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Stuck in the market?

25 years since the fall of the Berlin Wall: what now for the EBRD?

The EBRD - investing in changing lives? By its own account, less than a third of people in the region believe that their households lived better than in 1989

Introduction

In 2011, as the European Bank for Reconstruction and Development (EBRD) celebrated 20 years of operations in supporting transition to a market economy and pluralist democracy, transition had been patchy. Only the Czech Republic had ever graduated from EBRD operations and even by the bank's own standards, the economic and financial crises had exposed crucial weaknesses in the models it had promoted, such as the penetration of western banks into the region which spread the effects of the financial crisis, and the dependence on exports which had knock-on effects when the importing countries lowered their consumption. More broadly, market economics was - and is - far from solving the massive environmental and social challenges we all face. With this in mind, we produced a policy paper entitled "Are we nearly there yet? Dilemmas of transition after 20 years of the EBRD's operations"[1], in which we pointed out that if transition is the means, it is no longer very clear what is the desired end. The paper, among other things, proposed:

- a serious re-think at the EBRD about its added value and a change in the bank's mandate;
- the development of a more precise definition of environmental sustainability and better measurement of the bank's environmental, social and, in certain countries, development impacts;
- more specific criteria for engagement with undemocratic countries; and
- the development of a clear exit strategy for the EBRD in its countries of operation, to avoid its increasing 'mission creep' and speed up the graduation rate for recipient countries.

Three years later, these recommendations are more relevant than ever, and the need to critically re-examine the bank's operations more urgent. The EBRD has expanded rapidly into the Middle East and North Africa, but much of its original region of operations continues to suffer from serious problems. While much has recently been made of the tenth anniversary of Poland's entry into the EU and the country's transformation during the last two and a half decades, across the EBRD region more broadly, there is less reason for optimism.

Two of the bank's largest countries of operation, Ukraine and Russia, are in the midst of a serious conflict, and the majority of recipient countries suffer from high unemployment and inadequate social safety nets.

Public participation in decision-making remains pitifully low, partly as a result of persistent authoritarian tendencies and corruption in many governments. Consequently, social unrest has increased, not only in the well-known examples of the Arab Spring, Ukraine's Maidan and Turkey's Gezi Park, but also for example in Bulgaria, Romania and Bosnia and Herzegovina. No wonder the EBRD called its 2013 Transition Report "Stuck In Transition?" Could it be that the Iron Curtain has simply moved east?

In spite of this increasingly serious situation, the EBRD's operations seem to be proceeding largely unchanged: promote the private sector and hope that everything else will follow. This has lead to a situation in which the bank is 'stuck in the market', where the market in and of itself is seen as the solution for the region's difficulties. Because of this, the bank often lacks the necessary caution to recognise that 'promoting the private sector' without adequate public participation and safeguards against corruption and human rights abuses is likely to be counterproductive.

Although the bank has recently made some improvements in its safeguard policies such as restricting its coal power plant investments, tightening its industrial emissions provisions in its environmental and social policy, and improving its recourse mechanism, the EBRD has shown no signs of halting investments into controversial projects like hydropower plants that destroy biodiversity (eg. in Georgia and Macedonia) or mining projects that devastate local livelihoods (eg. the massive Oyu Tolgoi mine in Mongolia). At the same time, the bank is missing opportunities to improve its standards in other areas, and is lagging behind its peers in transparency and information disclosure[2].

Instead of truly responding to calls from its shareholders and civil society to show clearly how its projects really have positive human and environmental outcomes, the EBRD has adopted the strapline "We invest in changing lives", but it is still unable to prove it through systematic project-level information on its projects' results.

Failure to move from this banking mindset may cost the bank its reputation, but more importantly is too often working against the interests of those the bank is supposed to help - the people and environment in the bank's country of operations. This paper, which brings up to date our observations from Are We Nearly There Yet? aims to serve as a wake-up call to the EBRD and its shareholders to move away from its assumption that business volume is king, and as a public financing institution, choose quality over quantity.

The means to an end

"Transition" is the means to an end. But what is the end, according to the EBRD? *Following its mandate, the EBRD must: "foster the transition towards open market-oriented economies and to promote private and entrepreneurial initiative in the Central and Eastern European countries committed to and applying the principles of multiparty democracy, pluralism and market economics."*[3] *It is also obliged "to promote in the full range of its activities environmentally sound and sustainable development".*[4]

This rather wide mandate can be interpreted in various ways, so let us look at how the EBRD interprets each element.

Market-oriented economies

'Market-oriented economies' can mean more or less anything, from states with comprehensive welfare systems to states with almost none; from those with state-owned railway and energy companies, to those with all public services privatised.

The EBRD interprets healthy market-oriented economies as highly liberalised and privatised. Its transition indicators regard privatisation and liberalisation as ends in themselves. The bank awards points for activities that are optional, not obligatory, in a market economy. For example, many western countries have limited (if any) private sector involvement in the water sector, and public-private partnerships (PPPs) in the road sector - where they have been carried out at all - have often been controversial[5]. Yet for the EBRD a transition country cannot score top marks without these interventions. At the same time, a country can lose transition points for introducing socially progressive policies. In the 2013 EBRD Transition Report, Estonia lost a point under the heading urban transport following its decision to introduce free travel for all residents of the capital, Tallinn — a decision the EBRD referred to as 'not an efficient approach'.[6]

The EBRD's Office of the Chief Economist has acknowledged in recent years the need for strong institutions to support and regulate market activity, rather than concentrating just on privatising companies and liberalising markets. The economic crisis accelerated this shift and highlighted the need to reflect on what role the state can play in market economies. However, the EBRD continues to view the state as a support mechanism for markets rather than as a series of institutions that ensure public rights and welfare, and as well sees market rules as the only relevant set of principles rather than one of many often competing value systems that governments should take into account.

