

CEE Bankwatch Network comments on the draft EBRD strategy for Russian Federation

For more information

Vladlena Martsynkevych
vladlena@bankwatch.org

CEE Bankwatch Network's mission is to prevent environmentally and socially harmful impacts of international development finance, and to promote alternative solutions and public participation.

www.bankwatch.org

CEE Bankwatch Network welcomes the EBRD's revision of its Country Strategy for the Russian Federation for the period 2013–2015, and its emphasis on supporting diversification of the economy away from the resource extraction industries – particularly when coupled with energy efficiency – and on furthering opportunities outside of the main cities.

We would like to make several comments on the strategy draft, first on broader issues, followed by issues relating to individual sectors.

Political assessment and its relation to the strategy

Numerous reports from local human rights, environmental and public initiative groups¹, as well as international Human Rights Watch² and Freedom House³ show worrying limitations of civil society and media freedoms and human rights deteriorations in Russia. Thus, it is vitally important to emphasize events and legislation changes that have happened recently in the country. **The EBRD's draft country strategy contains a reasonable assessment of the situation, however it does not lay out what impact the political and democratic situation has had and will have on its investments in the coming period, and how the bank intends to ensure that its investments contribute to a deepening of democracy and human rights and avoid strengthening those who threaten this process.**

The EBRD claims “country strategies present political assessments of each COO, which will condition the level of involvement the Bank may have in each COO”⁴. As Russia is the largest country of operations accounting for 32 per cent of the Bank's 2011 annual business volume,⁵ it is particularly important to indicate how the political assessment for Russia will condition the level of involvement the EBRD has in the country.

1 http://www.ecmo.ru/main/abuse_rus/?drgn=1 and <http://www.ewnc.org/>

2 <http://www.hrw.org/news/2012/06/08/russia-reject-restrictions-peaceful-assembly>

3 <http://www.themoscowtimes.com/opinion/article/russians-are-afraid--and-for-good-reason/471469.html>

4 <http://www.ebrd.com/downloads/policies/sector/mining-operations-comments.pdf>

5 Draft Country Strategy for Russia, p.4

Corruption and transparency

The draft strategy rightly points to serious issues with corruption in Russia. However, as with the issues around democracy and human rights, it does not elaborate what impact this is having on the EBRD's decisions about making investments in the country. Are there sectors in which corruption is more pronounced than others? What message is the EBRD sending to the Russian government and companies on corruption when making its investments? Are there no-go areas for the EBRD in investments in Russia for the forthcoming period due to potential corruption issues? If not, why not?

In our opinion the EBRD needs to be extremely cautious about the kinds of projects it supports in countries with high levels of corruption and/or low public sector capacity. The bank has sometimes displayed a tendency to expect its countries of operation to run before they can walk, which is likely to have the effect of encouraging corruption and diminishing development outcomes rather than the opposite.

For example, undertaking rapid privatization without sufficient transparency safeguards and before sufficient anti-corruption safeguards are in place and before public officials have developed the capacity to negotiate beneficial deals through smaller, pilot projects is counterproductive. Furthermore, the EBRD continuously promotes the concept of public-private partnerships, an extremely complicated model which few if any governments even in advanced transition countries or 'developed' states have managed to get right. Promoting these arrangements in countries ridden with corruption and low public sector capacity is not

likely to end well. The EBRD needs to concentrate on basics in countries like Russia – strong safeguards against corruption, strengthening the capacity of public sector officials in project development and management, as well as negotiation skills. These should be practiced in smaller and simpler projects before leaping onto complicated projects with potentially serious consequences.

Another related issue is public transparency and information disclosure and the Bank's contribution towards this in Russia. This has been most obvious in the example of the first section of the Moscow–St. Petersburg motorway PPP, which the EBRD did not in the end finance, however we can nevertheless make some observations about the period during which the EBRD was assessing the project. In addition, as the bank has an ongoing partnership with the Russian state road agency Avtodor and is showing interest in financing future motorway PPPs in Russia, the issue has implications for the bank's future operations.

PPPs in several countries have resulted in failure to obtain good value for money or transfer a significant level of risk to the private sector, and have the potential to result in high levels of hidden public debt stretching over several decades. These are common even in countries more experienced with PPPs, but poor administrative capacity and corruption can multiply these issues and aggravate them significantly. Avoiding such scenarios requires a high level of public transparency – including tender processes with a sufficient number of competitors to ensure real competition and the public disclosure of Public Sector Comparator calculations, draft and signed contracts – something which is absent in many countries, let alone Russia where lack of public transparency and

corruption are commonly recognised problems. Where public transparency and disclosure of the relevant data cannot be ensured, the likelihood of a project being signed which is detrimental to the public budget or users of a certain facility is much higher, and the EBRD should not finance such projects.

