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The need for diversification in the Russian economy: a role for the EBRD?

By most conventional measures, the Russian economy has had a good run. After falling steadily through most of the 1990s, total output (gross domestic product – GDP) has grown impressively since 1999, averaging about 6.7 percent per year. Inflation and unemployment have declined; personal incomes have grown steadily; the federal budget is in surplus; foreign debts are being repaid ahead of schedule; and, most important, the rate of poverty in Russia has declined.

The improvement in the Russian economy is indicated, not only by dry economic statistics, but by the attitudes

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Sakhalin II problems persist despite ownership fight

Chronic and severe environmental and social problems on the Sakhalin II oil and gas project are persisting irrespective of the fundamental change in the project's ownership structure negotiated in recent months. The continuance of these problems shows that the culture of environmental irresponsibility runs deep in Sakhalin Energy Investment Company (SEIC). The withdrawal of the European Bank for Reconstruction and Development (EBRD) from Sakhalin II, coinciding with the Russian government-controlled Gazprom's takeover of the project, shows that the bank made the right decision – but for the wrong reasons.

Fool us once, shame on you. Fool us one hundred times...

EBRD decided in December 2006 to halt its consideration of Sakhalin II after the Russian government-controlled Gazprom agreed with SEIC shareholders, Shell, Mitsubi-

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of ordinary Russians. A poll conducted for the BBC World Service in 2006 found that Russians' perceptions of the Russian economy improved from a divided perception in 2004 to a plurality perceiving it getting better in 2005 (39 percent better, 27 percent worse). Compared to the widespread pessimism about the Russian economy a few years ago, these results indicate that Russian citizens are seeing tangible benefits from the improvement of the economy.

There is no reason to believe that Russia's economic performance will suddenly turn sour this year or next. In the long run, however, the economy faces significant challenges, one of the most daunting of which is the risky dependence on exploitation of oil, gas, and other raw materials for growth. This challenge can only be met by intelligent public policy and wise choices by private actors in the economy.

While lending by the EBRD and other international financial institutions (IFIs) is likely to be small relative to private capital flows and public investments by the Russian government, the IFIs can positively affect the long-term trends of the Russian economy through enlightened investments that lead to diversification of the economy.

Natural resource abundance – a mixed blessing

Russia relies heavily on the exploitation of its natural resources, particularly oil and gas, for its economic well-being. The IMF and World Bank estimate that in 2005 the oil and gas sector represented about 20 percent of Russia's GDP, generated more than 60 percent of its export revenues and attracted 30 percent of all foreign direct investment in the country. Over 50 percent of federal budget revenues come from oil and gas production. The OECD estimates that oil, gas and other natural resource sectors directly contributed more than one-third of Russian GDP growth in the years 2001-2004. Without rapidly increasing prices for its natural resources, Russian economic growth would have been quite modest. Russia would have struggled to run positive trade balances; it could not have paid off foreign debts so quickly; and the government's fiscal balance would have been precarious.

Unfortunately, commodity prices are inherently volatile. Just as oil and gas prices escalated rapidly in the past few years, they can fall quickly with an economic downturn in one or more key importing countries or through the development of excess production capacity. Prudent economic policy makers in resource-rich countries must assume that the sunny days of high commodity prices will inevitably be followed by rainy days of low prices.

To give credit where credit is due, the Russian government has taken some important steps. For example, it has used the windfall of taxes and royalties from high commodity prices to pay down Russia's external debt, and it has established a substantial fiscal stabilisation fund to mitigate the effects of future declines in oil prices.

The need for diversification

The government, with help from the IFIs, could do more. As many Russian policy makers have acknowledged, an important task for the government is to create the conditions for diversification of the economy. One of the negative effects of the boom in exports of commodities has been the appreciation of the ruble against other currencies, which makes it harder for Russian producers in other sectors to export and exposes them to greater competition from imports. It makes the manufacturing, agriculture and service sectors of the economy less attractive for investment and, over time, reduces their ability to compete.

One way to promote diversification would be to ensure that investments in non-resource intensive sectors are treated no less favourably than those in the natural resource sector. Unfortunately, as the production sharing agreement signed between the Russian government and a consortium of oil companies for Sakhalin II (an arrangement supported by the EBRD) illustrates, investments in natural resource projects have received preferential treatment. Ideally, the Russian government, with financial support from EBRD, should emphasise the development of non-resource intensive industries and renewable energies. As a minimum, the government should create a level playing field, based on a fair regulatory system that internalizes environmental costs.

The EBRD and other IFIs could make a greater contribution to diversification simply by ending their investments in Russia's natural resource sector. In its 2006 country strategy for Russia the EBRD identifies as one of its strategic orientations its intention to "foster competitiveness and industrial diversification of the economy."

Yet, the EBRD plans to continue its investments in Russian natural resource development, devoting about 5-10 percent of its annual business volume to that sector. A more rational approach to diversification would be to divert those resources to other sectors of the economy that would contribute to a more sustainable pattern of growth.

George Holliday, Bank Information Center

shi and Mitsui to acquire a controlling stake in the project. This followed months of saber-rattling by the Russian environmental prosecutor, Rospriodnadzor, a surreal episode that many observers described as a thinly veiled means to leverage Gazprom's control of the project. Following the Gazprom takeover, Rospriodnadzor seemed to disappear from the scene.

