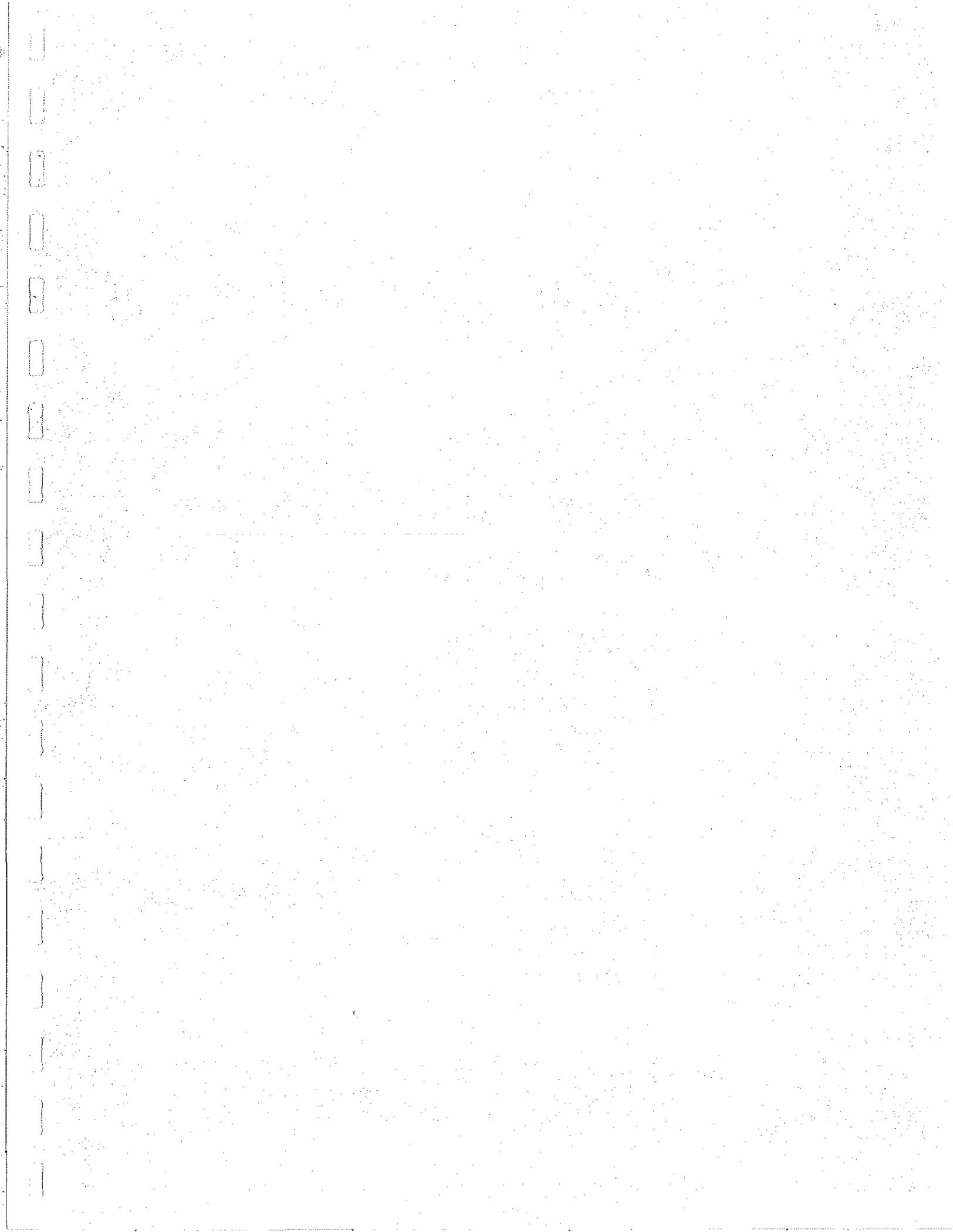
Председатель подвел итоги обсуждения, подчеркнув важность заинтересованности страны в проведении реформ и наличия соответствующего организационно-технического потенциала для их осуществления; необходимость работы Банка в партнерстве с другими донорами; а также принципиальную роль участия Банка в повышении заинтересованности и укреплении институциональной базы на начальном этапе перехода к рыночной экономике.

В ходе обсуждения некоторые члены Подкомитета заинтересовались, не мог ли большой объем кредитования на структурные преобразования в начальные годы рассматриваемого периода выступить в качестве тормоза реформ, отодвинув необходимость решения важнейших структурных проблем на более поздний срок. По их мнению, стратегия содействия, предполагающая в основном

РУССКИМ

осуществление АКД с ограниченным объемом финансовой поддержки России, была бы более подходящей, чем стратегия предоставления значительных объемов кредитования на структурные преобразования. Другие члены Подкомитета, однако, высказали мнение, что общее содействие, оказанное посредством

кредитования, имело принципиальное значение в рамках диалога Банка с российскими властями и что сама по себе АКД вряд ли смогла бы привлечь внимание правительства. В связи с этим они утверждали, что ничего не предпринимать в ожидании формирования широкого консенсуса, особенно в условиях кризисной ситуации, было нелегко. В таких обстоятельствах Банку пришлось принять на себя повышенный риск при осуществлении своей деятельности (особенно с учетом того, что он относительно слабо понимал особенности экономики страны) и попытаться укрепить заинтересованность общественности в осуществлении программ развития посредством своего участия, даже несмотря на то, что единства мнений в отношении целесообразности осуществления таких программ в стране могло и не быть.



FRANÇAIS

## Résumé analytique

L'évaluation de l'aide par pays (EAP) pour la Russie sur la période 1992-2001 montre que les activités de la Banque mondiale en Fédération de Russie ont eu des résultats décevants mais sont en voie d'amélioration. Bien que l'OED (Département de l'évaluation rétrospective) ait attribué une cote non satisfaisante aux résultats de l'aide de la Banque mondiale à la Russie pendant la période 1992-98 et indiqué que l'impact sur le développement institutionnel n'avait été que modeste, il a coté les résultats pour 1998-01 comme satisfaisants et indiqué que l'impact sur le développement institutionnel avait été substantiel.

L'EAP pour la Russie fait ressortir qu'une stratégie d'aide articulée autour des services analytiques et consultatifs, accompagnée d'un soutien financier russe limité, aurait été plus appropriée qu'une stratégie basée sur un gros volume de prêts à l'ajustement, car il se pourrait qu'en 1996-97 de tels prêts aient freiné les réformes nécessaires au lieu de les accélérer. Les décaissements auraient dû être effectués pour récompenser des actions et non des promesses. Pour expliquer sa cote des résultats à fin juin 1998, l'OED a attiré l'attention sur les gros volumes de prêts d'investissement à décaissement rapide, dont le prêt d'ajustement structurel (SAL III), qui ont eu des résultats non satisfaisants. Il a fait remarquer que les résultats de recherche et d'évaluation confirmaient qu'on ne doit pas s'attendre à ce que de gros volumes de prêts assurent la propriété-pays.

### Une décennie de transformation politique et économique rapide

Lorsqu'elle a décidé de devenir membre de la Banque en juin 1992, juste après la dissolution de l'Union soviétique, la Russie traversait une période de récession sévère et persistante. Le taux d'inflation était élevé et continuait son envol, et la balance des paiements subissait une pression sévère aggravée par la lourde dette extérieure héritée de l'Union soviétique et la désintégration de la zone rouble. La

ESPAÑOL

## Resumen Ejecutivo

La evaluación de asistencia a la Federación de Rusia correspondiente al período 1992-2001 demuestra que los resultados de las actividades del Banco en la Federación de Rusia mejoraron pero fueron decepcionantes. Aunque el Departamento de Evaluación de Operaciones (DEO) calificó como insatisfactorio el resultado de la asistencia del Banco Mundial a la Federación de Rusia durante el período 1992-98, con un impacto apenas moderado en el desarrollo institucional, ese mismo departamento consideró que el resultado de la asistencia en el período 1998-01 fue satisfactorio, con un considerable impacto en el desarrollo institucional.

La evaluación de la asistencia a la Federación de Rusia concluyó que una estrategia de asistencia orientada hacia actividades analíticas y de asesoría (AAA) con un limitado apoyo financiero para la Federación hubiese sido más adecuado que una estrategia que incluyera préstamos para fines de ajuste por grandes importes, ya que es posible que dicha actividad de préstamos durante el período 1996-97 haya demorado en lugar de acelerar las reformas necesarias. Los desembolsos deberían recompensar acciones en lugar de promesas. Como fundamento de la calificación general asignada a los resultados generales hasta junio de 1998, el DEO hizo hincapié en el volumen de préstamos de rápido desembolso y de préstamos para proyectos de inversión, incluyendo SAL III, cuyos resultados fueron insatisfactorios. Observó que las conclusiones de su trabajo de investigación y evaluación confirmaron que las grandes sumas de financiamiento no eran suficiente para garantizar la identificación del país con las medidas a tomar.

### Una década de rápida transformación política y económica

Cuando ingresó al Banco Mundial en junio de 1992, tras la disolución de la Unión Soviética, la Federación de Rusia transitaba una profunda y prolongada recesión. La inflación era elevada y se disparaba, y la balanza de pagos experimentaba serias presiones,

## FRANÇAIS

dissolution du cadre institutionnel dans la majeure partie du secteur des échanges a exacerbé les changements extraordinaires requis dans les prix relatifs. Les Russes ont hésité à prendre le chemin du capitalisme, incertains qu'ils étaient de l'impact sur leur vie et des risques d'un contrecoup politique. Les obstacles aux réformes étaient les sui-

vants :

- Des institutions gouvernementales conçues pour gérer et contrôler l'activité économique au lieu de la réguler et de la surveiller.
- Une structure économique basée sur la planification centrale plutôt que sur les incitations et l'avantage comparatif.
- Des systèmes de production et de distribution dominés par de grandes entreprises d'état qui assureraient également les services et la protection sociales.
- Un secteur financier nouvellement créé et mal régulé.
- Un système de paiement non fonctionnel.
- Une autorité en déclin dans un système fédéral central complexe.

La transition russe a été plus difficile que s'y attendait la communauté internationale. L'un après l'autre, des gouvernements russes ont lancé des programmes de stabilisation et d'ajustement du début au milieu des années 1990 avec le concours du Fonds monétaire international (FMI) et de la Banque mondiale, et l'encouragement de la communauté internationale. La plupart de ces programmes n'ont été que partiellement mis en œuvre en raison de la médiocre capacité institutionnelle et de l'insuffisance de volonté politique. En août 1998, un programme de stabilisation et d'ajustement structurel d'un an a échoué du fait des bouleversements externes et de l'inadéquation d'un ajustement fiscal. La Russie s'est trouvée en défaut de paiement de sa dette, le rouble russe a flotté (dépréciation de plus de 60 pour cent) et le rendement a chuté de plus de 5 pour cent.

L'écart entre l'actif et le passif qui s'est creusé était en partie dû à un processus lancé dans les années 1980, lorsque les chefs d'entreprise, les cadres gouvernementaux et la direction du parti ont commencé à s'appropriier les entreprises d'état et leurs actifs dans le cadre de ce que l'on appelait alors la

## ESPAÑOL

situación que se veía agravada por la enorme deuda externa heredada de la Unión Soviética y la desintegración de la zona del rublo. La disolución del marco institucional para la mayor parte del comercio de la Federación de Rusia exacerbaba las extraordinarias variaciones de precios necesarias en los precios relativos. Los ciudadanos rusos no se mostraban muy decididos a

adoptar el sistema capitalista, ante la incertidumbre de lo que esta decisión implicaría en sus vidas y la preocupación que planteaban los riesgos de un posible contrgolpe político. Los obstáculos a las reformas eran los siguientes:

- Instituciones públicas diseñadas para dirigir y controlar la actividad económica en lugar de regular y supervisar
- Una estructura económica fundada en la planificación centralizada en lugar de fundarse en incentivos y ventajas comparativas
- Sistemas de producción y distribución dominados por grandes empresas estatales que también prestaban servicios sociales y brindaban protección social
- Un nuevo sector financiero recientemente creado con una regulación insatisfactoria
- Un sistema de pago que no era funcional
- Debilitamiento de la autoridad en un sistema federal complejo y centralizado.

El proceso de transición de la Federación de Rusia ha sido más difícil de lo esperado por la comunidad internacional. Desde el inicio a mediados de la década de 1990, sucesivos gobiernos lanzaron programas de estabilización y ajuste con la asistencia del Fondo Monetario Internacional y el Banco Mundial, y el apoyo de la comunidad internacional. En su mayoría, estos programas se implementaron apenas parcialmente debido a la débil capacidad institucional y la falta de voluntad política. En agosto de 1998, como resultado de los impactos externos y la insuficiencia del ajuste fiscal, fracasó un programa de ajuste estructural y estabilización puesto en marcha un año antes. La Federación de Rusia suspendió el pago de su deuda, se estableció la libre flotación del rublo (con una depreciación del 60%), y el producto cayó más de un 5 por ciento.

La desigualdad de ingresos y bienes se ha incrementado, en parte a través de un proceso iniciado en la década del ochenta durante el cual los directivos de las empresas y los funcionarios del gobierno comenzaron

## FRANÇAIS

« privatisation spontanée ». Mais quelques aspects du processus de privatisation structurée y ont aussi contribué. La pauvreté s'est accrue et les indicateurs de développement social et humain ont décliné, les services sociaux se sont détériorés et les mécanismes de protection sociale « de type marché » ont été longs à se développer. La stabilité macro-économique a été difficile à atteindre, partiellement du fait que les autorités ne possédaient pas les instruments nécessaires pour réguler indirectement l'économie et du fait de dissensions sur la façon de répartir les coûts de l'ajustement. La petite ou moyenne entreprise a été découragée par le coût élevé d'entrée dans le commerce et de s'y maintenir, du harcèlement bureaucratique et de la faible primauté du droit.

Pourtant, même sans réforme politique majeure, l'économie commence finalement à reprendre. La privatisation rapide, le démantèlement des contrôles et, au milieu des années 1990, les réformes au niveau des prix et des échanges ont rendu le processus irréversible – bien qu'on ne soit pas sûr si une voie de transition plus facile aurait pu être trouvée dans le contexte des conditions initiales et des réalités politiques. La crise de 1998 a été un « virage » dans la transition russe. Ces trois dernières années, le gouvernement a fait d'importants progrès en matière d'ajustement fiscal, de régime d'incitations, d'approbation législative des réformes structurelles et du renforcement des institutions publiques. Grâce à des termes commerciaux favorables et aux effets de la dévaluation, la croissance a repris et l'inflation a décliné.

#### De l'investissement au crédit d'ajustement

Les actionnaires de la Banque, du FMI et de la Banque européenne pour la reconstruction et le développement (BERD) ont demandé à ces organismes de travailler ensemble pour faciliter la transition en offrant des conseils et de l'aide financière. La Banque a été chargée d'encourager et de surveiller les réformes structurelles, ce qui lui a posé un défi sans précédent du fait qu'elle ne connaissait ni le contexte ni les antécédents historiques du pays nécessaires pour ce faire. Une série de documents de stratégie ont établi que, en dehors de son aide

## ESPAÑOL

a tomar el control de empresas estatales y de sus activos a través de lo que se conoce como "privatización espontánea". Sin embargo, también contribuyeron algunos aspectos del proceso de privatización formal. El país ha registrado un aumento de la pobreza acompañado por una caída de los indicadores de desarrollo social y humano; se deterioraron los servicios sociales, y los mecanismos de protección social "de la economía de mercado" han tardado en desarrollarse. No ha sido fácil lograr la estabilidad macroeconómica, en parte porque las autoridades no contaban con los instrumentos para el control indirecto de la economía, pero también porque no existía acuerdo sobre cómo distribuir los costos del ajuste. Se ha desalentado el desarrollo de la pequeña y mediana empresa (PYME) debido a los elevados costos de ingreso y de la actividad comercial, incluyendo el débil imperio de la ley y el acoso burocrático.

Sin embargo, no se han experimentado grandes reveses en las políticas y la economía finalmente inició su recuperación. La rapidez con que se llevaron a cabo las privatizaciones, la desarticulación de controles, y las reformas de precios y comercio durante el inicio de la década de 1990 hizo que el proceso fuera irreversible, aunque no queda claro si podría haberse identificado un camino más fácil en vista de las condiciones iniciales y las realidades políticas. La crisis de 1998 constituyó un punto de inflexión en el proceso de transición de la Federación de Rusia. En los últimos tres años, el gobierno ha realizado grandes avances en materia de ajuste fiscal, régimen de incentivos, sanciones legislativas de reformas estructurales, el fortalecimiento de instituciones públicas, y el restablecimiento de la confianza pública en la capacidad del gobierno para llevar a cabo las políticas. Gracias al impacto positivo de las condiciones del comercio y los efectos de la devaluación, el país logró reanudar el camino de crecimiento y se redujo la inflación.

#### La transición de préstamos para la inversión a préstamos para fines de ajuste

El Banco Mundial, el FMI y el Banco Europeo para la Reconstrucción y el Fomento (BERF) fueron instados por sus accionistas a trabajar en conjunto para brindar asesoría y asistencia financiera destinada a facilitar la transición. Al Banco Mundial le fue encomendada la

## FRANÇAIS

complémentaire pour les efforts de stabilisation financés par le FMI, la Banque devait concentrer ses efforts sur la reconstruction des institutions dans une économie de marché, le développement du secteur privé et la mitigation des coûts sociaux de la transition. A cette fin, la Banque s'est engagée à accorder 55 prêts représentant au total 12,6 milliards de dollars jusqu'à la fin de l'année budgétaire 2001, dont 7,8 milliards de dollars ont été décaissés et 2,4 milliards de dollars ont été annulés. Jusqu'à la fin de l'année budgétaire 1996, les prêts étaient accordés principalement pour des projets de réhabilitation et d'investissement (à grande composante d'énergie). Plus tard, les prêts ont été principalement axés sur les opérations d'ajustement. Les conseils d'action politique étaient dispensés à travers les travaux économiques et sectoriels, l'assistance technique, et la conception et mise en œuvre des opérations de crédit.

À la demande de la communauté internationale, la Banque a accéléré la préparation de nombreux projets, tant pour l'investissement que pour le soutien budgétaire d'ensemble, bien que les chances de réussite aient été loin d'être certaines. Ces opérations haut risques/haut rendement n'ont pas réussi car la Banque ne possédait ni le contrôle des ressources ni l'influence nécessaire pour surmonter les obstacles sans précédent mentionnés ci-dessus. Les résultats des opérations axées sur la privatisation et la protection sociale ont été meilleurs que ceux des projets de stabilisation, du secteur financier et de restructuration du secteur pétrolier. Les conseils et les prêts de la Banque ont joué un rôle positif mais marginal dans l'élaboration des politiques et leur mise en œuvre jusqu'en 1998. Depuis cependant, de nombreux enseignements tirés des opérations de la Banque et des conseils analytiques de cet organisme ont été pris en compte. Cela explique en partie pourquoi les cotes de durabilité des opérations financées par la Banque sont plus positives que les cotes de rendement. Les bénéfices modestes cumulés, conjugués à l'impact positif des conseils de la Banque, ont contribué à établir les fondations du récent redressement en Russie.

Après la crise financière d'août 1998, la pertinence et l'efficacité de l'aide se sont beaucoup amé-

## ESPAÑOL

responsabilidad de promover y supervisar las reformas estructurales. Esta tarea constituía un desafío sin precedentes para el Banco ya que carecía de conocimiento sobre el país como así también de precedentes históricos para enfrentar este tipo de proceso. Una serie de documentos de estrategia estableció que, además de su asistencia complementaria en respaldo de los esfuerzos de estabilización financiados por el FMI, el Banco Mundial se concentraría en ayudar a construir las instituciones de una economía de mercado, desarrollar el sector privado, y mitigar los costos sociales de la transición. A tal fin, el Banco se comprometió a otorgar 55 préstamos por valor de \$12.600 millones hasta fines del ejercicio 2001, de los cuales US\$7.800 millones han sido desembolsados y US\$2.400 millones se han cancelado. Hasta el año 1996 las operaciones de préstamo se centró en actividades de modernización e inversión (con una importante participación en el sector de energía). Con posterioridad, la mayor parte de los préstamos se destinó a operaciones de ajuste. Se brindó asesoría para el desarrollo de políticas a través de trabajo en el frente económico y sectorial, asistencia técnica, y el diseño e implementación de operaciones de préstamo.

A instancia de la comunidad internacional, el Banco apresuró la tramitación de muchos proyectos, tanto de inversión como de apoyo general al presupuesto, aunque las probabilidades de éxito eran muy inciertas. Estas operaciones de alto riesgo y alto rendimiento no tuvieron éxito, ya que el Banco no contaba con los recursos ni la influencia para superar las limitaciones sin precedentes antes descritas. Las operaciones destinadas a privatizaciones y protección social tuvieron mejores resultados que las operaciones dirigidas a la estabilización, el sector financiero y la reestructuración del sector petrolero. Hasta 1998, la actividad de asesoría y financiamiento del Banco desempeñó un papel positivo, aunque marginal, en el diseño e implementación de políticas. Desde entonces, sin embargo, se han incorporado muchas de las lecciones recogidas de las operaciones del Banco y de la actividad de asesoría analítica. Esto explica porqué las calificaciones de sostenibilidad de las operaciones financiadas por el Banco son más elevadas que las calificaciones de los resultados. Sus beneficios modestos aunque acumulativos, junto con el impacto positivo de la asesoría del Banco,

## FRANÇAIS

lioré. La Banque a été prudente quant aux nouveaux prêts qui sont maintenant axés sur le développement social et institutionnel à long terme. Le dialogue politique sur les réformes structurelles s'est poursuivi et les activités de la Banque au niveau communautaire ont joué un rôle significatif dans la prévention des renversements de politique, l'élaboration du programme actuel de réformes et le renforcement de la propriété client. La Banque est devenue l'interlocuteur externe principal pour le programme de réformes sociales et micro-économiques, et le gouvernement a adopté un grand nombre de recommandations faites par la Banque. Parmi les réalisations appuyées par les interventions de la Banque citons l'amélioration de la gestion fiscale, l'orientation des programmes d'assistance sociale et la restructuration du secteur du charbon. La performance du portefeuille s'est également améliorée depuis 1999, partiellement en raison de l'annulation des projets en difficulté et partiellement à travers les efforts conjoints Russie-Banque visant à accélérer la mise en œuvre. Une question discutable est celle de la résilience de ces réalisations aux bouleversements externes, notamment à une chute importante des prix du pétrole et autres produits d'exportation.

#### **Les activités de la SFI et de l'AMGI dans le développement du secteur privé**

Une évaluation en profondeur des activités de la *Société financière internationale* (SFI), branche du Groupe de la Banque mondiale pour le financement du secteur privé, a été effectuée par l'OEG (le groupe indépendant de la SFI chargé de l'évaluation rétrospective des opérations). Jusqu'à fin 2001, la SFI a orienté la majeure partie de ses efforts sur l'assistance technique. Cette démarche répondait aux besoins de la première moitié des années 1990 et reflétait la grande disponibilité de financement des investissements de la BERD, ainsi que les inquiétudes persistantes de la SFI au sujet des hauts risques associés aux opérations d'investissement dans ce pays. Le montant des prêts engagés et des investissements de participation dans 48 entreprises privées des secteurs financiers, de fabrication et de détail s'élève à 0,71 milliard de dollars (0,51 milliard de dollars dans

## ESPAÑOL

han contribuido a crear los cimientos de la reciente reconversión de la Federación de Rusia.

Tras la crisis financiera de agosto de 1998, tanto la importancia como la eficacia de la asistencia mejoraron considerablemente. El Banco ha adoptado una postura prudente en la nueva actividad de financiamiento, que se concentró en el desarrollo social e institucional a largo plazo. El diálogo ininterrumpido en materia de políticas destinadas a reformas estructurales y las actividades de extensión del Banco influyeron para impedir reveses en el desarrollo de políticas, formular el actual programa de reforma, y fortalecer la identificación del cliente con el programa. El Banco se ha convertido en el principal interlocutor externo en la agenda de reforma microeconómica y social, y el gobierno ha adoptado muchas de las políticas recomendadas por el Banco. Los logros respaldados por las intervenciones del Banco incluyen el mejoramiento de la gestión fiscal, la selección de programas de asistencia social, y la reestructuración del sector de carbón. Desde 1999 también se advierte una mejora en el rendimiento de la cartera, lo que obedece en parte a la cancelación de proyectos insatisfactorios, así como también a los esfuerzos mancomunados de la Federación de Rusia y el Banco por acelerar la implementación. Aún resta evaluar la capacidad de respuesta de estos logros frente a impactos externos, en particular, la drástica caída de los precios del petróleo u otros productos primarios de exportación.

#### **Las actividades de la CFI y del OMGI para el desarrollo del sector privado**

El Departamento de Evaluación de Operaciones (DEP) independiente de la *Corporación Financiera Internacional* (CFI) realizó una evaluación minuciosa de las actividades de la CFI. Hasta fines de 2001, la CFI destinó la mayor parte de sus esfuerzos a operaciones de asistencia técnica. Esta estrategia era reflejo de las necesidades de este país durante la primera parte de la década de 1990, el acceso a abundante financiamiento para la inversión proveniente del BERD, y la continua preocupación de la CFI por los altos riesgos de las operaciones de inversión en el país. Los compromisos asumidos en virtud de préstamos e inversiones en capital accionario en 48 empresas financieras, manufactureras y minoristas del sector privado ascendían a US\$

## FRANÇAIS

34 sociétés, déduction fait des annulations). Cela représente environ un septième du volume de financement de la BERD. La SFI a exercé beaucoup de prudence en la circonstance et a fait preuve d'une résistance louable à la pression extérieure et aux incitations pour l'approbation interne.

L'OEG a mis en lumière les antécédents impressionnants de la SFI en matière d'opérations d'assistance technique, sa réponse aux besoins stratégiques, et sa contribution matérielle au processus de transition de la Russie. Mais en 1993-98, de concert avec d'autres institutions financières de développement, elle a accéléré ses investissements, en avance sur le processus de réforme, et les résultats ont été décevants. Principalement en raison de la crise de 1998 et de l'environnement difficile du commerce qui a entraîné des pertes pour la plupart des sociétés privées, notamment dans le secteur financier, 35 pour cent seulement des projets d'investissement de la SFI ont eu des résultats satisfaisants en matière de développement. En revanche, 96 pour cent des subventions des donateurs, canalisés à travers la SFI pour l'assistance technique, ont eu des résultats satisfaisants sur le plan du développement. Néanmoins, malgré les 1,100 enchères de privatisation que la SFI a aidé à réaliser pour les PME au début des années 1990, la SFI n'a pas encore établi une canalisation en gros durable pour les investissements dans les PME. En ce qui concerne l'avenir, l'évaluation menée par l'OEG est favorable à l'expansion planifiée des activités de la SFI visant à améliorer le climat des investissements des deux dernières années.

Selon l'examen des documents par son OEU (unité d'évaluation rétrospective des opérations), le programme de garantie de l'Agence multilatérale de garantie des investissements (AMGI) a répondu avec prudence et de manière sélective aux demandes des investisseurs privés étrangers pour une assurance-risque politique. Ainsi, il n'a pas subi de pertes au niveau des revendications en Russie, l'un des cinq pays les plus importants du portefeuille de l'Agence. Avant le déclenchement de la crise financière, l'AMGI couvrait les risques de transfert mais n'offrait pas de couverture pour la convertibilité monétaire. L'AMGI a continué de soutenir les projets après le

## ESPAÑOL

71 millones (US\$ 51 millones en 34 empresas, descontadas las cancelaciones). Esto equivalía a una séptima parte del financiamiento aportado por el BERD. La prudencia de la CFI en las operaciones de inversión fue acertada dadas las circunstancias, y reflejó una resistencia exitosa y loable ante la presión externa y los incentivos internos de aprobación.

El DEO concluyó que la CFI tuvo un registro admirable de operaciones de asistencia técnica; éstas dieron respuesta a las necesidades estratégicas y contribuyeron en gran medida al proceso de transición de la Federación de Rusia. Sin embargo, junto con otras instituciones financieras de fomento, la CFI elevó sus inversiones en el período 1993-1998 antes del proceso de reforma, con los consiguientes resultados insatisfactorios. Como consecuencia principalmente de la crisis de 1998 y la difícil coyuntura general de la actividad empresarial que provocó pérdidas en la mayoría de las empresas del sector privado, especialmente en el sector financiero, apenas el 35 por ciento de los proyectos de inversión de la CFI alcanzó resultados de desarrollo satisfactorios. Por el contrario, el 96 por ciento de las donaciones canalizadas a través de la CFI para asistencia técnica alcanzó resultados de desarrollo satisfactorios. No obstante, a pesar del éxito obtenido por 1.100 procesos de privatización que la CFI ayudó a realizar para las PYME a comienzos de la década del noventa, la CFI no había logrado establecer aún un canal mayorista sostenible para las inversiones en este sector. De cara al futuro, la evaluación del DEO respaldó la expansión planificada de las actividades de la CFI en respuesta a un mejor clima de inversión en los dos últimos años.

De acuerdo con un análisis documental de la Unidad de Evaluación de Operaciones (UEO), el programa de garantías del Organismo Multilateral de Garantía de Inversiones (OMGI) satisfizo con prudencia y en forma selectiva las necesidades de los inversores privados extranjeros en materia de seguro contra riesgo político. En consecuencia, no se han presentado reclamos por pérdidas en la Federación de Rusia, que se ubica entre los cinco primeros países en la cartera de dicho organismo. Antes de que se desencadenara la crisis financiera, el OMGI brindó cobertura para riesgos de transferencia pero no ofreció seguro contra riesgo de inconvertibilidad. El OMGI continuó brindando apoyo a proyectos después de que el país declarara la cesa-

## FRANÇAIS

défaut de paiement de la Russie pour sa dette étrangère. Bien que la demande en produits AMGI ait été relativement faible, sa couverture de 549 millions de dollars pour 18 projets — principalement dans l'agroindustrie, la transformation alimentaire et les boissons, les finances et les industries d'extraction — a néanmoins facilité l'investissement direct étranger de 1,3 milliard de dollars en Russie (voir l'annexe 12). Dans le secteur de l'investissement dans les services de marketing, le site web « PrivatizationLink Russia » a été lancé en octobre 2000 et fournit en temps opportun d'importantes informations aux investisseurs étrangers potentiels. L'OEUE a suggéré qu'à l'avenir l'Agence s'efforce de maximiser le montant de l'investissement direct étranger qu'il facilite, tout en diversifiant son portefeuille et en minimisant ses risques nets en Russie.

**Étapes suivantes**

La direction de la Banque a adopté les recommandations de l'OEUE pour une concentration plus pointue de son aide aux pays dont les gouvernements sont fermement engagés à l'égard des réformes et où il existe un consensus social dans ce sens. La gestion du secteur public, la réforme du système légal et juridique, le climat des investissements et du commerce, la réforme des pensions, les marchés fonciers, et la restructuration du secteur du charbon et de l'électricité sont des domaines à haut potentiel de retombées de développement. Le dialogue politique en cours et le programme technique consultatif sur la réforme du secteur bancaire doivent se poursuivre. Pour répondre à la demande des clients, l'aide de la Banque devrait comprendre un programme élargi de bons conseils pratiques et le renforcement du débat public sur les réformes. Les prêts en faveur des réformes devraient être conçus de manière à lier étroitement la progression satisfaisante des réformes aux décaissements effectifs. La Banque devrait également étudier la possibilité d'orienter une partie de son aide sur les régions spécifiquement engagées dans les réformes.

**Leçons apprises**

La leçon générique clé de l'expérience de la Banque en Russie est que la propriété pays est cruciale à la

## ESPAÑOL

ción de pagos de su deuda externa. Si bien la demanda de los productos del OMGI era relativamente baja, otorgó cobertura por \$ 549 millones para 18 proyectos — principalmente en el sector agroindustrial, de procesamiento de alimentos y bebidas, financiero y de industrias extractivas — lo cual facilitó una inversión extranjera directa de aproximadamente \$ 1.300 millones en Rusia (ver Anéxico 12). En octubre de 2000 lanzó sus servicios para promoción de las inversiones, el vínculo PrivatizationLink Russia en la página Web. La UEO sugirió que en un futuro el Organismo debería esforzarse por maximizar el volumen de inversión extranjera directa que facilita y al mismo tiempo diversificar su cartera, minimizando su exposición neta en Rusia.

**Próximos pasos**

La dirección del Banco concuerda con las recomendaciones del DEO, según las cuales el Banco debería concentrar aún más sus operaciones de asistencia en áreas que cuenten con un firme compromiso de reforma por parte del gobierno y con consenso social relativo. La gestión del sector público, la reforma del marco legal y judicial, el clima de inversión y empresarial, la reforma de las jubilaciones, los mercados de tierras, y la reestructuración de los sectores de carbón y electricidad ofrecen actualmente oportunidades de desarrollo con alto potencial. El diálogo continuo en materia de reforma de políticas y el programa de asesoría técnica para la reforma del sector bancario deberían continuar. En respuesta a las demandas del cliente, la asistencia del Banco debería brindar un programa ampliado de asesoría en materia de buenas prácticas, y fortalecer el debate público sobre las reformas. Los préstamos para reformas políticas deben estar diseñados para garantizar una relación estrecha entre el avance de la reforma y los desembolsos efectivos. El Banco también debe considerar la posibilidad de focalizar parte de su asistencia en regiones selectas que están comprometidas con la reforma.

**Lecciones aprendidas**

La principal lección genérica que se desprende de la experiencia del Banco en la Federación de Rusia es que la identificación del país con el programa es esencial para el éxito de la asistencia. Por lo tanto, es im-

## FRANÇAIS

réussite de l'aide. Ainsi, il est important que la Banque prête une attention particulière aux aspects politiques et institutionnels des réformes et consulte toutes les entités concernées du gouvernement et de la société publique, à l'amélioration de la pertinence et de la conception de ses activités et à la prudence afin de ne pas se lancer dans des opérations là où l'engagement laisse à désirer. Les autres leçons d'ordre général sont les suivantes :

- En raison des antécédents médiocres et de la faible propriété-pays quant aux réformes, un grand programme d'ajustement de l'investissement (notamment avec décaissements en début de période) risque de retarder le processus de réforme au lieu de l'accélérer.
- En présence d'antécédents médiocres et d'un nouveau consensus en faveur d'un programme de réformes, les prêts d'ajustement devraient être offerts après l'adoption gouvernementale des réformes nécessaires ou le lancement de leur mise en œuvre, comme ce fut le cas pour les prêts d'ajustement du secteur du charbon (SECAL). Les décaissements devraient être effectués en fin de période et modulés avec soin sur la base des progrès certains de mise en œuvre.
- Les résultats des activités analytiques adéquates doivent être disponibles en amont des prêts. Les AAA devraient être financées selon le rôle que la Banque devra jouer.
- Les calendriers de mise en œuvre doivent être réalistes.
- Pour que les projets d'investissement et de réhabilitation physique atteignent leurs objectifs de développement, les réformes politiques et institutionnelles doivent progresser de manière satisfaisante.

### Réponse de la direction et des autorités gouvernementales

La direction de la Banque estime que le passage de la politique de prêts d'investissement à la politique de prêts d'ajustement structurel n'était pas une réponse à faux aux défis que posait la réforme systémique en Russie en 1996. À son avis, une réduction de l'aide aux AAA et les petits prêts suggérés hypothétiquement par l'OED auraient entraîné la perpétuation du faible

## ESPAÑOL

portante que el Banco preste especial atención a los aspectos políticos e institucionales de las reformas, y consulte con todas las áreas pertinentes del gobierno y con la sociedad civil a fin de dar mayor relevancia, mejorar el diseño de sus actividades, y evitar las operaciones sin un firme compromiso local. También se rescatan otras lecciones generales:

- A la luz de antecedentes insatisfactorios y una escasa iniciativa de reforma por parte del país, un programa de préstamo para fines de ajuste (especialmente un programa con importantes desembolsos iniciales) corre el riesgo de demorar en lugar de acelerar la reforma.
- Ante la presencia de antecedentes insatisfactorios y un nuevo consenso para una programa de reformas, las operaciones de préstamo para fines de ajuste deberían ofrecerse después de que el gobierno haya adoptado en forma pública las reformas necesarias, o las haya comenzado a implementar, tal como sucedió en el caso de los Préstamos para el ajuste del sector de carbón (SECAL). Los desembolsos deben realizarse en etapas posteriores y estructurarse en forma cuidadosa en función del avance firme en el proceso de implementación.
- Debe tenerse acceso a trabajos analíticos adecuados en las primeras etapas de las operaciones de préstamo. Las actividades AAA deben financiarse en concordancia con el papel que el Banco pretende desempeñar.
- Los calendarios para la implementación del programa deben ser realistas.
- A fin de alcanzar los objetivos de desarrollo fijados en los proyectos de inversión y modernización de activos fijos, se requieren avances en el proceso de reforma de políticas y del marco institucional.