For many years, what was missing at the EBRD was any discussion about the impacts of transition for people on the ground most immediately affected by bank operations. It was generally accepted that reforms were painful for some people but that the ends would justify the means, but little detailed analysis was carried out to back up these assumptions until the EBRD's Life in Transition surveys in 2006 and 2010 brought some worrying findings (more details in the next section).

"Transition" is the means to an end. But what is the end, according to the EBRD?

Countries committed to and applying the principles of multiparty democracy and pluralism

The goal of applying multiparty democracy and pluralism ought to be somewhat clearer than promoting market economies or sustainable development. While western democracies are subject to criticism due to their frequent failure to represent the interests of ordinary people and to respond to massive challenges such as the financial crisis and climate change, there are at least a relatively clear set of criteria for deciding what a representative democracy looks like that can serve as a minimum condition for EBRD involvement in a country[7].

The bank's assessment of which countries need a particularly restrictive investment approach in order to avoid supporting undemocratic regimes only concentrates on a few of the world's very worst examples and does not restrict investments in other countries such as Azerbaijan or Russia which are considered undemocratic by metrics like those of the Economist Intelligence Unit and Freedom House. The bank is faced with a constant dilemma about whether it will achieve better results by engaging with authoritarian governments or isolating them. As we will see in the next section, so far the bank's engagement too often condones human rights violations and repression.

Environmentally sound and sustainable development

In 2011, we characterised the EBRD's interpretation of sustainable development as focusing on integrating EU environmental protection standards into its projects and pointed out that although following EU standards in transition countries would indeed bring improvements in many sectors, following the same development patterns as western economies would not lead to the desired result of sustainable development.[8] Since then, the bank has loosened rather than tightened its interpretation of sustainability. **In the bank's new Environmental and Social Policy, instead of a clear pledge to implement all EU environmental standards across its countries of operations, its new mantra is "Good International Practice", whatever that may be.**

The bank's vision of social justice is even less developed, and social standards and principles are less integrated in EBRD operations. In spite of its title, the EBRD denies it is a development bank, and even for the poorest countries it has not measured the results of its lending in development terms like poverty reduction, gender equality or employment gains, or assessed its contribution to the Millennium Development Goals. The bank has always assumed that the development of the private sector is good for everyone.

In recent years the EBRD has acknowledged the need for social inclusion, with for example the Office of the Chief Economist measuring certain indicators in its Transition Report 2013. This work has advanced furthest in the area of gender, which has to some degree been mainstreamed in the bank's operations in part due to the support it has received by several of the bank's shareholding countries. However the bank still lacks both an overall vision and clear goals for the positive social impacts it wants to have and the best means of achieving this, if indeed it is an appropriate institution to do so.

In summary, although the EBRD has moments of admitting that everything is not alright, such as in its revealing Life In Transition surveys, it is weaker at drawing appropriate conclusions and changing course. The bank still invests in just about anything to do with the private sector and calls it 'transition'. Even more worryingly, the EBRD is undertaking a significant geographical expansion to the Middle East and North Africa — and perhaps even creeping into countries of southern Europe like Cyprus[9] - while its basic raison d'être and ability to achieve long-term positive change in its countries of operation is less and less convincing.

Where are we now and how well is the EBRD contributing?

Not only has the final goal of transition become much less clear since the early 1990s, but also the different elements of transition have progressed at different speeds. Market economies have advanced considerably more so than democracy and sustainable development, although 2013's EBRD Transition Report shows that even these changes have reversed in some cases.

The EBRD took its first major step towards understanding ordinary people's experiences with transition in its 2006[10] and 2010[11] Life in Transition surveys. The results of the 2006 survey were quite mixed, especially considering that the survey was carried out in a period of strong economic growth. Only 30 per cent believed that their households lived better at the time of the survey than in 1989.

Generalised trust in other people increased only slightly between 2006 and 2010. In 2010, 34 per cent of respondents in the transition region answered that they have either "some trust" or "complete trust" in other people, compared to 30 per cent in 2006. For comparison, in western European countries in 2010, 42 per cent of people say they trust others (hardly a comforting figure in itself).

Presumably due to the financial crisis, support for market economies also dropped between 2006 and 2010 (from around 43 per cent to less than 40 per cent) in all central and eastern EU Member States apart from Bulgaria. Interestingly, less than 30 per cent of UK respondents and less than one-quarter of the French sample gave complete support to market economies. Support for a combination of market economies and democracy was higher in EBRD countries of operation than for any other system in both 2006 and 2010 but dropped from only 36 per cent to an even lower 33 per cent.

Market economies?

The EBRD's annual Transition Report[12] shows how far EBRD countries of operation have progressed towards building what the bank sees as a market economy. Bankwatch has often questioned whether the right indicators are used to measure this transition[13] for the following reasons:

- They provide an abstract economic view of transition and do not measure its effects on people nor, with the exception of sustainable energy, on the environment.
- Some of the countries that appeared to have made the greatest progress were also among those hit hardest by the financial crisis, so the indicators do not give sufficient guidance on economic vulnerabilities[14].
- Most of the indicators - such as privatisation — relate to means rather than ends and do not provide assurance that society actually benefits from the reforms that have been made.
- The model market economy outlined by the indicators includes elements that go well beyond what is required for a basic market economy[15] and whose positive economic and social impacts are far from proven, such as the presence of public-private partnerships and private equity funds.

