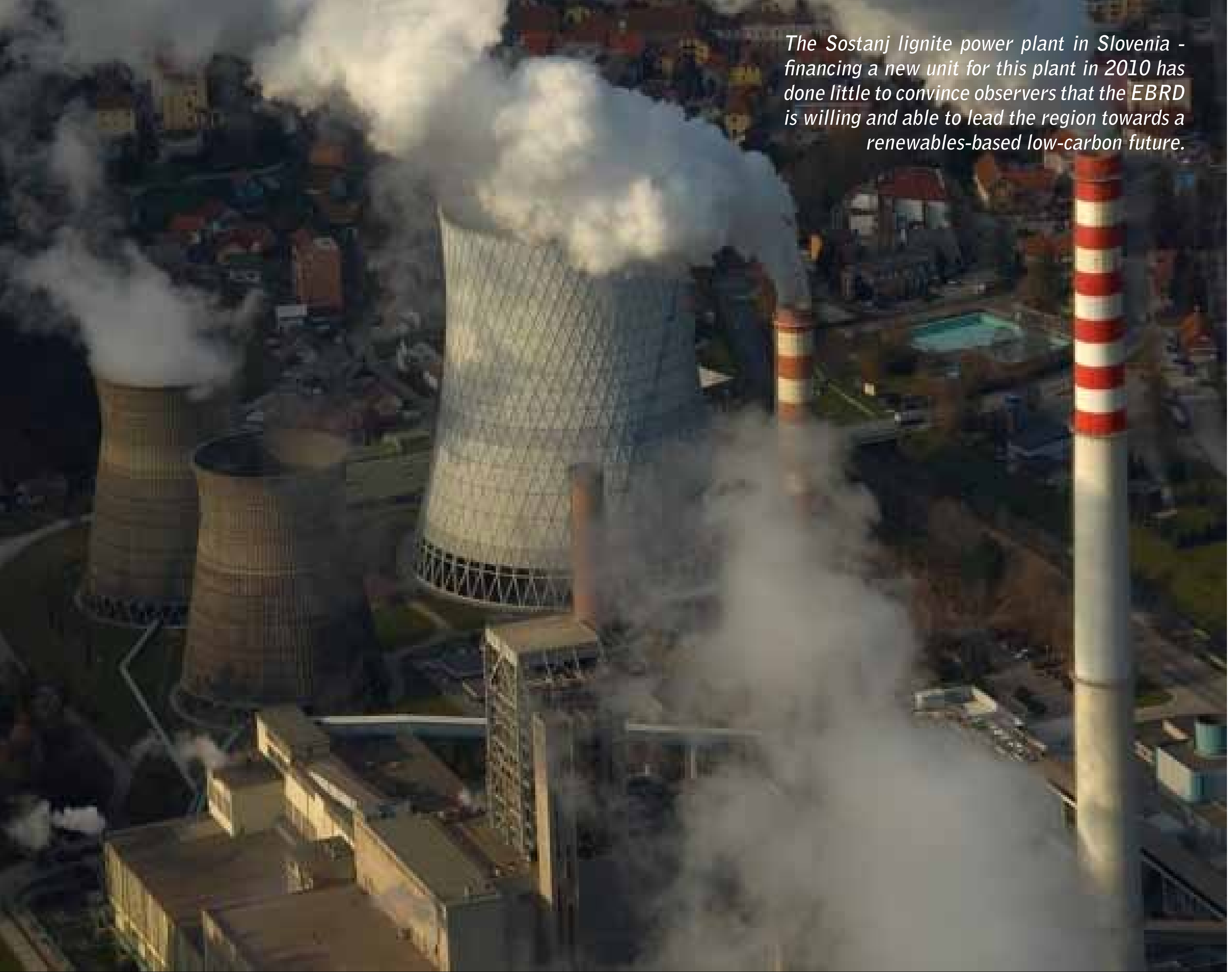
ARE WE NEARLY THERE YET?

DILEMMAS OF TRANSITION AFTER 20 YEARS OF THE EBRD'S OPERATIONS

CEE bankwatch network

MAY 2011



The Sostanj lignite power plant in Slovenia - financing a new unit for this plant in 2010 has done little to convince observers that the EBRD is willing and able to lead the region towards a renewables-based low-carbon future.

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INTRODUCTION

When the European Bank for Reconstruction and Development (EBRD) began its operations in 1991, it was a time of great triumphalism among Western decision-makers. Communism had been defeated, and market economics and democracy were the only way forward - indeed "the end of history" had been reached.[1] There was little doubt about what the EBRD had to do next: to make the former Eastern Bloc countries more like the West. And so the EBRD was endowed with its so-called transition mandate, to promote market economies, multiparty democracy and pluralism taking root in the region.

20 years later, the raison d'etre at the EBRD is less certain. Transition has been patchy - while the central European and Baltic countries, where a relatively high level of consensus prevailed about the necessity of market economics and democracy, integrated into the EU, countries further to the east are mostly still far from democratic and some can hardly even be called market economies. Moreover, the structural weaknesses in western economies that served as models for the former eastern Bloc have become all too apparent during the financial and economic crisis. Climate change, biodiversity loss, and the overexploitation of natural resources threaten humanity and numerous other species with extinction, and no country has yet found an environmentally sustainable economic model that does not exacerbate these problems. If transition is the means, it is no longer very clear what is the desired end.

To an extent the EBRD recognises this and has undertaken a number of initiatives to review its concept of transition and how it is measured. So far however the changes proposed are insufficient considering the scale of the problems with the transition concept in its present form.[2] In this paper we aim to take a wider look at the issues confronting the EBRD after 20 years of operations and offer some recommendations for the future of the bank.

THE MEANS TO AN END

Transition is the means to an end. But what is the end? What is the model society that the EBRD is promoting the transition countries to strive towards? According to 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]

The EBRD's mandate brings up at least three questions:

• What is the EBRD's interpretation of 'open market-oriented economies'?
• What are the criteria for 'countries committed to and applying the principles of multiparty democracy and pluralism'?
• What is its definition of 'environmentally sound and sustainable development'?

MARKET-ORIENTED ECONOMIES

In the early 1990s it seemed that this brand of transition aimed at achieving political and economic systems found in Western Europe, North America or Australasia. This scope is broad, ranging from the welfare systems of Scandinavian countries to the US and its minimal state healthcare system; from Italy and France with state-owned rail and partly state-owned energy companies to the highly-privatised UK.

Along with other multilateral organisations and processes ongoing at that time like GATT[5], the EBRD was interpreting healthy market economies as highly liberalised and privatised ones. Its transition indicators on the project and country level tend to regard privatisation and liberalisation as ends in themselves and award points for several 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 even fewer have undertaken any significant number of public-private partnerships (PPPs) in the road sector. Those that have implemented such schemes in these sectors achieved at best mixed results[6], yet for the EBRD a transition country cannot score top marks without these.