### Respuesta de la dirección y del gobierno

La dirección del Banco no coincide con la idea de que el cambio de préstamos para la inversión por préstamos para fines de ajuste estructural haya sido una respuesta equivocada a los desafíos de la reforma sistémica que la Federación de Rusia enfrentaba en 1996. En su opinión, si la asistencia se hubiera limitado a las actividades analíticas y de asesoría (AAA) y a pequeños préstamos, como sugiere la premisa hipotética del Departamento de Evaluación de Operaciones (DEO), esto hubiese implicado

## FRANÇAIS

impact de la Banque sur l'élaboration des politiques. Les prêts d'ajustement structurel de 1997 (SAL I et II) et le prêt d'ajustement pour la protection sociale (SPAL) étaient nécessaires pour influencer la conception du plan de réforme structurelle. Selon la Banque, ces opérations ont été des instruments indispensables et ont contribué à gagner la confiance pour éviter des renversements de politique économique, améliorer les relations de la Banque avec la Russie et planter les jalons du programme de réforme approuvé par le Gouvernement en 2000 et actuellement en cours de réalisation.

Les autorités russes estiment que l'EAP « donne une image objective des activités de développement en Russie pendant la dernière décennie et met en lumière les facteurs auxquels on peut attribuer les réussites et les échecs de la Banque. » Bien qu'elles soient en grande partie d'accord avec les évaluations des activités de la Banque dans chaque secteur, elles estiment que le résultat d'ensemble est satisfaisant étant donné que le processus de transition a été « très rapide », et que les développements ultérieurs à 1998 étaient le fruit des efforts faits pendant la période précédente et du rôle important joué par la Banque et le Fonds. Quant au grand nombre de projets problématiques du passé, les autorités ont souligné le partage des responsabilités avec la Banque dont un grand nombre d'opérations « n'étaient pas étayées par une compréhension profonde des problèmes de l'époque. » Enfin, elles estiment que les recommandations avancées par l'OED « coïncident dans une plus grande mesure avec la disposition du Programme pour la coopération de la Russie avec la Banque, récemment approuvée par le gouvernement. »

### Le point de vue des administrateurs

Le sous-comité du comité pour l'efficacité du développement (Committee on Development Effectiveness - CODE), organe du Conseil des administrateurs, a examiné aussi bien le rapport de l'OED que celui de l'OEG le 8 mai 2002. Il a approuvé dans ses grandes lignes les recommandations contenues dans les évaluations et a noté les assurances données par la direction, à savoir qu'elles seront incorporées dans la Stratégie d'aide par pays qui doit être soumise à l'examen du Conseil des administrateurs en plénière au

## ESPAÑOL

perpetuar el impacto limitado del Banco en la formulación de políticas. Los Préstamos de Ajuste Estructural de 1997 (SAL I y II) y los Préstamos de Ajuste para Protección Social (SPAL) fueron necesarios para influir en el diseño de la agenda de reforma estructural. La dirección del Banco también sostiene que estas operaciones proporcionaron las herramientas adecuadas y construyeron la confianza necesaria para impedir reveses en la política económica, mejorar las relaciones entre el Banco y el país, y sentar las bases del programa de reforma que fue aprobado por el gobierno por primera vez en 2000, y que se encuentra actualmente en vías de implementación.

Las autoridades de la Federación de Rusia consideraron que la evaluación de asistencia al país (CAE) "presenta una visión suficientemente objetiva de los acontecimientos acaecidos en dicho país durante la última década y explica en líneas generales los factores subyacentes a los éxitos y reveses del Banco". Si bien "comparten en gran medida los conceptos vertidos en la evaluación de asistencia a este país que analiza los resultados de la actividad del Banco en sectores particulares," calificaron al resultado general de la actividad como satisfactorio, ya que el proceso de transición ha sido "muy rápido" y los acontecimientos positivos posteriores a la crisis de 1998 fueron fruto de los esfuerzos realizados durante el período previo y el protagonismo del Banco y el Fondo. En relación con la porción relativamente alta de proyectos problemáticos en el pasado, señalaron que la responsabilidad era compartida con el Banco, ya que muchas operaciones "no se sustentaban en la comprensión absoluta de los problemas existentes". Por último, consideraron que las recomendaciones del DEO "coinciden en gran medida con las disposiciones del Programa para la Cooperación de la Federación de Rusia con el Banco - que fue recientemente aprobado por el gobierno."

### Perspectiva de los directores ejecutivos

El Subcomité de Directorio Ejecutivo del Comité sobre la Eficacia en términos de Desarrollo (CODE) analizó los informes del Departamento de Evaluación de Operaciones y del Grupo de Evaluación de Operaciones el 8 de mayo de 2002. En líneas generales, sus miembros respaldaron las recomendaciones realizadas en tales evaluaciones y destacaron que la dirección se comprometía a incorporarlas en la Estrategia de Asistencia por País que será sometida a consideración del Directorio Ejecu-

## FRANÇAIS

mois de juin 2002. Les membres ont souligné l'importance d'approfondir la cohérence, la coordination et le partage de l'information entre la Banque et la SFI. Le président a terminé son discours en soulignant l'importance de confier au pays la responsabilité des réformes et d'assurer la capacité de mise en œuvre ; la nécessité, au niveau de la Banque, de travailler en partenariat avec les autres donateurs ; et le rôle vital que joue la Banque en s'engageant à développer le sens de responsabilité et à renforcer les institutions très tôt dans le processus de transition.

Au cours de la discussion, plusieurs membres du sous-comité ont demandé si, dans les premières années, le gros volume de prêts à l'ajustement n'avait pas entraîné un retard dans l'application des réformes en raison de l'ajournement du règlement des questions structurelles cruciales. Ils estiment qu'une stratégie d'aide axée sur les AAA, avec un soutien financier limité à la Russie, aurait été plus appropriée qu'une stratégie de gros volume de prêts pour l'ajustement. Cependant, d'autres membres pensent que l'effet de levier des prêts a été crucial dans le cadre du dialogue de la Banque avec les autorités russes et que les AAA n'auraient pu, à elles seules, capter l'attention du gouvernement. Ainsi, leur argument est qu'il pourrait s'avérer difficile d'attendre un consensus général, notamment en période de crise. Dans ces circonstances, la Banque pourrait se voir obligée d'accepter un rôle à plus haut risque – en particulier lorsque sa compréhension de l'économie est relativement faible – et d'essayer de développer un sens de responsabilité à travers son engagement, malgré les divergences d'opinion éventuelles dans le pays.

## ESPAÑOL

tivo en pleno en la reunión fijada para junio de 2002. Los miembros exhortaron a una mayor coherencia, coordinación, e información compartida entre el Banco y la CFI. En sus conclusiones, el Presidente del Directorio destacó la importancia de la iniciativa de reforma por parte del país y de la capacidad para implementarla; la necesidad de que el Banco trabaje en sociedad con otros donantes; y el protagonismo que tiene el Banco en la formación de dicha iniciativa y en el fortalecimiento de las instituciones en las primeras etapas del proceso de transición.

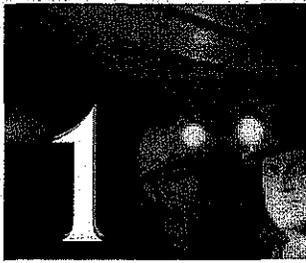
En el curso del análisis, algunos miembros del subcomité se preguntan si la gran cantidad de préstamos para fines de ajuste en los primeros años no habría retrasado las reformas al posponer la necesidad de abordar problemas estructurales críticos. En su opinión, una estrategia de asistencia orientada hacia las actividades AAA con respaldo financiero limitado para la Federación de Rusia hubiese sido más adecuado que la estrategia consistente en otorgar préstamos para fines de ajuste por elevados importes. Sin embargo, otros consideran que el apalancamiento generado por la actividad de préstamo ha sido esencial para el diálogo del Banco con las autoridades de la Federación de Rusia, y que probablemente las actividades analíticas y de asesoría (AAA) por sí solas no habrían podido captar la atención del gobierno. En este sentido, sostienen que puede ser difícil esperar hasta alcanzar un consenso generalizado, especialmente cuando se enfrentan situaciones de crisis. En tales circunstancias, el Banco podría tener que asumir mayores riesgos al intervenir – en especial cuando su grado de comprensión de la situación económica es relativamente menor – e intentar construir la iniciativa del país a través de su propio compromiso, si bien las opiniones en el país pueden estar muy divididas.

## ABBREVIATIONS AND ACRONYMS

AAA	Analytical and advisory services
AIDS	Acquired Immune Deficiency Syndrome
CAE	Country Assistance Evaluation
CAS	Country Assistance Strategy
CBR	Central Bank of Russia
CEB	Central Europe and the Baltics
CFAA	Country Financial Accountability Assessment
CIDA	Canadian International Development Agency
CIS	Commonwealth of Independent States
CMDP	Capital Market Development Project
CMEA	Council of Mutual Economic Assistance
COA	Chamber of Accounts
CPPR	Country Portfolio Performance Reviews
EBRD	European Bank for Reconstruction and Development
ECA	Europe and Central Asia Region
EFF	Extended Financing Facility
ESSP	Employment Services and Social Protection
ESP	Enterprise Support Project
ESW	Economic and sector work
EU	European Union
FCPF	Federal Center for Project Finance
FDI	Foreign direct investment
FIAS	Foreign Investment Advisory Service
FIDP	Financial Institutions Development Project
FSD	Financial sector development
GDP	Gross domestic product
GEF	Global Environmental Facility
GKO	Government short-term securities
GNP	Gross national product
HIV	Human immunodeficiency virus
HRMP	Highway Rehabilitation and Maintenance Project
IBRD	International Bank for Reconstruction and Development (World Bank)
IDA	International Development Association
IFC	International Finance Corporation
IFIs	International financial institutions
IMF	International Monetary Fund
LFS	Loans-for-shares [scheme]
MFTP	Management Financial and Training Project
MIGA	Multilateral Investment Guarantee Agency
MOF	Ministry of Finance
MPP	Mass Privatization Program
OECD	Organisation for Economic Co-operation and Development
OED	Operations Evaluation Department
OEDCR	Operations Evaluation Department, Country Evaluation and Regional Relations
OEG	Operations Evaluation Group
OEU	Operations Evaluation Unit
OFZ	Government short-term securities
PAR	Performance Audit Report

PFA	Public Financial Accountability
PIAL	Privatization Implementation Assistance Loan
PIUs	Project Implementation Units
PSD	Private Sector Development
QAG	Quality Assurance Group
SAL	Structural Adjustment Loan
SECAL	Sector Adjustment Loan
SMEs	Small and medium-size enterprises
SPAL	Social Protection Adjustment Loan
TA	Technical assistance
TB	Tuberculosis
TCA	Technical Cooperation Agreement
USAID	United States Agency for International Development
WTO	World Trade Organization

*Note:* All dollar figures mentioned in the text refer to U.S. dollars unless otherwise specified.



# Russia's Transition: From Plan to Market

## An Extraordinary Challenge

The transition that took place during the past decade in Central and Eastern Europe and the former Soviet Union has led to unprecedented political, economic, and social change.<sup>1</sup> The obstacles that Russia, its governments, and outside supporters faced in the transition to a market economy were formidable: deep economic distortions, major trade disruptions, serious environmental damage, and a total lack of market institutions. In the mid-1980s, economic stagnation and productivity declines had led the Soviet government to launch an economic restructuring process (*perestroika*) in parallel with political openness (*glasnost*).

Perestroika allowed private small-scale initiative and granted state enterprises considerable autonomy, but did not create mechanisms to ensure management accountability. As a result, many "insiders" began to take over state enterprises and their assets in a process referred to as "spontaneous" privatization. A banking sector was created, initially by divesting commercial activities from the State Bank. With inadequate regulation and supervision and low barriers to entry, the number of banks climbed to the thousands. Public investment and social expenditures increased, but there were no adjustments to prices and taxes.

These policies led to the abolition of central planning, but they also contributed to higher fiscal deficits, large external borrowings, high

inflation, and loss of control by central authorities over economic management (Mau 2000). The collapse of the Soviet Union in 1991 exacerbated the shifts in relative prices and the disruption of interenterprise linkages. An antiquated payment and legal system, the dismemberment of the ruble zone, and soft budget constraints induced a sharp rise of interenterprise arrears and the spread of barter trade.

The Russian Federation (Russia) that emerged in 1991 inherited weak institutions, a complex federal system, and a distorted economic structure dominated by oil and gas, heavy industry, and military production. Through late 1999, many observers feared policy backsliding with serious potential human and geopolitical consequences, as the Russian authorities were split over the speed

and scope of market reforms, and the Duma opposed most of the economic and legislative initiatives of the executive branch. This led to frequent government shakeups and to increasing regional autonomy. In turn, low trust in state institutions underpinned weak ownership of the reforms among the Russian people. The need to build market institutions and reorient public attitudes, as well as the overwhelming priority of creating a democratic political order out of the ruins of centuries of autocratic rule, combined with the social impact of population movements and with chronic environmental and demographic burdens, compounded the transition challenge.<sup>2</sup>

From 1991, transition to an open market economy was the key goal of successive Russian administrations. The initial steps were price liberalization, unification of the exchange rate, and privatization. Trade liberalization proceeded in most areas, but with some export restrictions remaining in the energy sector. Other government goals were regulatory reform, anti-monopoly policies, financial sector strengthening, and provision of an effective social safety net to protect the most vulnerable, but these were slower in getting started.

### **Institutional, Economic, and Social Performance**

The World Bank's country policy and institutional assessment puts Russia in the middle among transition economies, with high scores for the shift of production toward the private sector and price liberalization, but low scores for financial sector development, competition policy, enterprise reform, corporate governance, environmental sustainability, property rights, and public sector governance (transparency, accountability, and corruption). European Bank for Reconstruction and Development (EBRD) transition indicators portray a similar picture.

Over the past decade, Russia's gross national product (GNP) per capita declined substantially—by more than 50 percent, according to official statistics (see table 1.1), although the large changes in relative prices and the rise of a large unofficial economy make comparisons of economic estimates before and after 1990 unreliable. Although the decline in consumption was more

modest, the impact on poverty, income distribution, equity, and human development has been large, both in absolute terms and relative to other transition economies. In mid-1999, 55 percent of the population, especially children and the elderly, was living in absolute deprivation.<sup>3</sup> Inequality had doubled by 1993, with the Gini coefficient reaching 0.47. Human development indicators, which had deteriorated between the mid-1980s and the early 1990s, recovered only modestly (see tables A.3 and A.4). Health and education indicators dropped, the quality of services worsened, and social and geographic disparities in access grew.

Several stabilization programs were launched during 1992–94. But these were short-lived, as the authorities lacked the instruments to tighten fiscal and monetary policies. In 1995, a stabilization program adopted with International Monetary Fund (IMF) support succeeded in reducing inflation for almost three years. It rested on three legs: fixing the exchange rate as a nominal anchor, tightening credit to enterprises, and limiting Central Bank of Russia (CBR) credit. But the government could not hold to the program's fiscal policy nor implement the supporting structural reforms because of the opposition of key stakeholders. The fiscal slippage and low world prices for Russia's exports required increasing external borrowing to keep the progressively uncompetitive fixed exchange rate. In August 1998, the stabilization and structural adjustment program collapsed, triggered by declines in oil prices and the spillover of the East Asia crisis that undermined investor confidence.<sup>4</sup> Russia had to default on its debt and the ruble was floated (depreciating by over 60 percent), leading to the insolvency of most banks, a spike in inflation, and a severe, albeit short-lived, recession.

By the mid-1990s, the private sector was contributing more than 70 percent of gross domestic product (GDP). Most enterprises had been sold or otherwise transferred out of state hands, mostly to their workers, but without prior restructuring and breakup to enhance competition. Much of this transfer was done through a mass privatization program (MPP). Eager to stop the looting of state property by insiders, the reformers saw the voucher option for the MPP as

Table 1.1

Selected Macroeconomic Indicators  
(1990-01)

Indicator	Fiscal year											
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
GDP growth (annual %)	1.0	-5.0	-14.5	-8.7	-7.0	-4.1	3.9	0.9	4.9	5.4	9.0	9.0
GNP per capita growth (annual %)	-1.6	-6.5	-15.3	-8.4	-12.6	-4.4	3.5	0.7	6.4	3.3	11.2	7.5
GNP, Atlas method (US\$ billion)		569	469	412	373	333	349	383	331	256	246	253
Inflation, consumer prices (annual avg. %)	5.6	92.6	1354.1	895.3	383.7	188.7	47.5	14.8	27.7	85.7	21.6	21.5
REER index (1997 = 100)	61.2	121.5	13.5	34.0	23.6	68.0	91.7	100.0	72.1	46.0	58.9	70.4
Real wage rate (annual growth)					-8.0	-28.0	6.0	4.7	-13.4	-22.0	20.9	
Corporate profit, current prices (% of GDP)			3.0	2.4	1.3	1.6	0.6	0.7	10.4	1.5	3.5	
Gross domestic fixed invest. (% of GDP)	29	23	22	20	22	21	21	19	18	16	18	18
Exports (annual % growth)		-30.0	29.7	2.1	3.3	10.3	8.7	4.6	2.3	-1.7	27.0	2.8
Current account balance (% of GDP)			0.1	0.7	2.0	1.7	2.5	0.4	-0.3	10.5	16.1	11.2

Source: Official statistics and World Bank Unified Survey, 2002.

the only realistic method to privatize quickly and fairly. Transferring economic assets to private hands was expected to create a strong constituency for the necessary legislative and institutional changes that would underpin enterprise restructuring. But involvement by outside investors was minimal, primarily because of management's opposition and the decision to allow majority employee ownership. Enterprise managers eventually succeeded in controlling most privatized enterprises.<sup>5</sup> Subsequent efforts at case-by-case, cash privatization included the loans-for-shares (LFS) scheme, through which the government divested itself in 1995-96 of 13 large and valuable companies, mostly in the petroleum and metals sectors. This divestiture was done in a nontransparent way and for only a fraction of the market value of the companies involved.

Enterprise development and foreign direct investment (FDI) have been discouraged by corruption, poor macroeconomic management, un-

reliable enforcement, and unclear and conflicting laws and regulations, particularly those related to property and shareholders' rights. The high costs of entry and doing business, including bureaucratic harassment, discouraged small and medium-size enterprise (SME) growth. The same factors have constrained International Finance Corporation (IFC) and Multilateral Investment Guarantee Agency (MIGA) activities and, thanks also to continuing soft budget constraints, led to very slow enterprise restructuring. Through 1998, the energy sector was at the center of a growing nonpayment problem, which complicated economic management.

By 1998, gains included the elimination of shortages of consumer goods; greatly improved quality and variety of goods and services; ownership titles to housing for most households; greater social mobility, no longer shackled by pervasive administrative restrictions; and expanded access to the domestic political process and global information. New employment serv-

ices were established, administration of pension benefits improved, and social assistance became better targeted. However, proposed reforms of the labor laws and the pension system had not been adopted, and absolute levels of social benefits remained low.

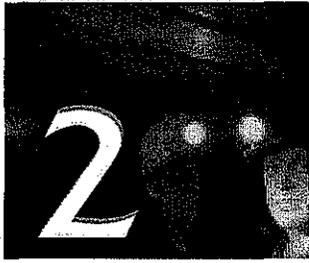
### **Recent Achievements**

The Primakov government that came to power after the 1998 crisis was widely expected to pursue lax monetary and fiscal policies. Instead, it improved fiscal discipline, kept a lid on inflation, allowed only a moderate amount of food aid so as not to damage agricultural producers' incentives, and abstained from reversing liberalization and other reforms. Unlike other countries that experienced financial crises during the 1990s, Russia overcame the 1998 crisis quickly and without international financial assistance. In mid-2000, the Kasyanov government endorsed a comprehensive medium-term program of policy and institutional reforms. Important reforms have since been adopted, including those in tax policy, urban land sales, the pension system, the land code, and business deregulation. Some, including tax reform, have been successfully implemented.

The last three years have seen strong economic performance. Good fiscal management, large balance of payments surpluses, and an impressive output recovery have been accompanied

by an improvement in business confidence and a drastic reduction of barter and enterprise payment arrears. Poverty incidence has declined sharply (from its peak in mid-1999 to 33 percent by the end of 2000, according to official estimates). The economy has been boosted by higher world energy prices and improved competitiveness of the non-oil export sector, thanks to the 1998 devaluation. Political stability and a broader consensus on reform have also played significant roles. Russia has effectively moved from a centrally planned to a market economy, albeit with considerable distortions and weak social services and safety net. Policy, institutional, and ownership changes have gone too far to be reversed.

Throughout this period, the Bank Group's strategic objectives were to ease Russia's transition from a planned to a market economy and help avoid the human costs and geopolitical consequences of a policy reversal by facilitating (a) the restructuring of old enterprises, (b) the creation of new enterprises, (c) an improved environment for investment, and (d) reform of social protection. The last was required because of the budget crisis, to ease the restructuring of the old enterprises, to help manage divested social assets, and to target benefits to the poor. Later, the Bank sought to help institute the rule of law, efficient public resource allocation, and improved service delivery.



# The Evolution of Bank Group Assistance

## The Bank's Goals

**T**he Russian Federation officially joined the Bank on June 16, 1992, as an upper-middle-income country on the basis of an estimated GNP per capita of \$3,830 for 1991.<sup>1</sup> In 1994, Russia was reclassified as a lower-middle-income country, with a GNP per capita of \$2,310. The Bank has developed nine annual country assistance strategies (CASs) or progress reports since 1992 that have consistently stressed the country's difficult initial conditions, the severe constraints on reform, and the risks involved in providing development assistance.<sup>2</sup> During FY93–01, the Bank's lending commitment to Russia has averaged slightly more than US\$1 billion a year—almost 0.4 percent of current GDP and 10 percent of the capital expenditures of the consolidated government.

Throughout this period, the Bank Group's strategic objectives were to ease Russia's transition from a planned to a market economy and help avoid the human costs and geopolitical consequences of a policy reversal by facilitating (a) the restructuring of old enterprises, (b) the creation of new enterprises, (c) an improved environment for investment, and (d) reform of social protection. The last was required because of the budget crisis, to ease the restructuring of the old enterprises, to help manage divested social assets, and to target benefits to the poor. Later, the Bank sought to help institute the rule of law, ef-

ficient public resource allocation, and improved service delivery.

## Early Phases

### The "Approach" Phase

Bank assistance to Russia between 1990 and 2001 can be divided into five phases. The first was an "approach" phase that began at the Houston Economic Summit in July 1990, when the leaders of the G-7 countries, with the agreement of President Gorbachev, asked the IMF, the World Bank, the Organisation for Economic Co-oper-

ation and Development (OECD), and the EBRD to undertake a joint study of the Soviet economy (World Bank and others 1990 and OECD and others 1991). The study was intended to provide recommendations for reform, offer guidance to external assistance providers, and prepare the Soviet Union for membership in the international financial institutions (IFIs).

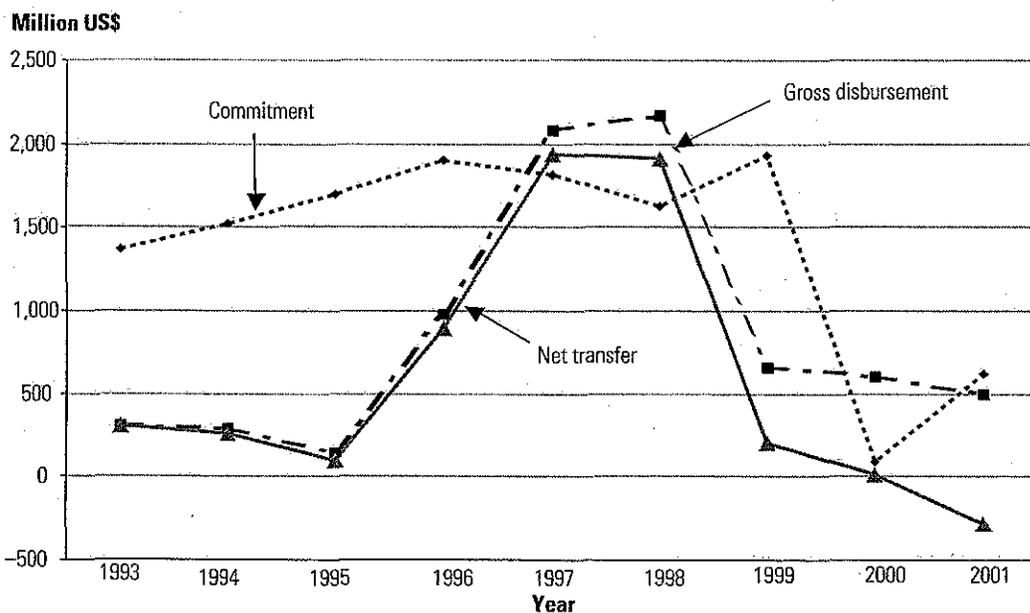
In March 1991, even before the establishment of a Moscow office in the fall, the Bank approved a \$30 million grant to finance a trust fund to provide technical assistance (TA) and project preparation. After the Soviet Union's collapse, the Bank reached a new agreement in December 1991 with what was now the Russian Federation over a share (\$13.5 million) of the original Technical Cooperation Agreement (TCA) grant. According to former government officials, however, the advisory services financed by this trust fund came too late to help in the preparation of the Gaidar reform program and its initial implementation in early 1992.

The IMF and the Bank could not provide quick-disbursing funds at short notice and before membership (the Soviet Union applied for Bank membership on July 1). Moreover, little bilateral assistance was granted during the turbulent period after the failed coup d'état in August 1991, the subsequent dissolution of the Soviet Union, and the appointment of a reformist government in late 1991. The absence of external support for Russia during this period has been criticized by several reformers and observers (see Sachs 1996; Åslund 1995, 2001).

**The "Learning and Investing" Phase**

This phase, from mid-1992 to mid-1995, began with the Bank emphasizing analytical work and staff-level inputs to policy discussions, particularly on the MPP. Given the consensus of the Bank's main shareholders, it also embarked on a rapid expansion of lending.<sup>3</sup> During the ensuing three years, the portfolio swelled from almost nil to a cumulative \$4.6 billion.<sup>4</sup> Bank manage-

**Figure 2.1** World Bank Gross Commitments, Disbursements, and Net Transfers



Source: SIMA and Global Development Finance.

ment was reluctant to provide large-scale budget support in the absence of a credible stabilization and structural reform program. Still, in August 1992, at the request of the G-7 and in parallel with the first IMF-supported program, the Bank approved a \$600 million Rehabilitation I Loan with virtually no conditionalities. However, Bank management held up Board submission of the Rehabilitation II Loan until mid-1995, when a number of trade reforms had been adopted and a new Standby Arrangement provided an IMF seal of approval for Russia's macroeconomic management. During this period, the Bank lent for 17 investment and TA projects; and in support of structural reforms (mostly in privatization), institutional development (including procurement, employment services, pension payment administration, private and financial sector development, land, agriculture, environment, housing, and tax administration), and infrastructure rehabilitation (including oil fields, highways, and urban transport).

#### **The "Consolidation" Phase**

A high share (65 percent) of project commitments experienced serious implementation problems (see table A.13), because Russia's institutions were not prepared to deal with the Bank's financial and administrative requirements.<sup>5</sup> Hence, from mid-1995 to early-1996, the Bank made only \$27 million in new commitments to Russia. This phase was marked by an intensification of supervision efforts, the start of annual Country Portfolio Performance Reviews (CPPRs), and major project restructurings. Portfolio performance turned around by 1997. Within a declining administrative budget, however, portfolio management work crowded out analytical and advisory services.<sup>6</sup>

#### **The "Renewed Lending" Phase**

This phase began in March 1996, when the Bank came under renewed pressure to lend after approval of the IMF's \$10.1 billion Extended Financing Facility (EFF).<sup>7</sup> New commitments by the Bank over the next two years amounted to \$5.3 billion, much of it (\$3.5 billion) for five quick-disbursing adjustment operations. During the four months before the July 1996 presidential elec-

tions, the authorities moved forward with important decisions, and the Bank approved \$1.4 billion for investment and TA projects (for enterprise housing divestment, capital market development, legal reform, and medical equipment) and \$0.5 billion for a Coal Sectoral Adjustment Loan (Coal SECAL I). This phase also signaled enhanced attention to the social sectors.

Until early 1997, the Bank had not taken part in the high-level discussions between the government and the IMF on the structural reform agenda. Its contribution had been indirect, through economic and sector work (ESW) and background inputs to the IMF. In March 1997, the new government led by Prime Minister Chernomyrdin appointed key reformers as deputy prime ministers. The Bank perceived a new window of opportunity and through December approved loans for an additional \$3.4 billion. Of this amount, \$3.0 billion was the first installment on a multiyear program of expanded adjustment lending (\$1.2-\$2 billion annually) to support stabilization and tax reform; elimination of budget arrears; transparent case-by-case privatizations; pricing reforms and competitive restructurings in power, natural gas, and railways; banking reform (Structural Adjustment Loans [SALs] I and II); social protection reform (Social Protection Adjustment Loan [SPAL]); and further coal sector reform (Coal SECAL II).

The 1997 CAS called for the Bank Group to move forward more aggressively with policy advice, technical assistance, and financial instruments to support private sector investments in natural resources, manufacturing, banking, and consumer industries. The IFC increased its gross investment approvals in Russia to more than \$200 million. Demand for MIGA's political risk coverage also rose. With a gross exposure outstanding of about \$260 million, Russia is today MIGA's fourth-largest client.

The 1997 CAS also placed great emphasis on regional infrastructure projects (water and sanitation, district heating, urban transport, and highway rehabilitation). Providing assistance to the regions had become popular among donors in the mid- and late 1990s. Subnational units were expected to compete for externally funded

projects, based on their interest and commitment to reform. Support for environmental activities, including through the Global Environment Facility (GEF), was highlighted. Finally, the strategy called for selective Bank assistance to high-priority institution-building programs (including legal reform, financial sector development, and science and technology).

Until the ripple effects of the 1997 East Asia financial crisis began to be felt in Russia toward the end of that year, quick-disbursing loans were not needed for balance of payments support, because the current account had always been in surplus and the ruble was appreciating in real terms. The emphasis given to adjustment lending was justified by the Bank as necessary to focus government attention on the longer-term reforms. But, apart from a handful of reformers in the government, commitment to the reform agenda of the SALs and SPAL was negligible. The loan conditions were mild and mostly tied to preparatory reform steps, such as submission of legislation to the Duma, rather than adoption of legislation, enforcement, and implementation.

Reform efforts began to slow down early in the summer of 1997, following the first signs of stabilization (Gaidar 1999). Yet, at the end of 1997, at the behest of the international community, the Bank increased the size of the SAL II and the Coal SECAL II, with substantial front-loading of disbursements.

### **The "Crisis and Recovery" Phase**

In April 1998, the appointment of a new prime minister with a reformist track record and the impending financial crisis offered the Bank an unprecedented opportunity to influence the reform agenda. At the same time, the Bank was called upon by its major shareholders to contribute around \$6 billion, much of it in quick-disbursing funds, to the July 1998 international emergency financial package aimed at counteracting the growing lack of confidence in the ruble. The Bank responded by accelerating the processing of the \$1.5 billion SAL III already in the pipeline, but this time insisted on multi-tranching, back-loading of disbursements, and stronger conditions that included actual passage of reform legislation by the Duma. As it turned out, dis-

bursements under the SAL III were limited to a first tranche of \$300 million and, following restructuring of the loan in mid-1999, a smaller tranche of \$100 million.

The 1998 crisis derailed the Bank's assistance strategy and adversely affected many projects, both directly, as in the case of banking sector operations, and indirectly, through the reduced ability of many beneficiaries—especially at the local level—to repay subloans extended by the Ministry of Finance (MOF). Through mid-1999, the Bank focused on understanding the social fallout from the crisis (for example, food and pharmaceutical needs, energy system breakdowns, supplies to the far north) and preparing a new program of support for those hit hardest. It assessed the damage to the financial sector, provided advice, and mobilized technical assistance in this area. It also engaged almost immediately with the new Primakov government in an intensive and high-level dialogue on structural policy. This dialogue was continued through mid-1999 and, with the added leverage offered by the restructuring of the adjustment loans (SAL III, Coal SECAL II, and SPAL), contributed to improved macroeconomic management and a strengthened linkage between reform progress and future disbursements. The Bank also took steps to protect the projects' special accounts in troubled banks, made the CPPRs a biannual event, and worked with government officials on restructuring the portfolio.

After the crisis subsided, new Bank lending was held back because of slow progress in the implementation of agreed reforms and in the preparation of new projects to higher standards (as agreed under the CPPR process). Lending was also restrained by the new government's determination to formulate and reach a broader internal consensus on a new medium-term reform program, and because the country's balance of payments and fiscal positions had improved. A \$400 million Highway Rehabilitation and Maintenance Project (HRMP II) was approved at the end of 1998 (to signal the Bank's determination to remain engaged), but it never became effective. New commitments from January 1999 through June 2001 amounted to only \$614 million, with no new adjustment loan. About \$2.8

**Table 2.1 World Bank Commitments (US\$ million)**

	Fiscal year							Cancelled	Total
	1992-95	1996	1997	1998	1999	2000	2001		
Rehabilitation loans	1,200	0	0	0	0	0	0	0	1,200
SALs	0	500	1,000	1,600	1,500	0	0	1,100	3,900
Oil, gas, and energy	1,100	628	40	0	0	0	85	352	2,105
Social sectors	1,110	470	137	29	0	0	130	120	2,766
PSD/FSD/infrastructure	1,519	763	216	0	400	0	162	1,069	3,017
Agriculture/environ.	629	80	40	0	0	60	226	118	1,043
Econ. public sector mgt.	70	21	56	0	30	30	0	72	289
Total	4,608	1,999	1,449	1,629	1,930	90	624	2,761	9,889
Memo: disbursements	729	981	2,006	2,172	1,657	606	605		7,856

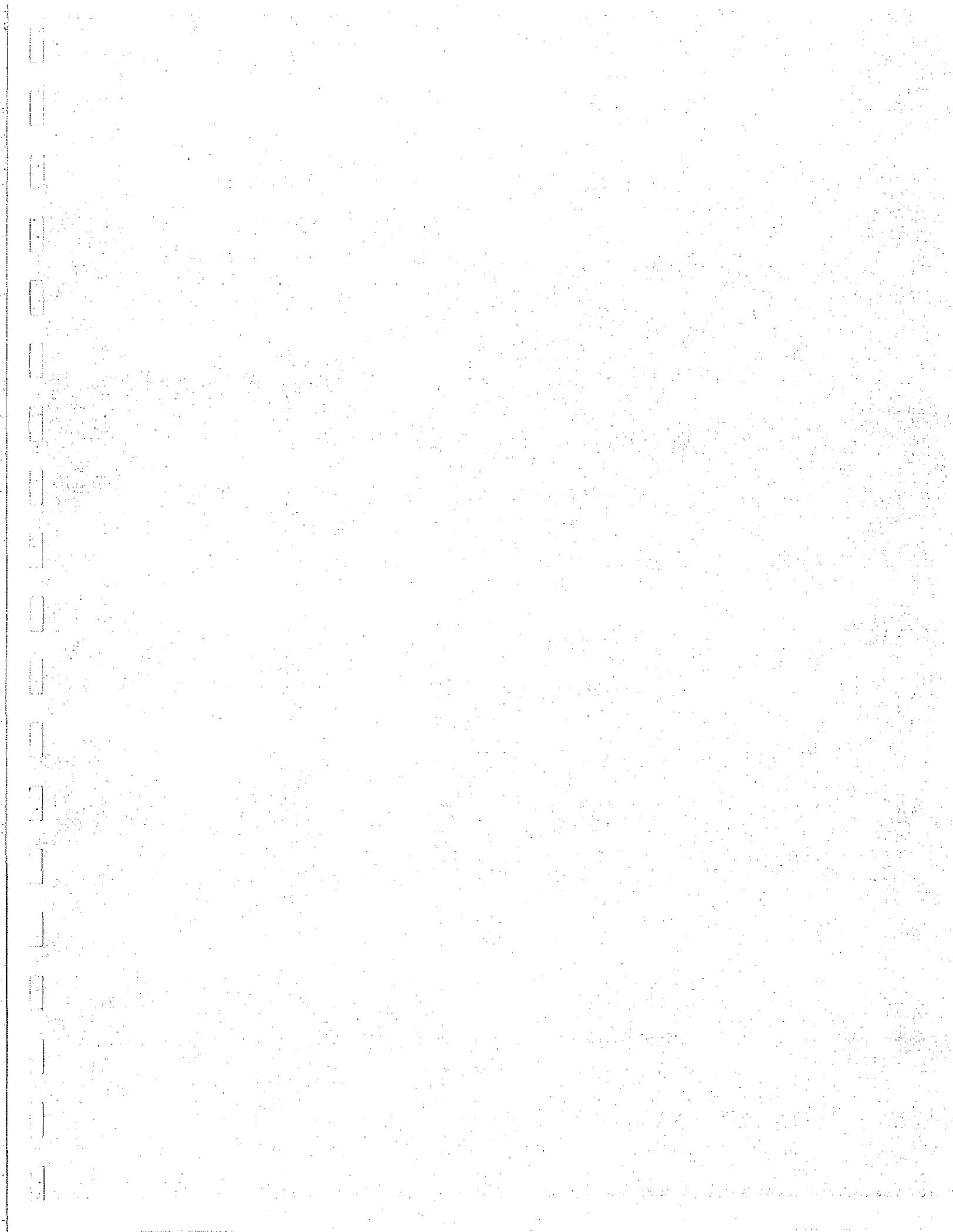
Note: The two Coal SECALs and the SPAL are in the SAL category.

billion of commitments were cancelled, including two lapsed loans (the Enterprise Restructuring Services Project in August 1998 and the HRMP II Project in September 1999) and the large residual balances of the SAL III (\$1.1 billion in August 2000).<sup>8</sup> The crisis also affected MIGA's portfolio by causing some investors to cancel or reduce MIGA coverage.