Yet, while an ulterior motive appears clear, only the most uninformed observers claimed that underlying environmental problems did not exist. Indeed, the environmental violations cited by Rospriodnadzor were very similar to evidence of damage that had been extensively documented by EBRD, environmental consultants and independent environmental groups for several years, and was a key reason why SEIC was never able to win an environmental clearance from the bank. Ironically, EBRD should have withdrawn its consideration for Sakhalin II several years ago when it became clear that the project was severely and irrevocably in violation of the bank's environmental policy. The fact that EBRD gave SEIC seemingly endless 'last chances' to comply but then only withdrew amidst the controversy of the Gazprom takeover indicates an evasion of responsibility at the EBRD's highest levels.

EBRD has indicated that it could reconsider the project in the future if the new group of shareholders could make a compelling case, but that *"the closer the project comes to completion...the less value EBRD financing could add."* This is especially true of the bank's additional environmental value.

Early on, EBRD played a role in pressuring some important project corrections such as a re-routing of subsea pipelines just around the southern end of the critically endangered Western Gray Whale's primary feeding area. EBRD also helped push for the establishment of a panel of experts to assesses project impacts and to recommend mitigation measures to protect the whale population, and the bank conditioned its approval upon adherence to these scientists' recommendations.

However, these recommendations were then frequently rebuffed, and indeed misrepresented in the press by SEIC, leading one prominent panel member to quit in protest and compelling the Director General of the International Union for Conservation of Nature (IUCN, which administers the panel) to publicly comment:

Concerns exist within IUCN, and have been expressed to my staff by the independent scientists, that the company may not be taking the [panel] process seriously enough... Concerns have also been expressed to us by some NGOs and scientists about the inaccurate interpretation of the [panel] recommendations by SEIC...such a loose, if not inaccurate, interpretation puts a serious dent in the credibility of the process for the scientists, IUCN and SEIC itself thus diminishing their value to the cause of conservation that brings us together in the first place...

On-shore, environmental groups and other observers witnessed EBRD's 'additionality' plummet as reasoned discussion about proper mitigation gave way to the thunder of the project's bulldozers plundering across Sakhalin's rivers and forests.

Tragically, with the project approximately 85 percent built, momentum appears set for the remainder of the construction phase to conclude as shoddily as it began. For example, independent monitors hired by SEIC to review the environmental performance of crews building pipelines across sensitive rivers in the winter of 2006-2007 have documented the same pattern of violations as recorded in previous seasons. These breaches include the dewatering of rivers, the dumping of soil tailings too close to rivers, a lack of specified erosion control measures, and other damage to wild salmon rivers. Indeed, the construction of pipelines directly across salmon spawning beds also continues, representing a gross violation of internationally accepted practice.

Meanwhile, negative social impacts continue, including housing costs that have soared to levels similar to those in Moscow, and an increase in violence and the spread of sexually transmitted disease (see, *inter alia*, "Boom Time Blues: Big Oil's Gender Impacts in Azerbaijan, Georgia and Sakhalin"). These impacts are only expected to abate once the project's construction boom turns to bust and thousands of introduced workers depart to the next big bank-financed oil and gas boondoggle.

Given the vast documentation of these environmental and social problems, the EBRD could never have approved Sakhalin II without fundamental and reputation-damaging derogations from its environmental policy. Yet, the EBRD's decision to withdraw made no mention of these violations and the highly controversial decision the bank had avoided. In so doing, the EBRD may be pleased that it dodged a bullet. However, the bank has apparently done nothing to avoid similar situations in which it gives a financially powerful yet environmentally irresponsible sponsor never ending chances to fix an irreversibly broken project.

What's good for the goose is good for the bankster

Other banks may not skirt their responsibility so easily. The export credit agencies (ECAs) of the US, UK and Japan continue to signal their interest in Sakhalin II. And, on April

23, 2007, Bloomberg reported that ABN Amro Holding and Societe Generale have provided USD 1 billion each in financing for Gazprom's purchase of Sakhalin II. ABN Amro is a signatory bank to the Equator Principles (EP) on environmental performance, while Societe Generale is under sharp international criticism for not becoming one.

The environmental policies of EP banks, the ECAs and EBRD are all underpinned by the environmental policies of the International Finance Corporation, the private sector arm of the World Bank. Since the EBRD could never establish that Sakhalin II met these standards, neither can the EP banks and the ECAs – without eviscerating their own credibility in the process. Moreover, many of these banks initially described Gazprom's takeover of the project as worsening the prospects of environmental protection, since the Russian gas giant isn't exactly known for its environmental sensitivities. That now makes it even harder than before for those banks to claim that the project complies with their environmental policies.

Crocodile tears

Unfortunately, policy consistency is not a hallmark of many of these banks. Many of their officials could be heard in December decrying Gazprom's takeover of Sakhalin II as a brutal and unacceptable act of forced nationalisation. Just a few months later, some of those same banks are joining Gazprom to feast on the spoils. These banks' financing of the Sakhalin II project condones Russia's nationalistic energy policy and Putin's heavy-handed tactics.

Incongruously, Shell, Mitsubishi and Mitsui have heaped praise on Gazprom; strange behaviour for supposed victims that causes many observers to suspect that there is more to the story, including the possibility that the agreement extends beyond the ownership of the current Sakhalin II scheme.

Confirming this view, an April 18 announcement by Shell revealed that the deal includes an "Area of Mutual Interest (AMI)" agreement between Gazprom and the project's foreign shareholders, with Shell's Exploration and Production chief, Malcolm Brinded, saying: "The AMI should create additional growth opportunities for the partners in the future." A February 2007 Petroleum Review article on Sakhalin II says the AMI "will cover both future Sakhalin oil and gas exploration and production opportunities, and the building of Sakhalin II into a regional oil and LNG hub." Crocodile tears for Shell, Mitsubishi, Mitsui.