The EBRD has focused more in recent years on the need for strong institutions to support and regulate market activity, rather than just concentrating 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 conclusions drawn by the bank so far are rather limited compared to the scale of the crisis in some of the transition countries. While the bank is active in promoting local currency markets to counter the risks of foreign exchange borrowing, recent research has suggested that "As far as the influence of institutional structures is concerned, good EBRD scores for price, trade, and foreign exchange liberalization appear to be associated with higher GDP falls" in the crisis, and that the EBRD is "failing to incorporate features that, in its own analysis, could mitigate vulnerability, such [as] adequate coverage for credits from household savings".[7]

What has generally been missing in the discussion is the impact of transition for people on the ground and on the wider environment. It was generally accepted that reforms were painful for some people but that the end would be worth it, but little detailed analysis was carried out to back up these assumptions until the EBRD's Life in Transition survey, carried out in late 2006, brought some worrying findings (see next chapter).

COUNTRIES COMMITTED TO AND APPLYING THE PRINCIPLES OF MULTIPARTY DEMOCRACY AND PLURALISM

The goal of applying multiparty democracy and pluralism is somewhat clearer than promoting market economies or sustainable development. Whatever the weaknesses of western democracies, there are at least a relatively clear set of criteria for deciding what a representative democracy looks like[8]. 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 which are considered undemocratic by the Economist Intelligence Unit and Freedom House. The overarching problem for the EBRD, however, is that after 20 years of operations, as we will see in the next chapter, there is still no clear methodology for how the bank can confidently promote democracy.

ENVIRONMENTALLY SOUND AND SUSTAINABLE DEVELOPMENT

The EBRD's interpretation of sustainable development so far has mainly focused on integrating EU environmental protection standards through a three-fold approach:

• to incorporate environmental requirements into project appraisal and implementation;
• to make investments specifically aimed at environmental improvements such as energy efficiency or pollution abatement; and
• to exclude certain activities – mainly those banned nationally or by international agreements but also others such as construction of nuclear power plants.

The next chapter will look briefly at how successful this has been so far, however the main issue is that this approach is not sufficient to ensure that the EBRD both supports only sustainable projects and promotes true environmental sustainability in its activities.

Although following EU standards in transition countries would indeed bring improvements in many sectors, it is not sufficient to implement the same development patterns as western economies, as these are also unsustainable.[9] This is clearly not an issue for the EBRD only - most governments and international bodies tend to approach sustainable development as a question of business as usual but with more public transport, recycling and renewables sprinkled in. Yet this is far from sufficient to address issues like climate change, biodiversity loss, soil erosion or the exhaustion of natural resources. No western government has yet adopted a coherent strategy for truly environmentally sustainable development, thus there is a lack of real-world country-level models for the EBRD to follow. Nevertheless there are many individual policies and projects that could provide inspiration for the EBRD to develop a clearer vision of truly sustainable development. The EBRD needs to apply the best available standards and support action that promotes higher than legally binding environmental standards, as EU standards for energy and resource-saving are not developed enough to reach its climate objectives[10].

Local produce in Croatia Author: Glen Scott

In certain cases transition countries even have environmental advantages compared to western countries, such as lower waste production, lower food miles, and higher agricultural biodiversity. These are poorly measured or understood and need to be studied and encouraged, rather than allowed to decline and then only later redeveloped. More broadly, however, **the EBRD needs to develop a vision of truly sustainable development – which meets the needs of the present without compromising the ability of future generations to meet their own needs – and a plan for how to get there.**

The EBRD has recently released its own report on the Low Carbon Transition[11], which explores opportunities to steer the region away from carbon intensive economies. But the solutions proposed rely too heavily on nuclear energy, with its economic, waste and safety problems, and carbon capture and storage, which remains unproven and is in danger of diverting financial resources from renewable energy and energy efficiency development. There is also a very heavy focus on carbon markets, which may be a risky strategy as they have not yet proven their worth in securing significant emissions reductions.

The bank's vision of social justice is even less developed, and social standards and principles are less integrated in EBRD operations. **Due to its mandate on transition to a market economy, the EBRD has never quite been sure whether it is a development bank or not, 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 in those countries of operation classed as 'developing'**. It has always been assumed that the development of the private sector is good for everyone.

Recently the EBRD has started to examine the impacts of its operations on poverty and gender. Both of these initiatives are very welcome. However the bank is still lacking both an overall vision and clear goals for the positive social impact it wants to have and the best means of achieving this. The development of a vision and goals also needs to take place in collaboration with a wider group of institutions, including those at the EU level, as the EBRD may not be the best placed for meeting some development goals. In particular, supporting health, education and access to drinking water sit uneasily with the EBRD's private sector mandate.

To sum up, the final destination of transition is not as close as it may have seemed in the 1990s and the roadmap for getting there is not as reliable as it seemed to be. Maybe it's time to pull over and figure out where the EBRD is at the moment.

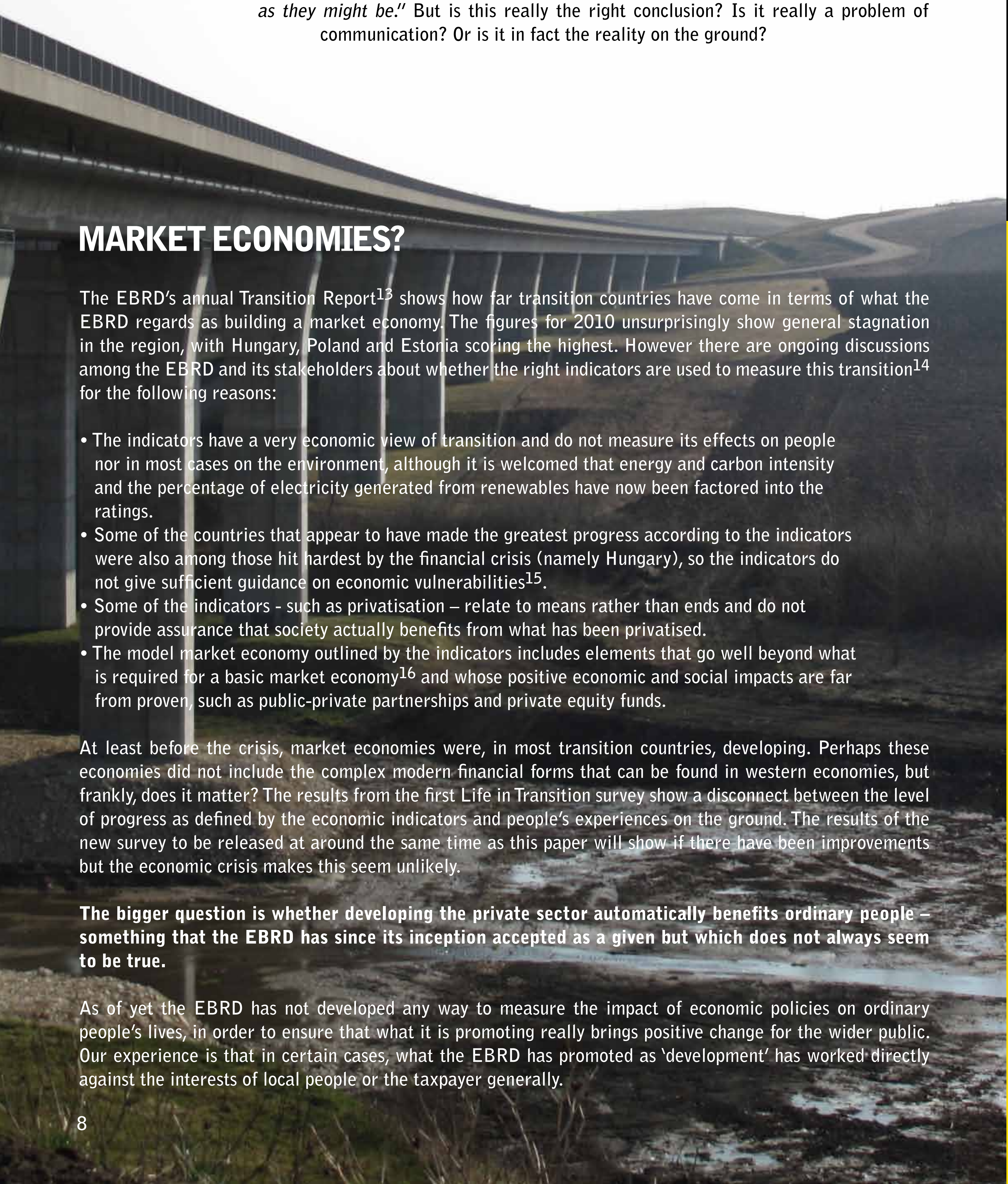
ARE WE NEARLY THERE YET?