The assistance strategy for the Bank Group since 1999 has centered on support for (a) public administration reform and reduction of corruption; (b) budget management, tax collection, and federal-regional fiscal relations; (c) improvements in the business environment; (d) private sector investments, including through partial risk guarantees and equity participation; and (e) rehabilitation of the education and health systems and efforts to address health crises, such as tuberculosis (TB) and acquired immune deficiency syndrome (AIDS). The analytical and advisory (AAA) role of the Bank Group has re-

ceived more emphasis—particularly in how to improve governance. The CAS documents stressed that Russia's transition will be a long process, and therefore a correspondingly long-term operational engagement was needed.

Since early 2000, in response to stronger Russian ownership of the reform agenda, the Bank has approved new technical assistance, investment, and guarantee operations to improve public sector management (statistical system, regional fiscal management, forestry management), private investors' incentives in forestry and coal, basic public services (municipal water, wastewater, and heating; urban transport; education reform; AIDS and TB), and social development (in the north) and environmental concerns (with a grant to end production of ozone-depleting substances). The government and the Bank have also agreed to intensify their policy dialogue, although there has been no demand for adjustment lending.





# Bank Products and Services

## Analytical and Advisory Services

The 1990 joint study (OECD and others 1991) identified the transition challenges and laid out a quick and radical approach to macroeconomic, price, and structural reform, based on political economy considerations and the transition experience of other economies. The study stressed the need to achieve both macroeconomic stabilization and price liberalization before introducing other reforms—such as privatization, and institutional and legal reforms—that would take much longer to implement. Much of the Bank's early advice and assistance was informed by the joint study, but the elusive stabilization and the slow pace of structural reforms soon presented the Bank with a new challenge.

In general, Bank studies have been highly regarded both inside and outside Russia, offering sound diagnoses and advice (box 3.1). Beginning in 1995, however, the Bank gave only secondary priority to ESW and did not disseminate its findings to a wider audience.<sup>1</sup> Most studies were published as research papers or working papers. No comprehensive formal country economic report was produced after April 1996. Until 2000, the government was not interested in Bank studies on the expenditure side of the budget or financial accountability. Important exceptions were studies of coal subsidies, intergovernmental fiscal relations, and tax administration. Between 1997 and 2000, the Bank produced formal sector reports only on the nexus of energy and the environ-

ment, education, and poverty and inequality. Knowledge about other sectors exists among staff, but OED found that only a small number of government officials and advisers had a good grasp of the Bank's current views on reform.<sup>2</sup>

Thanks to project funding or donors' trust funds, Bank staff and consultants have provided significant technical advice, but the policy dialogue was very limited through 1996. The Bank's advisory role expanded from the coal sector in 1996 to economy-wide issues in 1997–98, with an impact evident since 1999. The World Bank Institute's training activities—which the CAE did not attempt to evaluate—have reached about 2,150 trainers, 10,000 professionals, and 200 training institutions (see Annex 13).

As of mid-2001, panel reviewers for the Bank's Quality Assurance Group (QAG) had evaluated five ESW tasks on Russia, finding one of them highly satisfactory (the nonpayment study) and three satisfactory. They found the energy and environmental review "marginal" because of a lack of original analysis, weak presentation, too broad a scope at the conceptual stage, and little evidence of Russian input and of response to inputs from the peer reviewer or networks. In addition, the *Making Transition Work for Everyone* regional study (World Bank 2000c) was also rated highly satisfactory. It updated and supplemented various studies on poverty, highlighted the very negative consequences of Russia's transition for poverty and inequality, was well written, candid on difficult issues, and timely.

The Foreign Investment Advisory Service (FIAS) of the Bank Group has carried out several assignments in Russia. During the 1991–93 period, it offered advice on improving the business climate and the institutional structure for regulating FDI. In later years, it advised federal authorities on successive versions of the foreign investment law and on investment-related is-

ssues for World Trade Organization (WTO) accession, and worked with Novgorod Oblast on investment promotion. Since 2000, it has been assisting the central government and several oblasts by carrying out a series of studies of administrative barriers to investment. At the regional level, Novgorod Oblast acted on most of the FIAS recommendations and improved its risk rating among the oblasts from tenth to second.<sup>3</sup> FIAS's earlier efforts at the federal level had relatively little impact until recently. Political opposition to the recommended reforms has blocked progress, and many of the problems identified in the early 1990s continue to discourage investments today.

In October 2000, MIGA launched an initiative called PrivatizationLink Russia in partnership with the Canadian International Development Agency (CIDA) and Russian government agencies. The initiative was designed to reduce transaction costs and to provide easy, cost-free, transparent online access to information on privatization for investors around the world. This initiative is raising awareness about investment opportunities, but it would be premature to assess its impact at this early stage.

### Box 3.1

### Good Analytical and Advisory Services

*Transport* The diagnoses and solutions of a 1993 sector study were comprehensive and well articulated. The report covered all subsectors and included excellent chapters on their economic and financial performance and institutional framework. Its recommendations were practical and articulated for the short, medium, and long term. The study presented the basis for the institutional and policy objectives of Bank-funded transport projects and the SAL transport components. It was also discussed at several national and international seminars. A 1998 update was also well focused and practical, but was issued just two months before the financial crisis and had little impact.

*Coal* The Bank's first economic report on Russia in September 1992 accurately captured the main problems of the coal sector, which was operated by a monopoly and was characterized by massive cross-subsidization between high- and low-cost mines.

Although coal subsidies reached 1 percent of GDP in 1993 and 1994, the retrenchment of the sector was driven by loss of markets and the failure of many users to pay their bills, but was ad hoc, chaotic, and politically explosive. In 1993–94, the Bank joined with the government to analyze the sector's problems region by region, and considered the prospects for affected mine workers and their communities. The study was the basis of a successful restructuring program supported by the two SECALs.

*Nonpayment study* (a version of which was published in Pinto, Drebenstov, and Morozov 2000). A QAG review panel found this study very good on all criteria (relevance, internal quality, presentation, and likely impact). By the time it was presented in 1999, however, Russian economists already had a good understanding of the issue, and the problem of nonpayment was decreasing.

**Bank Lending Trends**

As of the end of June 2001, the Bank had made gross loan commitments to Russia amounting to \$12.6 billion for 55 projects. On two occasions, responding to worsening portfolio performance, the Bank and the government restructured certain projects. In the period FY95–98, loans and loan components amounting to \$315 million were cancelled. In FY99–01, \$2.4 billion was cancelled, including the balance (\$1.1 billion) of the SAL III and the full \$400 million of HRMP II.

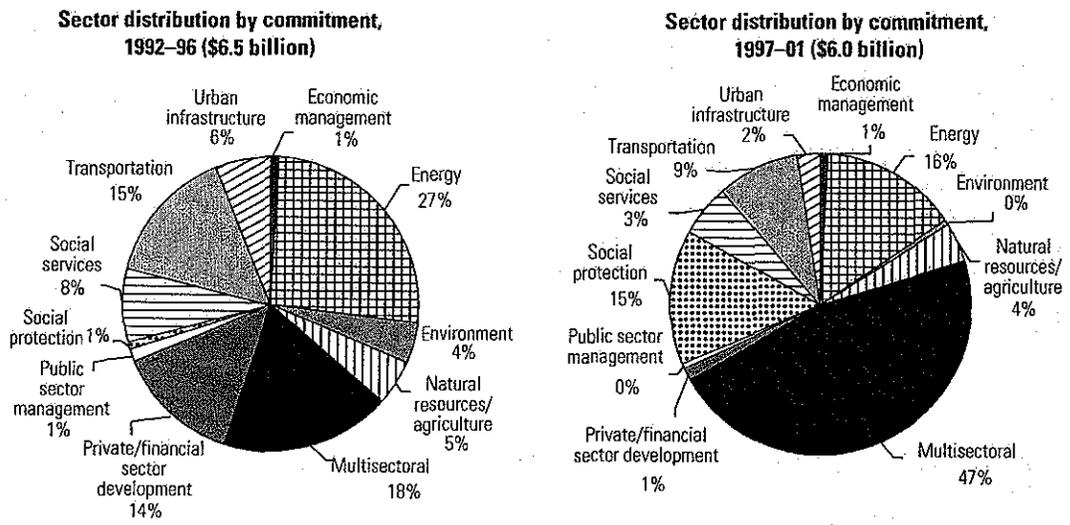
The cumulative commitment net of cancellations amounted to \$9.8 billion. Disbursements have totaled \$7.8 billion, of which \$2.8 billion was for investment or TA projects and \$5 billion for balance of payments and budgetary support. Thus, undisbursed commitments at the end of June 2001 amounted to \$1.9 billion. Annual gross commitments have averaged \$1.3 billion and disbursements \$0.8 billion, ranging from \$1.9 billion in FY99 to \$0.09 billion in FY00. The disbursement ratio, which measures disbursements against the previous year's undisbursed balance, ranged from a low of 1.3 percent in 1994 to a high of 20 percent in 1998, largely thanks to disbursement of adjustment loan tranches.

The composition of the Bank's lending differed substantially between the first and second half of the decade (see figure 3.1). In FY92–96, Bank funding (\$6.5 billion) went to rehabilitation and investment operations in many sectors, with a large presence in the energy sector (mainly oil and gas). Assistance in later years (\$6.0 billion) was dominated (90 percent of all new commitments) by adjustment operations and companion TA loans.

**Closed Project Performance**

As of the end of June 2001, OED had evaluated 15 projects (including the TCA grant) with a total commitment value of \$5.1 billion. Seven projects were rated satisfactory for outcome, while six were rated substantial in terms of institutional development (ID) impact. A starker picture emerges in terms of commitments, as only 28 percent of Bank lending in closed operations was rated satisfactory for outcome and 16 percent was rated substantial for ID impact.<sup>4</sup> When the 1997 adjustment loans are excluded, 7 of the 11 closed projects (64 percent) and 57 percent of net commitments received a satisfactory outcome rating. Reflecting the irre-

**Figure 3.1 Sectoral Composition of New Lending**



Source: Bank data.

versibility of most of the policy and institutional changes, sustainability was rated likely in 67 percent of projects and 78 percent of commitments. Except for sustainability, though, Russia's performance has been well below that of comparators as well as Bankwide and ECA averages (see table 3.1). The ECA Region's overall assessment of closed project outcomes differs fundamentally from OED's.<sup>5</sup>

Among the 15 closed projects, OED rated only 9 satisfactory for Bank performance at appraisal and during supervision.<sup>6</sup> The long average lag of nine months between approval and effectiveness and the high number of restructurings (13 projects) are largely explained by the inadequacies of the operating environment and weak domestic ownership of project objectives.

### IFC and MIGA Interventions

A parallel evaluation of IFC assistance by the Operations Evaluation Group (OEG) concluded that the results of its mature TA operations were impressive. It gave satisfactory ratings for the development contributions of all IFC privatization and post-privatization TA projects, but to less than half of its other TA activities (sector reviews, project identification, and project preparation). Weighting these operations by their

costs, the OEG rated 96 percent of IFC operations as satisfactory. The IFC's privatization efforts, which contributed significantly to, among other things, the transfer of most small enterprises in the country to private hands and created momentum for the overall privatization program, were particularly successful.

The IFC's investments in Russia were limited by the high-risk environment and by a corporate decision to leave the EBRD to provide the bulk of IFI financing to the private sector. The IFC's commitments for its own account (that is, excluding B loans for the account of participants) totaled \$0.5 billion. Roughly 20 percent was for financial institutions and investment funds. The results of the IFC's mature investments have been disappointing. Only 35 percent yielded satisfactory or better development outcomes (48 percent weighted by disbursements), and only 20 percent yielded satisfactory investment outcomes for the IFC (33 percent weighted). These results are significantly worse than the IFC's performance worldwide and elsewhere in Eastern Europe and the former Soviet Union, but were broadly in line with EBRD experience in Russia (see Annex 9). On a net basis, before deducting administrative expenses, the IFC lost \$37 million on its lending and equity investment operations

**Table 3.1 OED Evaluation Ratings of Bank Projects**

	Number of projects	Net commitment (US\$ millions)	Satisfactory outcome (percent)	Likely sustainability (percent)	Substantial institutional development impact (percent)	Satisfactory Bank performance at appraisal (percent)
Russian Federation	16	5,094	28	78	76	50
Brazil	61	6,545	38	70	51	70
China	52	6,958	37	83	72	84
Hungary	15	1,422	55	91	51	94
Poland	14	1,820	82	89	76	99
Mexico	28	2,542	79	67	40	84
Region/Bankwide						
ECA	115	11,427	35	75	44	83
Bankwide	1,070	88,492	79	60	39	73

from 1993 through the second quarter of FY02. After deducting \$63 million of administrative expenses (including \$29 million for advisory and TA operations), the IFC's operations in Russia made a net negative contribution of \$100 million to the IFC's profitability during this period. These costs and losses had to be covered by cross-subsidies from the IFC's operations elsewhere.

According to a desk review by its Operations Evaluation Unit (OEU), MIGA's guarantee program prudently and selectively met demands from private foreign investors for political risk insurance. As a result, MIGA has not suffered any losses in Russia, which is ranked in the top five countries in the agency's portfolio. Before the outbreak of the financial crisis, MIGA covered transfer risks but did not offer coverage for currency convertibility. Stop-loss limits and reinsurance were employed to manage the agency's net exposure in Russia. MIGA continued to support projects after the country's default on foreign debt. Although there was relatively low demand for MIGA's products, its \$549 million in coverage issued for 18 projects—mainly in agribusiness, food processing and beverages, finance, and extractive industries—nonetheless

facilitated an estimated \$1.3 billion FDI in Russia (see Annex 12) that could have been adversely affected by the moratorium. In investment services, the Web-based PrivatizationLink Russia was launched in October 2000, providing important and timely information to potential foreign investors.

### Portfolio Management

In the mid-1990s, once it became evident that many operations had not met the Bank's standard quality-at-entry requirements, the Bank and the government developed the CPPR process with a strong focus on performance and a willingness to discuss problems and take remedial action, including major project restructuring and cancellations. A number of shortcomings were identified, such as excessive delays in establishing implementation units and in finalizing subsidiary loan agreements and procurement documentation. A subsequent tightening of readiness requirements led to a slowdown in new project lending after 1997.

Since 1997, internal QAG panels have assessed 10 projects for quality at entry. They rated the Coal SECAL II (see box 3.3) and Elec-

#### Box 3.2

### IFC Country Program Strengths and Weaknesses

#### Strengths

- Strategic priorities were relevant and well aligned with country needs and the IFC's capabilities.
- Active pursuit of all strategic priorities, with consistently sound execution of TA operations.
- Unprecedented country-level scale of TA operations, regionally focused for strategic impact.
- Satisfactory or better outcomes for 96 percent of TA projects (weighted by value); major impacts.
- Nimble adjustment to evolved country needs and opportunities.
- Effective refocus on supervision follow-up in the wake of the 1998 crisis.
- Application of lessons learned in new investments, drawing from early lessons.
- Substantial expansion of investment approvals in 2001 in response to improving conditions.

#### Weaknesses

- Ramp-up of investment operations in 1995-98 ahead of significant reforms—with high droppage/cancellation rates and disappointing development and investment results.
- Mainly as a result of the crisis, Russia operations were a net drain on the IFC's profitability.
- The IFC yielded to pressure to make investment commitments in the hostile and unfamiliar business environment and, in some cases, lowered its standards and took risks that could not be mitigated.
- IFC strategies recognized the importance of developing SMEs, but it did not succeed in developing a sustainable wholesale intermediation channel that could be scaled up.

**Box 3.3****Coal Sector Restructuring—  
Best Practice Bank-Supported Project**

The Coal SECAL II Project was highly praised by a QAG review panel and the authors of the CAF background evaluations, despite the need for restructuring after the financial crisis and delays in meeting loan conditions. Its key achievements have been the sharp reduction and reorientation of budget subsidies to rationalization and downsizing rather than to inefficient production, the breakup of the coal monopoly, transparent privatization of viable coal mines, and enhanced public expenditure tracking and controls. There are several reasons for this project's success:

- The government had already worked on the design of the restructuring program with help from the British Know-How Fund before the Bank's involvement.
- The Coal SECAL I was designed on the basis of a solid sector report (see box 3.1).
- The project was preceded by extensive consultations with stakeholders.
- The environmental and social aspects were addressed by specialists.
- Concrete progress had already been made in restructuring the coal sector before the project's approval.
- The project's objectives were closely linked to the CAS.
- The project's design was technically sound, reflected the lessons from the Coal SECAL I, and allowed the Bank to strengthen the hand of the reformers in government at key, delicate moments during its implementation.
- A companion project (Coal IAP) providing implementation TA effectively complemented the adjustment loan.
- The short appraisal period and the quick disbursement of the first tranche reflected the skill of the task team, the responsive management review system (at all levels), and prior knowledge.

tricity Sector Reform Projects highly satisfactory and best practice (although the latter was to suffer severe implementation problems), and rated the St. Petersburg Rehabilitation, Electric Sector Reform, Bureau of Economic Analysis, SPAL, SAL I, SAL II, and the HRMP Projects satisfactory. The Health Reform Pilot and SAL III Projects were rated as marginal. Of the 15 projects assessed for quality of supervision, the Legal Reform and Komi Projects were rated as highly satisfactory and best practice, 13 other projects were rated satisfactory, and none was rated marginal.<sup>7</sup>

The percentage of projects at risk (according to QAG and Bank supervision reports) peaked at 65 percent (68 percent by commitment) in FY96 and at 68 percent (92 percent by commitment) in FY99. In both cases, intensive supervision, restructuring, and cancellations succeeded in improving the portfolio. By June 2001, projects and commitments at risk had been reduced to 24 percent and actual problem projects to 9 percent (6 percent by commitment) of 34 active projects (\$3.8 billion).<sup>8</sup> These figures, however, remained higher than those for comparators and Bankwide and ECA averages. The high disconnect be-

tween OED ratings at completion and Bank supervision ratings at exit (35 percent for the Russia portfolio, compared with 6 percent for ECA and 10 percent Bankwide) points to the possibility of strong upward bias in self-evaluation (see table A.5). Moreover, project implementation remains problematic, as suggested by relatively poor indicators for project age and disbursement.

**Project Implementation Units (PIUs)**

In 1995, faced with unsatisfactory portfolio performance, lack of clarity about whether ministries could legally enter into contracts for goods and services, and scarcity of skilled staff among Russia's underpaid civil servants, the MOF proposed, and the Bank agreed, to carry out implementation through independent legal entities established as non-commercial foundations. The foundations are overseen either by management boards with government representation or by interministerial committees. Bank loans have financed 100 percent of most PIUs' operating costs, including salaries in line with private sector norms, which drew criticism from Russia's Chamber of Accounts (COA) (Annex 14). In some cases, Bank objections to high salaries

## Box 3.4

## Selected Government Officials' Views of Portfolio Management

The views shared with the CAE February 2001 mission by the MOF officials directly responsible for overseeing the Bank's activities included some critical ones regarding the efficiency of the Bank's project preparation and management (for more on the government's views, see Annex 11).

- While hurried preparation often causes delays and problems with the implementation of projects, sometimes these are caused by the need to address complex institutional changes.
- Staff from both sides lack incentives to work expeditiously and deliver on time.
- Russian staff are not always performing adequately, notably when it concerns accepting a high degree of responsibility.
- Bank staff, however, do not always show a proactive approach to solve management and ownership issues, often leaving problem solving entirely to the Russian side.
- Russian bureaucracy is often matched by that of the Bank, which is relatively slow in providing "no-objections" or clearances.
- The professional quality of Bank staff is uneven.
- Since the interministerial committee for Russia and the Bank is difficult to convene and is also not the right body to deal with details of project preparation and implementation, a working-level group of government and Bank officials needs strengthening to ensure communication and cooperation on an ongoing basis.

have triggered corrective actions by the management boards.

In late 2000, the MOF raised the possibility of transferring implementation responsibilities from the foundations to individual ministries. The Bank welcomed further discussions on this issue, but advised that such a transfer would require loan amendments and new formal agreements. The Bank and the MOF are currently exploring realistic alternative options. Meanwhile, the MOF has assigned new projects to the best existing PIUs on a competitive basis, rather than creating new ones.

### Cost-Effectiveness

In the 1990s, the Bank's annual average administrative budget devoted to Russia was around \$11.2 million in constant 2001 prices—comparable to that for Brazil. It exceeded substantially what would have been allocated on the standard country norm until the mid-1990s. Since then, aside from the rebound associated with the Bank's internal Strategic Compact, the country budget was reduced, given Bankwide budget pressures and the maturity of the program. The highest amount (\$14.1 million) was in FY94, the lowest (\$9.6 million annually) in FY96 and FY97. Following a 15 percent increase in FY98, the budget declined in FY99 and FY00 before rising to \$9.7 million in 2001 (see table A.11).

AAA experienced especially deep cuts be-

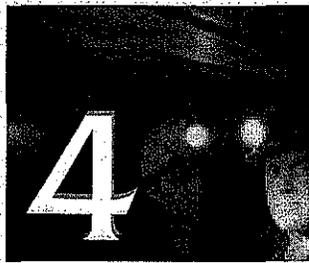
tween FY93–95 and FY95–97, by 75 percent (to 20 percent of Bank resources). In an environment of rapidly expanding lending, mounting portfolio problems, and constrained budgets, Bank management gave priority to project preparation and supervision. Spending on ESW almost doubled between FY98 and FY01, reaching 30 percent of the country program budget. Successive country directors have commented on the inadequacy of the resources for AAA, in light of the complexity of the transition challenge.

Lending preparation costs also declined markedly in real terms (22 percent per project and 39 percent per commitment) between FY92–96 and FY97–2001 and have been considerably lower on a per commitment basis than for most comparators. Meanwhile, supervision intensity increased by more than threefold on a per commitment basis, reflecting the stronger efforts to improve portfolio performance in FY97 and again in FY99–00. While supervision intensity remains in the middle of the range for comparators on a commitment basis, it is considerably higher on a per project basis. This pattern is due to the late 1990s concentration on a few large adjustment loans with complex supervision requirements. When program costs are related only to commitments rated satisfactory for closed and ongoing projects, the cost-effectiveness of Bank assistance to Russia is very low (see table A.12).

**Decentralization of Bank Operations**

To make its assistance more effective, the Bank posted the country director to the field in 1997 and transferred more operational responsibilities to the field office. The main goals were to im-

prove the policy dialogue and operational effectiveness and reduce supervision costs by delegating task management responsibilities to local professionals. Both goals have been substantially achieved.<sup>9</sup>



# Development Impact

## Private Sector Development

In the key reform areas of private sector development (PSD),<sup>1</sup> the 1990 joint study (World Bank and others 1990) recommended clarification and legal protection of property rights as a necessary first step. The study also recommended a flexible approach to privatization tailored to the type of activity and size of the enterprise, making use of the advantages of both “giveaway” and commercial methods of privatization. Revenues from the latter method were expected to help cover some of the costs of economic reform.

Demonopolization and the enforcement of hard budget constraints were noted as crucial measures for the restructuring of existing enterprises, the transfer of underused assets to new enterprises, and increased competition. An effective legislative and judicial basis, institutional capacity, and political commitment to the rule of law, corporate governance, and competition policy were also viewed as urgent. The study's priorities reflected the broad consensus on these fundamental issues among government reformers, the academic community, and IFI officials. The study, however, gave insufficient emphasis to public governance and bureaucratic harassment issues, which proved central to the investment climate and the entry and growth of new enterprises.

Throughout the decade, the Bank Group's sector assistance strategy was to focus on institutional development and policy reforms for competition; enterprise restructuring; rule of

law; financial, land, and housing markets; and reduction of bureaucratic harassment and of the tax burden on enterprises. The Bank Group correctly aimed at facilitating privatization and at fostering an enabling environment, with extensive analytical work, policy advice, TA grants (including donor-funded programs managed by the IFC), hybrid loans combining TA and credit lines (almost \$1 billion of commitments under the Privatization Implementation Assistance Loan (PIAL), the Financial Institutions Development project (FIDP), the Enterprise Support project (ESP), the Capital Market Development project (CMDP), the Enterprise Housing Divestiture project (EHDP), the lapsed Enterprise Restructuring Services projects, and quick-disbursing loans (two Rehabilitation loans and three SALs).

Beginning in late 1991, Bank staff played a significant role (together with United States Agency for International Development [USAID]-funded

consultants) in the operational design of the MPP, whose implementation was mostly funded by other donors, especially USAID, the EBRD, and the European Union (EU). The IFC also helped conduct 1,100 auctions in 5 regions. Alternative strategies that included breaking up enterprises before privatization were considered, but the reformers regarded all such schemes as unacceptably slow and complex (see Annex 7).

The IFC also played an important role in small-scale privatization. In April 1992, in Nizhny Novgorod Oblast, the IFC conducted Russia's first privatization auction of small-scale enterprises. The central government gave its approval to the process a few months later, and the IFC then took steps to extend it to trucking (see box 4.1) and farming and to replicate it on a national scale. By the end of 1993, virtually all small-scale enterprises in Nizhny Novgorod had been privatized. The IFC approach emphasized fair and open auctions. Where the IFC was involved only indirectly, many cities sold their small businesses through commercial tenders rather than auctions, and some

arranged noncompetitive sales or outright transfers to managers and workers. Regardless of the manner of privatization, however, various surveys of privatized small businesses have found evidence of major industry restructuring, higher profitability, lower prices, and better products and services (IFC 1994; Barberis and others 1996).

Overall, Russia made significant progress in terms of divesting state-owned enterprises. However, little headway was made on transparency of ownership and secondary redistribution of property. Moreover, the LFS scheme, which the Bank neither supported nor publicly opposed, inflicted significant damage to the credibility of the reform program. As a result, the privatization program has slowed significantly since 1996, despite the adoption in 1997 of a transparent framework for case-by-case privatization.

Bank assistance for improving the enabling environment had limited results through 1998, with little progress in establishing a conducive policy and institutional framework for enterprise restructuring, corporate governance, competi-

**Box 4.1****Trucking Privatization: A Bank Group Success (FY93-94)**

Both the government and the Bank considered privatization of the oversized and badly managed regional trucking monopolies to be an urgent priority. A request by the government of Nizhny Novgorod for IFC assistance in doing so provided the basis for close collaboration between the IFC and the Bank. Thanks to sector work, Bank staff were able to gain the support of the federal Ministry of Transport for privatization. Discussions among IFC and Bank staff, oblast authorities, and trucking monopoly managers and workers led to adoption of a scheme to auction 20 percent of the regional fleet and thus create hundreds of small transport businesses, and for the remaining 80 percent to be divided among 42 new, medium-size trucking firms to be established and privatized under the MPP (the October 1992 auction was the first successful test of the vouchers distributed to all citizens under the MPP). By July 1993, IFC-managed auctions in Nizhny Novgorod had transferred more than 800 trucks to private owners.

As it had done earlier for small-scale enterprises, the IFC then sought to extend the truck privatization process nationwide by distributing a privatization manual to regional officials, dispatching resident teams to nine other regions, and establishing a unit to provide short-term advisory and technical assistance to regional authorities elsewhere.

By 1995, competition had taken hold in Russian trucking, 88 percent of all automotive enterprises in Russia (including passenger transport enterprises) were no longer government controlled, all regions had completed or were carrying out privatization of common-carrier trucking, and 70 percent of them had used the Nizhny Novgorod model. In a follow-up IFC survey, 90 percent of the truck buyers in Nizhny Novgorod reported being satisfied with their purchases, and only 29 percent reported difficulty in earning a profit. None of the industrial enterprises visited for the OEG evaluation of IFC assistance reported problems with truck transport.

Source: OEG and IFC data.

tion, new entry, and private investment. However, the Bank helped prepare legislation and establish institutions conducive to PSD (e.g., the Anti-monopoly Commission, the Federal Energy Commission). There also is evidence of success for the Management and Financial Training project (MFTP), and for the on-the-job training provided under most Bank-funded projects. Finally, much of the Bank's advice during the last decade has found its way into the current reform program.

### Financial Sector Development<sup>2</sup>

In the late 1980s, an abrupt opening of the Soviet financial system led to a rapid proliferation of new financial institutions operated by sector ministries, state and cooperative enterprises, and private financial-industrial groups. The new system, however, failed to provide prudential regulation and effective supervision. Equity issues were used primarily to establish control over existing assets rather than to finance new investment. The emergence of a healthy, market-oriented financial system was impeded by a weak enterprise sector and by policy and institutional weaknesses.<sup>3</sup> Among these were soft budget constraints for both enterprises and banks; in-

adequate accounting and reporting standards; slow progress toward effective bank and capital market supervision; weak definition and enforcement of property, shareholder, and creditor rights; inadequate bank and corporate governance; and lack of transparent and effective processes for dealing with failed banks.

In the 1990s, the Bank and other donors sought to assist the authorities in promoting the development of the financial system. The Bank provided technical assistance to the CBR, and to selected banks and capital market oversight agencies, in the form of information systems hardware, credit lines, and policy advice through the FIDP, the ESP, and the CMDP through loans totaling \$489 million (4 percent of total Bank commitments for the decade). Other projects dealing with environmental management and housing divestiture also contained credit line components. The three SALs included proposed financial sector reforms. Only modest accomplishments could be attributed to these efforts by 1998, when the financial crisis left virtually all financial institutions insolvent. The monies available for strengthening bank supervision had been left unused, and the credit lines saw only

#### Box 4.2

#### Boosting Russia's Comparative Advantage in Space Technology

The Sea Launch project is an international joint venture involving the Boeing Company (United States), Kvaerner Maritime (Norway), Energia (Russia), and Yuzhnoye/Yuzhmash (Ukraine) to manufacture and export rockets and launch systems. The rockets are used to launch commercial satellites from a floating platform in the middle of the Pacific. Convinced that this private sector project could preserve thousands of skilled jobs in Russia and Ukraine, the Bank decided in 1996 to support the Russian and Ukrainian portions of the project with a partial risk guarantee.<sup>a</sup>

So far, nearly a dozen rockets have been manufactured and exported, and there have been seven successful launches. The risk prevention and mitigation mechanisms appear to be operating well. When problems have appeared, they have been solved systemically, so that the government did not have to pay any claim and all companies doing business in Russia—not just Sea Launch—benefited from the rule of law. Another partial guarantee project was approved by the Bank in September 2000 for the coal and forestry sectors and is expected to begin operation soon.

a. The guarantees are designed to help local enterprises increase or resume production, boost exports, and retain or create employment, while strengthening governance and the rule of law. They support commercially viable, private transactions and unbundle risks so that private participants bear 100 percent of the commercial risk, while the government is responsible only for damages caused by its own actions. The government promises (a) not to interfere with private transactions, (b) to solve problems that arise from unwarranted government interference, and (c) to pay compensation if government interference causes harm to the covered enterprise. The Bank's role is that of a counter-guarantor. If the government fails to pay a legitimate claim, the Bank pays and presents the government with a demand for reimbursement.

Source: Personal communication with Sea Launch's task manager, and supervision reports.

modest demand and hardly any disbursement. Little progress had been made in adopting international accounting standards and in encouraging the entry of foreign banks.

The 1998 crisis kindled the authorities' interest in receiving advice and technical assistance. Since then, frequent joint missions of Bank and IMF staff have focused on spurring reform and enhancing coordination of the assistance offered by the international community. A systematic effort has also been made to explain the reforms to a broader range of parties and interests. With substantial input from the Bank and the IMF, an Inter-Agency Coordinating Committee directed by the CBR, has drafted an agreement for the provision of technical and financial assistance by donors. Agreements have also been reached on the restructuring of the FIDP (to focus on bank supervision and drop its flawed accreditation process), the ESP, and the CMDP. Russia's banks have to adopt international accounting standards by 2004, and some have already done so. But many tasks remain on the reform agenda, and the emergence of a growth-supporting, stable, market-oriented financial system remains uncertain.

#### **Public Sector Management and Financial Accountability<sup>4</sup>**

Poor design and implementation of government programs have been major problems since Soviet times. Moreover, the rules developed during that time were inadequate to deal with the new realities of public sector management (PSM) during the transition. This resulted in significant negative effects on fiscal discipline, the effectiveness of public services, and the legitimacy of public institutions. Moreover, as in most transition countries, the primary financial accountability institutions are still in their infancy. Much remains to be done to achieve fiscal transparency, estimation of implicit subsidies and contingent liabilities, standard accounting practices, independent assurance of the integrity of financial information, and legislative/public scrutiny of government financial transactions.

With notable exceptions, the Bank paid little attention to fiscal management, capacity building, good governance, and public financial ac-

countability (PFA) in Russia, in either analytical studies or lending operations, until 1999. Bank staff attribute that to (a) the paucity of reliable information and analysis of Russia's system of government, (b) high turnover of senior and middle-level administrators in the government, and (c) the reluctance, until recently, of Russian officials to discuss such matters with the Bank. Government officials, however, stressed the secondary priority that the Bank gave to these matters during the 1990s.

Bank ESW on public sector issues customarily focused on intergovernmental finance in the early and mid-1990s, and there have been several Bank studies of tax-related issues, including the administrative burden and harassment of productive enterprises. However, Bank staff did only preliminary work on management of government expenditures and civil service issues because of resistance by the MOF. The resulting knowledge gap had a negative impact on the Bank's ability to advise on how to revamp the public sector.

The Rehabilitation Loans in 1992 and 1995 did not incorporate PSM issues, although the Bank's work to reform coal subsidies contributed substantially to the broader debate about how to improve controls on government expenditure. The 1997 and 1998 SALs included requirements for improving tax administration, budget management, and intergovernmental finance. Implementation through 1999, however, fell short of the agreed goals. The Bank approved six other relevant sector loans (for \$211 million) to support project portfolio management and development, the Bureau of Economic Analysis; tax administration (closed, with a satisfactory outcome rating), statistical administration, and legal reform. Supervision ratings are satisfactory, but it is too early to assess the efficacy of these projects.

Since the 1998 financial crisis, the Bank has placed stronger emphasis on capacity building, especially in public administration, the judicial system, revenue and expenditure management, and financial accountability. The Bank prepared position papers to assist the government's deliberations on modernizing public administration. Recent and ongoing ESW covers public investment, anti-corruption, and federal budget man-

agement, while other donors are funding reviews of public expenditures in specific sectors. To date, however, expenditure data inadequacies have severely hampered these efforts. The Bank's proposed lending includes relevant projects on treasury matters, regional fiscal reform, and customs reform.

Through the early and mid-1990s, the Bank's assistance was directed mainly at improving accounting and auditing systems in the private sector, where limited progress took place. The Bank paid limited attention to checks and balances in the public sector. Neither the preparation of consolidated financial statements of the government in accordance with generally accepted accounting principles, nor public expenditure and internal control reviews, nor the strengthening of capacity for an annual independent public audit of government expenditures were priorities, even when the Bank provided large loans for general budget support, as in 1997.