Conclusion

EBRD and Rospriodnadzor both rightly confirmed that Sakhalin II has involved severe violations of their environmental policies and laws. EBRD should have withdrawn strictly on environmental grounds, but didn't. Rospriodnadzor should have completed its environmental enforcement action, but didn't. Both responded to ulterior political considerations that compromised their environmental responsibility.

"Do you think any one noticed this from the outset?"

Now, the massive expansion of oil and gas projects via the newly announced AMI suggests that the people and environment of Sakhalin Island may suffer even further. All financiers potentially involved should halt their consideration until the scope of the environmental and social damage that could result is adequately assessed and prevented. Meanwhile, responsible EP and ECA bankers should steer clear of Sakhalin II and avoid the risks and damaged reputations that will hobble the banks that have signed up to the project.

The entire consortium of companies responsible, Gazprom, Shell, Mitsubisi and Misui, should take full financial liability for the damage they have caused up until now and in the future – including liability relating to any accident related to oil spills and Liquid Natural Gas transport.

Doug Norlen, Pacific Environment

EBRD tries to shrug off devastating Kashagan oilfield

The European Bank for Reconstruction and Development has made significant financial contributions to the development of the Kashagan Offshore Oilfield, which is located in the north Caspian Sea off the coast of the Republic of Kazakhstan. The EBRD's investment in this project threatens long-term negative impact for the residents of north western Kazakhstan, especially those living in Atyrau and Aktau and the many coastal settlements near the Kashagan Field.

Part of the North Caspian Sea Production Sharing Agreement, Kashagan is one of the largest oil finds of the last twenty years with an estimated thirteen billion barrels of recoverable crude oil.

However, Kashagan is rife with problems that threaten the viability of the project: economic, environmental, social and human rights concerns have slowed down its development, frustrating investors and operators alike. Dealing with the various problems has increased construction costs from an anticipated USD 27 billion to current projections of more than USD 60 billion.

An environmentally disastrous project, Kashagan threatens endangered species, the fragile north Caspian, and the hundreds of thousands of Kazakhstanis living near it.

Italy's ENI/Agip is the operator at Kashagan, leading the Agip KCO consortium, which is comprised of many of the world's largest oil companies: ENI/Agip, ExxonMobil, Conoco Phillips and Royal Dutch Shell each own 18.52 percent of the consortium's shares. France's Total holds 9.26 percent; Japan's Inpex 8.33 percent; and Kazmunaigaz, Kazakhstan's State Oil Company, also holds 8.33 percent of the shares.

EBRD financing

While the EBRD has not directly financed the extraction of oil from the Kashagan Field, since 2003 it has been financing projects that support oil extraction and export in western Kazakhstan, and specifically at Kashagan.

In 2003, the EBRD provided a USD 7 million loan to Caspian Offshore Construction Kazakhstan, to complete the construction of artificial islands in the Caspian Sea. The loan specifically goes toward the purchase of barges and tugs needed to complete construction. The artificial islands in the sea are the main base for extraction and are also the starting point for an undersea pipeline transporting oil onshore, where it will be refined at the Bolashak Refinery, once construction of that facility is complete.

Also in 2003, the EBRD invested in the construction of a highway from Atyrau to Aktau, providing USD 119 million to the Republic of Kazakhstan to widen the road. According to the EBRD (in its project summary document), the project will provide "improved road access between [the]... main port of Aktau and the important regional centre of Atyrau. It will also support the existing oil production area at Tenghiz."

Aktau is close to the Bautino Port from which tanker traffic travels to Baku, Azerbaijan. It is also the point from which barges and other ships travel to the artificial islands at the Kashagan Field in the north Caspian. Bautino Port is being upgraded to manage the heavy traffic anticipated as Kashagan comes on line.

In 2006, the EBRD provided a loan of USD 26 million and USD 4 million in equity to Balykshy LLP, "a specially created project company that will own and operate the marine support base," according to the EBRD's website. The EBRD's financing will support the construction of a marine support and supply base near the village of Atash. Balykshy LLP is wholly owned by Caspian Services, Inc., a US-based corporation (located in Utah) that provides on and offshore oilfield services. Caspian Services Inc., through various ventures, is involved in marine, geophysical and infrastructure development in the north Caspian region.

As the EBRD stated in a letter to the author in November 2006, "The Atash Bautino base is designed as an independent, 'merchant' project, which will market its support services to various offshore and onshore operators developing hydrocarbon projects in the Northern Caspian. One of the purposes of the project is precisely to increase competition and promote the creation of an efficient market for independent infrastructure supply and support services in the North Caspian."

Unfortunately, the EBRD financing of this and the other projects is contributing to environmental injustice in the North Caspian as well. Inadequate public consultation, loss of habitat for endemic species and risk to public health are among the problems associated with the development of the Kashagan Field and the projects connected to it.

Other financing

To date, Japan's JBIC has provided financing for Phase 1 of Kashagan development, including a USD 649 million loan to INPEX North Caspian Sea. This loan is co-financed by Japanese private banks including Mitsui, Mitsubishi and Mizuho.

In January 2007, a Memorandum of Understanding was signed by the participant companies in the Agip KCO consortium, those in the TengizChevroil consortium and KazMunaiGaz to create an estimated USD 3 billion trans-Caspian oil transport system. As reported by Eurasia Daily Monitor, the "agreement envisages a shuttle system of sea tankers to carry oil from Kazakhstan to Azerbaijan and into the Baku-Tbilisi-Ceyhan (Turkey) pipeline. The tanker system's capacity is projected at 25 million tons per year in the first stage and 38 million tons in the second stage. The oil port on the Kazakh side will be built in Kuryk." Kuryk is located in close proximity to the Atash Marine Supply Base.