Examples of how developments praised by the EBRD are not necessarily for the benefit of the public are numerous. To name just two from the 2013 Transition Report: the EBRD lauded Albania for managing to sell four hydropower plants — Ulez, Shkopet, Bistrica 1 and Bistrica 2 in early 2013, after previous failed attempts[16]. The IFC-backed sale[17] of the plants to a private Turkish steel company (KURUM) has been criticised for decreasing the stability of the Albanian electricity system, since the Bistrica plants are situated in the south of the country where there are fewer electricity generation facilities. The fact that two of the plants had been recently rehabilitated using KfW funds also raised eyebrows, as a public company took on the debt which is now benefiting the private buyer of the plants.

Likewise the launch of the privatisation of HZ Cargo, Croatia's rail freight operator, was also named as a positive development[18] - never mind that the sale later collapsed in January 2014, raising questions about whether it would not have been better to invest the effort into improving the existing management of the company instead of privatising for privatisation's sake.

The EBRD is due to make adjustments to its country level indicators for its November 2014 report, though past adjustments suggest no radical changes can be expected. However, with the EBRD's current indicators, in 2013, for the first time transition score downgrades (three in Hungary and two in the Slovak Republic) outnumbered upgrades (one each in Croatia and Tajikistan), hence the name of the report "Stuck in Transition?"

But taking a look beyond the EBRD's assessment, it is not enough to just 'develop the private sector.' As we can see below, **'the private sector' can include almost anything, and there is no guarantee that ordinary people will benefit.** While the EBRD is indeed making some investments into small and medium enterprises, other investments raise more doubts as to the level of need of its clients.

The EBRD billionaire club, starring from left to right, Russia's Andrey Filatov and Andrei Melnichenko and Poland's Jan Kulczyk.

Why does a public development bank finance Russian billionaires?

While the EBRD likes to see itself as encouraging good governance and avoiding financing for politically-exposed persons, it has quite a flexible definition of who makes a suitable client for a development bank. Scratch below the surface of anonymous-sounding project titles like the 'UCLP Energy Efficiency Loan,'[19] 'Far Eastern Rail'[20] or Global Ports Investments Plc[21], and it does not take long to find an oligarch hiding, usually behind some offshore financial centres.

In the case of UCLP, the loan approved in November 2013 is for JSC "Sea Port of Sankt-Petersburg" (SPSP), a subsidiary of UCL Holding BV. The company is owned by Vladimir Lisin, estimated to be the fourth richest person in Russia with a current net worth of USD 14.2 billion.[22]

Far Eastern Rail, meanwhile, received approval for an EBRD loan of no less than EUR 133 million in December 2013, but the bank is not even willing to share the name of its owner with the public on its website. Forbes reports[23] that Far Eastern Rail ltd. was registered in Cyprus in November 2013 and that 92.2 per cent of the company belongs to Linea Ltd (Bermuda) and 7.8 per cent to Altmirco Enterprises Ltd. Billionaire Andrei Melnichenko, who has hit headlines with his submarine-like yacht and astonishingly extravagant wedding, reportedly owns Linea[24], while his long-term associate Vladimir Rashevsky owns Altmirco.[25] Ironically, the loan was approved on the same day that the bank approved its updated Domiciliation of EBRD Clients policy, which is supposed to limit the EBRD's support for companies using offshore financial centres.

Global Ports Investments, for whom the EBRD approved a loan in 2011, is also owned via companies registered offshore. 30.75 per cent of the company is owned by Transportation Investments Holding Ltd (TIHL), also known as N-TRANS, which in turn is controlled by billionaires Nikita Mishin, Konstantin Nikolaev and Andrey Filatov.[26] However, their ownership goes through channels that are not fully known but involve a Bahamas-based company called Mirbay International.[27]

These people are also involved in the North-West Concession Company, which is carrying out the notorious Moscow-St. Petersburg motorway project through the Khimki Forest. In 2013 in response to a request by several NGOs including Bankwatch, French prosecutors began to examine allegations of corruption around the deal,[28] and in March 2014 NWCC co-owners, Arkady and Boris Rotenberg, were placed on the US sanctions list targeting Russia for its actions in Crimea.[29]

Or Polish ones?

In July 2013 the EBRD approved a loan of USD 60 million for the development of oil and gas fields in Tunisia by Serinus Energy[30] owned by Luxembourg-based Kulczyk Investments (over 50 per cent of shares) and Jersey-registered Pala Assets Holdings Limited (over 7 per cent of shares). Kulczyk Investments is in turn owned by Poland's richest man, Jan Kulczyk.[31] While the bank claims the usual transition benefits (promotion of an independent private company in a sector dominated by the state-owned company and increased corporate governance standards), is there really no more deserving project in Tunisia than the extraction of fossil fuels by someone who can surely find the money elsewhere?

Or Greek ones?

In 2010 the EBRD approved a EUR 37 million loan for the redevelopment of the Sveti Stefan island hotel complex in Montenegro[32] by the Greek shipping company Restis Group. The deal became controversial when Restis allegedly failed to keep to the deadlines in the deal and constructed buildings outside of the approved zones.[33] In July 2013 Victor Restis was arrested on suspicion of fraud,[34] throwing the project into further disarray.

While the main point in these cases is the EBRD's lack of added value and the use of development loans to support those who are certainly not in need, it should also be noted that in two of these cases, those involved have been alleged to be involved in corruption. While no guilt had been proven at the time of writing, these are not the only cases where the EBRD has financed projects with possible corruption issues. Our December 2013 paper on the EBRD and corruption in the coal sector[35] also pointed to the examples of the Kolubara mines in Serbia, and the coal power plants at Sostanj in Slovenia and Turceni in Romania, in which we concluded that the bank failed in its due diligence and in its reaction to later developments.