The Bank, however, adhered to the Bankwide fiduciary guidelines for project lending and, in the wake of allegations of misuse of IMF resources after the 1998 financial crisis, reviewed all adjustment loan disbursements. Although the Bank was satisfied that its funds were fully accounted for and used in accordance with the loan agreements, the authorities agreed to take additional measures of control and reporting on future disbursements. The Bank also attempted to improve specific aspects of financial management and control in the public sector, such as international competitive bidding on the infrastructure projects it funded and the development of a new law on government procurement in 1997. These efforts have yet to yield visible results. Until early 2000, the COA, the public sector's chief audit institution, did not take up an offer of Bank assistance for capacity building, exchange of information, and dialogue over the performance of Bank-funded projects (see Annex 14 for a summary of COA reviews of Bank projects that were shared with the Bank only in February 2001). In the past two years, Bank knowledge has been enhanced by a solid Country Procurement Assessment, preparatory work for a Country Financial Accountability As-

essment, and a review of standards and codes by the IMF.

### **Social Protection**

The Bank has viewed assistance for reform of social protection<sup>5</sup> programs as an important element of its assistance strategy since the early 1990s. Its advice focused on improved targeting of social assistance programs, enhancement of institutional capability, redesign of the social security system, and modernization of the labor code. The strategy has been implemented through its ESW and the 1992 Employment Services and Social Protection (ESSP) loan, the 1997 SPAL, the Coal SECALs of 1996 and 1997, and the 1998 Social Protection Implementation Loan (SPIL) of 1998. The three SALs also had social components.

The ESSP was a TA loan intended to help deal with the anticipated loss of jobs caused by enterprise restructuring. It also was intended to help develop plans for reforming the pension system and other aspects of the social safety net, but the government was not prepared to address these areas at a time when it had more pressing concerns, such as stabilization and market policy reforms. In the face of slow enterprise restructuring and a two-year delay in implementation, the objectives of the loan were changed to focus on the introduction of active labor market programs and on smoothing pension administration through the procurement of computers for local offices. The ESSP achieved these more modest objectives. The collection of taxes (including for the pension fund) remained unsatisfactory through 1998 and resulted in arrears in pension benefits and wage payments. Insufficient attention was given to social assistance targeting, even as poverty was increasing.

Bank lending for restructuring the coal mining industry included highly relevant components to ensure that wages and social protection benefits were paid, that employment services were provided to displaced miners, and that social assets were rehabilitated before being transferred from mines to local governments. These projects were highly effective in achieving the first objective, substantially effective in achieving the second, and disappointing in meeting the third.<sup>6,7</sup> Bank efforts to

## Box 4.3

## Bank Assistance for Gender Equality

"Feminization of Poverty" (World Bank 2000b) argues that the rise in unemployment, the drop in average earnings, and the deterioration of social services during the 1990s affected women more severely than men. Male life expectancy, however, deteriorated more sharply than women's, with the gap widening from 10 years in the late 1980s to 16 years in 1994 (it since has fallen to 12 years). At the same time, the collection of data disaggregated by gender declined in quality and coverage.

The Bank sponsored a number of studies and conferences on the impact of the transition on women and their changing roles,

but never articulated an assistance strategy to deal with gender issues. The 1997 Health Reform Pilot project included a component targeted at women and children, and several components of the SPAL package also benefited mostly women. Chief among these were increases in minimum pension and unemployment benefits. However, the Bank did not address other aspects of the proposed pension reform (such as the funded second pillar, with a close linkage of work earnings to retirement benefits) that may have a more negative impact on women than on men. It also did not address the issue of lower male life expectancy.

improve the tracking of funds from the treasury to the recipients were also successful.

The SPAL-SPIL package addressed several important reforms of the social protection structure. It focused government attention on the complexity of pension reform, and on the need for more effective targeting and for modernizing the labor laws. It helped increase minimum pensions; eliminate pension arrears; strengthen the financial status of the pension, child allowance, and unemployment benefit programs; and improve the targeting of many existing social benefits. SPAL conditions requiring the submission of pension and labor market laws to the Duma were formally met, but these reforms did not pass until 2001. Moreover, the project lacked a strong implementation focus at the regional level and ignored the important issues of consumer subsidies and group privileges.

Since the SPAL's closing in September 2000, the Bank has remained engaged with timely advice and technical assistance. Current prospects for meeting the Bank's objectives in the sector appear greatly improved. Reflecting a broad new consensus on pension and labor market reform, the Duma is expected to approve new legislation in early 2002. Some aspects of the proposed reform (e.g., the fiscal viability of the new pension system and the readiness of the financial sector to get involved in the funded pillar) still pose concerns, but implementation rather than policy design has come to the forefront. The Bank has also begun

working with the government on improving the quality of household budget surveys and poverty estimates.

### Energy Sector

The energy sector<sup>8</sup> has a more important role in Russia than in most countries. Oil, coal, and natural gas are among Russia's main exports. Domestic supplies of energy are critical for coping with Russia's harsh winters. And energy production is a major cause of environmental degradation. All of the energy subsectors faced similar problems in the early 1990s: persistently low prices, a poor regulatory framework, little competition, and environmental failure. By accepting nonpayment or barter for its output, the energy sector funneled large subsidies to the rest of the economy and allowed many enterprises to enjoy soft budget constraints. In addition, each subsector faced its own unique circumstances and transition challenges.<sup>9</sup>

The Bank has been active in the energy sector from the very beginning of its work in Russia, taking advantage of windows of opportunity in different subsectors and supporting those emergency activities and reform programs for which the government showed a clear sign of ownership. Oil sector issues (production, pricing, taxation, legislation to support joint ventures, and investment requirements) were important topics in the Bank's first country economic report in 1992 and in later CAS documents.<sup>10</sup> However, the Bank gave only limited

attention to the linkages between energy production and environmental sustainability. The 1994 coal sector report stands out as a high-quality sector work (see also box 3.1). The Bank has also had an active dialogue with the government on reform of the electric power sector.

The results of Bank assistance (including \$2.6 billion in lending) to the sector have been mixed. The outcome of the ongoing coal sector restructuring program (including \$1.3 billion in Bank lending) has been satisfactory. More than 70 percent of the least efficient mines have been closed, more than 65 percent of production has been privatized, and payments of wages and benefits to miners are now on schedule (see also box 3.2). A GEF project for reducing the consumption of ozone-depleting substances (ODS) was successfully implemented, as was the Komi Emergency Oil Spill Recovery and Mitigation project. A recently approved project in district heating reflects the lessons learned from previous pilot interventions that had mixed success, especially after the 1998 crisis weakened the financial capabilities of local administrations.

Considerable progress has been made in reforming the electric power sector, as envisaged under the SALs—more rational pricing since 1997, great improvement in cash collection since 2000, and a new resolve to demonopolize the industry since mid-2001. Moreover, cash collection in the gas sector now exceeds 95 percent, a more than fourfold increase over 1998. This turnaround has had salutary implications for fiscal revenues and service delivery, in addition to contributing to the reduction of arrears in other sectors. The reforms since 2000 were undertaken without any lending from the Bank, although they benefited from earlier policy dialogue with the Bank. The Bank also had made sound proposals to restructure and bring more transparency to the natural gas sector, suggesting the breaking up of Gazprom into independent production, transmission, and sales companies to enhance competition. But a comprehensive restructuring plan for this sector remains low on the government's priority list. The two completed oil rehabilitation projects contributed to significant increases in production and modest improvement in the taxation of the sec-

tor. However, the outcome of both projects was rated unsatisfactory by the Region and OED because of failure to make sufficient progress on policy and institutional reform objectives.

### **Overall Impact of Bank Assistance<sup>11</sup>**

The Bank set high standards for its assistance, reiterating in all CASs its end goals (consistent with those announced in 1991 by President Yeltsin) of promoting an environment conducive to economic growth while protecting the poor and vulnerable. Through 1998, the relevance of the Bank's operational objectives was substantial when set against the complex challenges of the transition, the fast-changing domestic and international situation, and the Bank's institutional priorities. The efficacy of Bank assistance, however, was modest.

Through the mid-1990s, the Bank Group's main achievement was the changes in ownership under the mass privatization program for medium-size and large enterprises and under the small-scale privatization program. Bank assistance was also instrumental in counteracting protectionist pressures and in setting up or supporting various institutions, which were, however, only able to perform their functions to a limited extent (e.g., employment services, pension administration, the Federal Energy Commission, the Federal Securities Commission). Other achievements were the limited introduction of competitive bidding in public procurement and an increase in oil production.

At the core of the transition challenge, however, PSM and the incentive regime for private sector development had not improved significantly through 1998. Moreover, the results of sectoral assistance were mostly disappointing, as the preceding sections illustrate (see also Annexes 3, 4, and 5). The IFC's contributions after the mid-1990s had less of an impact than those of earlier years. The tentative steps toward making the regions the focus of assistance also had limited success because of the absence of a sound national environment in which competition among subnational units could lead to positive results.

Considering the overall poor development results as of mid-1998 and the large volume of lend-

ing, the outcome of Bank assistance for the period FY1992–98 (through June 1998) is rated unsatisfactory and its impact on institutional development is rated as modest.<sup>12</sup> At the time of the financial crisis, Russia's fundamental changes in enterprise ownership and in other structural reforms (e.g., price and trade liberalization) were not likely to be reversed. However, the sustainability of macroeconomic policy was highly unlikely.

In the three and a half years since the 1998 crisis, however, the relevance and design of Bank assistance have improved significantly, although the slow pace of loan disbursements and delays in new project effectiveness continue. Important reform legislation has been successfully adopted. Implementation of the reform program has only started in a few areas, but its efficacy—that is, its contribution to economic performance—has been substantial, aided by the cumulative impact of earlier Bank efforts. By the end of 2001, Bank assistance had helped improve the incentive regime for sustained eco-

nomical growth, minimum pension benefits, the targeting of social assistance programs, and the restructuring of the coal sector. Most important, the dialogue between the Bank and senior Russian policymakers on structural reform, which has intensified since late 1998, played a major role in helping the current government formulate its program of market-oriented reform, good governance, and social responsibility. These are solid achievements.

Thus, the outcome of Bank assistance for the period from mid-1998 to 2001 is rated satisfactory and its institutional development impact is deemed substantial. The economy remains vulnerable to external shocks, in particular to a significant and prolonged drop in the price of oil. However, Russia's improved economic management; the heightened focus of Bank assistance on results, institutional development, and public sector management; and the broader ownership of the reform program suggest that satisfactory outcomes are likely to be sustained.



## Contributions to Effectiveness of Bank Assistance

**T**his evaluation confirms the crucial role of country ownership and domestic capacity in determining the outcome of Bank assistance. It also highlights the consequences of extraordinarily difficult initial conditions and severe external shocks. Internal divisions within the government that reflected the Russian electorate's unease about the pace and direction of transition prevented the formulation and conduct of a coherent reform program, although throughout the 1990s, Russia stayed the course in its economic and social transformation.

Where consensus was achieved, it was tenuous, given frequent changes at senior levels of government. The reformers, who were usually found in core economic ministries, had clear goals and programs. But they could not sway many line ministries (energy and agriculture, for example) to implement needed reforms. Long delays in decisionmaking on Bank-funded projects were common, reflecting differences within the government on how to use Bank funding and whether the conditions attached to individual loans were warranted. Furthermore, until the spring of 1997, the Bank—unlike the IMF—was not always perceived as a key interlocutor on policy matters.

Since 1999, the government has adopted many of the macroeconomic policies and structural measures that the Bank had supported since the early 1990s but that the reformers had been unable to push through. Still, there con-

tinue to be long delays in the use of loan funds. A call for closer scrutiny of borrowing for TA in the president's budget speech in 2001 was interpreted by some government ministries as a ban on such borrowing.<sup>1</sup> As a consequence, only one of the six loans and one guarantee approved since May 2000, all of which have TA components, had become effective by the end of 2001 despite the government's declarations of interest.

It is difficult to construct plausible counterfactuals in the case of such a complex program as Russia's, where much of what the Bank has done responded to explicit shareholders' expectations. The Bank had to organize itself quickly and had to reassign and recruit a large number of staff with the required skills.<sup>2</sup> External lending pressure and the high potential rewards of timely reforms induced overoptimistic risk assessments and project designs. In rela-

tion to its sectoral objectives, Bank performance has been mixed.<sup>3</sup> This section describes how the Bank tackled difficult challenges and, with the benefit of hindsight, identifies cases where it might have been more appropriate to adopt a different stance.

Offering Bank assistance mainly through analytical and advisory services and technical assistance loans—with less weight given to lending volume and short-term budget needs—would have been more relevant to the longer-term needs of institutional reform, capacity building, and public sector governance. It also would have been less costly for the country. A less proactive stance in Bank programming by major shareholders would also have allowed the Bank to exercise more caution in project selection and design. From the start, the Bank should have adopted the self-regulating lending strategy it followed after 1998—when resource transfers were no longer a priority for Russia and for the Bank's shareholders. Such a strategy would have linked project selection to ownership of systemic reforms, project approval to adoption of reforms and readiness for implementation, and disbursements to concrete progress on reform. While unlikely to change the main course of events in Russia, this approach would have implied substantially lower disbursements and, probably, better project outcomes and fewer operations.

In the first half of the 1990s, under pressure from shareholders, the Bank approved many TA and investment projects that were overly ambitious, far from ready for implementation, and in sectors with a weak commitment to reform (e.g., oil, agriculture, banking, and highways). Moreover, the Bank also lent for new investments in areas where (as in the housing and urban transport projects and in its credit lines) the frontier between public and private roles was shifting very rapidly and where the emphasis should have been on privatization and the strengthening of regulatory frameworks and corporate governance. Significant project design weaknesses were tolerated at entry in the belief that they could be corrected later. While the government and the Bank did succeed in turning the portfolio around by early 1997 through commendable in-

tensification of supervision and deep restructuring, the corrections in most projects carried substantial transaction costs and amounted to scaling down the projects' initial objectives, and thus their potential impact.

The ECA Region contends that its flexible and adaptable approach, which sought to build goodwill and provide meaningful support to hard-pressed reformers, was the most effective one for operating in an environment characterized by exceptionally difficult initial conditions, weak country ownership of reform, and an inadequate institutional framework. In its view, the Bank made reasonable judgments about borrower commitment at the time that projects were presented to the Board. Similarly, the government believes that allowances should be made for the extraordinary circumstances of going through dramatic political, social, and economic transformations. OED agrees with this view as far as some projects are concerned (e.g., in the social protection and electricity sectors, and in tax administration), but disagrees with respect to larger operations. The Bank should have adopted a more cautious stance on lending for those larger efforts while relying more on the provision of analytical and advisory services and TA loans and grants.

The general environment in Russia for Bank advice and lending improved only marginally between 1996 and 1998. In fact, deep disappointment with the LFS scheme<sup>4</sup> implemented in 1995–96 led the Bank to stress—albeit without success—transparent, case-by-case privatization in its policy dialogue and in the design of the SALs. It was also clear that Russia's structural problems—serious fiscal imbalances, soft budget constraints, large capital flight, little enterprise restructuring, poor governance, weaknesses in the institutional framework, lack of broad ownership of the reform program, and widespread nonpayment and barter—were persisting or worsening. All of these issues were the object of warnings from academic sources and were discussed at seminars and working meetings by the IMF, the EBRD, and Bank staff.

There are different views about the decision made by the Bank at the time. OED believes that the Bank's lending expansion in 1996–97 was not an appropriate institutional response, even

though the international community expected the Bank to support the Russian government with enhanced lending, not weaken it with open criticisms or threats to lending. Gaidar (1999) describes well the misplaced euphoria of the reformers in March 1997 that induced the Bank and the IMF to provide substantial financing with weak loan conditions.<sup>5</sup> While the Bank perceived its shift to policy-based lending to be the appropriate response to address systemic reform issues, the message sent to the Russian authorities was that geopolitical considerations would keep the international community's funding window open, regardless of missteps and hesitation in adopting the reform agenda.

Poor implementation by Russia of expected post-disbursement actions agreed to in the Rehabilitation II loan in 1995 should have reinforced concerns within the Bank about the efficacy of adjustment lending. Given Russia's poor record up to that point, the design of the SAL I was inappropriate and the combined size (\$1.4 billion) of the adjustment loans approved in June 1997 was excessive. The decision to follow up with a larger loan package (\$1.6 billion) six months later, accompanied by conditions that once again focused on preparatory activities

and promises rather than on adoption and implementation of reforms, although many post-disbursement actions agreed to in the SAL I had not been taken, was mistaken.

The modest results achieved by the SALs I and II suggest that the Bank should have insisted on strong, concrete actions to address the critical issues of fiscal responsibility, financial accountability, transparency in privatization, banking reform, the nonpayment system, and rule of law. By June 1997, the EBRD's president had warned the international capital markets of the high risk of financial investment in Russia. Once the Bank decided to proceed, the SALs I and II and the SPAL should have been much smaller, multi-tranched, and back-loaded. Such a stance would probably have prevented the increase in Bank exposure of \$2.2 billion between June 1997 and January 1998. And it might have induced an earlier reassessment of the country's creditworthiness by international financial markets, counteracted the pressures for real appreciation of the ruble, hastened its beneficial devaluation, and induced Russia to improve tax administration and expedite tax reform.

Absent a consensus for reform and visible actions, general budget support by the Bank

### Box 5.1

### External Views of Bank Performance

Observers who have been highly critical of Russia's policies during the transition (e.g., Stiglitz and Ellerman 2001; Cohen 2000; Reddaway and Glinski 2001) have also been critical of the Bank's assistance priorities and lending choices, especially its support for voucher privatization, its narrow circle of government interlocutors, and the SALs in 1997 and 1998. And one defender of Russia's achievements has also criticized the Bank, but from an opposite angle. "The Bank has also been important [in Russia, although less so than the IMF]. It has had a broader front of activities, but that has also meant that it has been less focused and less effective. It has tended to be slower in its actions than the IMF, and its agreements were overloaded with lots of small conditions which distract from the most important conditions. Over time, the Bank has become more focused on essential structural reforms that are doable, and it has abandoned its

previous preoccupation with investment projects that did not work out" (Aslund 2000).

The Russian and international experts who have reviewed the Bank's assistance to Russia as part of the background work for this evaluation have been critical of the timing of most of the Bank's adjustment lending as well as the large size of the loans and their soft and unfocused conditions. They have also remarked on the frequent turnover of staff dealing with Russia, and the consequent loss of knowledge and experience. They have expressed a high regard for the quality of Bank experts and respect for the Bank's ESW and research work on the issues involved in the transition. In addition, they have praised its policy advice, technical assistance, and support for skills training, and contend that these activities had a substantial, albeit indirect, impact on advancing the transition agenda.

should have been limited and directed only to sectors where the government had authority to implement a reform program and additional resources were needed to compensate for the social costs of reform. Only assistance in support of trade reforms (Rehabilitation II) and to the coal sector (Coal SECAL I and II) met these criteria. Elsewhere, the Bank should have offered AAA and TA loans (if donor grants were insufficient) to help prepare legislative proposals and action plans.

The ECA Region agrees that, by 1996, Russia faced systemic reform issues, and for precisely this reason, the Bank decided to shift from investment lending to structural adjustment lending. But it disagrees that this was a misguided response, as the risks involved were worth taking at the time, given the potential rewards. While retrospectively questioning the amount of structural adjustment lending, the Region believes that restricting Bank assistance to AAA and small loans would have meant a perpetuation of the Bank's limited impact on policy formulation. The 1997 SALs and the SPAL were necessary to influence the design of the structural reform agenda, beyond the limited impact of analytical and advisory services. The SAL II, moreover, was justified by the need to address the fallout from the East Asia crisis. The Region further argues that the lack of fundamental reversals in economic policy, as well as improved Russia-Bank relations, would not have taken place without the trust-building actions taken by the approval of the SALs I and II and the SPAL. Moreover, these operations sowed the seeds of the reform program adopted in 2000 and currently under implementation (see also Annex 8).

By the spring of 1998, the Bank found itself in a dilemma. ECA's economists had concluded that it would be difficult to maintain the fixed exchange rate and avoid a debt default. They were also concerned at the loss of competitiveness of the manufacturing sector due to the real appreciation of the ruble. Hence, the Region was reluctant to offer additional Bank resources to fend off the mounting crisis of confidence. In 1997, the Region had already expressed its concern about the trend in the exchange rate and about the advisability of further lending to the IMF. It did so again in early 1998.

In hindsight, Russia would have been better off by allowing the currency to float while pledging to address fiscal and structural reforms. By anticipating the crisis, Russia could have avoided incurring additional foreign debt (\$16 billion) in its unsuccessful attempt to avoid default (see Kharas, Pinto, and Ulatov 2001). But many other influential commentators and market analysts were arguing for a bailout, and the Bank had no direct responsibility for the macroeconomic and financial aspects of the program. While sharing the Bank's assessment that the fixed exchange rate would be very difficult to sustain, the IMF nevertheless thought it was best in the circumstances to push for more fiscal adjustment and an unchanged exchange rate regime, backed up by large-scale external assistance. As this view was also advocated by the Russian government and by the Bank's major shareholders, Bank management opted to participate in the July 1998 emergency package.

Bank management did absorb the lessons from the SALs I and II and sought to minimize the Bank's exposure by tranching and back-loading the funding of the SAL III. The first disbursement was only \$300 million out of a total \$1.5 billion Bank loan, which was itself only a small part of the \$22.6 billion international package of assistance. The SAL III also had more result-oriented conditions than previous loans, addressing the fundamental problems of the nonpayment system, the fiscal deficit, and the poor regulatory framework. The SAL III was geared to send a clear message to international investors that Russia had made a renewed and strong commitment to structural reform.<sup>6</sup> There seemed to be a decent chance that the various reforms would finally be approved by the Duma. Although they might have been too late to forestall the financial collapse, such reforms would have moderated its negative impact.

Given the limited progress on the reform agenda, only an additional \$100 million was disbursed at the time of the SAL III's restructuring in July 1999, before the loan's cancellation in September 2000. The large undisbursed balance and multi-tranched nature of the SAL III helped the Bank maintain the policy dialogue with the Primakov government. The subsequent re-

structuring of the SAL III aimed more at gaining government buy-in than at modifying the project's reform agenda, which remained as relevant after the crisis as it was before. Moreover, the Bank devoted significant efforts to strengthening and broadening ownership of the reform program through seminars and high-level policy dialogue. These efforts made a significant contribution to the internalization of the SAL III reform agenda, which is reflected almost entirely in the government's current program.

Furthermore, Bank-funded technical assistance to develop policy measures and support administrative capacity proved useful in adjusting utilities' tariffs, enforcing cash collections, and monitoring performance—critical steps in the dismantling of the system of nonpayment. The Bank's contribution to guaranteeing the regulatory and institutional framework already on the books proved critical in helping to attract foreign private financing to Russia's space ventures (see box 4.2). The Bank also succeeded (jointly with the government) in bringing about a marked improvement in portfolio performance through deep project restructuring and loan cancellations, and in improving the relevance of new

operations—focused on institutional and social development and the facilitation of private investment. The Bank applied stricter standards for negotiating loans, even at the cost of a slow-down in project lending. Since mid-1998, the Bank has also reached out more to the Duma and other stakeholders and has succeeded in improving its relationship with the MOF and the CBR. These activities represent a major improvement in Bank performance.

Aid coordination has been a challenge. In late 1992, the G-7 decided that the Bank should chair donor meetings to coordinate aid to Russia. The Bank organized only one such meeting, however, because the government has preferred to deal with donors on a bilateral basis. In 1994, the G-7 posted a retired Bank manager to Moscow to take the lead in coordinating assistance programs, but the arrangement did not work as expected and was soon abandoned. In the aftermath of the 1998 crisis, the Bank successfully coordinated food assistance to Russia, and coordination has also been close, albeit yet to show results, in the banking sector, where the Bank and the IMF share leadership responsibility.





# Lessons Learned and Recommendations

## Key Development Challenges

**R**ussia has made major progress in its transition from a planned to a market economy. Although the challenges remain daunting, the country is now much better positioned to address them. Domestic ownership of reforms to address the strategic challenges outlined below is now largely in place. Many reforms have been adopted by the Duma (see Chapter 1 and Annex 1), and swift and efficient implementation is now the main challenge.

A key item on the reform agenda is to make the public sector effective, efficient, and transparent. To spur private investment, it remains necessary to improve the business environment to foster enterprise restructuring and new enterprise creation by better defining property rights and strengthening the judicial system, corporate governance, and competition. Building confidence in, and improving the efficiency of, the financial system is also needed to mobilize the savings needed to sustain growth and to reverse the massive outflow of private capital. A consensus does not yet exist, however, on whether state-owned banks and certain other key industries should be privatized and on how monopoly power should be curbed. Proposals to allow the development of agricultural land markets remain highly contentious.

Russia risks a further deterioration of its human achievements unless corrective measures are taken and additional resources found to

mitigate the social costs of the transition by strengthening the social safety net, and the social protection system, and by dealing with an acute tuberculosis epidemic, an emerging HIV-AIDS crisis, growing alcoholism, and serious air pollution and environmental degradation.

## Lessons Learned

The key lesson of the Bank's experience in Russia is that country ownership is crucial to the success of assistance. Thus, it is important for the Bank to pay close attention to the political and institutional aspects of reforms and consult with all relevant units of government and civil society to improve the relevance and design of its activities and avoid operations where commitment is weak.

There are a number of other general lessons:

- In the face of a poor track record and narrow country ownership of reform, a large adjustment lending program (especially one with

front-loaded disbursements) risks delaying rather than accelerating reform.<sup>1</sup>

- When there is a poor track record and a new consensus on a reform program, adjustment lending should be offered after the government has publicly adopted the necessary reforms or has begun implementing them, as was the case for the Coal SECALs. Disbursements should be back-loaded and carefully modulated on the basis of solid progress in implementation.<sup>2</sup>
- Adequate analytical work should be available upstream of lending. AAA should be funded to the extent commensurate with the role the Bank is expected to play.
- Timetables for implementation should be realistic.
- For physical rehabilitation and investment projects to achieve their development objectives, progress on policy and institutional reform is necessary.

## Recommendations

### Focal Areas

As already set out in the 1999 CAS, rather than lending in niche areas or for pilot programs that are better left to bilateral donor agencies, Bank Group support for Russia should be directed to the areas where government commitment to systemic reform is strongest. As of the end of 2001, these are PSM and governance, legal and judicial reform for the protection of contract and property rights, business climate, pension reform, land markets, and coal and electricity sector restructuring. The rapid progress being achieved on the federal-level reform agenda and the shift in focus on implementation issues, many of which have strong regional dimensions, as well as the large needs of the regions, suggest that the Bank should consider targeting part of its assistance to selected regions committed to reform.

In the *public sector*, the Bank today is better positioned to help improve expenditure allocations, public administration, agency implementation and monitoring capacity, and financial management and accountability. The Bank should build on its recent work and cooperate

with the government and other donors to conduct periodic reviews of public expenditures. It should also seek to raise public awareness of PSM and financial accountability issues and intensify its dialogue with legislators and non-governmental organizations. The Bank can offer to finance TA directly and encourage its provision by other donors.

In *private sector development*, the Bank Group should (a) renew TA to anti-monopoly institutions and regulatory agencies at the federal and regional levels, (b) complete its analytical work on the cost of doing business, (c) begin preparing a judicial reform project, (d) expand support for arbitration mechanisms and voluntary mechanisms for the settlement of business disputes, (e) intensify the ongoing efforts to prepare Russia for WTO membership and analyze Russia's linkages with the EU and the Commonwealth of Independent States (CIS) countries, (f) offer new insurance guarantees to encourage private investment, and (g) invest directly in promising private ventures.

In support of *banking sector* reform, the Bank Group could (a) continue its technical assistance, advice, and promotion of a broader debate on financial sector reforms among public officials, the academic world, and the Duma; (b) support a training project for bankers and bank supervisors at both the managerial and technical levels, given the continuing need to develop modern banking and other financial market concepts, attitudes, and skills; (c) continue the policy dialogue on the restructuring of state banks; (d) concentrate the financing of the private sector through financial intermediaries in the IFC, as the 1999 CAS proposed; and (e) encourage further involvement of foreign banks in the country. The case for renewing Bank assistance for capital market development is weaker at the moment, and it will depend on progress regarding proper disclosure, accounting standards, corporate governance, and shareholders' rights.

Given its record in the *energy sector*, it would be appropriate for the Bank to (a) make a follow-up sectoral loan to support the completion of the coal restructuring program, (b) continue its assistance to improve the efficiency and financing of household energy use, (c) offer new assis-

tance to regional governments to reduce urban air pollution, (d) continue to build consensus on a program for reducing gas flaring by oil producers, and (e) encourage the government to strengthen environmental oversight. The Bank should remain engaged in the debate over the restructuring options for the gas monopolies and should be ready to expand, if necessary, its ongoing technical assistance for the restructuring of the electricity monopoly. The Bank Group should also consider guarantees, equity investments, and lending for power generation and transmission and oil and gas export pipelines, but only after restructuring is well under way.

In *social protection* and in the *social sectors*, the Bank should continue its current advisory role on the implementation of reforms, especially pension reform, and its financial support for capacity building. Selected interventions to support education and to prevent major public health crises are justified by the serious threat that inadequate financial and policy responses to these problems pose to long-term, equitable growth.

#### **Instruments of Assistance**

A shared vision with the government for improving PSM and financial accountability should precede any quick-disbursing operations. Their design should ensure a tight linkage between disbursements, reform progress, and cost of asso-

ciated policy changes. Flexible policy-based sector operations, including programmatic loans, are attractive instruments to support differing paces of reforms among sectors and ensure ownership by the implementing agencies, provided they relate disbursements to performance.

To respond to a strong demand for high-quality advisory services, the next phase of assistance should provide for an expanded AAA program designed to deliver good practice advice based on the Bank's global experience. The most urgent ESW task, the planning of which began in the fall of 2001, is preparation of a comprehensive economic report to take stock of Russia's progress to date and assess the reform program. To ensure its ability to provide concrete and specific policy and implementation advice during 2002–03, the Bank needs to build its institutional knowledge in key reform areas, including regulatory reform, public service delivery and targeting, and regional level reform efforts. To contribute to the strengthening of consensus on the reform agenda, a broad dissemination of such work remains crucial.

The next CAS should be based on consultations with a wider range of Russian stakeholders than has occurred in the past, including representatives of regional institutions, civil society associations, and external partners. It should also be disseminated more widely.



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ANNEXES

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## **ANNEX 1: A Thematic Overview of Russia's Transition Challenges**

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### **Transition Challenges**

The rules of the game changed dramatically in Central Europe and the Soviet Union in the late 1980s and early 1990s, as major political and economic reforms—before and after the collapse of communist rule—opened up new opportunities. It is difficult to overemphasize the magnitude of the changes required to move from a centrally planned to a market economy. On the eve of transition, communist countries had inappropriate policy, institutional, and legal frameworks; were overindustrialized, with capital stocks largely unsuitable for production in a market economy; and often provided excessive social protection and infrastructure.

Planners determined resource allocation, with scant regard for scarcity prices. Resources for inefficient investments were extracted compulsorily through high enterprise profits taxes and forced savings. Competition, including from trade, was nonexistent. Firms did not have financial independence from the state and rarely had direct contact with their suppliers, wholesale purchasers, or final consumers. When planning disappeared, it took a considerable time for firms to create these relationships. To ease the informational demands of planning, firms were gigantic, often highly vertically integrated, and oriented toward production rather than sales. Incentives to innovate and improve efficiency were weak, with firms facing soft budget constraints.

The structure of output favored industrial production, notably machine tools, heavy industry, and defense, while economic geography was determined in ways that would not have emerged through competitive forces (giving rise, for example, to the Soviet mono-towns). Massive restructuring was required to make supply consistent with demand, implying major shifts from

industry to services, from heavy to light industry, and from machinery and weapons to consumer goods. Such restructuring depended on the emergence of new firms as much as on a re-orientation of existing companies. However, planned economies contained virtually no small firms and lacked the institutional infrastructure to induce and aid their creation (supply of funds, legal frameworks, level playing fields with incumbents, etc.). The political system, largely built on relationships between managers and politicians, also favored incumbents.

Transition countries faced the dual tasks of building modern political democratic institutions and transforming their economies from centrally planned to market-based, from state-dominated to private sector-driven, from closed to open, and from industry- to services-oriented. By the end of the 1980s, there was a broad consensus among reformist economists in transition countries and among Western economists that the transition path required macroeconomic stabilization and the eradication of budgetary deficits (eliminating enterprise subsidies); price liberalization; an effective legal framework facilitating voluntary contracts and free entry and exit; competition in private markets to be enhanced through trade opening (exchange rate convertibility, reduced tariffs) and anti-monopoly policy; and the privatization of existing enterprises. Foreign direct investment (FDI) was seen as crucial in supplying private capital, managerial skills, and technology.

The transition challenge was compounded by the collapse of the Council of Mutual Economic Assistance (COMECON) trading bloc and of the Soviet Union, which caused severe disruptions of trade and interenterprise linkages, and extraordinary shifts in internal prices. All

the transition economies suffered a decline in output, but with strong reform programs, growth was restored in most of the Central Europe and the Baltic (CEB) countries by 1993, and FDI flows were significant by 1994.<sup>1</sup>

### **Russia's Specific Challenges**

In the early 1980s, with stagnant real output per capita and declining efficiency of investment, dissatisfaction with the performance of the Soviet economy was mounting. In parallel with President Gorbachev's policy of *glasnost* (political openness), *perestroika* (economic restructuring) began in the mid-1980s with an increase in social and investment expenditures, but no adjustment to prices and taxes. Private small-scale initiative, including cooperatives, was permitted. State enterprises gained considerable autonomy, albeit without accountability. This period also saw a liberalization of the banking system and the start of spontaneous privatization—the transfer of state property and enterprises to their managers. Together with declining world oil prices and an anti-alcohol campaign that reduced important sources of government revenues, these policies contributed to higher budget deficits, a dramatic growth in external debt, and growing black markets. The central authorities lost effective control over economic management (Mau 2000).<sup>2</sup> All efforts to frame an economic reform program met with strong internal resistance and only rhetorical backing from Western governments.

A failed coup d'état in August 1991 triggered the dissolution of the Soviet Union, which was later replaced by a consultative association (the Commonwealth of Independent States [CIS]) among most former Soviet republics. The independent Russian Federation (Russia) that emerged inherited an industrialized and urbanized society and high level of human capital, but also a backlog of environmental, military, and demographic imbalances. The country was also in a severe recession, but continued to have global significance. It is the world's largest country (17 million square kilometers), covering 11 time zones, and the sixth largest in population (146 million in 2001). It includes 22 percent of the world's forests and 32 percent of its natural gas reserves.

Russia's initial conditions were more difficult than in the CEB countries. Few Russians had any memory of the brief and distant experience with capitalism, entrepreneurship, and markets before World War I and the 1917 Bolshevik revolution. The economy had been shaped by at least six decades of distorted relative prices, repressed inflation, forced collectivization, and central planning. The country's wasteful, rigid, largely resource-based, military-oriented, and over-integrated economic structures were very vulnerable to shocks and international price fluctuations. Its large size, widely dispersed population, poor transport infrastructure, and economic geography made it difficult for trade to ensure sufficient competition outside a few large urban centers. The federal structure and an inadequate state apparatus added layers of complexity to economic and governance challenges.

The 1993 constitution provided for a strong presidency and established a bicameral legislature—an upper Federation Council representing the constituent states, and a lower State Duma, representing the disparate interests of political parties. However, neither the Duma elected simultaneously with the constitutional referendum nor the one elected in mid-1995 expressed majorities aligned with the president and his reformist economic team. It was not until the election of a new Duma in late 1999, and of President Putin in early 2000, that a more harmonious political relationship was established between the legislative and executive branches. The period through late 1999 was characterized by ideological and political splits over market reforms, perceived risk of backsliding, frequent shakeups and major divisions within the government itself—including between the regions and the center, and parliamentary opposition to the reform efforts. Frequent use of the presidential power to rule by decree also weakened the political consensus. Russia's transition was also hindered by the state's loss of control over natural resources, hostility to foreign investment, poor compliance by economic agents with the new rules of the game, and a low level of trust in state institutions and among market participants themselves. Sizeable internal population movements

(mainly from Siberia to more temperate areas) added to the challenge.<sup>3</sup>

On top of these problems, government attention was dominated by crisis management, with short-term and frequently improvised policy reactions to new emergency situations, rather than to the implementation of a longer-term and comprehensive stabilization and reform blueprint. Major reforms came in surges, driven by a thin layer of reformers temporarily enjoying the president's personal support and by the imperatives of the latest crisis situations. As a consequence, achievements were generally more successful when the state had to stop doing something rather than in longer-term institution building or reforms requiring concerted actions in different policy fields. Broader ownership of the reforms and policy implementation capacity remained fundamentally stunted, although the commitment of the reformist wing of the government was never in doubt, all Russian governments pledged their support to the reforms, and the electorate voted at every crucial turn for continuing the transition.