Environmental concerns

In addition to the pressure it places on the north Caspian, the Kashagan project poses serious threats to the local population. Agip KCO itself acknowledges that Kashagan will have detrimental effects on the fishing industry (Kazakhstan Today, March 27, 2007). Thousands of seal deaths earlier this year have also been attributed to oil development in the north Caspian.

The construction of the Bolashak oil refinery, thirty kilometres from Atyrau, raises serious concerns about toxic emissions in the air and impacts on the local population. The refinery will have the capacity to process 56-70 million tons of oil per year (Kazakhstan Today, March 27, 2007). An accident involving highly sulfurous Kashagan oil could prove deadly for the region's residents, and long-term exposure to elevated levels of hydrogen sulfide will cause serious health impacts, especially for children and the elderly, as they have done in other parts of Kazakhstan, including near the Tengiz and Karachaganak fields.

Currently, residents of the two settlements closest to Bolashak are concerned about the impact of toxic emissions on themselves and their livestock and worry that rumours of relocation will become a reality without prior public consultation. They worry the devastation wreaked on the villages near Karachaganak will be their fate as well.

Local residents also express concerns about the safety of the local water supply as the Bolashak refinery goes on line. Limited access to water in the settlements closest to the refinery scares local residents, and the possibility of pollution from the refinery itself could destroy these villages.

According to ENI, the consortium plans to pipe oil from Bolashak to the Kuryk Port, from where it will be transported to the BTC pipeline in Azerbaijan for export to western markets. (ENI Spa E Annual and Transition Report)

Conclusion

Kashagan and its supporting infrastructure projects combine the dangerous mix of environmental, economic and health risks that may pose serious threats to the local population and to the environment of Kazakhstan. To date, the local population has seen little benefit from the development of the Kashagan Field. The majority of construction and technical jobs go to foreign workers, leaving local residents unemployed and struggling to survive in an economy over-run with oil money that is passing them by. Brigades of construction workers also pose serious social and health problems to the local community. For example, in Atyrau, local residents condemn the rise of prostitution as the fault of the oil companies, who have little respect for local tradition and culture. As elsewhere in the world, STDs and drug abuse accompany prostitution, creating social problems in a society ill equipped to deal with them.

As the long-term results of their investments become apparent, the involvement of the EBRD and other banks in Kashagan will prove a poor investment, and certainly one that bypasses the local community.

Kate Watters, Executive Director, Crude Accountability

Aarhus Convention ignored by IFIs in Albania

In 2004 the Albanian media reported on the biggest investment in the country: a 560 hectare industrial park was to be constructed at the Bay of Vlora. The park was to be built by the sandy beach, right next to the nationally protected pine forest, close to an antique port and adjacent to the Narta lagoon that is protected under the Ramsar Convention on Wetlands.

The European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB) and the World Bank's International Development Association (IDA) offered to finance the park facility, the Vlora thermal electric power plant, in spite of the project's obvious interference with the uniqueness of the site and the Albanian state's non-compliance with the Aarhus Convention. The Bay of Vlora, renowned as one of the most beautiful bays on the eastern coast of the southeastern Adriatic Sea and considered to be the biggest tourism resort awarded with the title "Queen of Albanian Tourism", has been condemned to death.