Corruption is publicly acknowledged by the EBRD to be a huge problem in its region of operations. This is backed up by the Life In Transition surveys in which only 15 per cent of respondents believed that there was less corruption in 2006 than in 1989, while 67 per cent of respondents indicated that corruption is the same or worse than it was before transition began — rising to 75 per cent in southeast Europe. By 2010 the perception of corruption appeared no better — only in three countries was there a perception that corruption had decreased since 2006: Georgia, Uzbekistan and Turkey.

If the EBRD wants to contribute to addressing this problem, it needs to take much more care not only to do its own due diligence on its clients' corporate governance, but also to ensure that it responds adequately in cases where allegations are made by others either before or during projects. The EBRD's response to internal corruption scandals[36] in recent years appears to have been reasonably prompt, however the Chief Compliance Officer's response to corruption allegations with regard to its projects has been quite invisible. EBRD President Chakrabarti regularly mentions the issue of corruption, and the bank publishes annual anti-corruption reports[37], but as these do not name names, they are of limited use, and the recent reports appear to suggest that in most cases, no wrongdoing is established.

In some cases, words without action may even prove counterproductive and provide support to those engaged in corrupt practices. For example it was just six months ago that the EBRD almost signed an anti-corruption memorandum with the then Ukrainian President Yanukovych.[38] Looking back now, it is hard to see what this would have achieved except harming the EBRD's image in Ukraine.

Of course corruption is a sensitive topic and it is necessary to keep a certain level of confidentiality while investigations are ongoing, but in case it is concluded that there has been a high likelihood of corruption in an EBRD project, the bank could present a much stronger anti-corruption image if it showed publicly what it is doing to correct the situation in concrete cases.

Another important step that can be taken by the bank is to avoid promoting policies that increase the risk of corruption. Often it is not the precise projects financed by the EBRD that benefit elites, but the wider model of privatisation that is pushed by the bank. Sell-offs and concessions are likely to be counterproductive if carried out while basic governance issues have not been addressed in the countries of operations, and it is unclear why the bank is always in such a hurry to promote them.

Privatisation in Serbia

Transition started relatively late in Serbia but after the fall of the Milosevic regime and a new privatisation law, sell-offs of public companies soon gathered pace. However, a lack of government capacity and political will to ensure transparency and fairness in the procedures for privatisation resulted in numerous deals in which companies were sold to actors who were more interested in acquiring property than in ensuring the continuation of their business.

A Veroci resident living near the Kolubara lignite mine in Serbia, where allegations of corruption abound.

In 2011 Serbia's Social-Economic Council concluded that the results of privatisation had been catastrophic. More than 3000 public enterprises were privatised in Serbia from 2002 to October 2011, but 65 per cent of them had stopped working or were about to end operations. The social cost has been huge: about 83,000 jobs, or two thirds of jobs prior to the privatisation, had been lost. Serbia's State Privatisation Agency had cancelled 636 privatisation contracts mostly because the new owners did not pay their installments, failed to maintain the businesses or did not comply with established and agreed social programmes.[39]

While the EBRD has been involved only peripherally in the most controversial privatisations, the bank has consistently promoted privatisation as a policy while failing to examine the consequences.

One example is the 2006 sale for EUR 13 million of the fertilizer producer Azotara in Pancevo near Belgrade to a consortium of Lithuanian firms including Arvi and Sanitex, as well as Belgrade's Universal Holding. The contract was terminated in 2009 since the consortium sold the most valuable section, Karbamid 2, to a Russian company in 2007 for EUR 32.5 million without the approval of the Privatization Agency.

After this, Serbia's Agency for Privatisation appointed Radoslav Vujacic as the capital representative, who was, at the same time, Deputy Director-General of Srbijagas, Azotara's largest creditor. This is in itself caused a potential conflict of interest that has never been explained by the Agency.

During his tenure, Vujacic managed to cause further harm to Azotara, among other things by signing bizarre contracts to borrow wheat worth 12 dinars per kilogram from the company Victoria Logistic on 17 March 2010 and to sell the wheat to the company YU Point on 6 April 2010 for 9 dinars per kilogram. This transaction in itself is estimated by Serbia's Anti-Corruption Council to have caused around EUR 2.4 million damage to Azotara[40]. The case is pending at the time of writing and no-one has yet been sentenced.

Although the EBRD was not directly involved in the deal, it is interesting that all three of the main actors in the disputed wheat deal are EBRD clients: the EBRD is a co-owner of Victoria Group, which it supported with EUR 40 million in equity in 2008 and a EUR 45 million loan in 2007[41]. Srbijagas, which acted as a guarantor for the wheat deal, received a loan of EUR 150 million from the EBRD in 2010. Finally, YU Point was until 2012 owned by Zoran Drakulic, who also owned the Sevojno rolling mill that received a 2005 loan from the EBRD[42].

In spite of such findings, the EBRD, as well as others like the European Commission, are still pushing Serbia to carry out further privatisations and - even more difficult to get right - public-private partnerships. The bank provided technical assistance for the development of the Law on PPPs and Concessions, adopted in November 2010, and in 2012 supported the government with capacity building for the recently established PPP Commission[43]. In its 2013 Transition Report country assessment for Serbia, the EBRD state: "Efforts should be increased to advance the process of restructuring and privatising the remaining state-owned enterprises…"

Would it not be advisable to pick up the pieces from previous attempts and ensure that more effective anti-corruption structures are in place before proceeding further?