### **Transition Goals and Achievements in the 1990s**

The key goals of the new reformist Russian administration were to move quickly to a Western-style liberal democracy and an open, market economy. The first two post-communist Russian governments (through December 1992) began a series of market-oriented reforms, which proceeded irregularly through the end of the decade. Russia's economic objectives were announced by President Yeltsin in October 1991:

- Liberalization of most prices
- Unification of the exchange rate and liberalization of current account transactions
- Macroeconomic and financial stability to reduce inflation
- Accelerated transition to a market-based economy through privatization, regulatory reform, anti-monopoly policies, and improvements within the financial sector
- Provision of an effective social safety net to protect the most vulnerable citizens.

This evaluation takes the majority view among transition experts that policy, institutional, and

ownership changes have gone too far to be reversed, although the spread of their benefits to the poor remains crucially dependent on further improvements in economic, social, and environmental performance. Russia has effectively moved from a centrally planned to a market economy, albeit with considerable distortions and weak social services and safety net (see Mau 2000; Dabrowski, Gomulka, and Rostowski 2000; Shleifer and Treisman 2000; Fischer 2001). This is a historic achievement, to which the Bank made a significant contribution.

### **Economic Performance**

Official statistics portray one of the deepest and longest contractions of output among transition economies. Gross national product (GNP) per capita contracted by more than 50 percent through 1998 (see table 1.1 in Chapter 1). Such a deep recession can be largely explained by the necessary adjustment following the end of the Soviet economic system and the Cold War, which required sharp reductions in the production of military hardware and capital goods with limited appeal on the international market. Most economists, however, do not believe that gross domestic product (GDP) estimates before and after the transition can be compared, because of pre-1992 overreporting of output, distorted valuations, extensive barter and rationing by non-market means, and the recent growth of the unofficial economy, estimated in the mid-1990s at 42 percent of GDP (Åslund 2000). Moreover, the impact of the production adjustment on welfare was less severe, due to a more modest consumption decline and relative price corrections. In fact, at purchasing power parity, Russia's 1998 GNP per capita of \$6,186 was comparable to Lithuania's, and was higher than Latvia's and Bulgaria's. Positive economic growth finally resumed in 1999.

Domestic price liberalization was undertaken swiftly in most regions. Between January 1992 and early 1993, price controls were de facto eliminated on most goods at the retail and wholesale levels, with the exclusion of a few sensitive food items, housing rents, utilities, and petroleum products. Due mostly to the large monetary emissions and in smaller part to the

monetary overhang, officially recorded prices increased over 14-fold in 1992. While savers, workers, and pensioners were adversely affected, the social costs without price liberalization (involving severe shortages and black market activities) might have been higher (Mau 2000).

Russia also made rapid progress in liberalizing its domestic and foreign trade and its payment regime. A unified exchange system with a freely floating exchange rate was introduced in July 1992 (but see the next paragraph). On the import side, the tariff structure was largely rationalized by 1995, with the import-weighted average duty rate at 13–14 percent with a standard deviation of about 7 percent. The growth of exports outpaced that of imports, the current account balance was positive throughout the decade, and foreign trade already amounted to 45 percent of GDP by 1996–97, before the runup in oil prices. There was a substantial change in the geographic composition of trade, with CIS countries accounting for just 20–30 percent of Russia's exports and imports by 1996. However, exports remained dominated by raw materials, of which natural gas and crude and refined petroleum products were the major component, while machinery and foodstuffs were the leading imports. High subsidization of the domestic economy through price distortions and arrears in the energy sector was at the root of the economy-wide system of "nonpayments" and barter.

The government expects accession to the World Trade Organization (WTO) by 2003, which will further improve Russia's trade regime and integration in the world economy.

The initial stabilization effort aimed at reducing inflation and the consolidated fiscal deficit (to below 10 percent by the end of 1992). However, the central banks in the ruble zone (dissolved in 1993) pursued a highly inflationary monetary expansion that spilled over into Russia. Moreover, the Central Bank of Russia (CBR) in July 1992 and a new government in December 1992 abandoned all efforts at establishing fiscal discipline and credit restraint.<sup>4</sup> The stabilization strategy finally adopted in 1995 with IMF support rested on three legs: fixing the exchange rate as a nominal anchor, tightening credit to enterprises, and limiting central bank credit to the treasury. This strategy succeeded in reducing inflation to single digits by early 1998.

Progress on the fiscal deficit, however, remained insufficient until 1999, when the federal accounts first recorded a primary surplus (see table A.1). A variety of tax measures were introduced, but with declining output, weak tax administration and compliance, flaws in fiscal federalism, and continuous tax exemptions for inefficient enterprises, government revenues fell sharply. Expenditures were also cut, especially in military spending, subsidies, and investment, but not commensurately with the fall in tax rev-

Indicator	Selected Fiscal Indicators (1992–01)									
	Fiscal year									
	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Federal govt. balance (% of GDP)	-10.4	-6.5	-11.7	-5.7	-9.4	-7.1	-5.9	-4.2	-0.9	2.7
Revenue (% of GDP)	16.6	13.7	11.8	12.9	12.5	12.3	11.0	12.8	16.0	14.5
Expenditure (% of GDP)	27.0	20.2	23.2	18.6	20.9	19.4	16.9	17.1	16.1	14.5
Consolid. govt. balance (% of GDP)					-5.9	-7.0	-6.0	-3.2	-3.2	2.8
Revenue (% of GDP)					38.5	36.5	33.4	34.0	38.4	35.8
Expenditure (% of GDP)					42.1	44.4	41.4	37.2	35.7	33.1

Source: IMF staff estimates.

enues. After a tight monetary policy was imposed in early 1995, continuing large-deficit financing shifted to new sources: (a) domestic and (after 1996) foreign portfolio investors, who bought high-yielding short-term government securities (GKO and OFZs) and foreign currency Eurobonds; (b) the IMF and the Bank (the annual net resource transfer by the IMF and the Bank during 1995–97 was equivalent to 1.1 percent of GDP); and (c) foreign governments, mainly through debt rescheduling.

Government institutions, policies, and regulations perpetuated soft budget constraints for enterprises and banks by tolerating a dramatic increase in barter, tax, wages, pensions, and suppliers' arrears within the public sector and among energy and infrastructure monopolies. In the hands of managers incapable of or unwilling to restructure and under pressure from import liberalization, shrinking private and public demand, the real appreciation of the ruble, and the high real interest rates, enterprises and banks readily seized on the government's political unwillingness to cause bankruptcies and root out the "nonpayments system." The share of barter transactions in the economy peaked at 54 percent, and total payment arrears rose to about 40 percent of GDP in August 1998. The energy sector was at the center of this system that helped conceal fraud and tax evasion.<sup>5</sup>

The unsustainability of deficit financing became apparent only gradually, as yields fluctuated widely in 1996 in reaction to the president's electoral and health prospects. After allowing nonresidents to trade in short-term government debt instruments, yields continued to decrease from the end of 1996 through September 1997. Despite the government's renewed promises to the international financial institutions (IFIs), however, the nonpayments system, poor fiscal performance, and ballooning short-term debt issues persisted. By the end of October, a rapidly spreading international financial crisis and declining world market prices for oil, gas, and metals, superimposed on an uncompetitive fixed exchange rate and chronically weak fiscal management and microeconomic fundamentals, began pushing the Russian economy toward the precipice. With mounting debt service, investors

lost confidence in the ability of the government to maintain the exchange rate in the announced corridor and levy and collect sufficient taxes to service the debt. They began to cash out of Russian markets, thus driving interest rates up sharply. The protracted cabinet shakeup in early 1998—despite the new prime minister's reformist credentials—was a further blow to investors' confidence. Moreover, the continued political stalemate among key stakeholders—the federal executive, the Duma, regional leaders, oligarchs—impeded sound fiscal management and the structural reform agenda (Shleifer and Treisman 2000).

Fearful that a financial collapse in Russia could have dramatic internal and external social, economic, and political consequences, a large international emergency financial package of \$22.6 billion was quickly assembled and was announced in July 1998.<sup>6</sup> The bubble, however, burst on August 17, 1998, with a debt default and a forced float of the ruble. The worsening developments in some parts of East Asia and other emerging markets had only delivered the coup de grâce. The Russian financial crisis was rooted in a fiscal crisis, which was in turn rooted in a deeper structural crisis.<sup>7</sup> The ruble depreciation by 65 percent as of the end of September and the disruption in Russian access to international capital markets triggered the insolvency of most banks that were heavily exposed to foreign exchange risks, a spike in inflation, and a severe, albeit short-lived, recession.

### **Social Performance**

Country performance on poverty, equity, and human and social development has been disappointing, both in absolute terms and relative to other transition economies. Gains during the last decade included the elimination of acute shortages of consumer goods, which were the most debilitating social feature of the previous system; ownership titles to housing for most households; greatly improved quality and variety of goods and services; expanded access to the domestic political process and global information and opportunities; and social mobility no longer shackled by pervasive administrative restrictions. However, in mid-1999, according to official sta-

tistics, 55 percent of the population, especially children and the elderly, was living in absolute deprivation, up from about 32 percent in 1997. The long-term poor represent about 13 percent of the population.<sup>8</sup> Inequality had doubled by 1993 to Latin American levels (the Gini coefficient was estimated at 0.46 in 1993 and 0.47 in 1998). Human development indicators show a sharp deterioration between the mid-1980s and the first half of the 1990s, and then either stagnation or only modest recovery. While recovering from their worst levels, infant and maternal mortality remain high, life expectancy (especially male) low, and access to health services inadequate, relative to CEB countries (see tables A.3, A.4, and A.5).

Previous achievements in the social sphere were based on unsustainable and costly public systems for social protection, health, and education.<sup>9</sup> Nonetheless, these systems continued to crumble during the 1990s, because they were only partially reformed. The inability to maintain previous levels of social services and to provide a safety net to vulnerable groups in the face of rising costs and declining revenues has set back Russia's human and social achievements and undermined the political consensus on needed reforms—especially enterprise restructuring.

The social protection system Russia inherited required major restructuring. Social benefits needed to be targeted to help those most in need of assistance, for example, the unemployed and poor households. Reforms were needed in social insurance institutions to reduce the role previously played by enterprises and improve the administrative capacity at the local government and national levels. New employment services were established in the early 1990s, administration of pension benefits improved, and social assistance became better targeted in the late 1990s. However, proposed reforms of the labor laws and the pension system were not adopted. Absolute levels of social benefits remain to this date low—for example, the child allowance in 1999 is about 6 percent of the under-16 subsistence minimum, down from about 13 percent before 1998, and the minimum pension is below the level mandated by law, that is, below 80 percent of the subsistence minimum for the elderly.

Public financing for health and education has dropped sharply in real terms since the late 1980s. According to government officials, the main factor behind this trend was the lack of indexation of budget outlays.<sup>10</sup> Whatever the reasons, the result has been serious imbalances between supply and demand of skilled manpower in a rapidly changing labor market, worsening quality of services, and growing social and geographic inequalities in access to secondary education and professional training. The health sector, moreover, is suffering from chaotic decentralization, misplaced priorities, and inadequate health insurance contributions.

### **Institutional Performance**

European Bank for Reconstruction and Development (EBRD) transition indicators for 2000 put Russia in the middle among transition economies, with high scores for fraction of output in the private sector and price liberalization, but low scores for financial sector development, competition policy, enterprise reform, and corporate governance (EBRD 2000). The Bank's assessment of policy and institutional performance for the same period painted a bleak picture, but for 2001 shows substantial improvements. Poor performance is still noted in environmental sustainability, property rights, and transparency, accountability, and corruption in the public sector.

While conversion of state and party *nomenklatura* control over the factors of production into de jure ownership had already begun in the late Soviet years, it intensified in Russia in the early 1990s. The country also experienced a high degree of "state capture" by industrial-financial-media tycoons (the so-called oligarchs) at the national and local level, at least through 1998.<sup>11</sup> These developments, together with inflation and the arrears and massive drop in real wages and pensions, largely explain the cynical attitude about the free market among Russians that has been noted by some Western reporters (Free-land 2000).

Compared to most other transition economies, privatization in Russia was rapid, largely motivated by the fear of a communist return. Recognizing the state's inability to regulate the activities of enterprise managers, a small

group of committed reformers exploited the period of "extraordinary politics" in 1991–92 to initiate a quick reversal of the collective ownership of the factors of production created by the Bolshevik revolution. In this, they succeeded. By the mid-1990s, virtually all small-scale enterprises had been sold or otherwise transferred out of state hands, mostly to their workers. Under the mass privatization program (MPP) for medium- and large-scale enterprises, by June 1994, the government had (a) corporatized and registered more than 24,000 enterprises as joint stock companies; (b) distributed vouchers to virtually the entire population in some 89 oblasts, territories, and autonomous republics; and (c) privatized transparently over 16,000 enterprises, most of which were in the tradable sector. More than 70 percent of all Russian firms privatized under the MPP did so by choosing the majority employee ownership option (Logue, Plekhanov, and Simmons 1995). More than 41 million Russians became shareholders through direct share ownership or voucher investment funds. By the mid-1990s, the private sector was contributing more than 70 percent of GDP.

Enterprise managers eventually succeeded by legal means and/or intimidation to accumulate controlling stakes in most privatized enterprises. Involvement by outside investors was minimal, due primarily to management's opposition, facilitated by the decision to allow 51 percent insider ownership (an option chosen by most enterprises) and by the government's failure, until recently, to impose hard budget constraints on enterprises. The measures taken to sustain transparent ownership, assist in the secondary redistribution of property, and protect shareholders from fraud and abuse proved inadequate. As a consequence, and also due to continuing soft budget constraints, enterprise restructuring was very limited. Lack of demonopolization and restructuring before and after the MPP perpetuated low competition.

Some commentators have argued that the MPP involved overly complex relationships between various principal agents ("long agency chains") for the Russian economy just exiting from seven decades of central planning, and thus its sequencing should have been reversed.

They argued that support for the spontaneous privatization (through lease buyouts and cooperatives) by insiders that had started during *perestroika* would have been a better choice under conditions of poorly established property and legal rights and corporate governance, as it would have minimized agency relationships.<sup>12</sup>

Many other experts, however, maintain that Russia did not have a sufficiently developed institutional environment to prevent large-scale managerial expropriation of assets under the latter scheme. In any case, the sequencing of the MPP—privatization first, institutional and regulatory reform later—was not driven by faulty understanding of economic principles on the part of the reformers or their foreign advisers, but by domestic political realities. The choice of voucher privatization, involving the country's entire population in the redistribution process, was based on a legislative compromise adopted in the summer of 1991 (before the first post-communist government) between reformers and legislators eager to stop the looting of state property by insiders. Fearing a resurgence of communism, and faced with keeping foreign investors at bay and with a lack of basic legal regulations, secured property rights, and a capital market, they saw the voucher option as the only realistic method to privatize quickly and fairly. Transferring economic assets to private hands was expected to create a strong constituency for the necessary legislative and institutional changes.<sup>13</sup> Unfortunately, this proved not to be the case until the end of the 1990s.

Subsequent efforts at privatization on a transparent, case-by-case, cash basis included the loans-for-shares (LFS) scheme, through which the government divested in 1995–96 its shares in 13 large and valuable companies, mostly in the petroleum and nonferrous metals sectors, in a nontransparent way and for only about \$1 billion (Lieberman and Veimetra 1996). The LFS scheme, which entrenched powerful financial-industrial groups and undermined government revenue-raising efforts, was a quid pro quo for the so-called oligarchs' support of President Yeltsin's successful 1996 reelection campaign. This development and the MPP's shortcomings damaged the credibility of, and strengthened

opposition to, the privatization process. Indeed, further dilution of large government stakes has remained blocked to date.<sup>14</sup>

Efforts to promote demonopolization, new enterprises, and investment were lukewarm and achieved little. The economy remained plagued by inefficiencies and an unfriendly business climate. The initial rapid growth of small and medium enterprises (SMEs) in the early 1990s was driven by the numerous niche-filling and arbitrage opportunities that abounded at the time. This growth, however, was later stalled by an adverse institutional environment, a predatory bureaucracy, and lack of access to financing.<sup>15</sup> Cumulative net FDI inflows to Russia in the past decade have been minimal (less than \$12 billion), largely limited to natural resource sectors and geographically concentrated, with the cities of Moscow and St. Petersburg and the surrounding oblasts accounting for substantially more than half of total inflows of FDI (Broadman and Reanardini 2001).

Unclear and conflicting laws, poorly defined property rights, excessive regulations, an unreliable judiciary, corruption, opacity of ownership, corporate governance abuses, crime, and lack of confidence in the inadequate banking system and the government's economic management have discouraged investors from considering operations in Russia and constrained International Finance Corporation (IFC) and Multilateral Investment Guarantee Agency (MIGA) activities. Until August 1998, old and unprofitable firms continued to stay in business—by not paying taxes, utility bills, and suppliers instead of shedding their assets—while an overvalued exchange rate discouraged investment outside the export commodity sector. During the same period, a dual pricing system kept domestic prices especially low and discouraged investment in the oil sector. As a result, and also due to poor overall economic management and rising crime and illegal gains, capital flight averaged \$11–\$19 billion annually during 1994–99 (IMF 2000).<sup>16</sup>

The failure to put in place an appropriate regulatory framework and to restructure huge, monopolistic enterprises before their partial privatization entrenched powerful interests and

locked in structural inefficiencies. Important obstacles to private sector development (PSD) continue to characterize the Russian economy: (a) concentration of ownership and control in the hands of insiders who have failed to restructure the enterprises; (b) high costs of entry and doing business, including severe bureaucratic harassment of SMEs; (c) insecure property rights; (d) weak legal and judicial systems; (e) limited competition in product markets; and (f) a poorly regulated, undercapitalized, and deficient financial sector.

### Recent Achievements

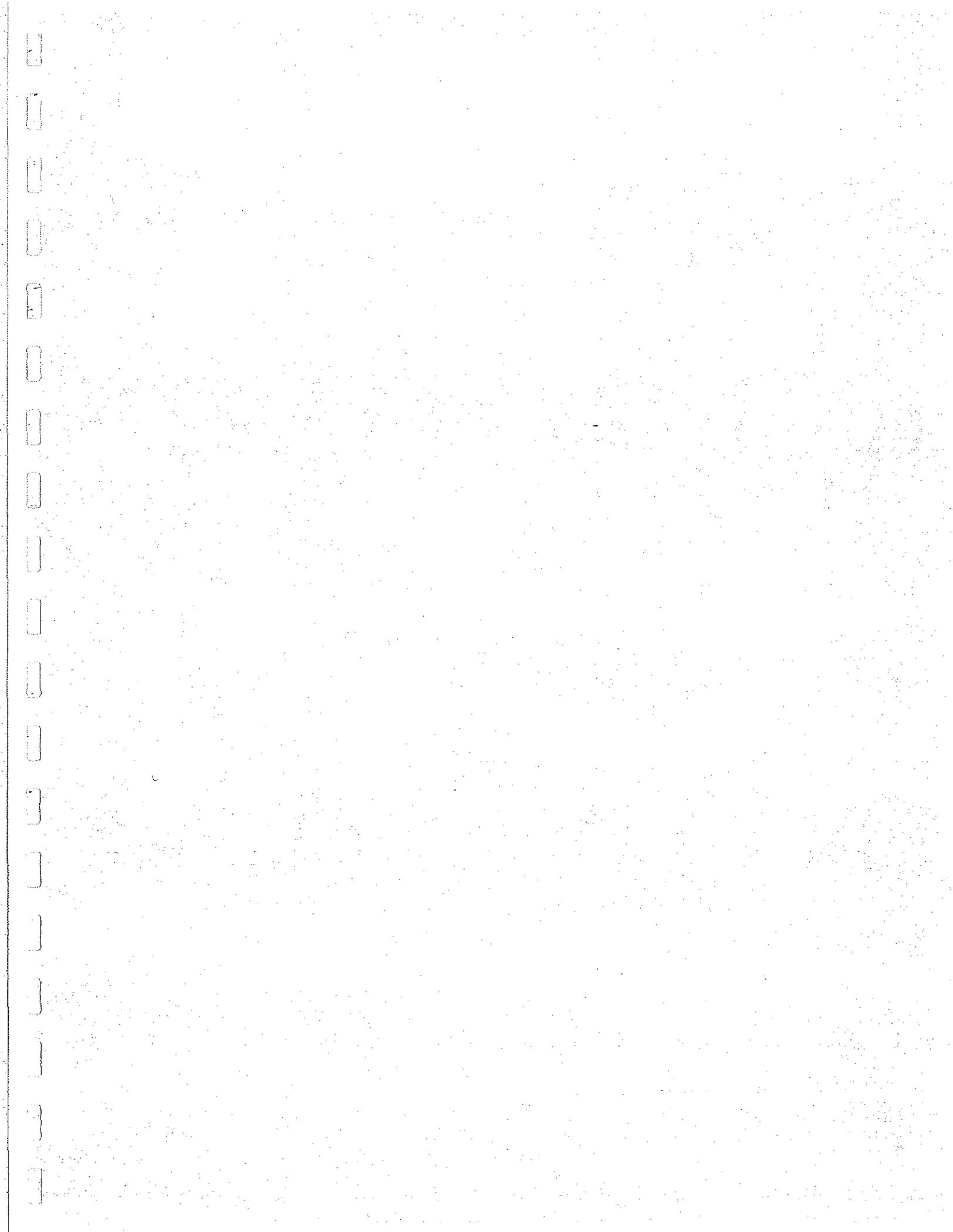
The last three years have seen strong economic performance and considerable progress on the reform agenda. Good fiscal performance, large balance of payments surpluses, and an impressive output recovery have been accompanied by an improvement in business confidence and a drastic reduction of enterprise payment arrears and barter. The economy has been boosted by higher world energy prices and improved competitiveness—through lower real wages of the non-oil export sector thanks to the 1998 devaluation, but political stability, a clearer policy direction, and a broader consensus on reform have also played significant roles.

The Primakov government, which came to power in September 1998 and was widely expected to adopt a new policy agenda—that is, abandoning monetary stringency, increasing spending, and reversing the limited structural reforms already adopted—soon realized that the Russian people had no desire for high inflation or for abandoning the efforts to develop a market economy. In fact, the government improved fiscal discipline, thus keeping a lid on inflation, allowed only a moderate amount of food aid so as not to damage agricultural producers' incentives, and abstained from taking steps to reverse liberalization and other reforms.

In mid-2000, the Kasyanov government endorsed a comprehensive medium-term program of policy and institutional reforms, developed by Russian experts—but remarkably similar to that long advocated by the international community.<sup>17</sup> Important tax reform—which brought the income tax rate down to a flat 13 percent, ex-

pansion in coverage of the federal treasury, and an overhaul of the center-region relationship—has been successfully implemented, resulting in greater tax compliance and the re-imposition of the center's authority over the regions. In 2001, the Duma approved legislation that reformed corporate taxes, cut the profit tax from 35 percent to 24 percent, clarified ownership and liberalized transactions in nonagricultural land, reformed the pension system, modernized the labor code, deregulated business activities, and brought needed changes in banking legislation. A restructuring plan for the electricity monopoly has been adopted and now awaits

implementation, and a number of legal changes were to be submitted to the Duma by the end of 2001. Already further along the legislative pipeline are other major reforms of social transfers, agricultural land markets (on a voluntary regional basis), further tax simplification and tax burden reduction, the legal system, the judiciary, further improvements in the business climate and corporate governance, and WTO accession. A major reform of the banking sector, a renewed privatization drive, further capital account liberalization, improvements in the health and education systems, and financing for science are also on the administration's agenda.



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ANNEX 2: A CHRONOLOGICAL OVERVIEW OF  
RUSSIA'S TRANSITION CHALLENGES

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**1990-91**

During the last two years of the Soviet Union, the government lost control of economic policy as it gave in to populist demands for spending while collecting less revenue. The rising budget deficit was financed by monetary emissions, causing hyperinflationary pressures. Because price controls were in place, shortages in all markets intensified enormously. Output plummeted as a result of the shortages, disruptions in interenterprise linkages after the disintegration of the Soviet and central European trading blocs, and general chaos. Unregulated banks (mostly finance arms of enterprises) mushroomed. Managers started the "spontaneous privatization" of their enterprises, over which a 1987 law had given them effective control, through lease buyouts. With the general collapse of law and order, crime rates rose rapidly.

**1992-93**

A new reformist Russian government (formed in November 1991) launched a program of radical market economic reform in January 1992. This initial reform period lasted through 1993. Its salient achievements were price liberalization and privatization of small, medium, and large enterprises. However, initial attempts by the reform government at balancing the budget failed, and the non-enforcement of price controls allowed previously repressed hyperinflation to surface. The Russian central bank did not even attempt to bring monetary policy under control, and competition in the issuance of rubles among Commonwealth of Independent States (CIS) central banks continued, thus fueling the inflation. Little was done to reform government institutions, and crime rates continued to rise.

**1994-95**

The December 1993 elections were perceived as a defeat for the radical reformers, and the government became dominated by state enterprise managers, who had benefited from the mass privatization. (Completed by mid-1994, it left about one-fifth of the issued shares in their hands and another two-fifths with their employees, according to Blasi, Kroumova, and Kruse 1997). The state bureaucracy started applying the restrictive regulatory laws that had remained on the books. Despite a halt to structural reforms, monetary stabilization was finally accomplished in 1995 under an IMF Stand-by program. Crime became increasingly organized, although it started to decline.

**1996-98**

At the end of 1995, the loans-for-shares (LFS) privatization of a dozen major companies marked the end of the state managers' dominance and the rise in influence of the so-called oligarchs from 1996 until 1998, a rise connected with their financing of the reelection of President Yeltsin in the summer of 1996. A few well-connected businessmen, who had made their fortunes in the late 1980s and early 1990s on arbitrage between state-controlled and free markets in various industries, strengthened their control over powerful financial-industrial groups. These groups with their substantial security services also edged out organized crime. This period was characterized by rising economy-wide barter and arrears that were supported and subsidized by the energy sector, a persistently large budget deficit, ballooning short-term public debt, rising stock prices, and a relatively stable but increasingly uncompetitive exchange rate. In August 1998, this phase of weak and ineffectual

government ended in a financial collapse with a debt default and a large devaluation.

**1998-2001**

Since August 1998, a more functional economic system has emerged. The government was forced to balance its budget because no financing was available. The discredited system of nonpayments and barter that was at the root of the financial crash dwindled swiftly. As a result of parliamentary elections in December 1999, a solid majority in support of market economic re-

forms emerged for the first time. Tax reform that had long been discussed was finally undertaken in a more radical form than anyone had expected. Other reforms to improve the business climate and urban land markets were also adopted. From 1999, contrary to most expectations, Russia experienced vigorous economic growth on the strength of rising oil prices, a real devaluation, and better economic policies. Crime and corruption have become endemic, but governance, judiciary reform, and social reforms have risen on the policy agenda.

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### ANNEX 3: EVALUATING BANK ASSISTANCE TO THE TRANSPORT SECTOR<sup>1</sup>

The transport system Russia inherited in 1992 from the Soviet Union had been designed to move large volumes of bulk commodities among centralized production facilities over long distances, with scant attention to scarcity prices. The resulting inefficient transport and price distortions affected the competitiveness of Russian industry and exports. In 1992, the fiscal burden of transport subsidies was large and growing (11 percent of total budgeted subsidies, or 2 percent of GDP). The greatest problem was large deficits among urban transport systems, although there were also significant and growing deficits in suburban commuter railways and airline services. Deteriorating road conditions also signaled the need for reforms and public investment in this subsector.

The Bank's analytical work emphasized fiscal issues and the need to transform transport institutions and services into competitive, market-oriented, privately owned ones; avoid investments in modernizing facilities unlikely to see much demand in the new economic environment; and protect strategic public assets. The strong views of Bank sector reports, complemented by project focus on maintenance rather than new investments, played a significant role in preventing large misinvestments.

Gross Bank lending for the sector at \$1.5 billion (11 percent of total Bank lending to Russia) has been relatively small compared to lending for transportation projects in other large countries such as Brazil, China, and India. The Bank approved road projects in FY94, FY96, and FY99; an urban transport project in FY95; and a Moscow urban transport project in FY01. However, the entire \$400 million for the FY99 highway project, which included a regional road component, was cancelled, and other projects were scaled down

during implementation. In total, close to 50 percent of the approved loan funds for transport have been cancelled. The Bank also assisted the transport sector by way of the first Rehabilitation Loan, which included financing of spare parts for buses and for seaport equipment. An in-depth sector review of Russia's ports by the Bank recommended fundamental reforms to enhance competition and transparency. It also found that investment requirements were relatively modest (because of past over-investment) and were needed mostly for rehabilitation and adaptation of superstructures. Nonetheless, at the request of the central government, the Bank began work on a port project, with a focus on St. Petersburg; this effort foundered because of the unwillingness of local authorities to undertake fundamental organizational changes. According to an agreed division of labor, the European Bank for Reconstruction and Development (EBRD) lent money to the railways, while Bank assistance focused on improved pricing and competition in the subsector. However, these and similar efforts under the Structural Adjustment Loans (SALs) to improve the transparency of the Road Fund were unsuccessful.

The relevance of the first highway project was substantial. Its focus on maintenance and rehabilitation ensured a high internal return, and private sector contractors were stimulated by the introduction of competitive bidding for work previously done by the public sector. Efficacy was only modest, however. The project was hampered by higher than expected costs, mainly due to limits in the bidding competition and the Highway Agency's resistance to auditing the Road Fund according to international standards. The focus of the urban transport project was on raising cost recovery from minuscule levels,

in exchange for the financing of new buses. Its relevance, however, is questionable. The Bank would have done better by assisting municipalities to privatize quickly and establishing regulatory institutions rather than financing public purchases of costly new buses. Indeed, transport capacity in cities not covered by the Bank project was maintained by a better combination of privatization and public purchases of second-

hand buses from Western Europe. The urban transport loan, moreover, turned out to be a disaster for most municipalities, whose debt service quadrupled after the 1998 devaluation (the Ministry of Finance (MOF) had insisted that subborrowers take the full foreign exchange risk).<sup>2</sup> These problems caused large loan cancellations, and progress was modest on railway pricing and negligible on restructuring.

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#### ANNEX 4: EVALUATING BANK ASSISTANCE TO THE AGRICULTURE SECTOR

Agriculture has proven to be one of the sectors most resistant to change, even though relative prices are now largely market-determined, subsidies fell from over 10 percent of GDP in 1992 to 2 percent by the end of the decade, and privatization has left only 10 percent of farmland in the hands of the state. But there has been very little change in farm structure or management, and gigantic privatized farms continue to operate as state and collective enterprises, with low factor productivity and few incentives to respond to changes in market signals. As in the early 1990s, the sector still badly needs (a) a clear legal framework establishing agricultural land markets; (b) reforms of marketing, distribution, and agricultural credit institutions, primarily at the regional level; and (c) a re-orientation of public support to facilitate the emergence of efficient farms rather than maintaining inefficient ones.

The Bank's recommendations throughout the decade were consistent and appropriate. In light of the poor policy and institutional environment, Bank lending was limited to a core program aimed at supporting market-based institutions, particularly land reform and farm privatization and restructuring, as well as assistance to the Ministry of Agriculture in developing market infrastructure, farmer information services,

and a viable private sector seed industry. Assistance to the sector has consisted of two loans approved in June 1994: a \$240 million Agriculture Reform Implementation Support (ARIS) project and an \$80 million Land Reform Implementation Support (LARIS) project.<sup>1</sup>

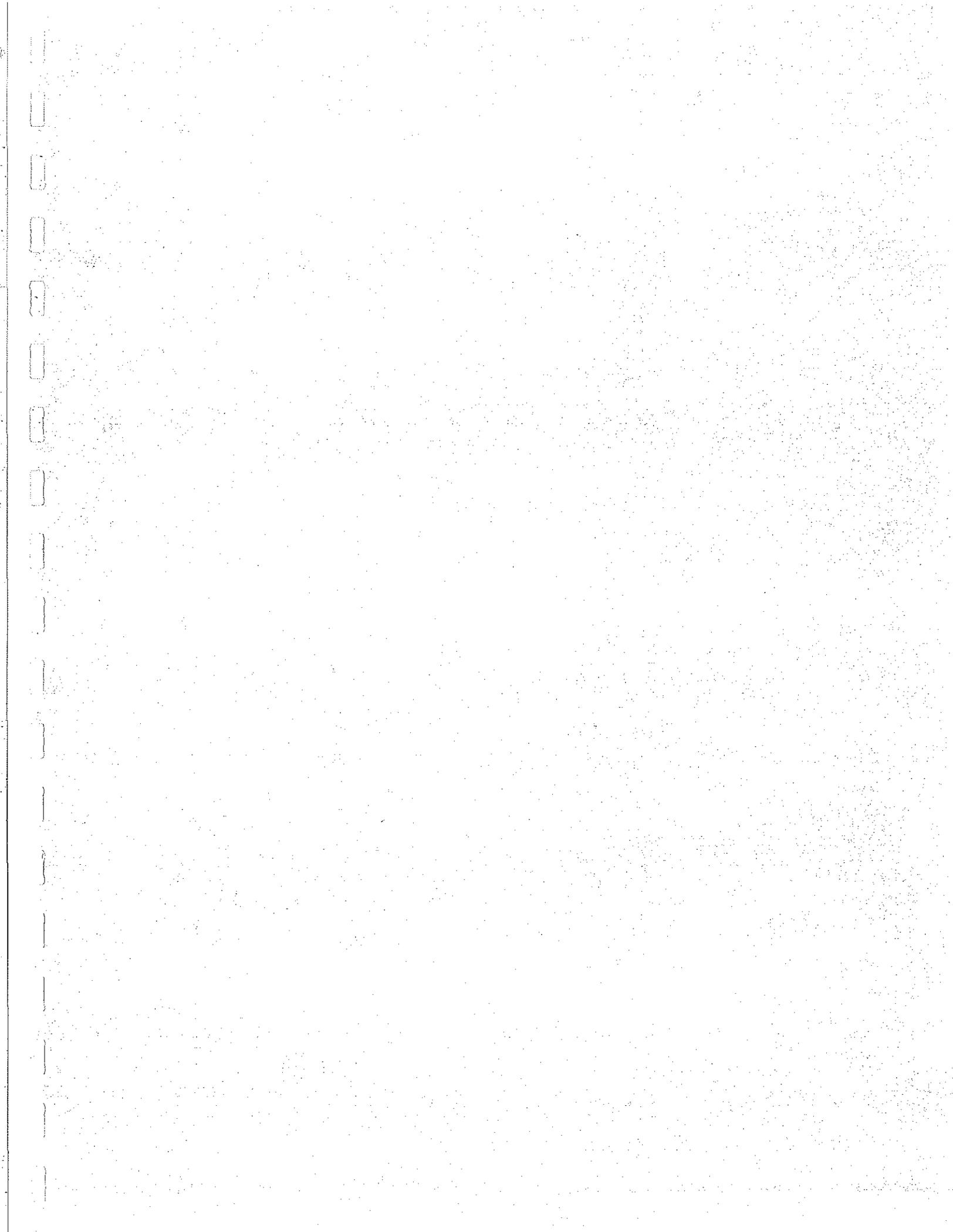
The loan components, however, were more prosaic than their description in the 1994 CAS and included strengthening information services to farmers and demonstrating the role of the private sector in agriculture by establishing pilot wholesale markets and seed processing facilities. Other goals included changes in seed quality production and marketing subprojects, the introduction of a uniform land registration system and cadastral mapping, and training. Progress on these narrower objectives has been very slow but is now reportedly satisfactory (except that the private seed enterprises cannot repay the sub-loans under the ARIS project). These achievements, however, have meant little so far, because the necessary legislative and policy reforms required to address the priority needs of the agricultural sector have yet to be adopted. ARIS was premature, and its relevance was modest at best. The focus of LARIS on building government capacity, however, may prove timely, given recent progress on land reform legislation.