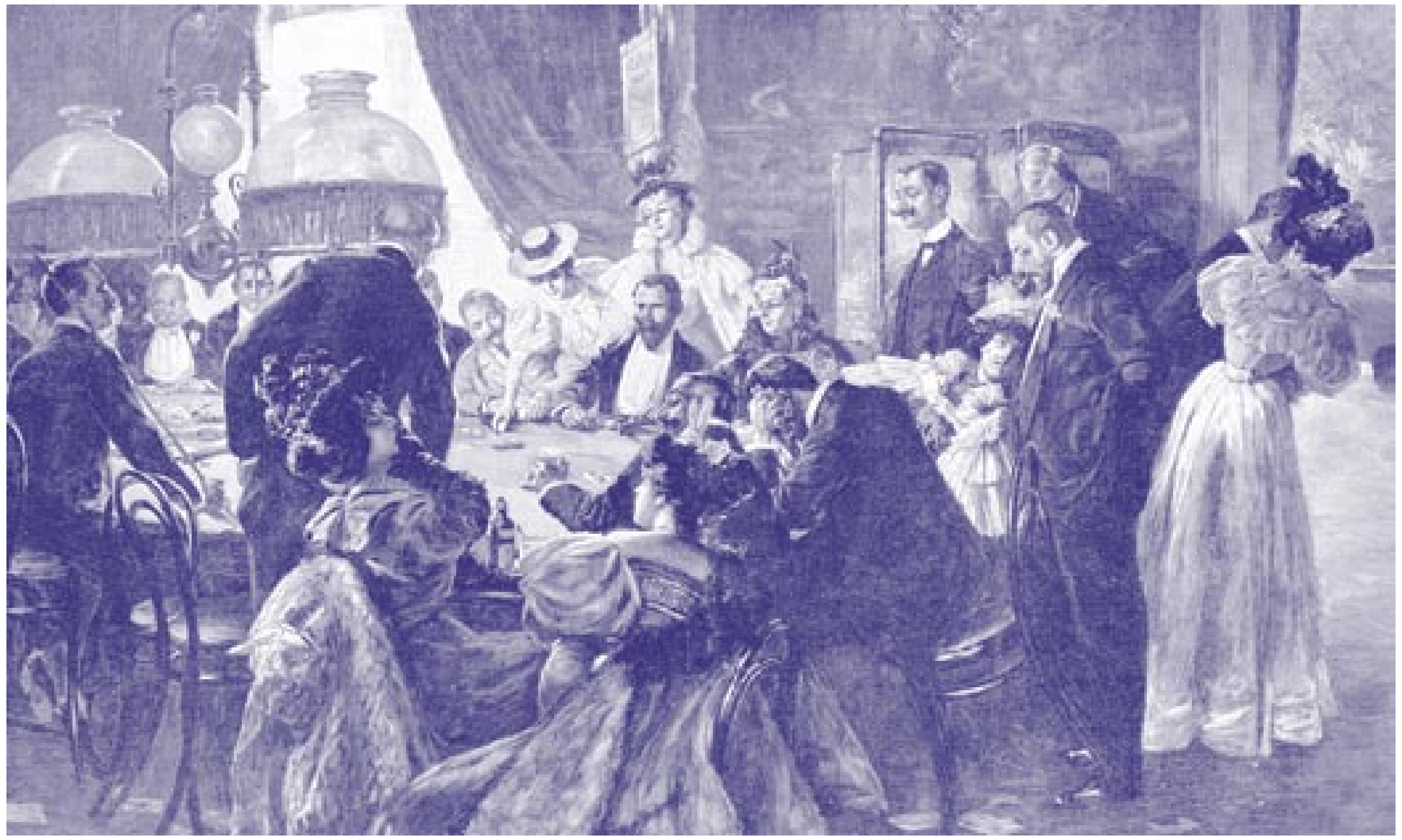
The Vlora Industrial Park is currently planned to be located only 1.5 kilometres from the centre of the city and surrounded by a residential area. In various stages, a complex of seven oil-fuelled power plants, the Albanian-Macedonia-Bulgaria (AMBO) pipeline outlet, storage facilities for hydrocarbons, a refinery, and industrial processing units are to be built. The industrial base will involve the processing of a high concentration of oil and gas: the AMBO pipeline terminal itself is supposed to accommodate 36 million tons of oil per year and the "La Petrolífera" Italian-Romanian terminal is slated to host 6-7 million tons of oil and oil by-products a year.

Despite the government's assurances that the power plants should provide a remedy to the increasingly acute energy situation in Albania, there are indications that the fulfilment of Albania's electricity demand features only as secondary to the export of electricity to the European energy market, particularly the Italian market.

The same views on the diversification of the Albanian energy system were used by the EBRD, the EIB, and the IDA when they agreed to support the construction of the 85-135MW Vlora power plants in 2004. Lending from these banks for a EUR 91-110 million project that should "help to reduce Albania's reliance on hydro generated power and ensure stable provision of electricity" amounts to EUR 40 million, EUR 40 million and EUR 20.3 million respectively. The electricity produced at the Vlora power plant is expected to cover 15 percent of Albania's energy needs.

Question marks have, however, been appearing over the project. The international financial institutions (IFIs) based their involvement in financing the power plant on a feasibility study and an Environmental Impact Assessment (EIA) commissioned from an international consultancy company. However, the EIA refers to a 100 MW thermal power plant while the government approved a power plant with a capacity of 300 MW.

All the decisions taken by the Albanian government passed through the approval of Vlora Regional Council, Vlora City Council and the Council of Territorial Adjustment without any significant public debate. These decisions were facilitated by and reached precipitously under the propaganda of development and without any technical information provided to interested groups. The Council of Territorial Adjustment approved the use of the territory



"I CALL YOUR COASTAL DEVASTATION, AND RAISE YOU SOME BLATANT DISREGARD FOR INTERNATIONAL AGREEMENTS" for the development of an industrial and energy park, the construction site for a coastal terminal for the storage of oil and oil-by products and associated port infrastructure, and the construction site of the power plant in three separate decisions on February 19, 2003.

Concerned about the sustainable development of Vlora and the health risks connected with the project, an initiative of a local NGO, "Alliance for the Protection of the Vlora Gulf", was established in March 2005. The pre-electoral political fights of 2005 and the urgent need to rebuild the Albanian energy sector, which is 90 percent based on unpredictable hydro power, for additional thermal resources, was an inappropriate atmosphere for the activity of the movement. In spite of this, the Alliance insisted that the Vlora power plant would destroy the environment, tourism, safe fisheries, natural habitat, ecosystem, coral colonies as well as the unique historical and cultural significance of the entire Vlora Bay and Narta Lagoon.

Aarhus Convention

On 27 April 2005, the Alliance for the Protection of the Vlora Gulf submitted a communication to the Aarhus Convention Compliance Committee (ACCC) alleging a violation by the Albanian government of its obligations under several articles of the Aarhus Convention, with the aim to influence the future decisions of the Albanian government, and to make the state publicly accountable. At the same time, the Alliance hoped that the three involved IFIs would freeze their financing for the Vlora power plant until the allegations were properly investigated.

The communication alleged that the Party concerned had failed to notify the public properly and in a timely manner and to consult the public concerned in the decision-making on the planning of the industrial park.

The Albanian government responded on 25 November, 2005, disputing the claim of non-compliance. It stated, inter alia, that the government had not made a decision on the development of the proposed industrial park as a whole; a decision-making process for the establishment of a power plant was under way, but no decision on an environmental permit had been taken; the public had been provided with timely and adequate access to information about the construction of the power plant; the government had never received any request for information on the projects from the communicant; the public had had the possibility to participate in the decision-making process for the power plant, as three public meetings had been organised at different stages of the process (feasibility study, scoping and environmental impact assessment), with the participation of local citizens and NGOs; and since the government had not made any final decisions yet on the projects, there was nothing to be challenged through the courts or other appeal bodies in Albania by the Alliance.