Not only has the final destination of transition changed 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, but even this is uncertain as the financial and economic crises have revealed weaknesses in the models proposed for the transition region's economies and raised questions about what kind of economy is the most desirable – questions which we believe have yet to be answered.

The EBRD took its first major step towards understanding ordinary people's experiences with transition in its 2006 Life in Transition survey[12], which was carried out among 29 000 people in the transition countries and published the following year. The results were quite mixed, especially considering that the survey was carried out in a period of strong economic growth. While respondents were optimistic about the future, with 54 per cent agreeing that children born today would have a better life than their own generation and only 24 per cent disagreeing, alarmingly only 30 per cent believed that their household lived better at the time of the survey than in 1989. 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 percent in southeast Europe. When asked what should be the first priorities for extra government investment, healthcare and education were the most frequent answers, with pensions also mentioned frequently, especially among older people.

75 percent of people in south-east Europe believe that corruption is the same or worse now as when transition began. Author: Charles Roffey

These findings raise tough questions not only about the implementation of transition but also about its purpose. The EBRD's new Life in Transition survey, to be published at around the same time as this paper, was carried out during a time of much greater economic hardship and surely will bring equally difficult questions.
One of the conclusions the EBRD drew from the first survey was that "*extra effort may need to be put into explaining why the introduction of competition and private sector involvement in, for example, the energy or transport sectors can lead to a better service for consumers and ultimately a more cost-effective way of supplying these services. The survey suggests that these lessons are not as well understood as they might be.*" But is this really the right conclusion? Is it really a problem of communication? Or is it in fact the reality on the ground?



MARKET ECONOMIES?

The EBRD's annual Transition Report[13] shows how far transition countries have come in terms of what the EBRD regards as building a market economy. The figures for 2010 unsurprisingly show general stagnation in the region, with Hungary, Poland and Estonia scoring the highest. However there are ongoing discussions among the EBRD and its stakeholders about whether the right indicators are used to measure this transition[14] for the following reasons:

- The indicators have a very economic view of transition and do not measure its effects on people nor in most cases on the environment, although it is welcomed that energy and carbon intensity and the percentage of electricity generated from renewables have now been factored into the ratings.
- Some of the countries that appear to have made the greatest progress according to the indicators were also among those hit hardest by the financial crisis (namely Hungary), so the indicators do not give sufficient guidance on economic vulnerabilities[15].
- Some of the indicators - such as privatisation – relate to means rather than ends and do not provide assurance that society actually benefits from what has been privatised.
- The model market economy outlined by the indicators includes elements that go well beyond what is required for a basic market economy[16] and whose positive economic and social impacts are far from proven, such as public-private partnerships and private equity funds.

At least before the crisis, market economies were, in most transition countries, developing. Perhaps these economies did not include the complex modern financial forms that can be found in western economies, but frankly, does it matter? The results from the first Life in Transition survey show a disconnect between the level of progress as defined by the economic indicators and people's experiences on the ground. The results of the new survey to be released at around the same time as this paper will show if there have been improvements but the economic crisis makes this seem unlikely.

The bigger question is whether developing the private sector automatically benefits ordinary people – something that the EBRD has since its inception accepted as a given but which does not always seem to be true.

As of yet the EBRD has not developed any way to measure the impact of economic policies on ordinary people's lives, in order to ensure that what it is promoting really brings positive change for the wider public. Our experience is that in certain cases, what the EBRD has promoted as 'development' has worked directly against the interests of local people or the taxpayer generally.

Author: Manana Kochladze

The M6 motorway PPP in Hungary: Shouldn't the EBRD concentrate on market basics rather than promoting complicated and often overpriced models that encourage off-balance sheet debt burdens?

BTC - in whose interest?

The Baku-Tbilisi-Ceyan (BTC) pipeline is a typical example of a private sector development project in which the interests of international financial institutions (IFIs), national governments and the project sponsor have been pushed at the expense of the political and socio-economic rights of ordinary people, while at the same time using public money to promote transnational corporate interests. Instead of tackling head-on the systemic problems of transition states - crippling poverty, ruined economies and endemic corruption - the EBRD financed a sprawling oil pipeline, with a justification that it would bring hope and benefits to the region's people. As EBRD Vice-President Noreen Doyle said at the official signing ceremony in Baku in February, 2004, "We needed to assure our shareholders that this project would be safe, that it would fairly benefit the population, and that it would bring sustainable benefit."

After seven years it is clear that the project has hardly benefited local populations in a meaningful way. In March 2011 the UK government ruled that the BP-led BTC Company consortium is violating international standards governing the human rights responsibilities of multinational companies in its operations. A project promoted as "world class" in its approach to human rights was found to be in breach of OECD Guidelines for Multinational Enterprises and the Voluntary Principles on Security and Human Rights, guidelines that the consortium was obliged to under the project's agreements, raising major concerns over the due diligence undertaken by the IFIs and particularly the EBRD prior to supporting the pipeline.