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**ANNEX 5: 1997 AND 1999 CAS OBJECTIVES AND OUTCOMES**

Development objective	Main results	Progress		
		1999	2001 Actual	2002-03 Prospects (%)
Private sector	Regulatory framework for case-by-case privatization in place	C	C	100
	• Transparent case-by-case privatizations	N	N	<33
	• Enterprise restructuring	N	S	>33 <67
	• Improvements of institutional capacity to handle bankruptcy cases	S	S	>33 <67
	• Accession to WTO	N	G	>67
Financial sector	• Regulatory framework in place (e.g., prudential regulations, exit legislation, IAS)	S	S	<33
	• Upgrade regulatory and tax framework for securities markets	S	S	>33 <67
Social safety net	• Real minimum pension at acceptable level	S	S	>67
	• Pension reform	N	S	>67
	• Modernize labor legislation	N	S	>67
	• Improve unemployment benefits	S	G	>33 <67
	• Improved targeting of social assistance	S	G	>33 <67
Social services	• Agreement on health financing reform	S	S	>33 <67
	• Agreement on education financing reform	S	S	>33 <67
Public sector and economic management	• Restructure intergovernmental fiscal relations	S	G	>67
	• Improve tax administration and tax system	S	G	>67
	• Coverage of treasury system increased	S	G	>67
	• Wage and pension arrears eliminated	G	G	>67
	• Strengthen legal framework and judiciary	S	S	>33 <67
	• Corruption Diagnostic Study (1999 CAS)	N/A	S	>33 <67
	• Public administration reform	N/A	S	>33 <67
Agriculture and rural development	• Adoption of legislation and procedures to facilitate land market transactions	N	N	<33
	• Restructuring of bankrupt farms	N	N	<33
Energy, environment, and infrastructure	• Reduction in subsidies to coal enterprises for investment and production	G	C	>67
	• Private sector participation in power generation and distribution projects	N	N	>33 <67
	• Utility tariffs to cover full economic costs, and cross-subsidization phased out	S	S	>33 <67
	• Independent regulatory agencies for infrastructure monopolies fully operational	S	S	>33 <67
	• Implementation of Environmental Action Plans at federal and regional levels	S	S	>33 <67

Note: N=negligible; S=some; G=good; C=completed.



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## ANNEX 6: BANK PERFORMANCE IN SECTORAL DEVELOPMENT

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In private sector development (PSD), the Bank Group's sectoral performance has been mixed. The IFC moved quickly in the early years to address needs for technical assistance in PSD, earning a high level of goodwill. In the second half of the decade, however, TA operations have focused on narrower objectives less central to the transition process. The IFC's investments—along with its losses—have been limited. In light of the generally unfriendly investment environment, the IFC's matching of its skills and resources to potentially viable investment opportunities in Russia not covered by EBRD financing has been appropriate and, to the extent it reflects resistance to the prevailing approval culture and external pressure to invest, laudable. MIGA's decision to offer coverage on a prudent and selective basis was equally appropriate. Bank analyses, advice, and TA on PSD were timely and on the mark. The Bank's credit lines to private enterprises, however, if viable from a commercial standpoint, should have been left for the IFC.

In the financial, transport, and agricultural sectors, Bank performance has also been mixed (see Annex 3 for the transport sector and Annex 4 for the agricultural sector). The Bank's early diagnosis of the financial sector was sound, with a clear recognition of the technical and political difficulties of the required reforms and institution-building processes. Its advice and the TA loan components also were appropriate, and have helped create a promising foundation of laws and institutional capacity. However, several aspects of its lending assistance were deficient.

The Bank should not have lent in the banking sector without full ownership of reform by, and a good working relationship with, the Central Bank of Russia (CBR). The Bank's policy ob-

jectives would have been better served by more vigorous monitoring and active advocacy of the institution-building components of its loans, especially the CBR supervision component. The accreditation and monitoring process for participating banks under the Financial Institutions Development project (FIDP) was flawed and supervision seriously deficient.<sup>1</sup> Appraisal and supervision reports before 1998 presented an overly optimistic view. Much of the work done under the Capital Markets Development project (CMDP) to strengthen the legal, regulatory, and institutional framework for the capital market was premature, given the inadequate government commitment to resolving the key issues of disclosure standards, corporate governance, and protection of shareholders' rights, without which improvements in the capital markets' infrastructure would prove sterile.<sup>2</sup> Through 1998, little attention was paid to the restructuring of state-owned banks—even though this issue was highlighted in prior economic sector work (ESW) on the sector—and to improving the conditions for foreign bank entry. Unlike the approach taken in successful Central Europe and the Baltics (CEB) countries, moreover, the policy dialogues surrounding enterprise and bank restructuring in Russia were not clearly integrated. Finally, the Bank did not do enough projects to create a broader understanding of the key issues and disseminate its own strategic vision for financial sector development.

The Bank's program of lending assistance to (and through) the banking sector should have been more limited, better designed, and closely supervised to minimize the Bank's reputational risk and achieve better coordination before 1999 between the Bank and other international fi-

nance institutions (IFIs) and donors. In all likelihood, however, the end results—the sector's insolvency after the 1998 debt default and devaluation—would not have been very different in light of the poor institutional and microeconomic environment and the dynamics of unsustainable public debt in the context of a fixed exchange rate regime.

In public financial management and accountability, the Bank had a decisive impact on the development of basic expenditure tracking systems in the Ministry of Finance (MOF) under the Coal Sector Adjustment Loan (SECAL) I, as well as a significant impact on the initial development of the accounting profession. Until relatively recently, however, the Bank made only slow progress in diagnostic work and in supporting the building of key institutions at the country-wide level—even during 1996–99, when it provided substantial quick-disbursing loans for budget support. The Bank's relationship with the supreme audit institution—which through 1999 the government considered an instrument of the opposition parties in the Duma—was difficult, but the Bank's efforts to establish a productive dialogue were limited. The inadequate assistance in this area reflected an insufficient appreciation by the Bank of the role of public sector governance in Russia's transition.

However, the Europe and Central Asia (ECA) Region did adhere to the formal, Bankwide fiduciary guidelines for lending and, furthermore, took some additional steps. In the wake of allegations of misuse of IMF resources after the 1998 financial crisis, the Bank reviewed all adjustment loan disbursements. Although satisfied that they were fully accounted for and used in accordance with loan agreements, it introduced a tracking system to ensure that disbursements of its remaining adjustment loan balances reached the MOF's budget accounts or were only used by the CBR for external debt payments. The Bank also endeavored to obtain a comprehensive report by the Chamber of Accounts (COA) on federal budget execution for

each year in which adjustment loan disbursements took place. As for the remaining portfolio, Bank staff have implemented diligently the "ring fencing" approach mandated Bankwide for project financial management. They took innovative steps to recover ineligible payments and to improve project audit quality, including reviewing the qualifications of private auditing companies and accrediting the competent ones.

In the social protection sector, the Bank's initial projections overestimated the risk of unemployment, because they assumed downward real wage rigidity and a much faster adoption of hard budget constraints on enterprises, as had been the case in CEB countries. Nonetheless, Bank performance was commendable under the early TA efforts and under the coal loans. Throughout the decade, the Bank was successful in keeping social protection on the government's reform agenda. With the Social Protection Adjustment Loan (SPAL), however, it was mistaken in its expected timetable for major institutional reforms and its weak conditionalities. The better alternative would have been to lend only for TA, until evidence of concrete reform steps and a need for compensatory financing of implementation costs became apparent.

In the energy sector, the Bank performed well not only in the successful restructuring of the coal subsector, but also in the electricity and the natural gas subsectors, where responsibility for the failure or limited progress of reform rested squarely with the government. In the oil production subsector, however, the Bank moved too quickly to make a rehabilitation loan—that is, before the government adopted the necessary reforms. The Bank was also unable to influence the oil transport subsector, which has been the major bottleneck to expanding oil exports. Finally, the Bank could not prevent—through policy dialogue or the leverage of its lending program—the mistaken decisions of the government to partially divest its shares in the gas and electricity monopolies before their restructuring and the establishment of a regulatory framework.

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## ANNEX 7: DISCUSSION OF OTHER COUNTERFACTUALS

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**Could greater budget support in 1991 and 1992 have led to a faster and smoother progress toward macroeconomic stabilization and reform?** Unlikely. Because the Bank could not provide assistance until Russia became a member of the Bank, such support could only have come from the G-7 countries. In any case, the Soviet Union's large borrowing in its final years had allowed it to be complacent about embarking on a serious transition program. Moreover, the tide turned against the reformers despite the \$1.6 billion made available by the IMF and the Bank in mid-1992 with virtually no conditions, clearly indicating that other loans would follow.

**Could early large-scale financing of the safety net have encouraged faster restructuring and stemmed the increase in poverty?** Unlikely, since the additional cost of maintaining social programs at their 1992 levels (11 percent of GDP) during the next six years would have been roughly \$20 billion annually. External assistance of this magnitude was simply not available.

**Would more determined support by the Bank for the lease buyout privatization option, pro-competition policies and institutions, or transparent case-by-case privatization have led to better privatization outcomes?** Probably not, although the Bank influence was diminished by its lack of grant resources and, in the late 1990s, by differing views among senior Bank managers. In 1991-92, Bank staff shared the reformers' view that, given the weak control environment, the lease buyout with no share-trading rights option was a recipe for asset stripping by the enterprise insiders. They

preferred case-by-case transactions and competitive restructuring before privatization, but the views of foreign advisers had little influence at that time. By mid-1991, the reformers and the legislature had already chosen the mass privatization strategy without prior competitive restructuring, on the basis of their political objectives and the realities on the ground. The Bank was left with no role other than helping to design the mass privatization program (MPP).

The Bank's subsequent efforts to minimize the MPP's shortcomings proved fruitless, but not for lack of trying. The government did not address the issues of competition and corporate governance, and thus the Bank's advice and technical assistance (TA) remained largely unused. Instead of the envisaged transparent cash auctions and case-by-case transactions that the Privatization Implementation Assistance Loan (PIAL) was to support, the government chose in 1995-96 the opaque loans-for-shares (LFS) scheme. The subsequent strong push through 1998 by the Bank also yielded nothing but an empty shell of a privatization framework.

**Would more attention by the Bank to fiscal issues have been possible and fruitful?**

While the Ministry of Finance (MOF) did not welcome work or advice by the Bank in the sensitive areas of tax structure reform and expenditure management and allocations, the Bank did not use sufficiently the leverage available to it from its lending program to engage the government in technical analyses. Nor did it use sufficiently its relationships with Russian policy institutes and the IMF to indirectly affect policy decisions. The IMF would have welcomed concrete recommendations on expenditure restructuring as input to its 1996-97 Extended

Financing Facility (EFF) program, but the Bank had little to say. Only in the areas of oil taxation and coal subsidy reduction was the Bank able to make technical contributions to fiscal policy options, as its main interlocutors were sector min-

istries. The MOF and the IMF, however, did not take up the Bank's recommendations on oil taxation because they were more concerned about the short-term revenue implications than the longer-term effects on incentives and revenues.

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## ANNEX 8: BANK MANAGEMENT VIEWS<sup>1</sup>

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We welcome this evaluation of the Bank Group's assistance to Russia between 1991 and 2001, which has been prepared during the first sustained period of growth in the Russian economy since the breakup of the Soviet Union in 1991. The CAE concludes that Russia's transition to a market economy was more difficult than anticipated;<sup>2</sup> but the very rapid privatization, dismantling of controls, and redirection of production and trade have led to an irreversible transformation of the Russian economy, albeit at high cost. We agree that Russia is now irreversibly on the path to a market economy, and believe that the World Bank Group played an important part in this transformation.

After the traumatic financial meltdown in 1998, Russia used the breathing space provided by high energy prices to develop its own comprehensive reform program. In a more stable political environment, the government has overseen the passage of important legislation through the Duma in key areas of the structural reform agenda, including a new tax code, judicial reform, deregulation, restructuring of the natural monopolies, urban land reform, and pension reform. Much remains to be done, and the implementation of these reforms will be difficult and complex. The Bank cannot, of course, claim sole or even major credit for these advances; that must go to the Russian government and people. But in our view (which we believe is shared by the government), the Bank Group, through the *cumulative* impact of its lending and nonlending work over the last 10 years, played a substantial role in assisting the reformers ensure the irreversibility of the reforms.

The CAE divides Bank Group performance into two periods; 1991–98 and 1998–01. According to the CAE, the efficacy of Bank assis-

tance before 1998 was modest, while since 1998, the relevance and design of Bank assistance has improved considerably. We do not find this division very useful, since we think it is the cumulative impact of our involvement over the period as a whole that needs to be considered. Notwithstanding the merits or otherwise of dividing the evaluation of the Bank's work into two somewhat arbitrary periods, the unstable and sometimes chaotic environment in which the Bank worked throughout much of the 1990s must be emphasized. The breakup of the Soviet Union, the disruption of trade, the construction of a new federal political and administrative system, the need to build a market economy from scratch, massive fiscal problems, volatile energy prices, and the large-scale movements of people and dislocation of established patterns of life were the daily backdrop to the Bank's work.

The early period of our engagement in Russia was a time of great unknowns and needs, and the Bank was usually without tested reform models. We tried to respond and learn quickly in many key sectors. Some of these experiments failed, and some succeeded, but we believe strongly that essential lessons were learned—by the Bank, by Russia, and by others—and that these lessons provided the platform for subsequent reforms. The investments, advice, and dialogue that worked have had a big payoff since 1998, and this payoff far outweighs the costs of the failed efforts. We therefore agree with the CAE's conclusion that the cumulative benefit over the last 10 years of Bank operations, together with the impact of Bank advice, contributed positively to Russia's performance since 1998.

We achieved this by pursuing a high-risk, high-reward strategy over the past 10 years.

During crisis periods, we came under pressure from many sides to speed up and increase resource transfers, because of legitimate concerns regarding the geopolitical, economic, and social consequences of failure in the reform process. The debate will go on for a long time about the optimal mix of money and advice during periods of macroeconomic instability, and we readily agree that we did not always get it right. We also agree that our objectives were sometimes too ambitious, with insufficient government ownership of the needed institutional reforms. Ideally, technical assistance (TA) for institutional development should precede large-scale investment,<sup>3</sup> but investment may be important even without institutional change. For example, the two oil rehabilitation loans failed to introduce needed institutional reforms, but they did improve productivity and finance essential rehabilitation that allowed production to be maintained. TA alone to the oil sector likely would have produced neither institutional reforms nor improved productivity.

We have learned that policies, however relevant, cannot be implemented absent strong institutions, and, indeed, the Russian experience has contributed to a rethinking of the development paradigm and a rebalancing of the relative roles of policies and institutions. Also with the benefit of hindsight, we can see areas that we should have emphasized more, such as public finance and corruption.<sup>4</sup> At times, we were overoptimistic about the speed and complexity of the reform process, while we sometimes underestimated the capacity of the Russian people to undergo such a searing transformation. And arguments will continue for a long time about the pros and cons of many government actions, including the mass privatization program (MPP) and efforts to maintain the exchange rate. But the bottom line is

that by taking risks, we contributed to the irreversible transformation that has taken place.

We agree with the general thrust of the lessons learned and recommendations, and the proposed Country Assistance Strategy (CAS) for 2002–04 is largely congruent with the focal areas and instruments of assistance suggested in the CAE. However, we would caution about the CAE's approach to the question of country ownership. Country ownership is crucial to the success of assistance. But achieving country ownership requires more than paying attention to the political and institutional aspects of reforms and consulting widely. Governments and countries are usually not homogenous, and the political process is rarely so clear cut that the Bank can guarantee "ownership" in advance of lending. The Coal Sector Adjustment Loan (SECAL) II project is a case in point. This project is regarded in the CAE as best practice, and indeed it was from the point of view of prior analytical work, consultations, and design. But the project would never have started if we had waited for consensus—it was then, and still is now, highly controversial. It is clear now that privatization of the coal sector is unlikely to be reversed, but this was absolutely not guaranteed when the program started.

We believe strongly, therefore, that the Bank must play a catalytic role in the reform process, and must be prepared to act quickly and decisively should the need and demand arise. We should always try to recognize, manage as well as possible, and be transparent about risks, but we should not shy away from engagement even if broad-based country ownership is not fully assured at the outset. Country ownership should be as much the goal of our work as a *sine qua non* for our participation, and it often cannot be achieved without failures and setbacks.

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ANNEX 9: RUSSIA: IFC COUNTRY IMPACT REVIEW  
INTERNATIONAL FINANCE CORPORATION  
OPERATIONS EVALUATION GROUP

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## **Executive Summary**

### **Scope**

This review evaluates the IFC's operations in Russia from late 1991 through December 2000. It considers the IFC's strategies, technical assistance (TA) activities, investment operations, and the effectiveness of collaboration between the IFC and the Bank.<sup>1</sup>

### **Overview**

During the 1990s, the IFC devoted the bulk of its efforts in Russia to TA rather than investments. This strategy reflected Russia's needs during the first half of the 1990s, the availability of investment financing from the European Bank for Reconstruction and Development (EBRD), and the IFC's continuing concern with the high risks of investment operations in the country. By moving quickly and effectively to address strategic, high-priority TA needs in the initial years, the IFC contributed materially to Russia's transition process and earned a high level of goodwill. Opportunities for addressing core transition issues through TA, however, decreased by the mid-1990s and, in light of the poor business climate before and after the 1998 crisis and its attendant losses, the IFC was appropriately cautious in expanding its investment operations. The IFC's matching of its skills and resources to country needs and potentially viable opportunities not covered by the EBRD has been well focused and appropriate.

### **Technical Assistance Operations**

#### ***Privatization and Capital Market Development***

In the early 1990s, the IFC addressed a unique opportunity. The scope and scale of Russia's needs were unprecedented. Initially, the IFC fo-

cused on two of the biggest immediate challenges in Russia's transition to a market economy—privatization and capital market development. The IFC's contributions were on an unprecedented scale, and the results of its efforts stand among its most significant country-level achievements. In addition, the IFC's TA efforts in Russia provided the experiential basis for similar activities in Ukraine and other former Soviet Union countries.

#### ***Investment-Related***

In line with Russia's evolving needs and donor objectives and constraints, the IFC's more recent TA has addressed narrower, second-generation transition objectives for deepening the transition process. These TA operations, many of which emerged from earlier activities, have been relevant and useful.

#### ***Outcomes***

Overall, the IFC's TA activities were broadly consistent with its strategies. This review finds that when weighted by their total cost, the development outcomes of 96 percent of the IFC's TA projects (46 percent by number) have been satisfactory or better.

#### ***TA-Related Recommendations***

The IFC's past use of donor TA funds aggregated to \$47 million during the review period. It has yielded excellent outcomes, but the IFC must still be concerned with the impact of its future TA operations. The IFC should consequently assess how it can best use the human and financial resources it can devote to TA to contribute to Russia's development, without losing the flexibility to react quickly to new needs and opportunities, as it has in the past.

Table A.2

Summary of the IFC's Strategic Priorities and Results

Focus	Proposed actions	Delivery	Outcomes
Privatization	TA for small-scale privatization; privatization linked to foreign investment; privatization of trading and privatization	Substantial, except for privatization linked to foreign investment. Though not envisaged initially, assisted with voucher privatization	All satisfactory. Major impact
Financial sector development	TA for financial sector and capital market development	Substantial advice on capital market architecture and leasing legislation	Though less than hoped, outcomes of TA operations still satisfactory or better
Financial sector investments	Investments in new financial institutions and institutional building; investments, creation of investment funds, and credit lines to assist SMEs	Disbursed investments in 9 institutions (3 new) and 4 funds, but no credit lines directed at SMEs	Development outcome satisfactory for 25% of evaluated institutions and funds on unweighted basis vs. 55% for all evaluated IFC financial markets projects outside Russia; 5% for institutions and 52% for funds on weighted basis
Real sector investments	Investments in oil, gas, and other resource businesses; businesses that generate foreign exchange; infrastructure; manufacturing; emerging businesses; restructuring areas where foreign investors see strong competitive advantage and lower country risks; locally owned companies; services; SMEs	Disbursed investments in 19 ventures. Specific types of ventures approved fit the IFC's strategies in some cases but not others	Development outcome satisfactory for 50% of investments on un-weighted basis vs. 68% for all evaluated IFC real sector projects outside of Russia; 70% on weighted basis

Note: Investment disbursement data reflect approvals through 2000; outcomes relate to 20 mature investments approved before the August 1998 financial crisis and evaluated in January-April 2001.

- In particular, it should look into the possibility of a TA project to develop alternative dispute resolution mechanisms, such as third-party arbitration, in Russia.
  - It should also review the EBRD's experience to consider how best to couple TA support for small and medium-size enterprises (SMEs) with sustainable wholesale investment operations through a variety of intermediary instruments.
  - Providing donors with fuller, more objective reporting, including evaluations of all TA activities in accordance with the IFC's prescribed standards. To avoid excessive costs, however, the depth of the evaluation work and the degree of independence should depend on the relative amount of money spent on the TA.
  - Showing a greater willingness to consider donors' views on substantive matters.
  - Showing a greater sensitivity to the donors' interests in sharing favorable publicity.
- The IFC must nurture continuing donor support. Donor funding depends on a wide range of factors, including changes in donor priorities, but the IFC can reduce the risk of losing donor support by:
- In the broader context of better Bank-IFC-Multilateral Investment Guarantee Agency (MIGA) integration of efforts to improve the investment climate and financial sector, the IFC

should establish close coordination with the Bank in soliciting and using donor TA funds in relation to these World Bank Group priorities.

**Investment Operations**

**Private Investment Climate**

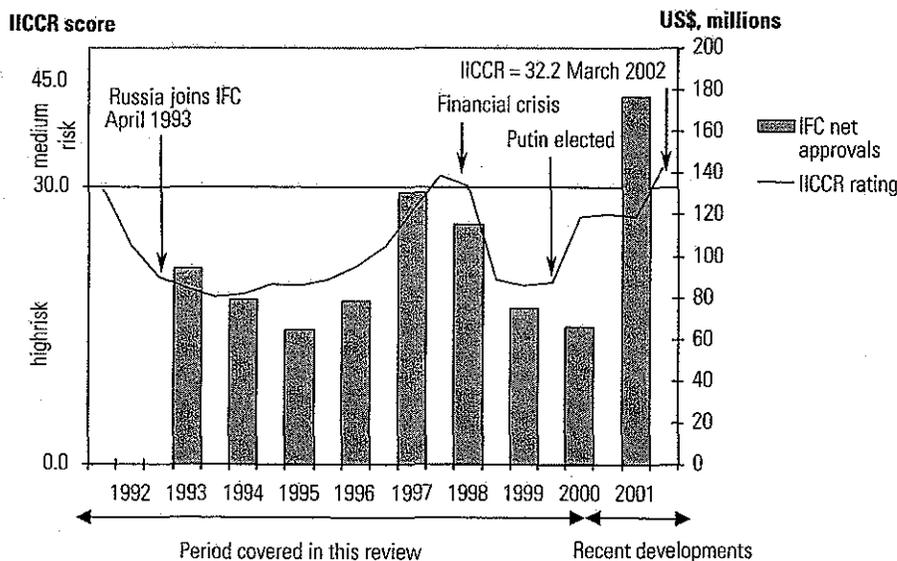
Unclear and conflicting laws, poorly defined property rights, excessive regulations, an unreliable judiciary, an inadequate banking system, corruption, opacity of ownership, corporate governance abuses, and crime have discouraged foreign investors from considering operations in Russia. Domestic investors face the same problems, and as recently as April 2001, President Putin estimated capital flight at \$2 billion a month, broadly the same as World Bank estimates. Over the past year, there have been favorable changes in Russia's investment climate. The State Duma approved legislation aimed at deregulation, the reduction of administrative and other barriers to investment and business activity, and better protection of property rights. These institutional reforms have enhanced Russia's investment appeal to financiers: both *Institutional Investor*

and *Euromoney* raised Russia's credit risk rating in their most recent (March 2002) updates. Reflecting renewed investor interest, and following a steady four-year decline, the IFC's net approvals during 2001 reached an all-time high level (see figure A.1). Serious obstacles remain, however, and if it is to sustain improvement in its investment climate, Russia must establish the rule of law through judicial reform, level-playing-field enforcement of laws and contractual commitments, and fair competition. There also remain a number of important unresolved issues in the areas of accounting and banking sector reforms, crime, and creating an SME-friendly environment, which need to be addressed to make Russia an attractive investment target and lay the basis for sustainable growth.

**Volume**

The IFC's net approvals for investments in Russia during FY93-00 totaled \$0.71 billion in 48 enterprises, putting Russia 10th between Thailand and Korea among the IFC's 15 largest countries of operation (by size of the economy) for the period. Net of droppages and cancellations, the

**Figure A.1** Russia: Institutional Investor Country Credit Rating (IICCR) and IFC Net Approvals



IFC made 37 commitments totaling \$0.51 billion in 34 companies, financial institutions, and investment funds.

### **Constraints**

Except for oil and gas, private sector investment has been small, and foreign companies have been wary of investing in Russia. Russian companies have often resisted restructuring or have been tainted by corporate governance abuses, opacity of ownership, or even links to criminal activity. The EBRD has been available to meet the financial needs of most projects having reasonable success prospects—through 2000, the EBRD committed \$3.66 billion in 112 private sector investments in Russia, more than seven times the scale of the IFC's investment volume.

### **Outcomes**

The overall record of the IFC's mature investments is poor. Only 35 percent (57 percent by value) have yielded satisfactory project development outcomes, and only 20 percent (40 percent by value) have yielded satisfactory investment outcomes for the IFC. In contrast to the IFC's worldwide evaluated sample, where development-investment "win-win" outcomes are the primary outcome category (42 percent of cases), in Russia, "lose-lose" outcomes have predominated (65 percent of cases). The EBRD's experience has paralleled the IFC's, but on a significantly larger scale. Had the IFC invested before the 1998 crisis in projects that it considered but dropped for reasons of perceived reputation, investment, and/or development risks, the likelihood is that their outcomes and the IFC's aggregate losses would have been worse. The IFC's caution in making investments was prudent in the circumstances and reflected a successful and laudable resistance to external pressure and internal approvals incentives.

### **Profit Contribution**

The IFC has suffered a negative net contribution from its operations in Russia.<sup>2</sup> Of the total negative contribution, 44 percent was from net loan and equity losses, 32 percent from related administrative expenses, and 24 percent for TA-related execution expenses.

### **Outcome Drivers**

The performance of the IFC's investments in Russia largely reflects the types of businesses in which the IFC invested; the partners and managers with which the IFC collaborated; developments in the Russian economy (especially the 1998 crisis); issues related to government, governance, and crime in Russia; and the related learning curve for the IFC's own work quality, especially in screening, appraisal and structuring.

### **Looking Ahead**

The challenge the IFC faces in Russia today is to base its investment strategy and judgments on future prospects while bringing to bear past lessons. While important impediments remain, foreign financiers perceive that Russia's enabling environment has been improving recently. Reflecting better post-crisis selectivity coupled with these changes in the enabling environment and the improved economic conditions in Russia, the current combined credit ratings for the IFC's Russian investments closely approximate those of the IFC's overall portfolio and are significantly better in terms of the weighted proportion of substandard investments. As a result, past performance may not be a harbinger of future outcomes. The IFC must monitor developments and should be prepared to move quickly (as it did in 2001) as opportunities and conditions allow, signaling through judiciously selected investments its confidence in the prospects for Russia's private sector development (PSD).

### **Investment Recommendations**

On a more specific level, the IFC should consider:

- Concentrating its promotional efforts mainly on oblasts with a good business climate (subject, of course, to private investors' being interested in investing in these oblasts): A selective approach may reduce the riskiness of the IFC's operations and may even encourage improved behavior by regional governments, particularly if the IFC makes clear the linkage between the business climate and the oblasts in which it will focus its investment promotion activities.
- Ensuring that it promotes good practice in front-end work and applies past lessons: The IFC's regional department should lead periodic

workshops that focus on past lessons learned that are specific to the Russian environment and relevant to current operational activity. Participation could include other PSD finance institutions active in Russia together with IFC B lender banks to capture as wide a range of experiences as possible. Past lessons should be carefully considered and applied, particularly in front-end work.

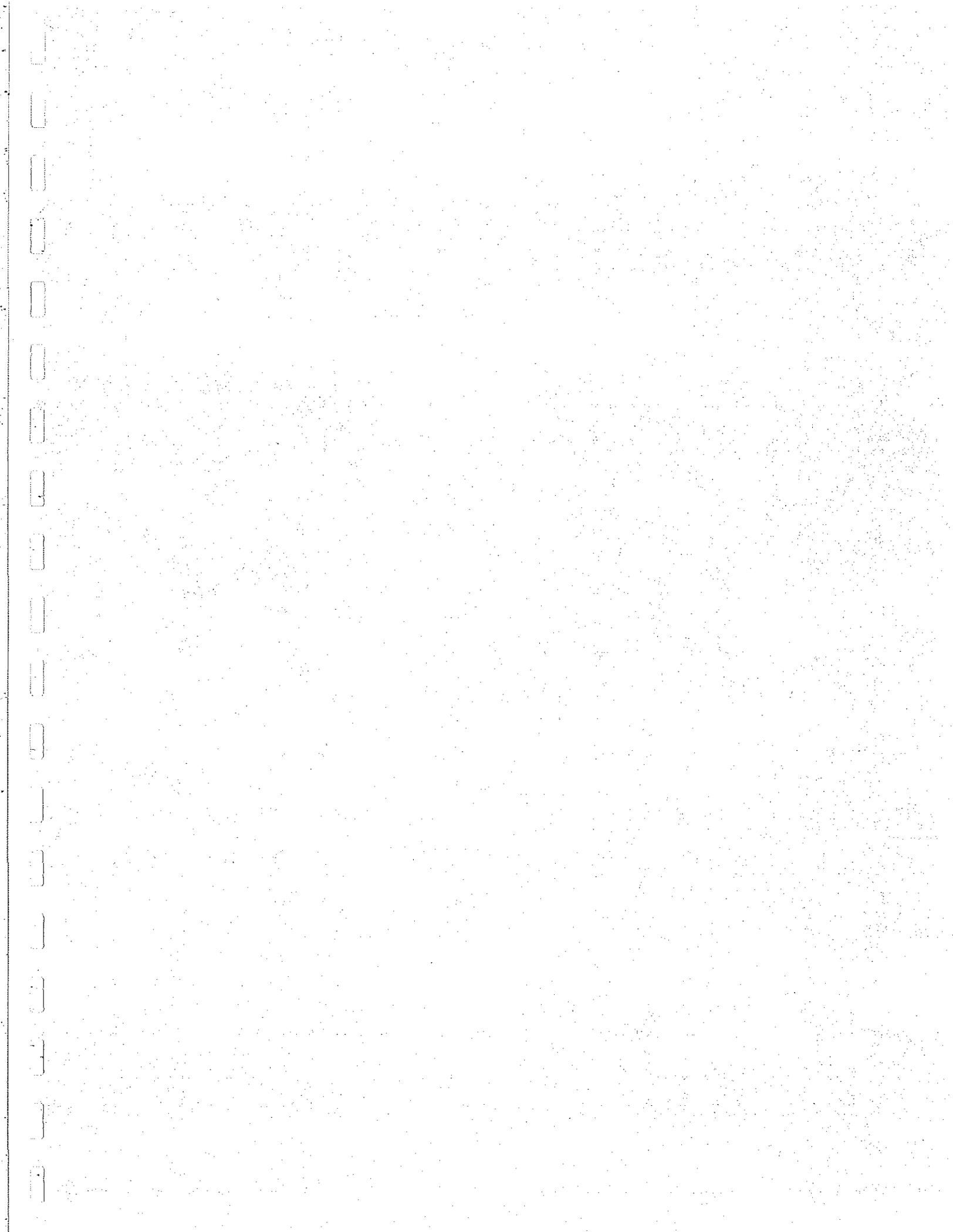
- **Increasing its efforts to finance Russian-sponsored businesses:** The IFC should not completely exclude the possibility that some financial-industrial groups may become reliable business partners. Moreover, it should get to know medium-size Russian businesses, particularly those based on Russia's highly trained technical manpower. The IFC should continue its efforts to assist financial intermediaries that can provide financing to larger numbers of Russian enterprises, and to use TA funds to develop local suppliers for large enterprises.
- **Giving greater attention to SMEs:** The EBRD has indicated to the IFC's G-7 shareholders that its experience with lending to SMEs through intermediaries has been successful. This evaluation has not encompassed the EBRD's experience beyond its reported overall success rates and loss experience, but the potential importance of the SMEs sector, and the challenges of developing sustainable wholesaling channels, call for the IFC to devote greater attention to it, as it has recently begun to do.
- **Playing a more active role in developing Russia's capital markets by exploring the possibil-**

ity of (a) issuing ruble bonds itself or providing partial credit enhancement for ruble obligations (as it is now considering) and (b) exploring the possibility of establishing insurance companies and pension fund management companies. The development of Russia's capital market is now constrained by the demand for and supply of long-term instruments. The IFC should seek to address both constraints.

- **In the context of the joint CAS and its pursuit, developing jointly with the Bank and MIGA a coordinated approach and division of labor for addressing obstacles and promoting improvements in the investment climate:** The World Bank Group must be more effective than it has been to date in realizing synergies from its substantial skills, experience, resources, and leverage potential for catalyzing change. The way forward lies in introducing coherent incentives across the three Bank Group agencies around shared priorities for sustained, mutually reinforcing pursuit of actions for improving the investment climate and banking system.

#### **General Recommendation**

Looking beyond Russia, the IFC should consider applying the positive lessons of its strategy pursuit in Russia in other early transition countries, by taking stock of country strategic needs and investment climate risks, bringing to bear its lessons learned in Russia, and shifting its resources nimbly between investment and strategically targeted TA operations as volatile country conditions and opportunities evolve.



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## ANNEX 10: VIEWS OF EXTERNAL ADVISERS AND OTHERS

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### **Professor Gur Ofer (external adviser) New Economic School (NES) Moscow, Russia**

I find the Country Assistance Evaluation (CAE) by OED on Bank assistance to the Russian Federation very good and mostly accurate and balanced, in the description of the transition in Russia over the last decade, in the evaluation of the successes and failures of the reform, in the overall impact assessment, and in the discussion of the roles played by the main players. In particular, I appreciate the ability to criticize the role of the Bank when it was warranted. The project ratings assigned are mostly accurate and fair. The evaluation confirms the general perception that the success of transition in Russia depended primarily on what Russia and its governments were able to achieve. The Bank's efforts were well intentioned, but could not go beyond what the client was ready to own. Both Russia and the Bank made many mistakes and could have done better. Still, with the help of the international community, Russia managed to pull itself out of the old regime and initial disorder and to put a solid foot on the way to a market economy.

However, I also find that the revisions and cuts in preceding versions of the Executive Summary, Chapter 1, and Chapter 4 diluted the key messages and weakened their "bite" significantly. In these three chapters, there is less detail, use of more general terms to indicate failures, and a somewhat rosier overall picture when compared with earlier drafts and with what I believe is the case. When one reads the Executive Summary after reading the full report and its annexes, one finds almost everything in the summary. However, if one reads the summary before reading the full

report, or instead of doing so, which many might do, one receives a somewhat rosier picture of what happened and of the Bank's role. The relegation of parts of the story of the transition in Russia (in Chapter 1) and of the development impact of Bank assistance (in Chapter 4) to Annexes 1-5 also fragmented the flow of the narrative and made it more difficult for the reader to follow the complex interaction between domestic developments and the role of the Bank.

There are many factors that made Russia (and most Commonwealth of Independent States [CIS] countries) a more difficult transition case than most of the East European economies, and this is described in the report (Annex 1). The reform in Poland may have created overoptimistic expectations, and the earlier attempt to emulate it may have caused more negative consequences than expected. Given the more severe initial conditions, including political ones, and the special global status of Russia, one may conclude that Russia emerged after 10 years of reform better than could have been expected. Still, many mistakes had been made, including by the Bank. The most important oversight of the Bank was that it failed to appreciate the especially difficult and complex situation (historical, political, social, and psychological) presented by Russia, including the deep feeling of humiliation for the collapse of the empire, in contrast with the feeling of liberation in East Europe. The Bank therefore failed to tailor a specific assistance paradigm that will take Russian complexities and sensitivities into account.

Chapters 2 and 3 are good. Early on, it became clear that Russia is a special case in many respects and that lessons from other developing countries may not be enough. This should have justified a significantly higher budget for eco-

conomic sector work (ESW) preparation, technical assistance (TA), supervision, and deeper research work. In 1997, the special research division that provided research and support for transition work was closed. The decision to move more operational work to the Moscow office and to give it more authority was correct, albeit late. It is not clear at this point to what extent the plan was implemented fully, not only in terms of number of staff members but also in terms of real decision power.