The Alliance maintained that there had been only pro forma public participation in the project, because most of those who had participated were governmental employees and functionaries from one political party. The Alliance also maintained that the state-owned Albanian Electrical Energy Corporation (Korporata Elektroenergjetike Shqiptare - KESH) had only announced the public discussion on the construction of the power plant and the documents had only been made available in February 2004, after the EIA process had already been concluded.

The dialogue between the Albanian government with ACCC was difficult as the government did not answer crucial questions and failed to provide all the requested documents.

Yet, in its Draft Findings and Recommendations from March 23, 2007, the ACCC acknowledges that although some efforts were made to provide for public participation over the decision by the Council of Territorial Adjustment of the Republic of Albania on the siting of the power plant near Vlora, "these largely took place after the crucial decision on siting and were subject to some qualitative deficiencies, leading the Committee to find that the Party concerned failed to comply with the requirements in question".

National mechanisms

With the communal elections approaching, the opposition based its election campaign on the promise of a local referendum in the Vlora district regarding the industrial park. After the victory of the opposition in the elections of July 2005, a special government commission met in three consecutive sessions with the representatives of the ministries, experts and the Alliance. However, neither the formal report nor the information was provided to the Alliance, which believes that the new government was pressed by the World Bank and private investors to approve the environmental and construction permissions in the interest of initiating the construction works.

In reaction, the Alliance conducted a referendum against the industrial park on its own. It collected 14,000 signatures – 10 percent of the electorate in Vlora – which was the sufficient amount for organising a referendum according to Albania's Constitution.

However, on 25 November 2005, the Election Committee refused the request for a referendum simply because former opposition representatives, now in power, voted against. The Alliance then appealed this decision to the court in Tirana despite having doubts about the prospects of a successful outcome. The Supreme Court rejected the appeal in December 2006. The effort to involve the Albanian Ombudsman failed too because this institution has only a recommendatory role. The judicial system in Albania is very slow and in many aspects corrupt, and there has not been a single case up to this day that has been decided in favour of an environmental complaint or charge.

The IFIs non-role

With the national executive and judiciary mechanisms failing to achieve a turnaround in the project, the Alliance sought the interruption of the loan disbursement from the three involved IFIs as the only way to stop the construction of the power plant. The Alliance entered into a dialogue with the World Bank and the EBRD, having received mostly negative responses.

In its response from 25 October 2006 to a letter from the ACCC secretariat, the EBRD confirmed that it was providing financing for the construction of the power plant and denied that it would be involved in the industrial park. The EBRD claimed that its Board of Directors had approved the financing for the power plant following its review of the project documentation, including reports on compliance with its policies and procedures on public consultation. The project was subject to EIA and public consultations that had been carried out in accordance with Albanian EIA legislation and the World Bank's environmental guidelines, which were comparable to the EBRD EIA requirements. Nevertheless, the fact that the IFIs viewed public consultation as satisfactory despite the negative findings of ACCC raises questions about the quality of the IFIs' procedures and the due diligence process.

Therefore on April 30, 2007 the Alliance submitted a request for a World Bank Inspection Panel´s investigation into the Power Sector Generation and Restructuring Project. It asserted that the World Bank's management failed to consider the fact that the project is based on the material misrepresentation of the site; the EIA upon which the World Bank's loan was based was misleading, illegal and wrong; and the World Bank's procedure leading to the project is in violation of Albania's laws on environment, public participation, cultural heritage and EIA, as well as the EU's laws and guidelines.

The World Bank was ultimately charged with violating various provisions of its own operational policies and procedures. As a result of the Alliance's persistence, the World Bank announced that its Inspection Panel would visit its Tirana office to investigate the procedures regarding the Vlora power plant on May 3, 2007.

Conclusion

On February 9, 2007, KESH signed a EUR 92 million contract with Italy's Maire Engineering SpA to build the Vlora power plant, ignoring the findings of ACCC and the democratic efforts of the Alliance over the preceding two and a half years. One month later, the deputy Minister of Industry was criticised for national treason when he declared that "the new government is not interested in building a large scale industrial zone in Vlora for all the different energy products planned by the former government".

Albanian political dynamics seem to be fuelled by despotism, incompetence and corruption. Working in parallel, the IFIs could and should be playing an important role in enforcing the ultimate accountability for badly planned projects. However, the fact that the World Bank and EBRD have denied any violations of the Aarhus Convention sends an alarming signal about their disposition to put things back on track. This is even more disturbing given the recent ambitious engagement of the World Bank and the EBRD in the consultations on promoting the application of the principles of the Aarhus Convention in International Fora.

Aleksander Mita, Alliance for the Protection of the Vlora Gulf

Squeezing the poor: the EBRD's role in privatisation in Montenegro

On May 21, 2006, Montenegro became the latest country in the Balkan region to become independent. The country is in the process of accession to the European Union and the European Commission has identified corruption and organised crime as the key challenges to be overcome if stable development is to be secured.

Latterly, the deceased guru of laissez-faire economics, Milton Friedman, moved away from the mantra of "Privatisation, privatisation, privatisation!" to recommending privatisation only if there are capable institutions in place to conduct transparent bidding processes. However, the Government of Montenegro is proudly underlining their progress in the implementation of a laissez-faire economy by promoting a high level of privatised property, while ignoring the social, economic and environmental consequences of such a process.