Konzum or else.... EBRD support for Croatia's omnipresent Agrokor

In 2010 the EBRD in its country strategy for Croatia admitted that the market dominance of Agrokor, owned by Croatia's richest person, Ivica Todoric, was becoming a cause for concern. This rather late realisation came after the EBRD had in 2006 provided EUR 110 million in equity for the company, as well as four loans for its operations in Croatia, Bosnia and Herzegovina and Serbia, totalling around EUR 126 million.[44] Even after realising that Agrokor's dominance was an issue, the EBRD approved in 2011 a further loan of EUR 5 million for the company. Undeterred by Agrokor's retail dominance, the bank is considering backing its takeover of Slovenia's Mercator, which also operates in Croatia and Serbia.[45]

In other cases there is no evidence that EBRD-financed projects enrich particularly privileged persons or work directly against the interests of local people, but it is legitimate to ask whether this is the best that can be done with international development finance. While the EBRD states on its website the transition impact that its projects are expected to have, some of these justifications are extremely thin.

Let them eat shopping centres

In the ten years between 2004 and 2013, the EBRD approved financing for no less than 19 shopping centres totalling more than EUR 876 million. This figure does not include investments with a predominant food retail element, nor indirect investments by the plethora of property funds supported by the bank during this period, so the real figure is likely to be much higher. In particular, the Poland-based Globe Trade Centre group has received an astonishing ten loans and equity investments since 2000 worth EUR 316 million for various property investments including shopping centres. But where is the transition impact here? What kind of a priority is this for a multilateral development bank? Such investments would most likely happen sooner or later without the EBRD's help.

Such investments risk contributing to public scepticism in the region about the role played by the EBRD and the degree to which its investments address real public needs. The cases above also lead to the conclusion that **while there is most likely a development justification for supporting some private sector activities, the EBRD cannot take this for granted and must develop measures for the impacts on real people and undertake projects that clearly benefit people and the environment. Projects that do not clearly benefit ordinary people and the environment should not be financed with public money.**

Countries committed to and applying the principles of multiparty democracy and pluralism?

'Democracy' is much maligned in many of the countries that nominally have democratic political systems but where many people feel alienated from decision-making processes. The EBRD's Life in Transition II report even detected a decrease in support for democracy between 2006 and 2010 in all new central and eastern EU Member States except Bulgaria. Overall, around 45 per cent of respondents in the survey preferred democracy over any other political system, which hardly sounds overwhelming, though at least much fewer supported authoritarian governance. Nevertheless, while recognising the frequent weaknesses of multiparty democracy, the principles it aims to uphold such as freedom of speech, the media and of assembly are crucial and that the EBRD's mandate of operating only in countries committed to and applying these remains extremely important.

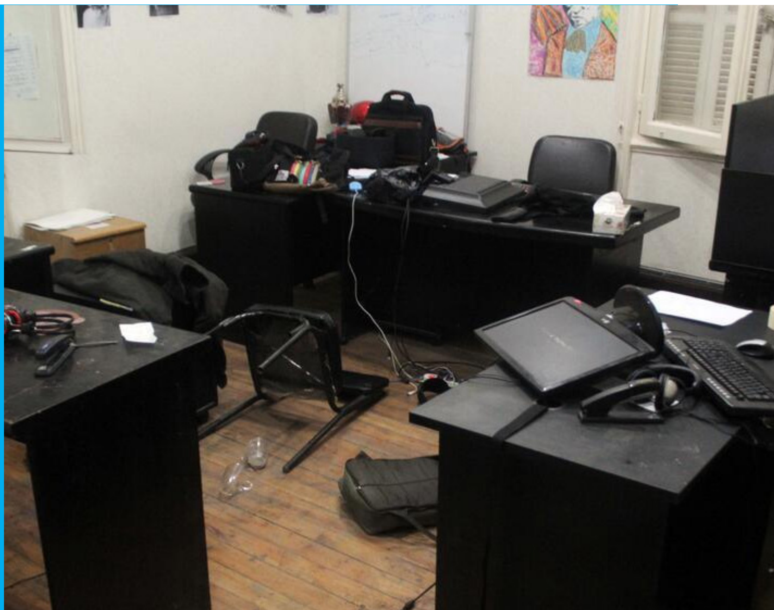
In the last 25 years, multiparty democracy has spread unevenly across transition countries, and in recent years the situation has stagnated in countries like Belarus, Turkmenistan, Azerbaijan, Uzbekistan and Kazakhstan and worsened in other countries, with alarming results in Ukraine, Russia and Egypt particularly. So what has the EBRD done under its mandate to ensure that it works only in countries committed to and applying the principles of multiparty democracy and pluralism?

A bank is not the most obvious institution for promoting democracy, yet the EBRD does have some tools at its disposal. It can limit or refuse to finance activities in countries that are clearly not applying the principles of multiparty democracy and pluralism, as there is a high risk that investments will benefit elites at the expense of ordinary people. With this in mind, the EBRD has limited its activities in Belarus, Turkmenistan and Uzbekistan to small-scale private sector activities that do not provide significant support to the regimes[46], moves which have been widely welcomed by civil society groups. Unsatisfied with the results, in recent years the EBRD has switched to a 'calibrated' approach in Turkmenistan and Belarus, where the bank rewards achievements in improving democracy by increasing its support for the public sector. While it is too early to tell whether this approach will lead to long-term changes in these countries, the situation needs to be watched carefully. It may turn out that non-engagement is still preferable. As the EBRD's Transition Report 2013 states, "Individual countries will themselves ultimately decide on their preferred form of political governance". The report is right to advise patience, however this should not be taken as a reason to continue supporting undemocratic regimes.