Chapter 5 is focused and fair. It needs a specific paragraph that discusses the nature of the implementation difficulties and lack of willing ownership encountered by the Bank staff. More such difficulties had to be anticipated, at least after a while, and more projects rejected not as inadequate but because of weak commitment and dedicated domestic owner and/or as nonimplementable. It was and still is the responsibility of the Bank staff to determine implementability. Therefore, when the implementation fails in otherwise good projects, it is also their responsibility.

Chapter 6 incorporates the lessons from previous failures (and achievements). It emphasizes domestic ownership, even matching as a precondition (as with respect to the highly needed banking reform); more careful examination of implementation potential; higher level of conditionality, partly through the segmentation and stepwise execution of larger projects; and a sharp increase in analytical and research work and training, with an emphasis on the institutional dimension of projects.

Chapter 4, together with a number of annexes, discusses the main policy packages of the transition process in Russia and the involvement of the Bank. The emphasis of the Bank on institutional development, especially in the public sector but also in the social sphere, came late. More emphasis on these two areas at an early stage could have improved the transition process significantly. Recommendations in these directions are included in the CAE. Unfortunately, the outcome table and other project ratings are relegated to annexes.

What follows is a more detailed discussion of a few major reform areas where I disagree with the main thrust of the OED report.

### **Privatization and Its Aftermath: The Crisis of 1998**

The discussion of the privatization process in Russia (mostly in Annex 1) is balanced and correctly presents the systemic, economic, and political constraints under which the mass privatization via vouchers was decided upon and implemented. The report also mentions some of the serious negative consequences that followed and the heavy price paid later, in lack of proper corporate governance, little institutional development, minimal restructuring and investment (including foreign), and the growing phenomena of arrears, nonpayment, and barter and their fiscal consequences.<sup>1</sup> The report mentions that there was a lot of enterprise "stripping," also under the voucher scheme, not only before, and that this gave a bad name to the process. There is also an appropriate emphasis in the report on the political motivation of the choice. There is, however, little or no mention of two consequences of the chosen mode of privatization—first, the very serious political fallout and the loss of a chance for political consensus on the reforms (see more in the discussion of the counterfactuals below), and second, the negative developments in the real sector were a major cause of the 1998 crisis, maybe more important than the fiscal and other causes mentioned in the report.

The report mentions the difficulties caused for the Russian economy by the overvaluation of the currency during the mid-1990s and also the beneficial influence of the real devaluation, one of the consequences of the 1998 crisis. It is somewhat ironic that that one of the most beneficial impacts on the recovery of the Russian economy came about as a consequence of a crisis that everybody tried to prevent, rather than as a response to an initiated policy by the government or a strong policy recommendation by, for example, the Bank.

### **Financial Sector Development**

A well-operating financial, especially banking, sector is essential for the restructuring of the Russian economy. The report emphasizes the institutional weakness of the financial sector throughout the period, but there is not enough

emphasis on the fact that, even with much better regulatory and cultural environment than were available, there were not enough know-how and skills in Russia to properly perform market-oriented banking services. In this respect, the early evaluations by Bank staff of the capability of the banking sector to improve and to fulfill its very important role were much too optimistic. This is why an early opening up to foreign banks, with active government support, might have helped, first to do the job and second to help train and upgrade domestic banks. It has to be admitted, however, that any such move would have encountered a strong resistance by the domestic banks, the central bank (until very recently), and the "nationalistic" political forces (see counterfactual discussion below). In many transition economies in Central and Eastern Europe, foreign banks now own most or even the entire banking sectors, with beneficial consequences. This should have happened in Russia (and in the above-mentioned countries) much earlier.

#### **The Counterfactual (Chapter 5 and Annex 7)**

There are two levels of the counterfactual story, that of the reform in Russia and that of the involvement of the Bank. For the reform program, one can offer many improvements: in the privatization program, financial sector reform, fiscal behavior, institutional reform, and so forth. A somewhat slower privatization process with fewer insider schemes, preceded by a serious bank reform that included bringing in foreign banks, could have reduced the extent of the "virtual economy" syndrome and achieved a better fiscal stance in earlier stages—a stance that could have been used to mitigate the social outcomes and the extent of poverty. A more careful exchange rate policy could have, with all the above, avoided the crisis.

The political instability and policy oscillations should be partly credited to the personality of President Yeltsin and to the ruling culture that he brought with him from the old regime. Still, had there been more attention paid to the social strife and to measures to mitigate it, there could have been a higher degree of political and social consensus, less rule by decree, better

democratic processes and, possibly, less need to rely on the oligarchs and buy their support with the corrupt loans-for-shares (LFS) scheme. Despite all the fears, the near-communist Primakov government, after the 1998 crisis, did not reverse any of the reform steps taken and maintained a relatively solid fiscal stance. Even the idea of creating state development banks didn't fly. Couldn't an effort at building political consensus have been attempted earlier?

What could the Bank have done better (other than doing everything a little better)? I agree with most of the CAE's suggested alternatives, such as the avoidance of some major loans in the mid-1990s; making more grants for technical assistance (TA); avoiding going into projects with no clear Russian ownership and low chances of satisfactory implementation (which constituted the majority of the projects); anticipating the crisis, even at the earlier stages of the emergence of the virtual economy; and so forth.

The Bank could have made a difference in the early 1990s with more money. The huge sums mentioned in Annex 7 were, of course, unrealistic. However, substantial aid until a better fiscal balance could have been achieved might have been possible (with all the other donors together). The Bank put too much emphasis on a small budget as compared with a balanced one. Campos (1999) found evidence that in transition countries, government expenditures are positively, not negatively, associated with economic growth in transition economies. A position by the Bank that a balanced budget is more important than a small one had the potential to create more public resources for social support, thus also mitigating the discontent and the fear of a communist takeover and contributing to a higher level of political consensus.

**Leonid Polishchuk (external adviser)  
Project Director and Research Associate  
Center for Institutional Reform and the  
Informal Sector (IRIS)  
At the University of Maryland, United  
States**

The evaluation candidly acknowledges that a very limited country knowledge and little prior

experience of assistance in post-communist economic transition were available at the beginning of the Bank's involvement in Russia. However, over the last decade, such knowledge has been steadily increasing, by way of learning by doing, through numerous studies of Russian reforms, and from international comparisons. This evolving knowledge background is important for evaluation of the Bank's Russian programs, as it allows identification of "second-best" benchmarks reflecting the level of understanding of the situation at the decisionmaking time.

The original choice of main thematic priorities by the Bank, which emphasized institution building, private sector development (PSD), and social safety nets, was fully justifiable in the early 1990s, and remains so in hindsight. Although the Bank was slow to reflect the need to pay greater attention to public sector management and accountability in its assistance programs, necessary adjustments have eventually been made.

However, until late 1999, the progress in the above areas remained modest, and the programs of the Bank had little impact on unlocking the policy reform stalemate that prevailed for most of the decade. Moreover, at times politically motivated "quick fixes" offered by the Bank without necessary conditionality prolonged the impasse by softening policymaking constraints and undermining the credibility of the reform programs.

The Bank can take credit, at least in part, for the accelerated reforms after 1999, when many of the policies that it previously advocated and helped develop have been finally put to work. Critically important conditions for this breakthrough were stronger political will and social consensus for reform, missed for most of the past decade. These ingredients for successful transition were supplied "exogenously," with no immediate relation to the Bank's earlier efforts.

The report concludes that the Bank "did not command the resources or the influence to overcome the unprecedented [domestic sociopolitical] constraints"—an argument intended to vindicate the strategy of waiting for winning conditions while accumulating the stock of policy blueprints that would be available when a win-

dow of opportunity opens up. It could be argued, however, that support in the society for reform and reform policies themselves are complementary factors of successful transition. This leads to the question of whether it was prudent for the Bank to concentrate large resources on the latter of these ingredients, while conceding that the former is beyond any significant influence. Evidence of this stance includes the downgrading of the initial social protection programs aimed to provide safety nets at the early stages of transition to small-scale technical projects, such as procurement of computers for pension administration offices, and the general inclination to respond to a lack of reciprocity and commitment in implementation of social programs by reducing such programs to purely TA efforts. The massive privatization—another major program that was intended to broaden support in the society for the new economic and institutional order and to which, admittedly, the Bank's attitude was ambivalent—has led to the opposite results, leaving widespread resentment and contempt.

While much of the report deals with the assessment of risk associated with various Bank projects, it remains silent on whether the overall approach of betting on exogenous emergence of domestic winning conditions was excessively risky. This is not a purely counterfactual inquiry relevant solely for the assessment of earlier policies—the report itself acknowledges that "the resilience of [the recent policy reform] achievements to external shocks" remains "an open question." It would have been also useful to discuss what, if any, means the Bank could have deployed, given the constraints of its status and role, to advance the emergence of the winning conditions as an explicit programmatic objective.

Overall, the report provides a balanced, accurate, and fair assessment of the World Bank's programs in Russia. It is useful and relevant not only in retrospect, but for the future involvement of international donor agencies in Russian reform. Some of the conclusions of the report, such as the importance of domestic ownership and capacity, and the role of political constraints, as well as an assessment of the Bank's efforts to

reflect these factors in its programs, highlight useful lessons for policy reform and development around the world.

**Ivan Szegvari (external adviser)  
Senior Country Economist  
European Bank for Reconstruction and  
Development (EBRD)  
London, United Kingdom**

The evaluation report is a very well-written, informative, and balanced evaluation of the first decade of Russia's economic transition and the World Bank's role in this tumultuous process. I fully share most of the conclusions of the report, including the general assessment according to which the modest but cumulative benefits of the Bank's operations, together with the positive impact of its advisory activities, contributed to building the foundations for Russia's recent turnaround. Educating a generation of experts and policymakers and providing support for the reformers in crucial periods is, in my view, the key component of this contribution.

Russia's transition, the report rightly claims, involved and still involves an extraordinary challenge. The only thing I would have emphasized more is the inherent lack, in the case of Russia, of a longer-term integrating objective, a shared vision, and a powerful social and political cohesive force, like nation building and the European Union (EU) accession have been for the Central European countries and the Baltics.

I guess that the single most debated sentence of the entire report will be the one related to the policy dilemma during the runup to the 1998 crisis: "In hindsight, Russia would have been better off by allowing the currency to float while pledging to address fiscal and structural reforms." I am not sure. The actually available policy choices at that time were much more complex and formidable than that. The alternative was definitely not a simple change in the exchange rate regime combined with some recalibration of the reform agenda. The devaluation was generally seen (partly because of the huge foreign currency exposure of most of the large banks) as a policy step inevitably leading to the collapse of the banking system, to the loss of credibility of the

pursued stabilization course and the entire reform process, and to a deep political crisis. We all know now that all this happened anyway. We also know that the overall implications of the crisis turned out to be in many respects less damaging than thought—or even salutary. It does not change, however, the then-perceived policy-making constraints, assumptions, and expectations—that is, the actual circumstances of the decisionmaking process.

Related to the international dimension of the above policy dilemma, the same paragraph continues: "But many other influential commentators and market analysts were arguing for a bailout and the Bank had no direct responsibility for the macroeconomic and financial aspects of the program." I think the first part of the sentence is a bit of an understatement. Those influential commentators included the U.S. and German presidents, the undersecretary of the U.S. Treasury, and the deputy managing director of the International Monetary Fund (IMF), among others. The second part suggests that the Bank as an institution had a different view about the bailout. If I am not mistaken, the differences in views were about using the international financial institutions (IFIs) as a channel for a clearly politically driven rescue program (and the associated double-standards) and not about the necessity or desirability of the bailout itself.

I like more the reserved tone of another related assessment of the report: "It is unclear whether an easier transition path could have been found given the initial conditions and the political realities." Yes, a large dose of intellectual modesty is warranted when it comes to our understanding of the dynamics of the Russian transition process. Despite the benefits of hindsight, Russia's history remains full of surprises. Who would have thought the speed of political stabilization since late 1999 was possible? Who would have dreamed that a full-fledged radical reform program was feasible, even in early 2000? Who would have expected the post-crisis government to implement the tightest financial policies since the start of the transition process?

"The key lesson of the Bank's experience in Russia is that country ownership is crucial to the success of assistance." I could not agree more.

However, I have a slightly different interpretation of what follows from that. First, what exactly does "country ownership" mean in the case of pre-crisis Russia, given its divided government, the unpredictable president, and the enormous political opposition to the stabilization and reform process? Given also the geopolitical context and implications of Russia's transformation, the IFIs support of the reformers and their agenda under these circumstances was a risk worth taking—in fact, a risk that had to be taken. Moreover, if we push the ownership lesson too far, we may end up saying—rather unhelpfully—that assistance should be delivered and will be most successful when there is no need for it.

When discussing the effectiveness of Bank assistance, the report states in several places that instead of the large policy-based lending programs, the Bank should have relied more and mainly on policy advice. I think the report has a somewhat romantic view about the potential role of policy advice, especially in the context of the 1997–98 pre-crisis developments. It basically assumes that there were ready-made good policy recipes waiting to be communicated to and implemented by the Russian policy-makers. With the possible exception of the first years of transition, the lack of policy advice has never been to my knowledge a serious decisionmaking constraint. By the latter part of the 1990s—thanks to, among others, the Bank-established Bureau of Economic Analysis—the Russian experts and politicians were already in a much better position to make informed judgments about their realistically available policymaking choices than any outside adviser or organization. What was missing above anything else was the coun-

try ownership of their stabilization and reform program and, closely related to that, their policy implementation capacity.

**Marek Dabrowski (contributor to the Country Assistance Evaluation)  
Deputy Chairman  
Center for Social and Economic Research  
Warsaw, Poland**

I found the CAE draft to be a well-balanced and very well-written document.

I generally support the decision to divide the analyzed period into two subperiods and agree with the views on Russia's and the Bank's contributions to the overall improvement of the economic and political situation, greater domestic consensus around reform-oriented policy, and greater ownership of the reform as expressed in the Executive Summary, Chapters 4 and 5 of the main text, and Annex 8.

The political changes after the December 1999 Duma elections and the March 2000 presidential elections became the most powerful factor behind the more comprehensive and consistent reform strategy of the government in recent years, in contrast to the earlier periods. External conceptual contributions, including that of the Bank (even when cumulated from previous years, like the conditionality of Structural Adjustment Loan [SAL] III) were helpful to the government in designing its reform program and concrete actions, but cannot be seen as the primary factor that influenced the course of events. In fact, the same good policy advice did not have a chance to be implemented earlier because of the political obstacles.

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**ANNEX 11: RUSSIAN FEDERATION GOVERNMENT VIEWS**

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**Transmittal Letter**

March 26, 2002

Mr. J. Linn  
Vice-President  
World Bank

Dear Mr. Linn,

On instructions of the IBRD Governor for the Russian Federation, Mr. V. B. Khristenko, I have enclosed comments of the Government of the Russian Federation made on the paper "Russian Federation: Country Assistance Evaluation" that was prepared by the Operations Evaluation Department.

Please take into account the submitted comments during the review of the report "Russian Federation: Country Assistance Evaluation."

Sincerely,

A. Bugrov  
Executive Director of the World Bank for Russia

**[Abridged] Comments of the Russian Federation Government on the Report "Russian Federation: Country Assistance Evaluation" of the Operations Evaluation Department of the World Bank<sup>1</sup>**

**Basic Conclusion**

We take a generally positive view of the proposed draft document, which relies on an analysis of the concrete circumstances influencing the operations of the World Bank Group in the Russian Federation and offers a well-balanced assessment of their results. The document presents a sufficiently objective picture of developments in Russia over the past decade and outlines the factors behind the Bank's successes and setbacks. The recommendations offered as to further areas of the Bank's operations in Russia generally do not conflict with the views of the Russian leadership and, to a greater extent, coincide with the provision of the Program for Russia's Cooperation with the Bank that has been recently approved by the government. We hope that these recommendations will be fully taken into account as the Bank's new Country Assistance Strategy is drafted for Russia.

At the same time, there seems to be room for improving the document. Below are our comments, which could be taken into account in finalizing the document.

**Evaluation of the Reform Process in Russia in the 1990s**

The Executive Summary, the Introduction, and Annex 1 attempt to analyze the reform process in Russia over the past decade. Overall, we share most of the assessments, but the following points deserve attention.

The authors say that "the Russian transition has been more difficult than expected" (Executive Summary). [This reference has been qualified in the CAE in response to the comments that follow]. But in fact, the opposite argument would be more valid: transition to the market that involved dramatic changes in the government and political setup has been generally more smooth and trouble-free than many people would expect. Ten years ago, apocalyptic scenarios of inevitable chaos, famine, and civil war across the expanses of the former Soviet Union were commonplace.

That they have been forgotten today is evidence of successful transformation. An alternative scenario of a smoother progress of reform than that which has actually taken place would be an abstraction. The document itself bears evidence of how difficult it is to formulate a univocal assessment of the progress of reform in Russia. For example, contrary to the authors' above assertions, they say in Annex 1 that "the progress to date was unexpected by most observers.... This is a [changed to match current text] historic achievement to be." [This reference has been edited out from Annex I.]

Nor can we agree with the statement that all the reform programs attempted in Russia until the late 1990s failed. Although some of them were not fully implemented, for various reasons, a continuous trend for carrying on transformations was generally in evidence. There is every reason to believe that not a single program of reforms has ended in failure, that is, in a slip to the past or reversal of any measures taken earlier. [In response to this comment, the CAE now refers to lack of implementation instead of failure of programs.]

In this context, the statement to the effect that "through late 1999 there was a chronic risk of backsliding" seems absolutely groundless. Moreover, that statement is effectively then denied, with the admission that "throughout the 1990s Russia stayed the course in its economic and social transformation." [Text has been modified in response to this comment.]

The interpretation of the political processes is simplistic and misrepresents the nature of real Russian democracy. Characteristically, the document takes a negative view of the rise of open contradictions between the State Duma and the Russian Federation government, while stating that "the Bank paid limited attention to checks and balances." In our opinion, these two statements are in serious conflict. [See Chapter 1, note 2.]

We take exception to the approach characterizing the year 1998 as the divide between six

years of "wasted time" and the subsequent period of accelerated structural reform. In our view, the economic developments of 1998 offered an opportunity to make better use of the potential of reform built up over the preceding period. The consequences of the 1998 crisis included a dramatic change in the domestic structure of relative prices that triggered the restoration of the normal discipline of payments and tax collection and also helped rid the budget of the unbearable burden of debts, one result of the latter being a substantive streamlining of expenditures. However, the institutional and structural preconditions for this positive change had been put in place before 1998.

Finally, the 1998 crisis provided evidence of the most important achievement of the preceding period, namely, the ultimate victory of anti-inflationary approaches in formulating monetary and fiscal policies.

It is these conclusions that are prompted by the sufficiently convincing outline of reforms set out in Annex 1. In this sense, we share the better-balanced position of the ECA Region, presented, in particular, in note 12, Chapter 4.

### **Assistance Efficiency Evaluation**

We have some doubts about the results of project evaluation as presented under "Closed Project Performance." They seem to suggest that the evaluation methodology used does not take full account of the comprehensive character of the Bank's operations, overall results of projects implementation, and specifics of the conditions for their implementation in Russia.

We believe that the retrospective analysis of the Bank's possible operations scenarios in Russia, in particular, the hypothetical option of the prevalent use of technical and consultative assistance with limited loans, is one-sided. The position of the ECA Region seems to be more realistic. In our view, financial support, including support for the budget, provided by the international community at crucial junctures of Russia's recent history played a certain, though not decisive, role in strengthening the consistent course of reform and structural change. Apart from that, in the absence of a vigorous lending program, the very possibility of the Bank's effi-

cient technical assistance to a country whose institutions and economy were in fact a mystery to the Bank is rather doubtful. The principle of adaptive learning through practical operations remains valid both for the borrowing countries and for the Bank itself.

We would expect the document primarily to offer a more detailed and critical analysis of decisionmaking processes not only in the borrower country, but also in the Bank itself, which would better conform to the character of the document. Nevertheless, the institutional misjudgments of the Bank itself are often explained away in the document through extraneous circumstances (such as "pressure from shareholders"), while the numerous objective problems confronting the democratic government in a country going through dramatic political, social, and economic transformations are taken into account to a lesser extent.

### **Cooperation Aspects Not Covered in the Bank's Report**

In our view, some important aspects of Russia's cooperation with the Bank have not been adequately appreciated.

Generally speaking, one of them is such a fundamental fact as the very rapid process of transition from the planned economy to the market. The successful experience of such transformation, carried out both in Russia and in other transition economies during the 1990s, is substantially different from the practice of transformations supported by the Bank in other regions throughout the more than 50 years of its existence. In a short period of time, many countries have traveled the road from joining the Bank to restoring sustainable economic growth and gradually cutting back on the Bank's loans. It would seem that no other group of borrower countries (including industrialized nations that actively used the Bank's resources all the way until the 1970s) made such progress so speedily. This unique achievement gives us reason to assess the operations of international financial institutions in Russia and other transition economies as generally successful.

As Russia's conduct as an individual borrower is analyzed, we would hope for recognition of the

country's unique achievement in overcoming the 1998 crisis. Out of the large number of medium-income countries that went through crises and dramatic devaluation during the 1990s, Russia was, perhaps, the only one that was actually cut off international financial assistance during its most difficult time of trial. The repeated positive appreciation of the Russian authorities' actions after August 1998, we think, should include mention of that fact. [This has been noted in the "Recent Achievements" section in Chapter 1.]

Finally, at the level of concrete developments mentioned in the document, it would seem appropriate to lay additional emphasis on the fact noted in Annex 6. Indeed, in spite of the repeated accusations that the Russian side has been misapplying the Bank's funds, a thorough investigation has confirmed that "they were fully accounted for and used in accordance with loan agreements." Nevertheless, the Russian side agreed to additional measures of control over the application of the Bank's funds. [This has been noted in Chapter 4 in response to this comment.]

The document lacks a detailed analysis of work with the SAL III. In our view, that work has laid bare serious problems in preparing such Structural Adjustment Loans, problems that could be important to the Bank as a whole; these include, in particular, inefficiency caused by excessive loan conditionalities and excessively broad coverage of many sectors simultaneously. [See note 6, Chapter 5.]

### **Issues of Implementing Bank Operations in Russia**

It should be frankly admitted that many of the Bank's operations in the key sectors, such as the financial one, did not rely on a thorough understanding of the existing problems. That fact was partially admitted by the Region in the 1999 interim CAS. We agree that the Bank's applied research program for Russia needs to be revitalized considerably, which calls not only for adequate financing under the administrative budget, but also for a more extensive use of local researchers and consultants. The program should be coordinated more closely with the Russian Federation government, fully meet its pri-

orities, and make better use of Russia's research potential. Positive developments in that sphere inspire certain optimism.

The quality of the Bank's Russian projects portfolio is a constant subject of discussions between the Bank and the Russian Federation government. A relatively high share of problem projects is due to factors on the side of both the borrower and the Bank itself. Box 3.3 offers a generally adequate reflection of the views of the Russian Federation government as regards the management of the projects portfolio. There are quite a few unresolved problems in this sphere, including, in particular:

- High costs and poor quality of project preparation
- The role of project implementation units and their relationships with line ministries
- An excessively high share of administrative expenditures in project costs
- An excessively high cost of the services of consultants recruited for the implementation of the Bank's projects in Russia—such costs are often incomparable with the amount and quality of the services rendered
- An excessive share of expenditures on technical assistance both under individual projects and the portfolio as a whole
- The financial sustainability of projects implemented through subloans to end borrowers.

The problems also are the focus of internal discussions in the government. Lack of a streamlined and efficient mechanism of project evaluation and implementation is the most sensitive aspect of the Bank's relationship with the Russian Federation. The Russian side has a great interest in technical assistance and in gaining cutting-edge experience in organizing such a system. In particular, we would expect the Operations Evaluation Department to offer a more in-depth analysis of project implementation. Regrettably, the report does not pay sufficient attention to this aspect.

### **Sector-Based Country Assistance Strategy**

We for the most part agree with the assessments of the results of the Bank's activity in individual sectors.

As regards the Bank's contribution to the private sector development, the authors are correct in saying that the contribution could have been weightier if the Bank had had a more critical attitude toward the issues of providing transparency of privatization measures. Furthermore, the Bank should have insisted with greater resolution on providing a linkage between the privatization programs and creation of an adequate legal and regulatory environment for the development of the private sector.

In the financial sector, where the outcome of the Bank's activity is the least impressive, the authors correctly note the shortcomings of the Financial Institutions Development project, including the inadequate process of accreditation of commercial banks and poor coordination with the Bank of Russia. Many of the participating commercial banks are known to have gone bankrupt during the 1998 crisis, which affected the Bank's reputation and brought about large financial losses for Russia. It should also be noted that the costs of project administration (which was done by the consulting firm Arthur Andersen) amounted to a record high share as compared with Bank's other investment projects in Russia.

We believe that the failure of the project is explainable; apart from the structural and managerial problems inside Russia and the exogenous factors, with low quality of project preparation and management, insufficient knowledge, and lack of practical experience on the part of the Bank staff. We are aware that similar problems occurred elsewhere in the world, too, which reflected the little attention that the Bank generally paid to the development of the financial sector. In our view, the current level of the Bank's efforts in this sector does not yet correspond to its significance for the future sustainable development of Russia.

The authors correctly note that at the initial stage, until 1998, the Bank did not pay proper attention to the issues of providing proper quality of the state administration system, including management of state resources and reform of the civil service and legal system. This considerably worsened the efficiency of the Bank-financed programs. We are satisfied that at present the

Bank is actively repairing the omission and puts these issues on the top of its agenda in Russia.

The Russian party generally appreciates the Bank's contribution to the reforming of the social sector. Its accomplishments in this area are quite rightfully noted. It should be also mentioned, however, that after the 1998 crisis, which entailed a steep worsening of the standards of living, the Bank reduced the overall volume of lending to Russia without offering any supplementary assistance to mitigate the social consequences of the crisis.

We are ready to agree with the authors' conclusions that the goals of the Bank's activities in Russia set 10 years ago proved to be too ambitious compared with the outcomes. At the same time, we believe that the insufficiently impressive results of the Bank's activities are more than offset by the irreversibility of the reforms catalyzed with Bank participation. The dialogue between the Bank and the Russian Federation government on the key issues of the structural reforms, development of the social protection system, improvement of the investment climate and business environment, and improvement of state institutions, as well as the implementation itself of the Bank projects in Russia, is known to have significantly promoted the general progress of the country along the track of transformations, which led to adoption and launching of implementation of the current program of the government of the Russian Federation that incorporates many of the Bank recommendations.

#### **Coordination of International Assistance to Russia and Project Quality at Entry**

The authors of the report correctly point out the lack of an efficient mechanism for coordination of international assistance rendered to Russia, which caused significant dissipation of resources. The lack of coordination brought about a situation where similar technical assistance projects or applied research programs would be implemented in the same sectors or regions at a short time interval between those, whose results nobody controlled or used. Often the Bank insisted on Russia borrowing its funds to finance technical assistance or project preparation programs despite the fact that similar projects had already been implemented with the help of other donors.

As regards the assessment of the activities of the Bank itself, we agree that low input quality and hasty preparation of projects, as well as too large a volume of operations that eventually caused cancellation of the large sums of previously committed resources, were the reasons for the unsatisfactory outcomes of implementation of a number of the earlier Bank projects in Russia. We believe that if the Bank had had available instruments such as the APL and LIL at the time, the resulting effects of its Russian programs would have been much better.

### **Overall Evaluation of the IFC Country Assistance Strategy in Russia**

In the early 1990s, the formation of the general strategy of the IFC in Russia was influenced by multidirectional factors. On the one hand, the opportunities for profitable investments in Russia were limited, while the risks were high. On the other hand, the key IFC shareholders prompted the corporation to intensify technical assistance to Russia for the development of a market economy, placing at its disposal sizeable sources of grant resources to finance such programs. Furthermore, from the very beginning, the IFC met with certain competition from the recently established European Bank for Reconstruction and Development (EBRD).

While appreciating the positive role that the IFC played in the development of the private sector in Russia, including through its technical assistance programs, we nevertheless believe that the IFC simply had no clearly formulated strategy for Russia at all for a long time. This had an adverse impact on its activities and caused unprofitableness of its operations in this country at the early stages. To a certain extent, this is also true for the technical assistance strategy, because in those operations, the IFC relied on the grant financing provided by donor countries and, therefore, was under the influence of the preferences of the latter.

### **1. Areas for Technical Assistance to Russia by the IFC**

Initially, technical assistance provided by the IFC focused on two of the most important problems of Russia's transition to a market economy: pri-

vatization and capital market development. The bulk of its efforts and resources were concentrated on providing technical assistance in the area of privatization, which was in line with the Russian government's priorities. The IFC was by far not the only participant that actively assisted in carrying out the complicated, large-scale process of privatization. However, very good results, both qualitative and quantitative, were achieved in those regions and areas on which the IFC focused its efforts. Here we share the opinion of the authors of the report.

As regards the IFC's technical assistance in the area of development of the financial market, while sharing on the whole the positive assessment made in the report, we at the same time believe that the IFC could have been more active there and could have made a more significant contribution to it.

In their report, the authors cautiously speak in favor of the continuation of the IFC technical assistance programs in Russia. Apart from the area indicated in the report (creation of courts of arbitration), technical assistance promoting the development of small and medium-size businesses in Russia could be of special significance. Because providing support to small and medium-size enterprises has been a priority for the Russian government, earlier and more systematic participation of the IFC in this area can only be welcomed. Technical assistance programs could serve as a basis for more successful preparation and implementation of investment support programs for this segment of the private sector.

### **2. Evaluation of the IFC's Investment Operations**

The report characterizes the amount of IFC investment operations in Russia as modest, while emphasizing the impossibility of giving a simple answer to the question of whether the IFC could and should have done more. At the same time, the authors are inclined to believe that the IFC was responding to the opportunities of potentially viable investments untapped by the EBRD in a way that matches well its available knowledge base, skills, and resources.

If one should proceed from an assumption that the IFC chose the role of a minor player in

the Russian arena (compared with the EBRD) and has preferred to follow the same line ever since, then, indeed, one should hardly expect it to be more active in its investment activity. But in this case, one should recognize that the principal factor restraining IFC investments in Russia has been its own strategic aims, and that by far not all is explainable by the difficulties of Russia's investment climate. It should be also noted that the Russian Federation government was not aware of this "division of labor" with the EBRD.

We cannot agree with the so-called losses of the IFC from its operations in Russia (Chapter 3, "IFC and MIGA Interventions"). Two-thirds of those "losses" are the administrative costs, including the costs of consulting services, which were known at the very beginning to be unable to yield any profit. The report also says that the low level of IFC investments in 1998 was a positive factor, inasmuch as *if the IFC had invested in the projects that it considered, but then refused to implement, then its operating outcomes in the development area and financial results of its operations, in all probability, would have been even worse*. In our opinion, those results are evidence of the shortcomings in the IFC investment activity in Russia. In particular, those investors who had made investments in the real sector of the economy mostly benefited from the implications of the 1998 crisis, because the depreciation of the ruble improved the situation for both exporters and manufacturers serving the domestic market.

As regards the analysis of the causes of the current situation, the report, regretfully, does not go beyond those on the Russian side, while mistakes and errors of the IFC remain without proper attention. We view this as a grave flaw in the report, bearing in mind that one of its key objectives was to make a thorough and impartial analysis in

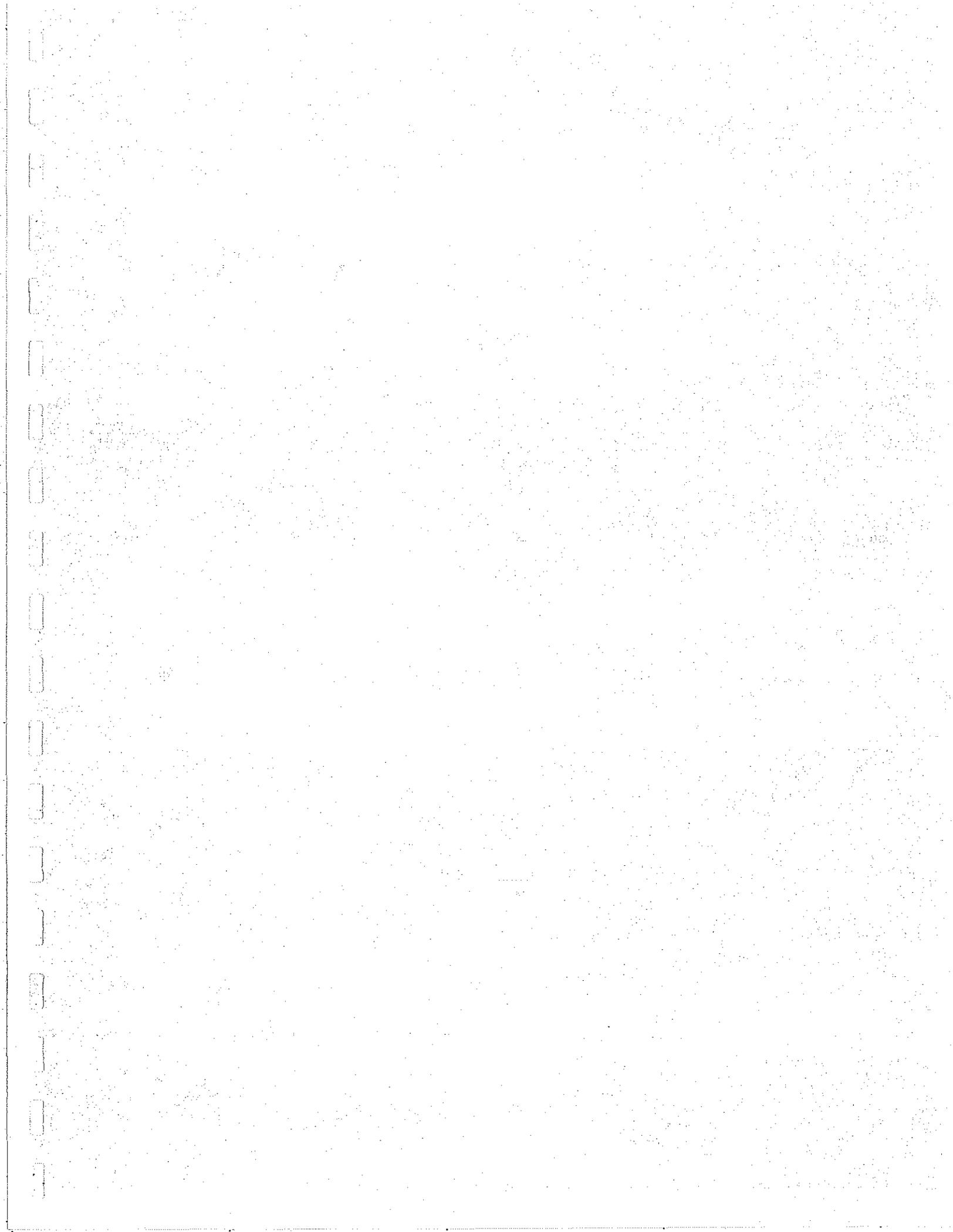
order to help the IFC learn a valuable lesson from the past experience so as to improve the efficiency of its investments in the future.

On the whole, we share the views set forth in the report concerning the future lines of IFC investment activity in Russia and believe that they should form the basis of a future strategy for IFC activities in Russia.

### **Coordination of IFC Activities with Other Bank Group Members**

Cooperation between the IFC and the IBRD is, in our opinion, a very important subject. Regrettably, the report does not properly cover it. It seems to us that the strategic partnership and operational interaction between the IFC and the IBRD that are required to improve the efficiency of assistance rendered to this country and promote the development of the private sector should be the main object of analysis there.

The Russian party has more than once called for making the support provided to the development of the private sector into a set of well-coordinated, mutually complementary, and synergistic actions taken by the IFC, the IBRD, and the Multilateral Investment Guarantee Agency (MIGA). Therefore, first, we deem advisable any organizational changes inside the World Bank Group that would be conducive to such actions, including changes to the Bank Group's field units in Russia. Second, we deem necessary a closer integration between the Country Assistance Strategies of the Bank and of the IFC along with their respective work programs, including research and technical assistance programs. Third, we would like to emphasize our interest in their undertaking joint or parallel operations using a combination of various instruments that the World Bank Group has available.