Moreover, the role being played by the major international financial institutions (IFIs) is not helping to curb the corruption and lack of transparency attached to privatisation. As the case of the Aluminium Plant Podgorica unfortunately demonstrates, letting things rip when it comes to privatisation can lead in a direction that none of these institutions' corporate goals support.

The Aluminium Plant Podgorica (KAP) is the largest economic entity in Montenegro, which prior to privatisation accounted for some 10 percent of total employment in Montenegro, nearly half of the country's industrial production, around 20 percent of GDP and some 40 percent of total exports. KAP is also the largest consumer of electric power, as well as being the largest water, air and soil polluter in Macedonia - KAP produces around 280,000 tons of alumina and 103,000 tons of aluminum a year, and it never received a usage permit due to the high levels of pollution. It is also located in the immediate vicinity of the National Park Skadar Lake, one of the largest bird habitats designated as a Ramsar Site (the Ramsar Convention is an international treaty for the conservation and sustainable utilisation of wetlands).

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Although the government sought a strategic investor to snap up 65 percent of the state-owned shares in KAP, on July 27, 2005 KAP was actually sold to a British offshore company "Eagle Capital Group". The owner of that company is another offshore company, the Cyprian "Salomon Enterprises", allegedly also the owner of the Russian Rusal. After signing the agreement, "Eagle Capital Group" changed its name into "En Plus Group" and moved their headquarters from the Virgin Islands to the British island of Jersey. In addition to the purchase price of EUR 48.5 million euros, the new owners were obliged to invest another 55 million, and an additional 20 million into the environment.

The full KAP privatisation agreement was declared a business secret, but one year later, due to a public campaign from the Montenegro NGO MANS, it was published.

The role of the IFIs in the privatisation process

According to correspondence from the European Bank for Reconstruction and Development to MANS, "In December 2003, the Bank signed a loan with the Government of Montenegro to provide 3 million euros in debt financing for retaining a privatisation adviser to the Agency of Montenegro for Economic Restructuring and Foreign Investments to ensure that KAP is privatised through a transparent and competitive process. The EBRD also stated to MANS that "the project was screened C/1, and therefore, in line with the EBRD's Environmental policy, no public participation is required".

However, such an explanation contradicts the information about the project on the EBRD website where it is stated that "active public information and consultation will be encouraged", while "development of a Public Consultation and Disclosure Plan will be part of the proposed second phase of environmental due diligence. Part of the loan proceeds will be spent on an environmental study and development of environmental and health and safety management which will be covenanted in the loan agreement."

MANS raised concerns that the privatisation process was not transparent and that information on pollution had remained secret, and also asked the EBRD if the government had fulfilled the requirements of the loan related to transparency. The EBRD confirmed the existence of such a requirement under the terms of the loan agreement, stating also that: "study documents are of a commercial nature as they are currently being used by the Government of Montenegro as the basis for negotiations with potential investors".

Although informed that the KAP privatisation process lacked transparency, and in spite of its own policy and the conditions of the loan, the EBRD never requested the government to publish the information, while documents on environmental pollution and privatisation conditions remained secret until, as a result of a number of trials and extensive public pressure, they were revealed 20 months later. Information on pollution was published at the end of 2006 and the privatisation contract remained a business secret until March 2007.

Social consequences of the privatisation

As KAP is the largest consumer of electricity, its price was one of the key issues to be resolved through the privatisation. The government was ready to sign the contract with a 5-year guaranteed fixed price of electricity, while the public strongly reacted demanding market prices for the new owners. World Bank experts developed a formula for calculating the price of electricity, setting it as a condition for new loans to Montenegro, and KAP was sold. Under the extraordinary formula devised by the World Bank, the price of electricity for KAP is calculated on the basis of the price of aluminum at the stock exchange. The market price of electricity is no longer a concern for KAP's new owners – if the price of aluminium at the stock exchange goes down, KAP will pay less for electricity no matter what happens with price of electricity at the stock exchange.

Since the contract in this way guarantees the continuous supply of electricity and prices calculated on the basis of the price of aluminium, the significant rise in electricity prices in the region and increased importing of electricity did not affect the new owner of the KAP.

Instead, the complete burden of the increased prices of imported electricity was transferred to people living in Montenegro as well as the small and medium-sized enterprises whose bills increased by more than 70 percent in January and by more than 40 percent in February this year. This created a major social crisis in a country where, according to the World Bank, 1/8 of the population is extremely poor and 1/3 is economically vulnerable. The state Ombudsman has said that the electricity shock for most people violated the right to decent living. Trade unions said that the January shock destroyed all efforts of the government to decrease Montenegro's poverty rate and they have threatened a general strike should this happen again.

During this period, the IMF organised consultations with the government and parliamentary parties asking for market prices to be immediately introduced with prices for households to be doubled, decreasing prices for small and medium enterprises, while the price for KAP was not to be changed.

MANS invited citizens to sign a petition asking the government to guarantee the same treatment for households as KAP: continuous supply of electricity by prices from local sources and a social policy for the poor. This campaign raised the strongest public support ever and in three weeks we collected almost 30,000 signatures.

In response, the government claimed KAP was sold in a highly transparent process supported by the EBRD, that the formula for the electricity price was set up by the World Bank, and that KAP has no subsidies but is paying the highest price for electricity in the region. The government went on to state that the privatisation contract is so good that it cannot be published, since then governments from other countries where Rusal – one of the bidding companies – operates might ask for the revision of their contracts. Three weeks after starting the campaign, and following further strong public pressure, the contract was finally published and the allegations that KAP has a privileged status in paying electricity were confirmed.