Two recent examples vividly illustrate this point.

What signals is the EBRD sending in Egypt?

Since 2011 Egypt remains in a state of flux, and the EBRD has since the outset of its engagement in the country emphasised that flexibility would be necessary in interpreting whether Egypt is on a trajectory to becoming a multiparty democracy. However the level of flexibility that the EBRD has shown is growing to worrying levels and looks dangerously like the bank condones the country's numerous ongoing human rights abuses. This year the bank will make a decision about whether



The offices of Cairo-based Egyptian Centre for Economic and Social Rights shortly after security forces raided their premises.

Egypt will become a full country of operation, while the bank has already approved several large projects there.

As the EBRD ponders its decision, it should bear in mind what Human Rights Watch recently pointed out in a letter to US Secretary of State John Kerry: “Since assuming power on July 3, 2013, Egypt’s military-backed government has killed well over 1,000 protesters and locked up more than 16,000 people, many solely on the basis of their peaceful exercise of rights to free expression, association, and peaceful assembly. The mass death sentences handed down by an Egyptian court to 529 alleged members of the Muslim Brotherhood on March 24, in a trial lacking even basic elements of due process, is but one example of an escalating climate of extreme political repression.”[47]

But if we were the Egyptian government, we wouldn’t have the impression that the EBRD is concerned about this at all. Since it began operations in Egypt, the EBRD’s board has approved nine loans worth up to USD 584 million. In December 2013 the bank approved a USD 50 million loan for IPR Transoil Corporation[48]. This followed another USD 40 million loan for the Kuwait Energy Company that had been approved in May 2013, ostensibly aimed at gas flaring reduction, but also financing field development.[49] The oil industry and natural resources in general are widely recognised — including by the EBRD’s own 2013 Transition Report — as enabling regimes to avoid serious implementation of democracy due to the revenues that make them less dependent on income from taxes. Therefore these projects would not seem to be the natural choice for development loans in the country, all the more so because at the time of writing, only 8.6 per cent (USD 50 million) of EBRD-approved loans in Egypt have been dedicated to its supposed priority of small and medium enterprises, while there have been no renewable energy projects.[50]

The IPR loan was followed in February 2014 by the approval of two more Egypt projects — one for Nestle, hardly the most needy cause in the country, and the other for the state electricity company for a conversion of two existing open cycle power plants to combined cycle gas turbines. While the latter project may at least benefit the wider population and decrease the plants’ gas consumption, the timing of the loan signature on 31 March was unfortunate to say the least, just days after a mass death sentence was pronounced for 529 alleged Muslim Brotherhood members.

While the bank may not have widely advertised that the signing of the loan took place, the signal sent to the government was clear. The bank needs to adjust much more carefully its engagement in Egypt with the events on the ground, develop a plan of how to engage in a way that does not support the regime, and clearly state where is the line in the sand beyond which it will halt its operations in the country.

Russia: need we say more?

For many years, we have raised questions about countries that while not as far down the democracy league tables as Turkmenistan, Uzbekistan and Belarus, are nevertheless authoritarian and repressive. The EBRD's country level transition indicators do not incorporate any indicator on democracy, so it is unclear how democratic a country has to be before the EBRD considers it to be applying the principles of multiparty democracy and pluralism. One such country is Russia, and in Are we nearly there yet? We raised the question: "Considering the political power of the country, can the EBRD effect significant change there? How much leverage does the EBRD have to effect change in a country with large oil and gas revenues? Even if many of the EBRD's investments are in the private sector, how can the bank be sure that these do not indirectly support the current regime?" Unfortunately events in the recent months have proven these questions to be more than justified. Bankwatch argues that, as a part of the EU response to the current crisis, Europe's two multilateral public banks, the European Investment Bank and the EBRD, should suspend lending to Russia at least until a solution that is acceptable to both Ukraine and Russia is negotiated. If the two banks are to resume lending, they should do so after having reviewed their lending practices in such a way as to ensure that the public financing they are channeling to Russia is used to address the concerns of the poorest.

In the longer run, while the idea of increasing interdependence with Russia and encouraging its integration into the global economy sounds like a pleasing theory, the EBRD's shareholders need to ask themselves: what next for the bank? How realistic is it that an institution like the EBRD can help to improve the lives of ordinary people in a country like Russia? Should the bank continue to operate there at all? Should it adopt an approach of restricting investments to municipal and private sector operations, as in Belarus?

The above examples show the very real and difficult dilemmas that the EBRD faces on the country level, especially as it is being asked by its shareholders to move south and east, but also the tendency of the bank to overestimate its potential to do good in undemocratic countries and underestimate the confidence-boosting signals its investments send towards undemocratic regimes.

As mentioned above, the EBRD's Transition Report 2013 points to the inhibiting effect that natural resources have on the development of democracy, and it is precisely the more eastern and southern countries of operation that are rich in those resources. The EBRD has shown many times that it is aware of the need to help countries diversify away from their reliance on natural resources. Yet its investments in its new countries of operation — such as Serinus Energy in Tunisia, IPR and the Kuwait Energy Company in Egypt, the Compagnie Miniere De Seskaoua in Morocco and its numerous mining investments in Mongolia — show that it is forgetting this lesson.