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## ANNEX 12: MIGA'S ACTIVITIES IN RUSSIA

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### **MIGA Guarantee Program**

The Russian Federation joined MIGA on December 29, 1992. MIGA insured its first project in Russia in June 1993 and has since issued 26 more guarantees. These contracts supported estimated foreign investments of \$1.3 billion in 18 projects. MIGA's maximum aggregate liability of all issued contracts (active and nonactive) in Russia is \$549 million. Russia's share of MIGA's total coverage issued between FY1990 and FY 2001 is 6 percent of the gross liability assumed. MIGA's outstanding portfolio in Russia on June 30, 2001, was \$263.5 million (gross).

MIGA's guarantee portfolio was affected by the financial crisis of 1998 as private investors scaled down their investments and subsequently cancelled or reduced MIGA coverage. Some cancellations occurred in an effort to cut costs while continuing the projects. Other potential investors abandoned or delayed projects. Since FY2000, MIGA has seen its guarantee volume increase slightly.

Overall, MIGA-supported projects constituted a significant share of the modest cumulative net foreign direct investment (FDI) flows of \$9.9 billion between 1996 and 2000.<sup>1</sup> Russia remains one of the top five countries in MIGA's portfolio. Relative to International Bank for Reconstruction and Development (IBRD) loan commitments and International Finance Corporation (IFC) financing, MIGA's guarantee operations in Russia have been proportionate.

MIGA's portfolio is biased toward agribusiness, food processing, and beverages, priority sectors identified by the 1995 Country Assistance Strategy (CAS). While the agency has contributed to the development of the banking and financial sector, it has not played a major role in financial markets reform. MIGA support to the financial

sector began only in FY1996, and some investments have been scaled down considerably in the aftermath of the financial crisis. However, MIGA-supported projects provide specialized financial services in the agricultural sector (e.g., commodity financing) and thus broadened financial markets. In addition, mining, manufacturing, and services projects also received MIGA support.

In successfully collaborating with the IFC, OPIC, and other development institutions on several projects, MIGA has increased its leverage and used its resources efficiently. Insofar as MIGA has thus far not suffered any claim losses in Russia, it can be assessed that the agency has made prudent underwriting decisions in an environment of political and financial instability. Selective coverage, stop losses, and reinsurance were used to limit the agency's net exposure. MIGA continued to support projects in Russia even after the country's default on foreign debt, helping facilitate some private investment flows in a critical period.

### **Investment Marketing Services Activities**

MIGA has implemented the PrivatizationLink Russia project (PLR)<sup>2</sup>—an initiative to develop a free online service for investors interested in Russian privatization opportunities in partnership with the Canadian International Development Agency (CIDA). The project was carried out in cooperation with the Russian Ministry of Property Relations and the Russian Federal Property Fund. The PLR is designed to make information on privatization in Russia more transparent and accessible to investors around the world and lower transaction costs. Although it is too early to assess the impact of this effort, it is raising awareness about investment opportunities in Russia by providing easy, cost-free access to in-

formation for potential investors and establishing effective means of communication between investors and the privatization agency. The great demand for information posted on this Web site, as well as the support from the government, are indicative of its appeal.

### **Conclusions**

MIGA has clearly contributed to the development of the Russian private sector through its guarantees and investment marketing services. Its guarantee program has prudently and selectively met demands from private foreign investors for political risk insurance and has enabled a number of investment projects to go forward. However, MIGA guarantee activities are

currently limited by a relatively low demand for coverage from investors.

In the future, the agency should continue its prudent underwriting while seeking to diversify its Russian portfolio to make it less vulnerable to future crises. MIGA should strive to simultaneously maximize the amount of FDI facilitated while minimizing its net exposure in Russia.

The PLR is providing vital information tailored to investors' needs, which may lead to additional foreign investment in Russia. MIGA should continue its successful investment marketing activities in cooperation with the Russian government. These are cost-effective and appropriate tools to disseminate information to potential foreign investors.

—Operations Evaluation Unit (OEU),  
MIGA (July 31, 2001,  
updated submission).

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## ANNEX 13: THE WORLD BANK INSTITUTE'S ACTIVITIES IN RUSSIA

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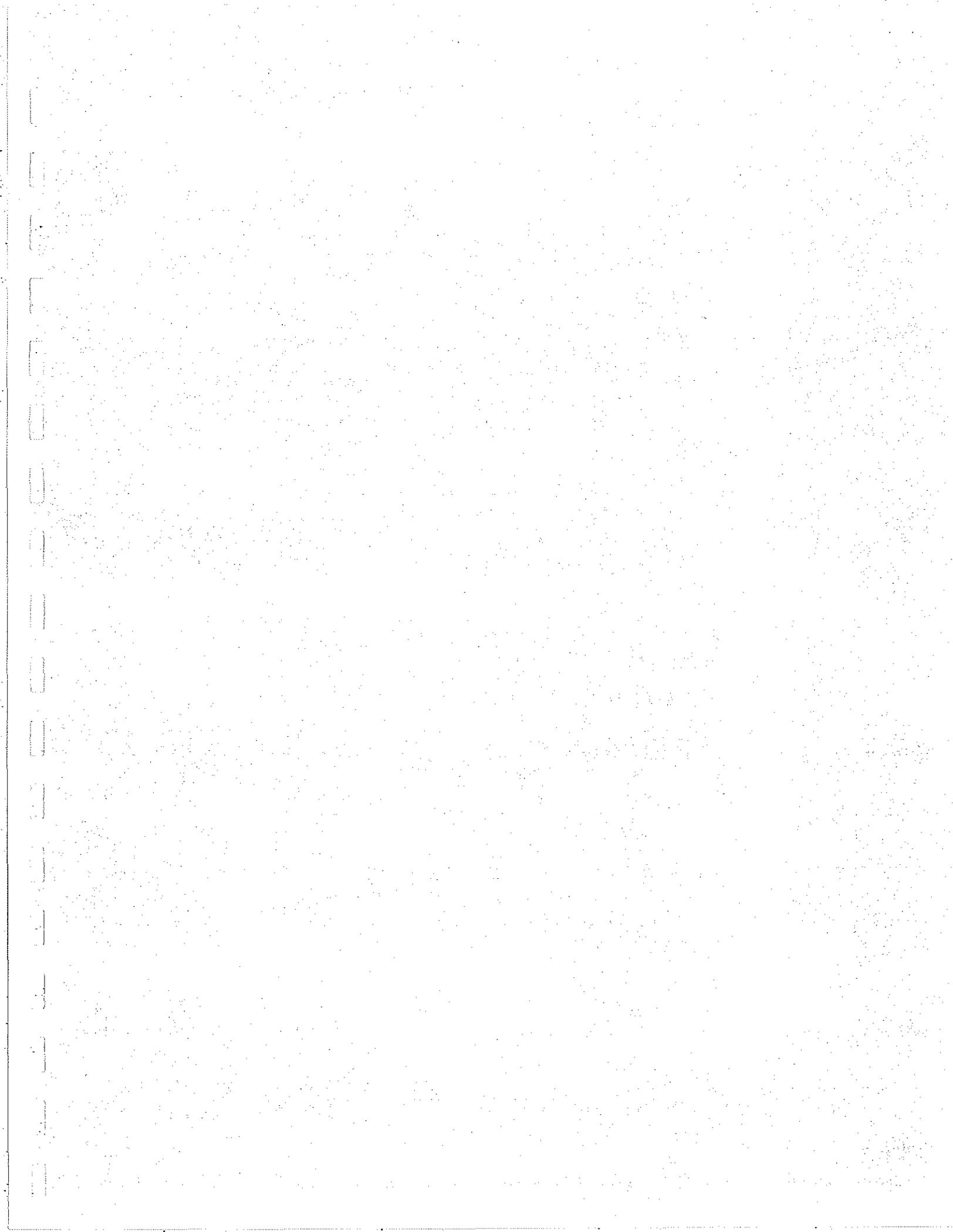
The assistance of the World Bank Institute (WBI, previously EDI) is aimed at creating human and institutional networks, sharing best world experience and knowledge, providing exposure to market economics concepts, and disseminating the findings of Bank studies. By the end of FY94, the WBI's Moscow office had 15 Russian professionals. By the mid-1990s, it helped create strata of market-oriented professionals as it trained 2,150 trainers, partnered with 200 Russian institutions, and reached indirectly 10,000 individuals through its training courses, for which it prepared textbooks, glossaries, and case studies. It made use of modern information technology, opening a Russian language Web site, producing videos and CD-ROMs, conducting distance learning, and electronically networking partners. It reached parliamentarians, the mass media, government administrators at the federal and local levels, project managers, local experts, and private sector legal entities.

Since 1996, WBI programs have been integrated into the Russia CASs and WBI staff have worked more closely in supporting Bank Group operations. In line with CAS priorities, WBI activities have focused on macroeconomic and public resource management, corporate governance, the social sectors, and the environment. As part of linking learning and lending and

to contribute to the Bank's intensified portfolio management efforts, the WBI provided training in project management, administration, procurement and disbursement (more than 25 seminars were delivered upon request of local Project Implementation Units [PIUs] in the last three years). Moreover, WBI staff participated in Bank missions related to education and training projects.

In the last three years, the WBI has moved the focus of its programs to the local level, building institutional capacity in the regions, and in 2000, the Canadian International Development Agency (CIDA) and the WBI signed a three-year partnership agreement on training and capacity building in Russia in fiscal federalism and media development in Russian regions. The efficiency of WBI outreach efforts was magnified by bringing the existing pool of local partners and WBI alumni into informal networks of professionals. More than 200 Russian institutions now have WBI-trained staff, using WBI-approved training materials and operating within the network of WBI local partners. According to the WBI's evaluation and tracer studies, many WBI alumni were promoted as advisers to central and local authorities, used efficiently new analytical tools, and were involved in decisionmaking for various development initiatives and programs.

—World Bank Institute.



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## ANNEX 14: RUSSIA'S CHAMBER OF ACCOUNTS' VIEWS OF WORLD BANK-FUNDED PROJECTS

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### Preface

The following is a summary of an overview report (presumably in late 1998) to the Duma by the Chamber of Accounts (COA), Russia's supreme audit institution, on the "basic problems related to effective use of the funds borrowed from the IBRD" and of the views expressed by senior COA officials to the Operations Evaluation Department (OED) Country Assistance Evaluation (CAE) mission in February 2001. It does not reflect the position or concurrence of the World Bank or OED. All COA reports on Bank-financed projects were considered confidential until recently and were made available for the first time to the Bank's Moscow office in February 2001.

### Overview Report

The Russian Federation is facing two major issues vis-à-vis the World Bank at the moment: the necessity of a portfolio review in order to save the borrowing program, and the necessity of urgent actions to recover sub-lent funds from end borrowers. The preliminary estimate of the COA and the Federal Center for Project Finance (FCPF) (a nonprofit foundation funded by the Bank and supervised by the Ministry of Finance [MOF], which is the Project Implementation Unit [PIU] for the Portfolio Development project) is that the total amount of active loans can be reduced by \$700–\$800 million. The situation regarding the payback of borrowed funds was favorable at the date of the COA review (only interest and commitment payments were required). However, starting from 1999, when the first loan's repayment was scheduled, the situation would become worse, as the end borrowers who received sub-loans from the federal budget are unable to repay their debts because of the 1998 financial crisis.

The COA overview report raised other generic issues:

- Currently, major control and managerial functions in preparation and implementation of projects are carried out by Bank experts, rather than by appropriate governmental agencies.
- The government (the MOF and other ministries) actively participate in the preliminary stages of project preparation, but lose interest after loan effectiveness and the beginning of PIU financing.
- The wide range of the projects' objectives and the predominance in the portfolio of projects not directly linked to the investment needs of the productive sectors show a lack of long-term cooperation of Russia with the Bank that reduced the effectiveness of Bank loans.

### Criticisms Raised during the OED CAE Mission

- COA officials bemoaned the excessive salaries paid to PIU officials, which create perverse incentives for government officials.
- COA officials believed that Bank assistance for the coal restructuring program was misplaced, as it focused on reducing production rather than on enhancing supplies of those types of coal most suited to the existing power plants. [This finding is in marked contrast with OED's positive assessment of Bank assistance in this area.]

### Other Views Contained in Selected Project Reviews

- The main objectives of the Structural Adjustment Loans (SAL) I and II in the areas of tax reform, private sector development (PSD), banking system reform, and export trading reforms were not achieved.

- Adjustment loans were spent on debt service and various budget expenditure items unrelated to the purpose of the loans. [That is indeed the nature of all adjustment loans.]
- Various projects had weak implementation monitoring systems.
- In the projects reviewed, the COA found only minor expenditures deemed unreasonable or contrary to the loan agreements.

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## ANNEX 15: LESSONS FROM EXTERNAL EVALUATIONS

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Lessons of evaluations from the European Bank for Reconstruction and Development (EBRD), the European Union (EU), the United States, the Netherlands, and Sweden point to important recommendations that are also relevant to improve the effectiveness of external lending and nonlending assistance.

### Portfolio Management

The evaluations from the EBRD, the EU, and Sweden pointed out that operationalization in the region required that developmentalists:

- Ensure adequate knowledge of country political, economic, and social conditions relevant to the specific areas of interventions.
- Commit to a long-term framework for assistance.
- Focus on institution building, training, and legislation.
- Ensure adequate resources and influence by the donor agency in a few selected areas of interventions rather than spread assistance thinly.
- Identify clearly all opposing and supportive stakeholders' coalitions.
- Stress cost sharing, twinning, demand-driven facilities, and use of Russian professionals in technical assistance (TA) projects.

### Project Management

Evaluations from the Netherlands, the EBRD, the EU, and Sweden also reflected the importance of the need to:

- Rely upon, and involve from the start, beneficiaries and stakeholders with common objectives.
- Ensure the ownership and support of central as well as local authorities, and of key civil society organizations.

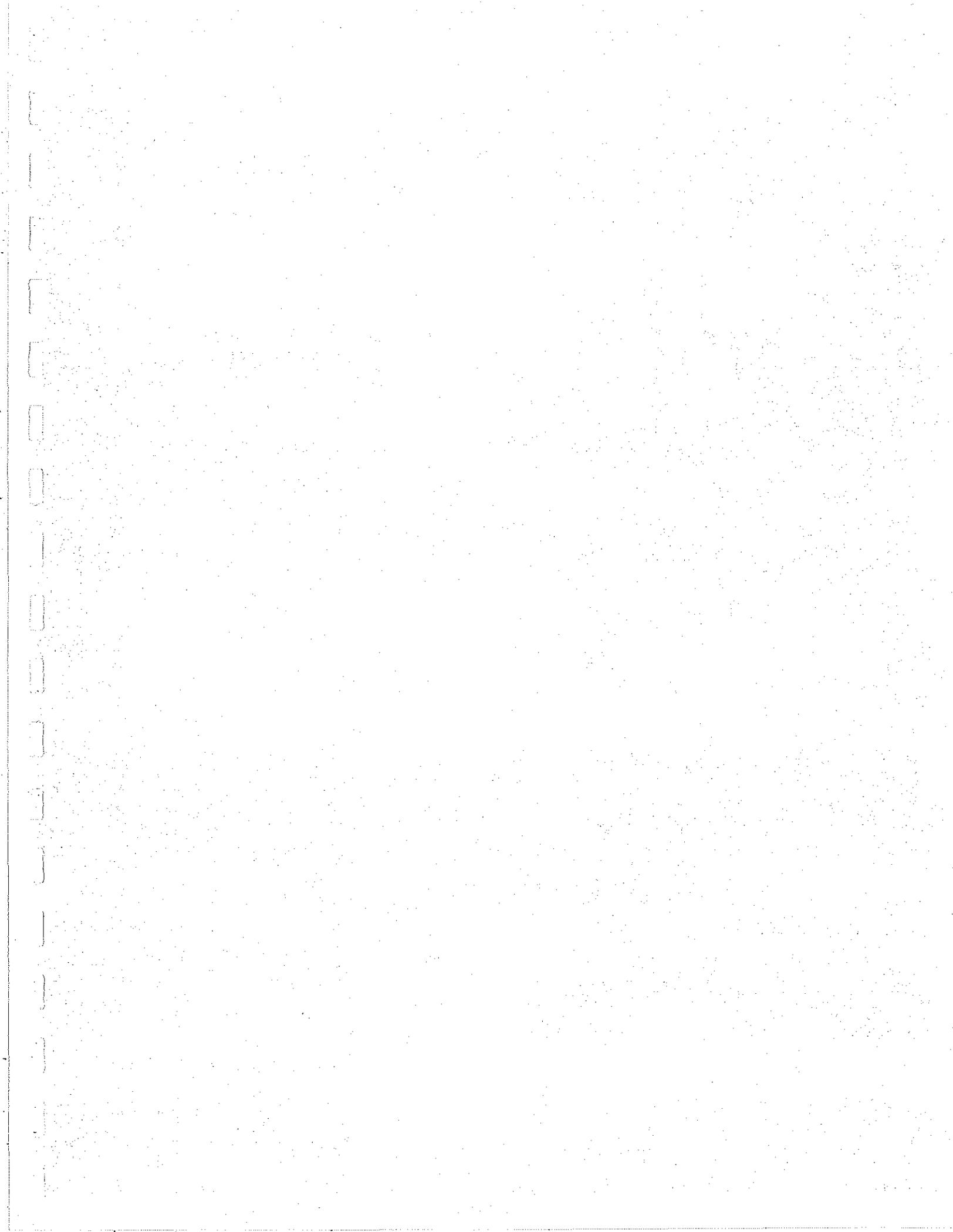
- Avoid projects in sectors and industries with a high degree of barter.
- Define clearly the objectives of interventions and link them to concrete measures necessary for their achievements.
- Ensure flexible project designs and management.
- Plan for monitoring and evaluation systems and follow up on their findings.
- Clarify procedures early on rather than during implementation.
- Tailor the project to country-specific conditions.
- Minimize dependence on individuals.
- Plan ahead for coordination among government agencies and partners.
- Monitor carefully the relevance of project objectives in the course of implementation and adjust, if necessary, with the changing environment.
- Rely for implementation on professional managers with operational autonomy, but within clear mandates, guidelines, and effective monitoring of performance.

### Privatization Reforms and Partnerships

The EBRD, the EU, and the Netherlands also recommended that the programs take measures to:

- Partner with other donors and other relevant organizations in transition countries of central Europe.
- Design support for balance of payments and budgetary support should support the reforms that will prevent the reoccurrence of the same problems.
- Embed advice and interventions in support of reform in a strategic framework.

*Source:* Various evaluation reports summarized and reviewed by Rema Balasundaram (OEDPK) in a background note prepared as an input to the CAE.



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## ANNEX 16: GUIDE TO OED'S COUNTRY EVALUATION RATING METHODOLOGY

This methodological note presents the basic elements of OED's Country Assistance Evaluation (CAE) rating methodology for the Bank's country assistance. The Bank's role has been increasingly country based, policy oriented, and programmatic. Hence, over the past seven years, (FY95-01), OED has evaluated the development impact of country assistance programs in 45 countries. This note reflects the lessons of this evaluation experience.

### **Bank Country Assistance Performance versus Country Performance versus Bank Performance**

Three possible objects must be distinguished in country-related evaluations: the country's development performance, the performance of the Bank's assistance program, and the Bank's own performance in designing and implementing the program. While interrelated, they are not identical. Favorable Bank program outcomes do not always translate into favorable economic and social development results for the country, nor does a strong Bank performance necessarily mean that the assistance program was successful. Poverty reduction in a country may fail to occur even if the specific programs supported by the Bank have had good outcomes. Equally, the programs supported by the Bank may succeed even if the Bank's own performance has not been satisfactory.

Thus, the results of a Bank assistance program could be rated as highly satisfactory even for a client that did poorly in areas not addressed by the Bank's program. From the record of the CAEs we have done to date, we discovered there were:

- Clients whose prolonged periods of development were matched by successful Bank assistance (e.g., Poland, Ghana, and El Salvador)

- Clients that achieved above-average development results, even though the Bank's assistance did not fare nearly as well (e.g., Costa Rica)
- Clients in which the Bank's assistance achieved significant development results, despite lagging country development (e.g., Ethiopia).

Also of note is that, in conformity with its mandate, OED does not rate the development performance of the client country or the aid performance of its non-Bank partners. Yet, it is critical to have a clear view regarding both these issues to correctly assess the outcome of the assistance program and any obstacles the Bank contended with in designing and implementing its Country Assistance Strategy. Hence, active participation of the client, non-Bank partners and the region in the evaluation process is likely to lead to the best results.

### **Building a Metric Algorithm**

Intermediate development objectives, such as financial sector adjustment and integrated rural development, are often the indispensable pathways to the realization of higher-order objectives, such as poverty reduction. So the causative links between the two must be identified. Work can then proceed toward design of a ratings scale with appropriate weights.

At times, clients may have some development goals at odds with the broad-based goals embodied in the Bank's Comprehensive Development Framework (CDF). Normally, such conflicts would be identified and resolved in the Country Assistance Strategy (CAS), enabling the evaluator to focus on whether the tradeoffs adopted were reasonable. In other instances, key development constraints may not have been identified or addressed by the Bank's assistance program.

Such omissions tend to emerge upon examination of development behaviors and endowments observed during and preceding the period under evaluation. Finally, the evaluator must be alert to possible major shortcomings in the assistance program results, such as violations of the Bank's safeguard policies.

Rating the outcome of the assistance program then involves an investigation into the relevance of its primary objectives in contributing toward a resolution of one or more key constraints hampering client country development, the program's efficacy in having achieved its major relevant objectives with minimal shortcomings, and its efficiency in containing the costs per unit of benefit delivered.

**Institutional Development Impact**

This can be rated as high, substantial, modest, and negligible/negative. Ratings are based on an assessment of the Bank's assistance impact on strengthening the client country's capacity to manage, among others, the following areas:

- Economic management
- The structure of the public sector and, in particular, the civil service
- The institutional soundness of the financial sector
- Legal, regulatory, and judicial systems
- Monitoring and evaluation systems
- Aid coordination
- Financial accountability
- Building nongovernmental organization capacity
- Social and environmental capital.

**Sustainability**

This measures the likelihood that the development benefits of the country assistance program will be maintained. Sustainability can be rated as highly likely (4), likely (3), unlikely (2), highly unlikely (1), or nonevaluable. Future work will focus on refining the definition of sustainability to distinguish between the expected duration of benefits versus the likelihood that some or all of the expected benefits may not materialize.

**Ratings Scale**

**Outcome.** Currently, OED uses six rating categories for outcome, ranging from highly satisfactory to highly unsatisfactory

Highly satisfactory	The country assistance program achieved significant progress toward all major relevant objectives, possibly with minor shortcomings. Best practice development impact was achieved in one or more areas.
Satisfactory	The country assistance program achieved significant progress toward all major relevant objectives, possibly with minor shortcomings.
Partially or moderately satisfactory	The country assistance program achieved significant or acceptable progress toward a majority of the major relevant objectives, but failed to address—or did not make acceptable progress toward—at least one major relevant objective.
Partially or moderately unsatisfactory	The country assistance program failed to address—or did not make acceptable progress toward—a majority of its major relevant objectives. However, progress toward at least one major relevant objective was acceptable.
Unsatisfactory	The country assistance program failed to address—or did not make acceptable progress toward—any of its major relevant objectives.
Highly unsatisfactory	The country assistance program failed to address—or did not make acceptable progress toward—any of its major relevant objectives, and it had at least one major shortcoming, such as a violation of the Bank's safeguard policies.

### Three-Dimensional Evaluation

OED has developed three modules dealing with different perspectives, or dimensions, of Bank assistance:

1. **Products and services dimension:** The evaluator adopts a "bottom-up" analytical approach to the major Bank Group inputs: loans, economic sector work (ESW), strategic advice, aid coordination, and resource mobilization.
2. **Development impact dimension:** The evaluator adopts a "top-down" analytical approach, rating the overall outcome and results of the Bank's program of assistance. Counterfactuals are applied.
3. **Partner performance dimension:** The evaluator assesses responsibility for the impact of the country assistance program to four sets of actors: the Bank, its aid partners and stakeholders, the client country, and exogenous factors. The contribution of each is rated

independently and then blended into a dimensional rating. However, to minimize the risk of steering all debate among the key partners over their performance ratings, OED does not make these explicit in its CAEs.

The dimensional scores should be equal (or nearly so), because they capture different facets of the same assistance result. Were a large disparity to arise, this would signal some inconsistency, requiring adjustments among the three dimensional scores, in this way mitigating the effects of rating subjectivity. For example, good partner performance (assessed against current policies and standards) combined with favorable exogenous conditions may contrast with an apparently poor development impact, thus requiring a revision of one or both assessments (e.g., by concentrating on the adequacy of policies and standards or on the accuracy of the development impact indicators).

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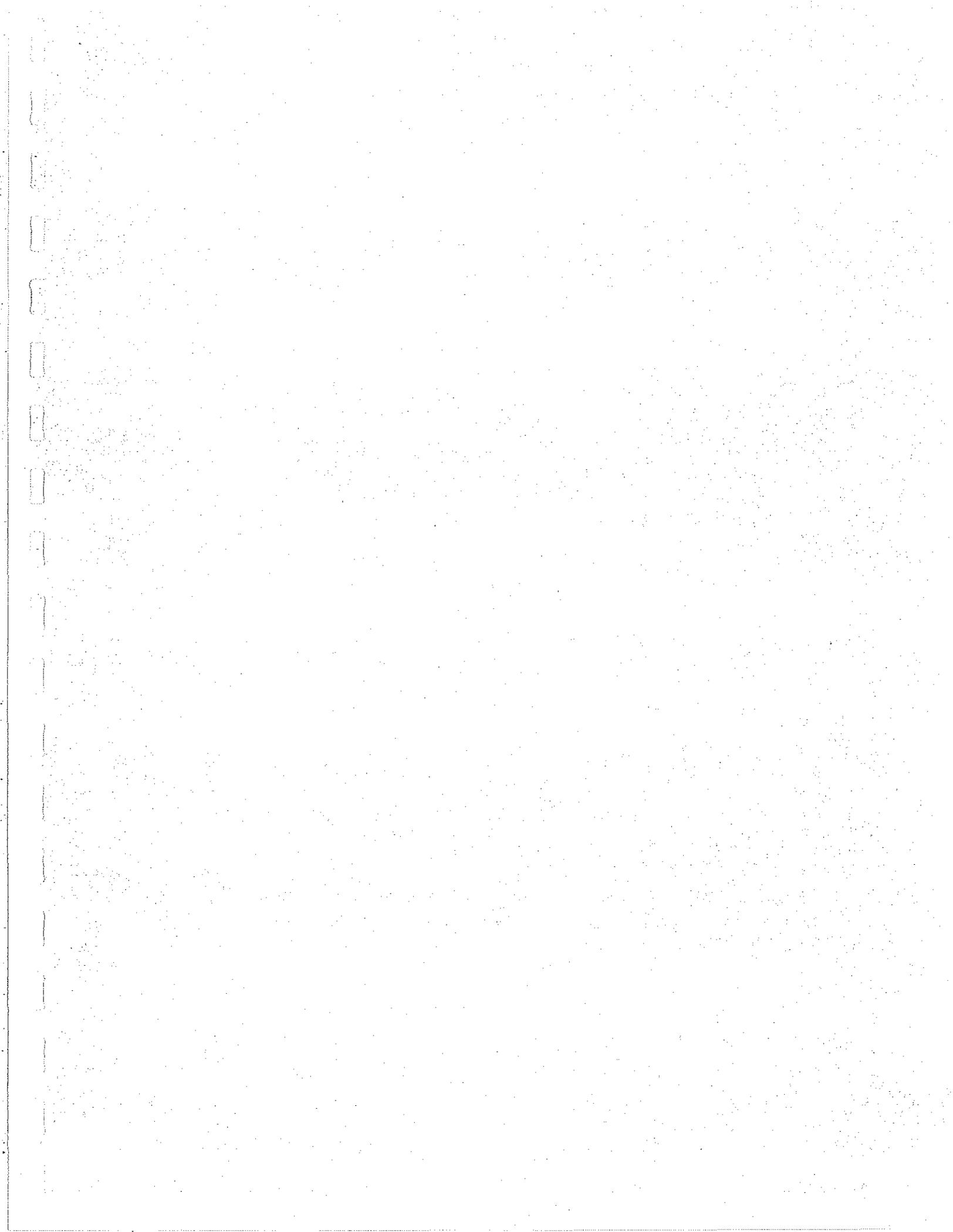
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**ANNEX 17: BACKGROUND PAPERS PREPARED FOR THE RUSSIA CAE<sup>1</sup>**

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<b>No.</b>	<b>Title</b>	<b>Author(s)</b>	<b>Report date</b>
1.	"Russia: Bank Assistance for Social Protection"	Lawrence Thompson (consultant)	November 15, 2001
2.	"Russia: Bank Assistance for Social Protection"	Marina Kolosnitsyna IET Irena Topinska CASE	November 3, 2001
3.	"Russia: Bank Assistance for the Energy Sector"	Richard Berney (consultant)	December 4, 2001
4.	"Russia: Bank Assistance for the Energy Sector"	Yuri Bobylev IET Jacek Cukrowski CASE	December 7, 2001
5.	"Russia: Bank Assistance for the Private Sector and Financial Sector Developments"	Alexander Radygin IET Barbara Blaszczyk CASE	January 8, 2002
6.	"Russia: Bank Assistance for the Financial Sector Development"	Fred Levy (consultant)	October 26, 2001
7.	"Russia: Bank Assistance for the Private Sector Development"	Saul Estrin and Alan Bevan (consultants)	January 8, 2002
8.	"Russia: Bank Assistance for the Public Sector Management and Governance"	Baran Tuncer (consultant)	January 8, 2002
9.	"Russia: Bank Assistance for the Public Financial Accountability"	Vinod Sahgal and Deepa Chakrapani (OEDCM)	January 8, 2002
10.	"Russia: Thoughts on the Privatization Debates a Decade Later"	David Ellerman (DECVP)	February 4, 2002

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ANNEX 18: REPORT FROM THE COMMITTEE ON DEVELOPMENT  
EFFECTIVENESS (CODE)

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The Informal Subcommittee (SC) of the Committee on Development Effectiveness met on May 8, 2002, to discuss the Country Assistance Evaluation (CAE) for Russia (CODE2002-0021) and the International Finance Corporation (IFC) Country Impact Review (CIR) for Russia (CODE2002-0026), both covering the period from 1992 to 2001. While OED rated the outcome of World Bank assistance to Russia as unsatisfactory between 1992 and 1998, with only a modest impact on institutional development, the outcome in the period 1998–2001 was rated satisfactory and the institutional impact deemed substantial. The OEG's evaluation found the IFC's efforts relevant and well-executed, while outcomes were mixed. OED emphasized the two main lessons of the evaluation: the importance of broad-based country ownership for the success of policy-based lending and the need for the Bank to resist pressures to lend. It felt that an assistance strategy oriented around analytical and advisory activities (AAA) with limited financial support for Russia would have been more appropriate than one involving large volumes of adjustment lending, since such lending in 1996–97 may have delayed rather than accelerated needed reforms. Disbursements should have rewarded actions rather than promises. In support of its overall outcome rating through June 1998, OED highlighted the large size of quick-disbursing and investment loans, including the Structural Adjustment Loan (SAL) III, with unsatisfactory outcomes. It noted that research and evaluation findings confirmed that large amounts of lending could not be relied upon to ensure country ownership.

Management responded that financial support had been critical for progress in the Bank's dialogue with the Russian government, and,

since the beginning of the program, it had been actively encouraged by shareholders—for example, in view of the global liquidity crisis of 1997–98. While welcoming OED's evaluation and agreeing with its recommendations, management disagreed with OED's assessment of the outcome of Bank assistance. It noted that many reforms implemented after 1998 reflected Bank advice provided during 1992–98 and built on reforms from that period. Therefore, the outcome of Bank assistance ought not to be rated over separate subperiods. IFC management welcomed the CIR and the OEG's assessment that IFC's strategic focus on technical assistance (TA) and its decision to follow the lead of the European Bank for Reconstruction and Development (EBRD) had been appropriate. It noted that lessons, particularly relating to TA, were already informing IFC operations in other transition countries.

#### **Overall Conclusions**

The SC broadly supported the recommendations of OED and the OEG's evaluation reports and noted management's assurance that they will be incorporated into the development of future Country Assistance Strategies (CASs). Members underlined the importance of country ownership of reforms and capacity to implement them, the need for the Bank to work in partnership with other donors, and the vital role of Bank engagement in building ownership and strengthening institutions early in the process of transition.

The chair representing Russia welcomed the CAE and CIR and appreciated their having taken account of the government's comments. Noting that the synergies from the Bank's engagement went beyond the impact of individual projects,

he underlined the role of the Bank in assisting in the development of ownership of policy reform in Russia, evidenced by the lack of backsliding in the reform process. In view of the fact that positive developments post-1998 resulted from efforts made in the previous period and the important role played by the Bank and the International Monetary Fund (IMF) in this, the government felt that the outcome of the Bank's assistance to Russia during the entire period ought to be considered satisfactory.

Issues raised by the SC that are relevant for the forthcoming CAS discussion at the Board are as follows:

#### **Ownership**

Members commented on the complexity of defining ownership, assessing its existence *ex ante*, and applying the concept operationally. OED clarified the criteria used to judge ownership and the need to take account of it in the design and choice of instruments. Members noted that the political compulsions behind the volume and speed of initial Bank lending to Russia had resulted in unsatisfactory outcomes for policy-based loans and some investment projects. At the same time, some members felt that it could be difficult to wait to build broad consensus, especially when faced with crisis situations. In such circumstances, the Bank might have to accept greater risks in acting—particularly when it has relatively less understanding of the economy—and try to build ownership through its engagement, even though there might be divided views in the country.

#### **Bank Strategy**

Some members felt that the leverage provided by lending had been critical to the Bank's dialogue with the Russian authorities and that AAA alone would likely not have captured the government's attention. Other members wondered whether the large amount of adjustment lending in the early years might not have retarded reforms by postponing the need to deal with critical structural issues. Several members agreed with both OED and management that the seeds of the improved performance of the Russian economy after 1998 could be discerned in Bank assistance before

1998, although some noted that the period after 1998 was short and the irreversibility of recent reforms remained to be seen. One member wished to understand better the evolution of the Bank's strategy in Russia over the decade.

Some members wondered whether the early phase of Bank support had been used to build knowledge on Russia and whether existing knowledge had been adequately integrated into the program in a timely manner. Management responded that analytical work had indeed been undertaken. Some of this work from outside and inside the Bank had provided key underpinnings for the SALs. Members noted that a major lesson from the Russian experience was the need to focus on institutional issues early on, particularly the evolving role of the state in the transition to a market-oriented economy and concomitant political economy and public sector management (PSM) issues. A clearer recognition of Russia's capacity constraints would have resulted in more realistic expectations on the part of the Bank and a program better calibrated to the circumstances in terms of the pace and sequencing of reform.

Members also asked whether the IFC had largely reacted to events rather than having a strategy for engaging with Russia. IFC management responded that the IFC had indeed articulated the country strategy for Russia described in the OEG report and, in pursuit of the strategy, had resisted political pressure to invest. Overall, members acknowledged the difficulty of operating in a volatile and evolving environment about which the institution had been relatively uninformed while facing pressure from shareholders to lend.

#### **Partnership**

Members wished to understand the lessons for better coordination from the partnership with the IMF, particularly with regard to the appropriate role of the Bank in situations in which the two institutions disagreed but the Bank did not have the lead. Some members noted the need for joint evaluations with partners when working in complex political environments. Other members expressed concern about the lack of collaboration between the IFC and the In-

ternational Bank for Reconstruction and Development (IBRD) indicated in the CIR. Members urged greater coherence, coordination, and information sharing between the Bank and the IFC. They also asked for greater clarity on the relationship of the IFC with the EBRD. Management responded that while the overall relationship between the IBRD and the IFC has been synergistic and collaborative in key areas, with the IFC focusing on specific operations while the Bank addressed the business environment more broadly, more could be done to enhance collaboration. It also said that the IFC and the EBRD collaborated on larger projects, but there was healthy competition on smaller projects; client preferences prevailed.

**Poverty**

Several members emphasized that the Country Assistance Evaluation (CAE) ought to have addressed in more detail the problems of poverty and inequality in Russia, particularly because declining living standards in the mid-1990s had made reform more difficult. They asked for more information on the impact of the Bank's assistance strategy on social disruptions and poverty in the country. OED pointed out that these issues had been treated in Annex 1, and management commented that methodological issues had constrained past analyses of poverty. Resolving these issues during the forthcoming CAS period will make it possible to address poverty issues more systematically.

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*Sharon Weber, Chairperson*