The Overseas Private Investment Corporation, a US government insurance agency and also a backer of the BTC pipeline, released a telling report on the project in October 2010 following a 2007 complaint from Bankwatch. The report offers revealing evidence about problems connected with the pipeline. It describes several tests that show the pipeline wall had been weakened, with mentions of excavation and repair of the pipeline in one section in Georgia. A controversial, untested pipeline joint sealant is being used as campaigners and investigative journalists revealed seven years ago. Along with a descriptive range of technical details that do not inspire confidence, the report highlights how OPIC followed its site visit with a letter reminding the BTC Company of its obligations "to comply with the applicable environmental and social policies and guidelines of the lenders, with the [Environmental and Social Action Plan], and with national law."

In light of the glaring violations and lack of professionalism described above, the December 2010 revelation on Wikileaks of a giant gas leak on a BP platform at the Azeri-Chirag-Guneshli gas field in September 2008 should come as no surprise. The gas leak resulted in two fields being shut, output cut by at least half a million barrels a day and production disrupted for months. Another cable, written a few weeks after the blowout, describes Bill Schrader, BP's then head in Azerbaijan, admitting that it was possible the company "would never know" the cause although it "is continuing to methodically investigate possible theories".[17] In 1998 the EBRD supported the expansion of the Chirag field with a USD 100 million loan.

In other cases there is no evidence that EBRD-financed projects 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 the justifications are extremely thin.

Is this what development looks like?
Author: Красноярск124

EBRD – improving people's lives?

RTS City, Kazakhstan, 2010: "The Project will support the expansion of the growing segment of outdoor in the advertising market in Kazakhstan ... contribute to the restructuring of the Kazakh outdoor advertising industry … market expansion will be visible for the Company's suppliers, since the Company now produces its constructions locally … the Project potentially offers strong demonstration effects to the market through further innovation brought in the Kazakh market by the worldwide leader in street furniture ... will also improve competition in the corporate sector in Kazakhstan, which will have access to this new channel to advertise their products. Advertising promotes competition, access to information, and is a key element of any modern economy." Does the EBRD really believe that people in Kazakhstan have no more pressing needs than to have their streets littered with visual advertising pollution?[18]

Advent Central and Eastern Europe IV private equity fund, regional, 2008: "The transition impact of the proposed project would come from the following three areas: institution building and development of sustainable private equity managers in the region, restructuring of investee companies and accelerating the creation and development of industry leaders in the region, and demonstration effects of new ways to finance activities in less advanced transition countries, including the use of leverage."

Similar justifications are almost always given for EBRD private equity investments, most of which are to entities registered in offshore financial centres and where a surprising number of former EBRD staff are top managers. A closer look at what Advent invests in[19] shows a random mixture of midsize companies with no clear development impact, including Ultimo, 'Poland's largest debt purchase and collection business'.[20]

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 their real needs.

Another serious problem with the development of markets in the region is the high level of corruption, as the EBRD has learnt all too well during the past year,[21] coupled with low levels of institutional capacity and public participation to help keep this in check. In deals involving the public and private sector it is notoriously difficult to distinguish between incompetence and corruption, but the EBRD has a role to play in avoiding both. Although it has its public procurement rules, there are a number of cases that suggest the EBRD needs to tighten its due diligence in this area to more actively defend the public interest in line with its role as a public institution.

Zagreb wastewater treatment plant: why did the EBRD not do more to ensure that the public sector got a better deal?
Author: UZOR

The EBRD – a public institution defending the public interest?

In a number of cases the EBRD has approved financing for deals which may increase the role of the private sector but do not provide the value-for-money for public budgets and therefore the taxpayer. Examples include:

The Zagreb wastewater treatment plant PPP,whose costs since 2001 have risen from EUR 176 million to around EUR 326 million. According to the state auditor, between April 2004 and the end of 2006 the City of Zagreb had already paid the concessionaire ZOV 75.5 percent of the basic fixed costs of the plant's construction, raising the question of why the city could not have raised the funds to carry out the project through normal public procurement.[22] This year Croatian media have reported that the national anti-corruption authority is looking into the case.

The EUR 9 billion **Slovak D1 motorway PPP**, whose price rose from an already high starting price of 7.8 billion and involved hardly any risk transfer to the concessionaire after the construction stage. The PPP, whose advantages compared to ordinary public procurement had never been convincingly proven,[23] was later abandoned after a change of government in Slovakia, but the fact remains that the EBRD approved the project.

The **M6 motorway project in Hungary** attracted criticism from the Hungarian State Audit Office due to a PPP model having been chosen without comparing the costs against normal public procurement. A calculation was made only after the concession contract had been signed.[24]

The cases above 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 people and the environment should not be financed with public money. **As a public institution the EBRD also needs to establish itself as a clear defender of the public interest** in cases where limited public institutional capacity is in danger of closing deals that do not offer the public good value for money. If it is not willing to do this, it must not finance such deals at all.

COUNTRIES COMMITTED TO AND APPLYING THE PRINCIPLES OF MULTIPARTY DEMOCRACY AND PLURALISM?

In the last 20 years democracy has spread unevenly across the transition countries, and in recent years the situation has stagnated. In general the more western countries of operation have integrated into the EU while countries further to the east still suffer from various degrees of authoritarianism, with few if any signs of positive change. So what has the EBRD done under its mandate to promote democracy?

A bank is not the most obvious institution for such a job, yet the EBRD does have some tools at its disposal. It can refuse to finance activities in countries that are clearly not applying the principles of multiparty democracy and pluralism. In the context of low or zero democracy, there is a severe risk that investments will benefit elites at the expense of ordinary people. The EBRD has mainly used this clause to limit its activities in Belarus, Turkmenistan and Uzbekistan to small-scale private sector activities that would not provide significant support to the regimes[25], moves which have been widely welcomed by civil society groups. In recent years the EBRD has decided that its non-engagement with the public sector has not brought significant results in democratic reforms and has decided to switch to a 'calibrated' approach in Turkmenistan and Belarus, rewarding achievements in improving democracy with increased public sector investment. The calibrated approach may prove useful, however the benchmarks for individual economic sectors, which allows increased investment into the public sector, are much clearer than the criteria on democratic improvements. This raises concerns both that the democracy indicators may be interpreted more subjectively and that primacy is placed on economic criteria alone.

This calibration approach is new and at an experimental stage. It needs to be watched carefully to see if it yields results during the next few years. Only then should it be considered for use in other countries and by other institutions. It may turn out that non-engagement is still preferable and that democratisation should be left to the people who live in the country or supported through means other than a bank.

Further questions are raised by the countries that while not as far down the democracy league tables as Turkmenistan, Uzbekistan and Belarus are nevertheless authoritarian and repressive.

Turkmen President Berdymukhammedov: Will the EBRD's new 'calibrated' approach encourage democratisation in Turkmenistan?

