WORLD BANK OPERATIONS EVALUATION DEPARTMENT

OED REACH

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Country Assistance Evaluation: Russian Federation

Update based on the *Russian Federation: Country Assistance Evaluation.*.

- The outcome of large-scale Bank lending to facilitate the transition from the plan to the market proved disappointing until a consensus for reform materialized following the 1998 financial crisis. Since 1999, however, the outcome of Bank assistance has been satisfactory, given strengthened government commitment to the reform agenda and improved relevance of Bank interventions.
- Looking ahead, Bank assistance should be channeled to sectors and regions with demonstrated commitment to reform. The primary instrument should be an expanded AAA program. Policy-based lending should be designed to ensure a tight linkage between actual reform and disbursements.

Challenges and Achievements

Following the dissolution of the Soviet Union, Russia experienced a long and deep recession and high inflation. The transition faced formidable obstacles, given the Soviet legacy and the lack of a national consensus regarding the direction and pace of socio-economic transformation.

Social and human development indicators declined, and poverty and inequality increased. In August 1998, a year-long stabilization and structural reform program collapsed. Russia defaulted on its debt, the ruble depreciated by more than 60 percent, and output dropped further. The financial crisis was triggered by the ripple effects of the East Asia crisis but Russia's vulnerability was rooted in inadequate fiscal and structural adjustment.

Since 1999, the government has made significant progress in reducing the fiscal deficit and in structural reform. Public trust in government is on the rise. Growth has accelerated, aided by a positive terms of trade shock and the ruble devaluation.

Today, the transition to the market appears irreversible, thanks to rapid privatization, dismantling of controls, and redirecting of trade and production.

Impact of Bank Assistance

Beyond its complementary support for IMF-funded stabilization efforts, the Bank's strategy sought to help build market institutions and mitigating the social costs of the transition. These were relevant goals, but the risks of large-scale lending were high, given the Bank's limited knowledge of country conditions.

External pressure to lend was high. As part of an international effort to assist Russia, the Bank delivered advisory services worth $20 million and committed 55 loans for $12.6 billion through end-FY01 (of which $7.8 billion were disbursed and $2.4 billion cancelled). Through FY96, lending focused on rehabilitation and investment, especially in energy. Thereafter, most lending was directed to large adjustment operations.

The Bank's influence over economic policy and structural reforms proved limited. The "loans for shares" privatization proceeded despite its lack of transparency and its inequitable outcome, but the Bank would not have been able to influence it even if it had adopted a stronger public stance regarding its shortcomings. Similarly, the institutional constraints affecting project approvals and implementation were not amenable to easy solution. However, prodded by its major shareholders, the

Bank rushed the processing of many projects and the outcome of most of them, including those supporting stabilization and the banking sector, turned out to be unsatisfactory

Operational performance experienced a turnaround once the operating environment improved. Since 1999, Bank assistance has helped improve the incentive regime for sustained economic growth, minimum pension benefits, the targeting of social assistance programs, and the restructuring of the coal sector. The sustained dialogue on structural reforms and the Bank's outreach activities have played an important role in preventing policy reversals, formulating the current reform program, and strengthening client ownership. Portfolio performance has also improved –through the cancellation of troubled projects as well as joint Russia-Bank efforts to improve implementation.

Bank and Borrower Performance

The unprecedented challenges of the transition, the country's limited ownership of reforms, an administrative apparatus unsuited to a market economy, and strong vested interests underlie the unsatisfactory outcome of assistance through FY98. The force field of an international community keen to support Russia through a proactive approach induced bold risk taking by the Bank. Project design was over-ambitious and the size and design of adjustment lending was based on overoptimistic assumptions regarding ownership of reform and domestic capacity.

In OED's view, offering Bank assistance mainly through analytical and advisory services and small 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. The Bank should have exercised more caution in project selection and design, as it did in the case of the coal sector operations. The upfront disbursements of the 1997 adjustment loans should have been smaller and more focused on results, as was the case with the 1998 SAL III.

Recommendations

Looking forward, the Bank should focus its assistance even more sharply on those sectors and regions with clear commitment to reform and broad social consensus. Public sector management, legal and judicial reform, the investment and business climate, pension reform, land markets, and coal and electricity sector restructuring offer high-potential development rewards. The Bank should expand its AAA program to deliver good practice advice based on the Bank's global experience and strengthen its dissemination to influence the public debate on reforms. Policy-based lending should be designed to ensure a tight linkage between actual reform and disbursements.

Management and Government Comments

Bank management agreed with the CAE's recommendations, but disagreed with the CAE's unsatisfactory outcome rating of assistance through FY98, stressing that the satisfactory outcome for recent years is rooted in past activities. In its view, the Bank's approach was based on appropriate flexibility, adaptability, and realism. The 1997 adjustment loans were necessary to gain influence over the structural reform agenda.

While the Russian authorities "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 "generally successful," pointing to the steady and "very rapid process of transition. " 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." 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."

Task Manager: Gianni Zanini (202) 458-5747
Group Manager, OEDCR: Ruben Lamdany (202) 473-0118 · Director: Gregory K. Ingram (202) 473-1052