Since the government never accepted to decide upon the citizens' petition, instead of a petition MANS opted to formulate petition requests in the form of a draft law to be reviewed by the parliament.

After we started collecting signatures for the parliament, our activists were arrested by the police, and local inspections were preventing us from collecting signatures for the petition. However, again thanks to strong public support, in three days we collected over 7000 new signatures. The law is now incorporated into the parliament agenda, and it is expected the parliament will make a decision before the end of this month.

Consequences of the privatisation on the environment

The demands for electricity and its price are increasing, where KAP alone consumes 44 percent of the total electricity consumption in Montenegro. The government is trying to use the so-called "electricity shock" from January and February to get public support for building new sources of energy as is planned within the Draft National Spatial Plan for Montenegro.

In the part of the plan related to the energy sector there is not a single word about KAP as the biggest consumer, and it does not take into consideration the fact that KAP, after the expiry of the agreed 5-year price honeymoon, will lose the state subsidies for the price of electricity and will have to procure from the international market, thus effectively reducing the need to import energy for smaller consumers.

The Draft Plan is currently in the parliamentary procedure and it stipulates the construction of 11 new hydro power plants and 4 thermo plants. The plan envisages two alternatives for the River Tara that go through the Durmitor National Park, included in the UNESCO World Heritage list: one option to build three hydro plants and another to transfer waters from the upper flow of the Tara to the River Moraca.

Vanja Calovic, Executive Director, MANS

More EBRD money to fund more Mittal tragedy in Kazakhstan?

Following a postponement, the Mittal Steel Temirtau Health & Safety Project will be discussed and likely approved on June 12, 2007 by the board of directors of the European Bank for Reconstruction and Development (EBRD).

The project is intended to improve the metal and mining complexes in Temirtau (in the Karaganda region of Kazakhstan) of Mittal Steel Temirtau (MST). The particular aim is to improve the health and safety practices at MST's coal mines in Karaganda and bring them into line with international best practice.

On first sight, this proposed project is not controversial. However, when the actions (or non-actions) of MST in recent history are considered, there must be serious doubts about MST's willingness to improve labour and safety conditions for its workers.

In 1997 the EBRD approved a USD 54 million loan for MST to restore the company's productive capacity and improve the efficiency of its steel mills and coal mines. The loan to Mittal was co-financed by the IFC and accompanied by additional financing programs through financial intermediaries with the aim to mitigate the environmental and health and safety impacts of the facilities and align the company's performance with World Bank standards. The project is considered by the EBRD to be complete and successfully implemented.

However MST remains one of the largest polluters in Kazakhstan, emitting 95 percent of the total harmful pollutants into the air of Temirtau. With the increased steel plant production, the total amount of pollution deriving from MST activities has increased

Repeated accidents in the coal mines have left doubts about Mittal's successful implementation of the coal mines' Environmental Action Plans within the project. A methane explosion at the Lenin mine killed 41 miners in September 2006; an explosion at another MST-owned mine killed 23 people in December 2004.

In 2004 the cases of industrial injuries leading to fatalities at MST increased by a factor of five; and the rate of industrial accidents tripled. In 2006 there were 217 cases of industrial accidents, including 48 fatal cases and 17 which lead to severe injuries.

The approach to health and safety issues demonstrated by MST up to now raises serious doubts about its ability to bring the company into line with international best practice. Workers in Temirtau and Karaganda have long alleged that the company has done little to improve the labour and safety conditions since taking over Kazakhstan's largest metal factory and the mines that fuel it 12 years ago.

According to MST's Metallurgical trade union leader Yuri Baranov, the equipment at the plant has become obsolete. The same situation exists with the equipment at Mittal's coal mines. Some of the miners who survived in September's blast said that some of the equipment they were using was more than 20 years old. None gave their name for fear of losing their job.

So what can be the results of the Environmental Action Plans at MST's coal mines that were so successful according to the EBRD? Why is the EBRD now interested in providing a new loan to a company that clearly did not implement the requirements of its previous project? It's also worth bearing in mind that Arcelor Mittal, which runs 61 plants in 27 countries, should be pretty well placed to provide decent coal mining equipment without recourse to European taxpayers' money.

It is not the only one inexplicable aspect in the MST case. Mittal Steel's acquisition of the Termitau steel and power plants and coal mines results from a tax-alleviation scheme and generous state incentives. According to the contract signed with the Kazakh government in 1995, the investor did not need to observe any new environmental laws for a ten-year period following the date of privatisation of the facility and was exempt from paying taxes and pollution fees. The company was also exempt from any social liabilities of the previous owners of the steel plant and coal mines. During this ten-year period regional governing organisations such as the Karganda department for environmental protection and others have had very limited access to the company's sites and documentation. Such an agreement has had a devastating effect on the environment. And on many occasions MST has violeted national environmental and work and safety legislation.

There has also been no public access to the project's environmental information nor opportunities to participate in the project after the completion of its due diligence. People living in Termitau, Karaganda and other communities have not been able to voice their concerns about the environmental and social impacts associated with the project since no project-related information was made available for public reference.

MST has created serious environmental and social implications for the citizens of Temirtau and the results of the previous EBRD financed project at MST are still unclear for local communities. So far an environmental audit on MST recently conducted by Golder Associates Europe has not been released and local people have once again been excluded from the process of environmentally important decision-making.

The delayed EBRD vote on this project may be an indication that alarm bells are ringing in London. This is long overdue.

Dana Sadykova, EcoMuseum

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