Azerbaijan: not a democracy
Author: David Davidso

Many EBRD countries of operation including Kazakhstan, Azerbaijan and Tajikistan are considered more undemocratic than Belarus, but the EBRD limits its activities in Belarus and not in the others.[26] It is also questionable how genuinely Russia adheres to democratic principles. Who can consider free speech widespread in Russia after the violence against opponents of the Moscow-St. Petersburg motorway routing through Khimki Forest?[27] 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?

Here the EBRD faces a dilemma: several of its shareholders want to prioritise the more eastern transition countries because the bank can have a greater development impact there, yet these are precisely the least democratic regimes. Without clear indicators on democracy and how investments help or hinder democratisation, the EBRD risks supporting undemocratic regimes at the expense of the wider population.

The same problem plagues the proposal for the EBRD to expand its operations to the southern Mediterranean countries. While Mubarak and Ben Ali have been overthrown in Egypt and Tunisia, it is still far from clear who will follow them and to what extent the economic infrastructure will stay in the hands of the existing elites.

While less visible but equally important, opportunities to develop democracy and public participation are offered by the EBRD's requirements for public consultations on individual projects and subsequently addressing complaints about the 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 – the Moscow–St. Petersburg motorway, the proposed Zagreb incinerator, and the clashes in Usatove, Ukraine regarding a sudden change in the routing of Ukrenergo's transmission lines come to mind. On other occasions the EBRD has uncritically repeated the claims of the project promoter[28] or agreed to derogations of its requirement to publish a Project Summary Document, which has effectively shut down the debate on the project before approval.[29] This is unacceptable, particularly in contexts where there are few sources of independent information.

Recently there have been some positive developments, such as the gender pilot projects to increase the quality of consultation and ensure that women's perspectives are also included. Such initiatives need to be further developed and encouraged, and the EBRD needs to pro-actively ensure the quality of consultations and follow-up during implementation. If the EBRD moves further south and east it cannot leave consultation and information disclosure to the project promoter if it wants its projects to bring real benefits for local people.

In summary, after 20 years of experimenting in promoting democracy on the country level, the EBRD has still not found a formula for success that could apply to other countries.

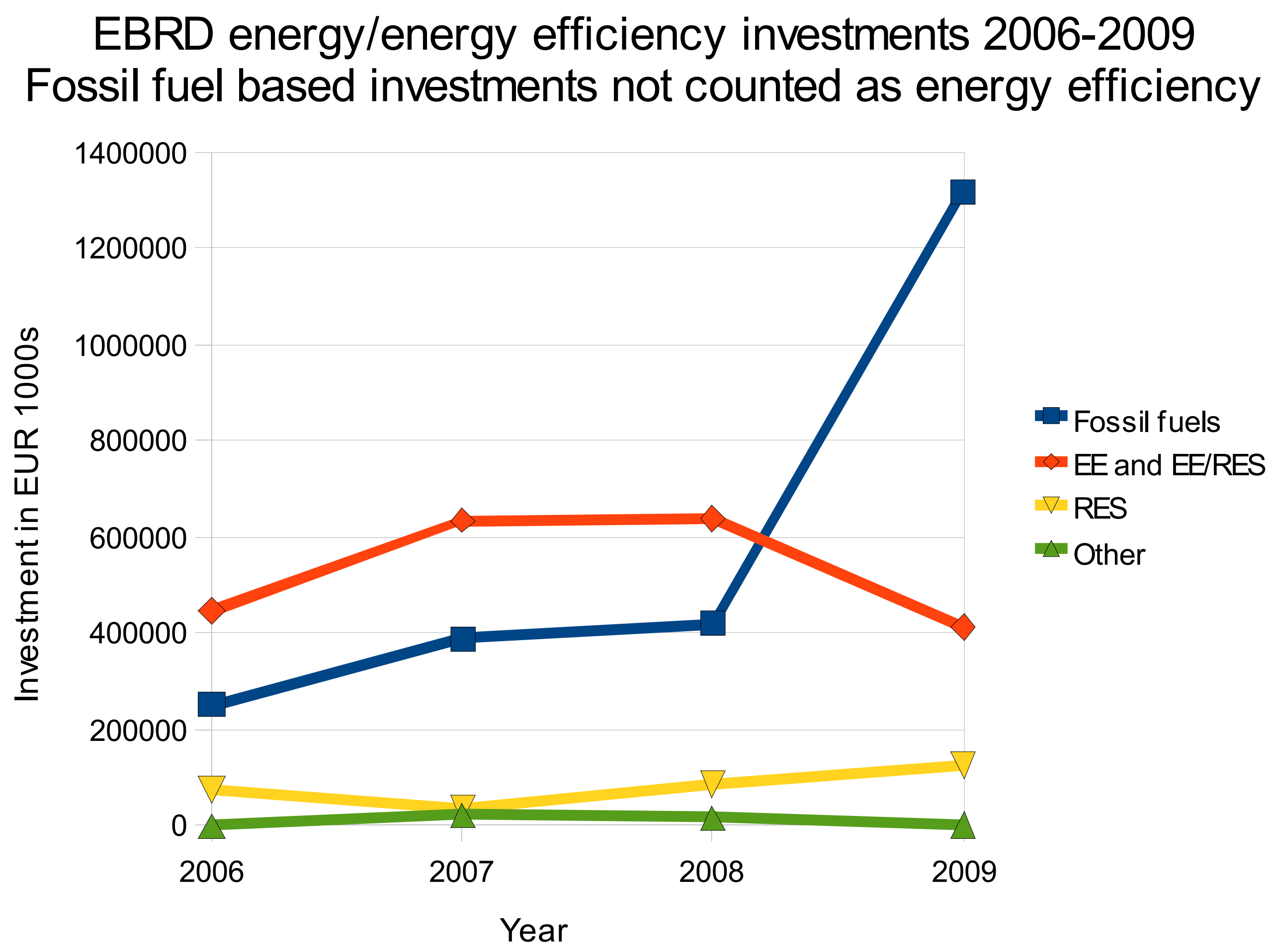
ENVIRONMENTALLY SOUND AND SUSTAINABLE DEVELOPMENT?

The transition region is quite far from environmentally sound and sustainable development. The average energy-related emissions per unit of GDP is about two and a half times that of the EU-15 and 50 per cent higher than the world average[30]. The EBRD has made some positive contributions in this area, with the 2006 launch of its Sustainable Energy Initiative geared towards energy efficiency lending. Between 2006 and 2009 the EBRD lent between EUR 2.1 and 3.2 billion for energy efficiency measures.[31] There is plenty more work to do, and in some cases project appraisal needs to be strengthened to identify possible limitations in the success of its projects.[32] Energy efficiency also must not become a ruse to finance anything – the two shopping mall projects in Croatia financed by the EBRD in 2009 and 2010 are clear examples of where energy efficiency is used to justify projects with no other development justification, especially as one of them includes 2,600 parking spaces that severely weaken its environmental credentials. Notwithstanding the improvements that need to be made, the EBRD's emphasis on energy efficiency is a positive start that should be built on.