On the micro level, opportunities to promote democracy and public participation are offered by EBRD requirements for public consultations on individual projects and its mechanism for addressing complaints lodged about projects once implemented. In this area experiences are mixed. On some occasions the EBRD has considered in earnest concerns about its operations from the public and civil society organisations. A recent example is the Kolubara B coal power plant project, which the bank abandoned after repeated issues arose with a previous loan to the same company, Serbia's EPS. But on other occasions, the bank has proceeded to approve projects like the Sostanj unit 6 in Slovenia, the Ombla hydropower plant in Croatia (now cancelled), the Boskov Most hydropower plant in Macedonia, the Oyu Tolgoi mine in Mongolia and the Ukraine nuclear safety upgrade project in spite of warnings about serious flaws from civil society organisations, while uncritically repeating the claims of the project promoter.

A further area of concern where the bank has failed to set a good example for public participation and information disclosure is in its categorisation of certain projects as 'B' projects, which do not require a formalised environmental impact assessment process or public consultation. Some of the bank's most controversial investments in recent years have been categorised as 'B', including Ukraine's nuclear safety upgrade project, Serinus Energy, the Kolubara mining project and the Turceni coal plant rehabilitation in Romania. This has effectively shut down the debate on the project before approval and is unacceptable, particularly in cases where there are few sources of independent information.

Unfortunately, after some positive developments a few years ago with e.g. gender-sensitive pilot consultations for certain projects, we have seen a decline in the bank's commitment to raising its standards on public participation and information disclosure, with repeated revisions of the Public Information Policy failing to bring any noticeable improvements. If the EBRD wants to be seen as a force for good, increasing the public participation standards in its countries of operation and enabling its clients to obtain a social licence to operate, the bank needs serious reforms.

A child in Tsogttsetsii near the Oyu Tolgi gold and copper mine in Mongolia's Gobi desert

Environmentally sound and sustainable development?

It hardly needs to be repeated that the EBRD's countries of operations are far from environmentally sustainable. The energy intensity of economies in the region remains far above the OECD average in many cases[51], waste management systems (where they exist at all) fail to correspond to the burgeoning variety of materials produced by the consumer society, tap water is not potable in many places, and air pollution from transport and burning coal plagues numerous cities. What some of the transition countries do still have is a high level of biodiversity compared to western Europe, although it is too often under threat from projects like motorways, hydropower plants or mining.

As a bank with an explicit environmental mandate, the EBRD is keen to present itself as contributing to environmental improvements in its projects. Sometimes these consist of projects with an entirely environmental goal such as renewable energy or energy efficiency projects through the bank's Sustainable Energy Initiative (SEI), while in other projects the bank sees its added value in bringing higher environmental standards to otherwise not-particularly-green projects, ranging from shopping centres to open-cast mines. Between 2006 and 2012, the EBRD invested EUR 11 billion into 602 projects via its SEI, with an expected greenhouse gas emissions reduction, according to the bank, of over 55 million tonnes[52]. The EBRD's presentation of the greenhouse gas emissions reductions is rather optimistic (as it relies on predictions, not outcomes and does not include the bank's whole portfolio, so reductions in the SEI can be cancelled out by other projects), and the bank's definition of 'sustainable energy' is so flexible that it included the construction of a lignite power unit at Sostanj in Slovenia and at the Belchatow plant in Poland. Overall, Bankwatch disputes the classification as sustainable of around one-third of SEI investment volumes.[53] Nevertheless, in spite of these shortcomings, it is clear that significant efforts are being made to invest in energy efficiency by the bank and that some results are being achieved.

Another positive development occurred in December 2013 when the EBRD announced a strict limitation on its lending for coal power plants within the scope of its new Energy Strategy. However the bank's overall approach to climate change remains unclear, with no bank-wide greenhouse gas emissions reductions targets,[54] and no commitment to reduce investments in oil and gas. Indeed the step forward on coal was somewhat marred by the bumper number of oil and gas projects approved by the EBRD in 2013, which included Bankers Petroleum in Albania, Kuwait Energy Company[55] in Egypt and Ukraine, Romgaz in Romania, Irkutsk Oil II in Russia, Serinus Energy in Tunisia and IPR Transoil Corporation in Egypt[56]. 2014 also started worryingly with the approval of a USD 200 million loan for Lukoil in Azerbaijan.

The results of projects approved several years ago are also still being felt, providing a reminder of why the EBRD needs to think in a more precautionary manner.

Belchatow II

This project, approved in 2005, involved the construction of a new 858 MW lignite-fired unit at the massive Belchatow power plant in Poland, the largest absolute emitter of CO2 in Europe[57]. The new unit, which started operation in September 2011, was supposed to replace units 1 and 2, which the plant's operator (BOT Elektrownia Belchatow SA, taken over by state-owned Polska Grupa Energetyczna (PGE) in 2007) pledged to close by the end of 2015.


Photo by Machinas/Pawel Oborski

Belchatow releases huge amounts of dangerous air pollutants such as sulphur dioxide, nitrous oxides and particulate matter.

The EBRD counted on the new unit being more efficient and less polluting than the old ones and therefore reducing CO2 and other emissions. However the new unit alone will emit yearly 5.5 million tonnes of CO2 for at least 40 years of its planned lifetime, which extends beyond 2050, the year by which the EU energy sector should be decarbonised[58], thus locking Poland in to carbon-intensive energy production.

At the same time, it has come to light that under Poland's Transitional National Plan the operator wants to continue running the units beyond 2020,[59] thus undermining the very purpose of the EBRD project to begin with.

The EBRD's climate impact remains concerning. Even with the bank's strict limitations on financing of coal power plants, the Kosovo government is counting on the EBRD to finance its controversial new lignite project, and the bank has so far failed to confirm that it will stay away from the project.