In the Moscow–St. Petersburg motorway, several crucial elements of transparency were missing. The lack of public participation and harassment of project critics are relatively well-known and have been discussed with the EBRD since 2009, however there were also other issues such as changes in the legal status of land in Khimki forest which appeared to contravene the law, as well as the fact that the project company, North West Concession Company, was made up of a complex web of companies, many of whom were based in offshore jurisdictions and most of whose final beneficiaries could not be traced by members of the public.⁶

Whether the EBRD was concerned about any of this is unclear as there are no public indications one way or the other. While the company structure was not illegal, it did conceal the fact that no less than four billionaires are the final beneficiaries of the project, and left a number of questions about the development impact of such an arrangement given the possible losses in tax income for the Russian state resulting from it. That the EBRD ever considered financing such an opaque project is unacceptable. Interestingly, the North West Concession Company has changed its structure twice since the original structure was published, and the largest final beneficiaries have now been publicly disclosed. It is unclear why untangling the ownership structure of a project company was left to civil society initiative and not required for public disclosure

6 Vinci – a cover for oligarchs and tax havens in Russia's first road PPP: http://bankwatch.org/documents/Vinci_oligarchs_taxhavens_Khimki.pdf

by the EBRD as a basic requirement for the project. In addition, no satisfactory explanations have ever been given for the change in the status of the Khimki forest land and then President Dmitry Medvedev has admitted that the routing through Khimki Forest seems to have been chosen due to special interests and not because it was the best route.⁷

There is no sign from the EBRD's public statements that the bank had issues with any of these aspects of the project, in spite of them constituting – at the very minimum – a lack of transparency, and at worst downright corruption.

The Bank's August 2011 Memorandum of Understanding with the state road-building agency Avtodor⁸ sent further signals that the bank is ready to co-operate with institutions associated with a lack of transparency, potential corruption and possibly even violence against opponents (at the very least, it can be said that Avtodor has not shown any public signs of concern regarding the dramatic events around the Khimki Forest).

While Avtodor obviously needs to raise its standards, the EBRD's decision to support the institution while claims of violence and corruption around its projects still remain unaddressed leaves a sour taste. **The bank therefore needs to make clear to all stakeholders what exact kind of transparency and public disclosure it is promoting in Russia, and what are the minimal conditions under which it will get involved with certain companies or institutions.**

Development impacts

Related to the above, in its draft country strategy, the EBRD does not mention the frequent use by Russian companies of offshore jurisdictions, especially in Cyprus. While this is not illegal, it has an impact on the transparency and tax implications of projects, and we would expect the bank to comment on the approach it will take to this issue in its work in Russia.

7 Kremlin website: Transcript of the Council for Civil Society Institutions and Human Rights, 1 February 2011, <http://www.kremlin.ru/transcripts/10194>

8 <http://www.ebrd.com/pages/news/press/2011/110818.shtml>

Similarly, the draft strategy highlights the bank's intentions to support private equity funds. Given that these are often based in offshore jurisdictions and given the lack of evidence to support the idea that private equity funds consistently lead to positive development outcomes, this proposal needs to be better justified by the banks on the basis of concrete evidence.

The energy sector

We very much support the bank's goal of increasing energy efficiency investments and sustainable renewable energy in Russia and believe that this is one of the areas where the bank can have the greatest added value. At the same time we would like to point to the necessity to prioritise demand-side energy efficiency investments, especially residential improvements. As we have done elsewhere, we would also caution against counting new units at coal power plants or extended lifetimes of the plants as energy efficiency investments, as they result in an overall larger amount of emissions from the given plant than would have been the case if the plant had closed.

Agriculture

The EBRD plans to: *“Support agribusiness development and improve regional food security by developing more projects that improve energy efficiency, develop modern infrastructure and set higher standards in the food supply chain under the “Integrated Approach to Reform the Physical and Financial Infrastructure of the Grain Value Chain”.*

The bank's current plans to support US agribusiness giant Monsanto in Russia, among other countries, raise questions about the direction the bank plans to take with its support for the agriculture sector in the coming years. While this is partly a question for the Bank's agriculture strategy across the board, not only in Russia, it should be made clear in the Russia Country Strategy how the bank's support in the agriculture sector will contribute

to strengthen small farmers, which is key to ensuring the survival and employment of people in rural regions.

Recommendations:

The EBRD needs to amend its country strategy as follows:

- It needs to be shown how the political assessment is going to impact on the EBRD's investments in 2013–2015.
- It needs to be shown how the high levels of corruption in Russia are going to impact the EBRD's investments.
- In view of the levels of corruption and the political situation, the EBRD should concentrate on getting the basics right in terms of public sector capacity and should avoid overly complex projects such as PPPs until the situation has improved considerably.
- It needs to be explained how the bank will make more visible efforts to push for greater transparency and the fight against corruption in Russia, and what its conditions are for getting involved with institutions that currently suffer from unacceptable practices.
- The EBRD should lay out its approach to the use of offshore jurisdictions by Russian companies and how it will act to minimize these and ensure public disclosure of ultimate beneficiaries of projects. The bank has a policy on offshore jurisdictions; however, practically it does not address these questions.
- The bank needs to either better justify the development impacts of private equity funds with clear evidence or remove this aim from the strategy.
- In the energy sector, demand side energy efficiency, in particular residential energy efficiency should be prioritised, along with sustainable renewable energy. Fossil fuels, including power station renovations or replacements that prolong the plants' lifetimes should not be financed.
- It needs to be made clear how the bank will support smaller-scale agricultural producers in Russia.