Unfortunately these investments are being undermined by some of the EBRD's other activities. EBRD lending for renewables more generally pales in comparison with its lending for fossil fuel-based projects. Moreover EBRD lending for fossil fuel-based projects increased significantly between 2006 and 2009.[33]

With last year's calls from the G-20 to phase out subsidies for fossil fuel[34], recently supplemented by the European Parliament's call for its fellow public bank the European Investment Bank to phase out fossil fuel investments, the EBRD is going in the wrong direction. Even its Low Carbon Transition report advises that "Policies that reduce or eliminate subsidies to fossil fuels and energy-intensive economic activities will at the same time increase the opportunities for, and returns to, climate mitigation activities."[35] It remains to be seen whether the bank will follow its own advice.

Are fossil fuels the best the EBRD can do with public money?



It is often argued that a fossil fuel phase-out in the EBRD's region of operations is not going to happen any time soon[36] or that taking coal out of the energy mix may mean an increase in nuclear capacity. However this argument fails to distinguish between debates that need to happen on the national or regional level and from the question about where public financial support should be directed. Indeed countries do need to make strategies for their energy mix and for some rich in fossil fuel resources or that currently rely heavily on nuclear power, it will be challenging, but not impossible, to scale down energy use and switch to renewable energy. **However EBRD money is not meant to support everything but only those sectors which contribute to truly sustainable development and which are not able to access financing from other sources.** Renewable energy and energy efficiency are clear examples of activities that need and deserve support in the region.

In other sectors EBRD operations need to be tightened up in terms of their objectives and implementation. Some EBRD projects aim at environmental rehabilitation, and these should in principle be one of the bank's most important contributions in a region with a notorious environmental legacy, dramatically illustrated last year by Hungary's red sludge disaster. However the cases monitored so far by Bankwatch and its partners, including Dundee Precious Metals' mining operations in Armenia and ArcelorMittal's steelmaking across the region, raise questions about the use of public financing for companies that are not able to prove concrete, positive environmental results.

One of the main problems is actually getting hold of the information about exactly what improvements are to be made as part of the project and when; whether the improvements have been done; and what has been the exact impact (emissions reductions etc). In seeking to improve corporate responsibility, the EBRD relies on its clients to release this information, but what little information the clients release is often incomprehensible, unable to demonstrate any improvements over time, or missing important information.

Most EBRD countries of operations have minimal provisions for access to information and the EBRD must be ready to mitigate this by becoming more transparent itself. **The disclosure of countries' votes in board meetings (this is after all a public institution), the contractual requirements for the project sponsor — particularly on environmental and social issues — and on the concrete results from its projects in real human or environmental development terms[37] are a must.** As it reviews its Public Information Policy this year the bank has a chance to address this problem, however the draft does not look promising.

The problem goes well beyond transparency though. The EBRD Evaluation Department – which is surely able to access much more information than the general public - pointed out that for environmental change resulting from projects between 1996 and 2009, "*cumulatively 24 per cent of the evaluated projects were rated Substantial or Outstanding, while 53 per cent achieved Some environmental change. However, in 2009 no projects attained an Outstanding rating, which is cause for some concern*." The evaluation report also points out that in recent years the proportion of projects achieving Some change has grown at the expense of other ratings, especially higher ones.[38] The EBRD needs to pay attention to how it can improve the environmental change aspect of its projects, as this in principle represents clear added value from a public bank in the region. But when done poorly it erodes public trust in the institution.

The EBRD has become increasingly aware of the social impacts of its lending during recent years, through difficult cases like the resettlement attached to the Gazela Bridge rehabilitation in Belgrade. Here EBRD involvement may have resulted in better conditions for the resettled people than would have otherwise been the case, but so far still has not been successful in ensuring long-term accommodation or employment. The EBRD has dedicated additional resources to social issues, which is welcome, however there is much to be done to ensure that the bank's projects bring unequivocally positive benefits for people in the region.

Tbilisi rail bypass, Georgia, 2010: Although the purpose of this project, to prevent oil being transported through densely populated areas, sounds amiable, the route chosen for the bypass still passes through the densely populated Avchala district and so undermines the project to a point. Also the process of land acquisition has failed to compensate some of the affected landowners, and some local residents have already filed complaints to the EBRD's Project Complaint Mechanism. Moreover the project will result in the abolition of Tbilisi's main passenger rail station, resulting in a lower quality of service for passengers who will have to travel by metro to get from one station to the other.

Properties affected by the Tbilisi rail bypass project.
Author: Green Alternative

One area in which the impacts of EBRD operations are unclear is employment, a particularly important issue especially during times of economic crisis. While the EBRD argues that it cannot have an unequivocally positive impact on employment due to the need to lay off employees from overstaffed state enterprises, it is nevertheless important to endeavour that its projects resulting in lay-offs are balanced by job creation from other investments. The EBRD has the potential to contribute to job creation in financing micro, small and medium-size enterprises (MSMEs), however almost nothing is known about the results of the EBRD's financial intermediary lending, and without more information it cannot be shown to be making a positive impact.

There have been positive trends at the EBRD in recent years to examine its impacts in the areas of gender equality and poverty alleviation. These initiatives are welcomed, however they are still at an early stage, and the EBRD has not so far developed significant experience or expertise with these issues. This is related to a wider dilemma at the EBRD: is it a development bank or not? We believe that the answer must clearly be yes, and that the EBRD's results must be measured in terms of their real impacts on people and the environment, not only on a presumed link between private sector and human development.

CONCLUSION: WHERE SHOULD THE EBRD BE IN 10 YEARS TIME?

Given the difficulties with the transition mandate outlined above and the results achieved so far, there are different courses of action open to the EBRD and its shareholders. In all cases 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.

MANDATE

If the EBRD continues with its current mandate, combining market promotion, environmental sustainability and democracy, we believe that the countries of central and eastern Europe should be ready to graduate from operations within the next five years, as the private sectors in these countries are already well developed, democracy is comparable with some other EU countries and financing for environmental sustainability is to a certain extent available from other EU sources.

Within that same period the EBRD should either have made a significant impact on democratisation and the promotion of human rights in countries further to the east or should disengage from countries that no longer fulfil clear criteria on democracy. As the bank moves its operations further east, it needs to shift its emphasis towards more clear development goals and adjust its investments to this end, with less focus on the private sector and possibly with greater use of grants as well as loans.

Given this scenario it is likely that within the next ten years the EBRD will have done as much as it can to promote market economies and that its current mandate should be concluded completely or changed to a clearer poverty reduction mandate. The question then is what the difference between the EBRD and the World Bank, specifically the International Finance Corporation, would be. The European Commission should in any case examine whether its participation at the EBRD necessitates the bank, when investing in developing countries, to follow poverty reduction/eradication goals set out in Article 208 of the Lisbon Treaty and how the Commission aims to ensure this.