A relatively new, but increasingly concerning trend is the bank's impact on rivers and associated biodiversity through its growing enthusiasm for hydropower plant projects. Before 2011, the EBRD had not financed the construction of a large hydropower plant since 1994, and then it suddenly decided to finance three.

The examples we have drawn attention to here are most likely just the tip of the iceberg. But unfortunately as the bank's new Environmental and Social Policy looks set to lower the bank's standards even further, we can expect more and more environmentally harmful projects to slip through the EBRD's due diligence in the coming years.

The EBRD's large hydropower spree

In 2011, the EBRD approved loans for the construction of the Paravani hydropower plant in Georgia, the Boskov Most plant in the Mavrovo National Park in Macedonia and the Ombla plant in Croatia. All three were subject to complaints to the EBRD's Project Complaint Mechanism (PCM) and were found to be non-compliant with the bank's Environmental and Social Policy.

The 70 MW Boskov Most hydropower plant in Macedonia is to be located on the Bistra mountain, the core reproduction area of the critically endangered Balkan lynx. A complaint was submitted to the PCM by environmental organisation Eko-svest in 2011 alleging that the Bank failed to undertake adequate research before project approval and that it failed to recognise the site as a critical habitat. The PCM report found that the assessment of the project's potential impacts on biodiversity was not sufficient to satisfy the biodiversity protection requirements of the EBRD's 2008 Environmental and Social Policy, and that this automatically led to a violation of the policy's provisions on public participation.

The 68 MW Ombla underground hydropower plant near Dubrovnik in Croatia was approved in 2011, on the condition that an additional nature impact assessment would be carried out. The plant was planned to be built in a cave complex in a future Natura 2000 area that had not been fully researched but was known to contain endemic species. Zelena akcija/Friends of the Earth Croatia submitted a complaint to the PCM stating that the EBRD had failed to ensure adequate environmental assessment prior to project approval; that the project would damage critical habitat without due justification, and that there had been inadequate public consultation. The PCM report agreed that according to the EBRD's Environmental and Social Policy, the biodiversity assessment should have been done before the bank approved the project and that failure to do so also led to inadequate public consultation. In May 2013 the EBRD loan for the Ombla plant was cancelled.

The 87 MW Paravani hydropower plant in Georgia was approved by the EBRD in July 2011. It includes a 14 kilometre derivation tunnel to bring water from the Paravani river to the Mtkvari river upstream from the village of Khertvisi. In some periods this would leave only 10 percent of water in the Paravani river - inadequate to ensure the survival of downstream flora and fauna - while at the same time, the project creates a significant risk of flooding Khertvisi. Environmental group Green Alternative submitted a complaint in December 2011 and the PCM confirmed violations of three sections of the EBRD's Environmental and Social Policy relating to biodiversity and public participation.

After the clear problems with the first three large hydropower plants, it might have been expected that the bank would take a step back from similar projects in the future. However after a brief respite in 2012, the EBRD is set to finance a new series of plants in 2014: the 185 MW Adjaristsqali/Shuakhevi plant[60] and the 105 MW Dariali plant[61] in Georgia, and the 280 MW Alpaslan II plant[62] in Turkey, whose reservoir will extend over an area of up to 55 km2 and affect directly or indirectly 22 villages.

Looking to the future: where should the EBRD be in ten years time?

We usually end our papers by making recommendations, but since we have made most of them many times already, for a change let us pose an open question: with the EBRD's expansion to the Middle East and North Africa, as well as with mentions of increased co-operation in different forms with countries as diverse as Cyprus, Libya, and even China, where should the bank be in ten years' time?

One of the opportunities to discuss this may come in 2015 when the European Commission review's the EU's development finance architecture. In the same year, the bank will have its fifth Capital Resources Review, an opportunity for its shareholders to take stock, see what has been achieved and what should be done next. This will be a valuable opportunity to ask searching questions that often get lost in business volumes and project development opportunities.

The EBRD, as an institution designed with a finite lifetime, needs clearer criteria for countries to graduate from its operations or for its disengagement in a particular country. In other words, the EBRD needs to have an exit strategy and a clear set of criteria to show when it has completed its task or when it considers it no longer possible to have significant added value in a particular country. As an immediate priority, the countries of central and eastern Europe should graduate from the EBRD, as the private sectors in these countries are already well developed, democracy is comparable with other EU countries and financing for environmental sustainability is to a certain extent available from other EU sources.

But if the bank continues to move south and east, it will have more and more difficult dilemmas on its hands in relation to the issues we have raised above. How much can the EBRD truly achieve in Russia or other countries with authoritarian regimes? If natural resources tend to be a barrier to the development of democracy, why is the bank investing so much in them? What will be the difference between the EBRD and the IFC or EIB? If difficult economic conditions persist in its region of operations, who will believe in transition any more and how will the EBRD respond to this challenge?

The EBRD, in spite of the knocks that its transition model has taken, says in its 2013 Transition Report that "countries can promote and accelerate the return of reform, particularly if international integration, domestic leadership and broader social movements work hand in hand." But unless social movements genuinely participate in the decision-making and agree on the goals to be reached, it seems unlikely that such a happy partnership can be achieved. From the recent events in the EBRD's countries of operations and elsewhere, it seems that rather the opposite is taking place. The gap between rich and poor is increasing, climate change is gathering pace, and governments taking unpopular decisions without real public participation are increasingly the object of protests and civil unrest.

If the EBRD wants to be seen as a positive force in these interesting times, it needs take a step back, learn to listen, think outside of its market box and put quality before quantity.

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