Alternatively the EBRD mandate may be changed sooner to more effectively rise to the environmental and social challenges faced by the transition region, including the ongoing need for energy efficiency investments, the development of renewable energy sources, the need for waste reduction and sustainable resource management practices, the development of community banking and financing for MSMEs, public transport, the development of organic agriculture and local food supplies, the need for water supply and wastewater treatment investments, the empowerment of women and minorities, environmental remediation, public sector health and education investments and so on. While the needs are greatest outside the EU, in a few of the central and southeast European countries there may still be a role for the EBRD given this scenario for several more years if there is a clear division of tasks among the EIB and EU funding instruments like the Cohesion Policy and Instrument for Pre-Accession Assistance to avoid covering the same sectors and regions.

This scenario would see the bank moving away from supporting large companies especially in sectors that are already profitable but environmentally unsustainable, like the extractive industries, and taking on the risk for smaller initiatives such as not-for-profit companies or credit unions that are viable but pioneering in the region and have difficulties accessing attractive finance.

Given the lack of experience by the EBRD in areas such as poverty reduction and gender equality, and the lack of clarity on whether it is a development bank and what its focus should be during the next few years, in neither scenario is it in our opinion appropriate for the EBRD to expand geographically to the southern Mediterranean or elsewhere.[39]

INSTITUTIONAL GOVERNANCE

If the EBRD is to change its mandate and continue its operations, rather than concluding its current mandate, several governance changes are required if the EBRD is to have a positive impact on people and the environment in its region of operations.

As the EBRD intends to strengthen its activities in the southern and eastern countries of operation, improvements in public consultations and information disclosure as outlined above will be necessary in order to ensure that projects are designed to reflect the needs of ordinary people and the environment and not only governments and companies.[40] More development expertise within the EBRD would be necessary, including among the Executive Directors, the majority of whom are currently from Ministries of Finance rather than development ministries.

The EBRD needs to re-examine its criteria for deciding which countries comply under Article 1 regarding commitment to and implementing multiparty democracy and pluralism. In addition to its policies on Turkmenistan, Belarus and Uzbekistan it must develop a more careful approach towards other countries where political rights are limited, to avoid its investments benefiting elites at the expense of ordinary people and the environment. The bottom line is that the EBRD must ensure that undemocratic regimes do not benefit from its financing, and clear criteria and political benchmarks on how to do this are necessary.

Resettlement of the informal settlement underneath Gazela Bridge, Belgrade: EBRD involvement resulted in slightly improved conditions for the resettled people, but still has not ensured long-term accommodation or employment

RECOMMENDATIONS

20 years after the start of EBRD operations, the bank's shareholders need to seriously consider what is the added value of its operations in the former Eastern Bloc and to change the bank's mandate or bring it to an end.

The shareholders, and especially EU countries, should examine the EBRD's contribution to the Millennium Development Goals when the bank operates in developing countries.

Considering the many issues facing the transition region at this time, if EBRD shareholders decide to change the mandate, we believe that the most appropriate task would be to promote a transition to environmentally sustainable, socially-just, and renewables-based societies rather than just market economies.

Irrespective of any change of mandate, the EBRD needs to:

• develop clear criteria for the graduation of countries or its disengagement. 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 certain country.
• define better environmental and social sustainability in order to ensure that these concepts do not continue to be subsumed by its private sector focus.
• strengthen its measurement and disclosure of the environmental and social impacts of its operations – on poverty, employment, pollution, recycling levels and so on — and ensure that environmental and social issues are integrated into its transition indicators.
• develop clear criteria and benchmarks for its operations in undemocratic countries beyond those where it already restricts its activities in order to avoid benefitting elites at the expense of the wider public and environment.
• ensure that it is not promoting unsustainable market models, nor market elements that are unnecessary for a basic market economy and whose development benefits not been proven.
• defend public interests in contract preparation between the public and private sector.
• expand its exclusion list or change its sectoral policies to limit its activities to those which are most effective in achieving environmental sustainability and human development goals, and those which lead new markets rather than financing already established industries.
• maintain its work in energy efficiency and environmental rehabilitation, while improving the project appraisal for potential projects.
• continue to improve its consultations on projects and policies by taking the inputs more meaningfully into account
• improve considerably its information disclosure, including on board meetings and countries' votes, the contractual requirements for the project sponsor — particularly on environmental and social issues — and on the concrete results from the projects in real human or environmental development terms.

Until the above are carried out and the EBRD has clarified its long-term aims and improved its criteria for having achieved transition, the EBRD should not undertake any further geographical or capital expansion.

FOOTNOTES

1 - Francis Fukuyama, The End of History and the Last Man. Free Press, 1992
2 - See for example CEE Bankwatch Network's comments on the EBRD's country level transition indicators http://www.bankwatch.org/publications/comments.shtml?x=2284068
3 - EBRD: Basic documents of the EBRD, p.5
4 - Ibid.
5 - The General Agreement on Trade and Tariffs, subsequently the World Trade Organization
6 - See for example CEE Bankwatch Network: Never Mind the Balance Sheet – The dangers of public-private partnerships in central and eastern Europe, November 2008
7 - Myant, Drahokoupil: International integration, varieties of capitalism, and resilience to crisis in transition economies, Manuscript submitted for review to Europe-Asia Studies, 21 January 2011
8 - See for example the Economist Intelligence Unit's annual Democracy Index http://graphics.eiu.com/PDF/Democracy_Index_2010_web.pdf
9 - In case there is doubt on this point, consider the following: overfishing; the enormous quantities of waste produced – much of which is still not recycled or which is exported to the Global South to be recycled in appalling conditions; mountain-top-removal coal mining in the US; tar sands oil extraction in Canada and elsewhere, laying waste to vast swathes of land and water, and whose additional energy inputs for extraction and processing result in higher CO_2 emissions than for ordinary oil; dependence for electronics on minerals from unstable countries such as tantalum from the Congo etc.
10 - CEE Bankwatch Network press release: Time is running out for EU decisive action on resource efficiency, warns Bankwatch, 22 April 2011 http://www.bankwatch.org/newsroom/releases.shtml?x=2284668
11 - EBRD/Grantham Research Institute on Climate Change – The Low Carbon Transition, April 2011, http://www.ebrd.com/downloads/research/transition/trsp.pdf
12 - EBRD: Life in Transition: a survey of people's experiences and attitudes, May 2007, http://www.ebrd.com/pages/research/analysis/publications/transition.shtml
13 - http://www.ebrd.com/pages/research/publications/flagships/transition/archive.shtml
14 - See for example Bankwatch's comments on the EBRD country level transition indicators, March 2011 http://www.bankwatch.org/newsroom/documents.shtml?x=2284068
15 - For more analysis see Myant, Drahokoupil: International integration, varieties of capitalism, and resilience to crisis in transition economies, Manuscript submitted for review to Europe-Asia Studies, 21 January 2011
16 - For example western economies survived for decades without public-private partnerships, private equity funds and other forms of financialisation, yet transition countries with much lower public sector planning and regulatory capacity are now being encouraged to introduce them.
17 - Tim Webb: Wikileaks cables: BP suffered blowout on Azerbaijan gas platform, The Guardian, 16 December 2010 http://www.guardian.co.uk/world/2010/dec/15/wikileaks-bp-azerbaijan-gulf-spill
18 - Not to mention the absurdity of the assertion that advertising promotes access to information. Such claims degrade the concept of access to information and its importance for democratic processes.
19 - At least Advent does, unlike most other Private Equity funds, reveal what it invests in. The situation with EBRD-financed bank credit lines is even less transparent, with no information available about the final beneficiaries.
20 - Advent International website: http://www.adventinternational.com/globalpresence/CentralEurope/poland/Pages/Poland.aspx, accessed 22 April 2011
21 - In March 2010 an EBRD employee was arrested, while in December the Bank's Russian Executive Director was dismissed in connection with corruption allegations. In both cases the Bank appears to have acted correctly, although it would be more reassuring if the bank released more information, with full respect to ongoing police investigations, about what has been done to correct any damage done.
22 - For more details see CEE Bankwatch Network: Never Mind the Balance Sheet – the dangers of public-private partnerships in central and eastern Europe, November 2008, www.bankwatch.org/documents/never_mind_the_balance_sheet.pdf
23 - For further details see: bankwatch.org/documents/IP_EBRD_D1motorway_10May2010.pdf
24 - State Audit Office of Hungary: Summary of the comparative audit on the funding arrangements for motorway development projects (0645), 2006 http://www.asz.hu/ASZ/nemzetk.nsf/0/F4BBF73B25A33019C12578240038ECCA/$File/0645.pdf
25 - Such as financing for small and medium enterprises or general manufacturing
26 - The Democracy Index league table 2010 is reproduced at http://en.wikipedia.org/wiki/Democracy_Index. Although Belarus' ranking for 2011 is expected to be lower due to the crackdown on protests following the disputed election in December 2010, it must be borne in mind that the EBRD's restricted approach was developed well before this – its latest Country Strategy was approved in December 2009.
27 - For a chronology of what the routing's opponents have had to endure, see the Movement to Defend Khimki Forest's website: http://www.ecmo.ru/main/abuse_en/?drgn=1
28 - In the case of KCM Plovdiv the EBRD claimed that there was no evidence that the high level of lead in the blood of the population from the surrounding area is related to the operation of the lead and zink smelter, although studies by the Bulgarian National Health Institute claim the opposite.
29 - For example the 2010 Centerra revolving debt facility, the 2010 INA loan, or the 2009 MOL gas storage project
30 - EBRD/Grantham Research Institute on Climate Change – The Low Carbon Transition, April 2011, p. 10 http://www.ebrd.com/downloads/research/transition/trsp5.pdf
31 - The variability depends on the criteria used for the inclusion of certain projects in the category of energy efficiency For more details and methodology see: www.bankwatch.org/documents/EBRDenergylendingfigures2006_2009.pdf
32 - See for example the Evaluation Department's findings on the 2006 ArcelorMittal Kriviy Rih project in Ukraine. The aim of the project was to optimise the use of current production capacity, and increase the productivity and energy efficiency at ArcelorMittal Kriviy Rih (the "Company") in Ukraine (http://www.ebrd.com/english/pages/project/psd/2006/36813.shtml). However the EBRD Evaluation Department found that there is "limited scope for energy efficiency gains at Soviet-style steel mills, as those were built to use cheap energy from external supplies and are not designed to capture and recycle waste gases". (EBRD: Draft strategy for Ukraine 2011-2014, p. 59 http://www.ebrd.com/pages/country/ukraine/comment.shtml) This should have been clear at the start of the project. Likewise projects in the energy sector that result in the lifetime extension or capacity increase of fossil-fuelled thermal power plants are problematic, as emissions need to be reduced drastically in absolute terms and not only per unit of power produced.
33 - This trend is visible irrespective of whether energy efficiency improvements in fossil fuel-powered energy generation facilities are counted as energy efficiency or as fossil fuels. Further explanations available at www.bankwatch.org/documents/EBRDenergylendingfigures2006_2009.pdf
34 - While it may be objected that EBRD loans are not subsidies, they clearly offer an advantage to the recipient in terms of encouraging private sector investors to invest in the same project or sector and thus have a promotional effect.
35 - EBRD/Grantham Research Institute on Climate Change – The Low Carbon Transition, April 2011, p. 40 http://www.ebrd.com/downloads/research/transition/trsp.pdf
36 - Several of the EBRD's countries of operations are rich in oil and gas or coal or all three, which decreases the incentive for governments to explore alternative sources of energy
37 - eg. how many people got access to drinkable water as a result of the project, how much recycling did the project introduce, how much was waste production reduced by the project?
38 - EBRD Evaluation Department, Annual Evaluation Overview Report for 2010, June 2010, p.12 http://www.ebrd.com/downloads/about/evaluation/1006-1.pdf
39 - For further explanation on this see a letter from 30 civil society organisations to the EBRD, 23 March 2011: http://www.bankwatch.org/newsroom/documents.shtml?x=2281377
40 - In some cases the EBRD makes an effort to ensure that individual project consultations are carried out according to its standards. It needs to strengthen these efforts by ensuring that concerns raised during the consultations are properly followed and addressed, even if this means significant changes in project design. Additionally the EBRD has made some changes as a result of its Country Strategy consultations, but these almost never involve changes in the actual investments that the bank plans for a country. If the consultations are to be regarded as meaningful by their participants, more meaningful changes as a result of the inputs need to be visible.

NOTES

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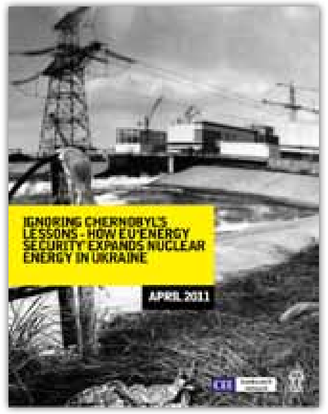

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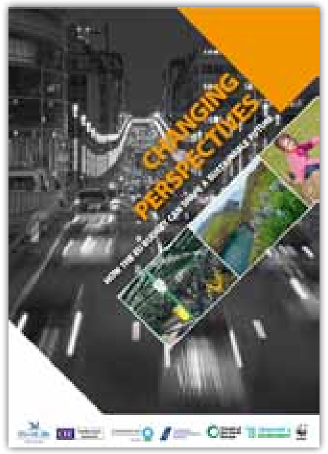

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