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Development**

**„EBRD: Strategic Priorities for the Russian Federation”**

**Association of European Businesses,  
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Excellencies,  
Ladies and Gentlemen,  
Dear President Hartmann and Dr Schauff!

Thank you for the invitation to address the members of the Association of European Businesses. We are honoured by the strong presence of business representatives at today's event and I take this as a sign of encouragement: It clearly demonstrates that the interest of investors in the Russian economy remains strong.

**I.**

This is especially important as the global economic crisis has hit Russia hard. This year our economists forecast a fall in output of -8.5 per cent in 2009. This represents Russia's steepest recession since the early years of transition, ending a period of exceptional growth which had started in 1999.

The Russian government has responded to this unprecedented challenge well. A currency collapse has been averted through prudent policies and systemic banks have been refinanced. The reserves which had been accumulated in previous years have not been wasted, but used wisely for economic stabilisation in times of need. The rebound of the stock market since the beginning of this year is a sign that investors have not lost their faith and today there are signs that the global economy is recovering – albeit in a slow and uncertain way – which should also ease the pressure on Russia.

However, it would be premature to assume that the testing times are over. What we are seeing at the moment is a “bottoming out” of the crisis and for the next year our economists predict a return to growth in Russia with an expansion of the economy by up to 3 per cent. But in order to secure sustainable, long-term recovery important lessons must be learnt from the past 12 months.

The crisis did not start in Russia. Its causes lay in the Western financial markets. But what the crisis has done to Russia and the wider EBRD-region is to expose existing weaknesses and vulnerabilities, which had not been addressed properly or sufficiently in the years of rapid economic growth.

For the Russian Federation we can identify the following major challenges:

- The economic downturn and fall in global commodity prices have emphasised the importance of **diversification of output and exports** for sustainable long-term economic development. Diversification will in turn rely on both innovation and further integration into the world economy, as well as addressing existing infrastructure bottlenecks.
- The sharp economic slowdown also highlighted the importance of strengthening the financial sector and **capital markets development**, and exposed the current fragility of the rouble markets.
- Furthermore, the crisis has underlined the **need to bolster the competitiveness** of the Russian industry through market-based restructuring and improved production efficiency, in particular energy efficiency, and has emphasised the importance of developing the micro, small and medium-sized enterprise sector.
- Deepening Russia's **integration into the global economy** and advancing its membership in the World Trade Organisation is an important anchor to promote competitiveness of domestic industry and services. This would help reduce the recent import tariffs across various sectors that Russia introduced in response to the financial crisis.
- Remaining weaknesses in the institutional and regulatory framework and in corporate governance practices need to be addressed to **improve the investment climate** and revive foreign direct investment.

## II.

The EBRD's activities and investments in Russia are designed to address these challenges which we are tackling both with our long-term strategy and crisis response. Russia is our largest country of operations and will retain a key role in our activities also in the future. Yesterday, I signed an important loan to TGK-8, a subsidiary of Lukoil and one of Russia's 14 territorial power generating companies, which lifted our investments in Russia so far this year to over \$ 3 billion.

I am mentioning this example not only because of the financial significance, but also because it exemplifies very well what the EBRD can contribute to the development of Russian companies: The \$300 million loan will be used for the refurbishment of the Krasnodar central heating plant in Southern Russia with state of the art equipment which does not only meet EU Best Available Techniques and environmental standards but will also dramatically improve the environmental and operational efficiency of the plant.

It is also noteworthy that this loan was already our third this year in the power sector and aimed at **improving energy efficiency**. However, we also have other priorities in Russia:

- **Strengthening the Russian *Mittelstand***: Yesterday we signed a \$150 million loan to Borets, a local company which produces pumps used in many sectors of the economy. Over the year we have provided similar loans to foreign and local companies, with a focus on SMEs outside Moscow and St Petersburg.

- **Transforming the country's infrastructure:** In July we provided a \$500 million loan to Russian Railways RZD for the modernisation and reform of one of the world's largest transport companies. An upgrading of the railway network and system is key to improving the transport infrastructure of the country.
- **Supporting the real economy:** Earlier this year we also extended a \$180 million loan to high-tech company Sistema. Through our loans and equity investments we are actively supporting the diversification, competitiveness and integration of Russian companies.
- **Bolstering the financial sector:** The \$75 million loan we provided to Bank of St Petersburg in June is an example how we are supporting long-standing partners and contributing to the strengthening of the capital base of the sector.

### III.

These investments are an expression of our strategic priorities for the Russian Federation. We are currently finalising our new strategy for the country which will be submitted for approval to our Board of Directors in their next meeting and set the course for our activities for the next three years.

Our strategic priorities herein are:

- Energy efficiency
- Diversification, modernisation and competitiveness of the real economy
- Infrastructure development
- Strengthening the financial sector.

Allow me to elaborate on these four points in some more details:

#### 1. Energy efficiency

The EBRD launched its Sustainable Energy Initiative in 2006 with the aim to address the climate change challenge and promote a more efficient use of energy in its countries of operations, thus also contributing to improved energy security in the region. The results of this initiative have exceeded our expectations and led to 21 million tonnes of annual CO<sub>2</sub> emission reductions and over 8 million tonnes of oil equivalent in annual energy savings. Investments reached €2.7 billion through 166 projects in 24 countries.

Because of the importance and urgency of the challenge we have this year launched the second phase of the initiative with even more ambitious targets. Objectives include a financing target range of €3 to 5 billion for a total project value of €9 to €15 billion and carbon emissions reductions of 25 to 30 million tonnes per annum.

The Russian Federation plays a key role in the implementation of this initiative, with energy efficiency becoming an integral part of our activities in Russia. We will focus on the demand side of energy use by reducing waste of energy and greenhouse emissions in all sectors, which will be important to support corporate competitiveness and combat climate change. An Energy Efficiency Action Plan is currently being negotiated with the Russian authorities.

#### 2. Real economy

Supporting and strengthening the modernisation, competitiveness and diversification of the Russian economy remains a key task and challenge. The needs remain huge and Russia is now paying the price that not enough has been done during the growth period to lessen its dependency on the export of natural resources. At the same time we are well aware that economic diversification is a long-term project. Therefore it is all the more important that concrete steps are taken and supported now which will then be able to expand once the Russian economy returns to healthy and sound growth.

The EBRD is supporting these efforts by focusing on diversification and enhancing value-added manufacturing and on sectors where most impact can be made. In the last few years we have seen very encouraging signs of new Russian companies starting up at local level, often with advanced know-how and technologies. Helping and allowing this kind of enterprises to develop, grow and prosper is clearly the way forward for the Russian economy and should sooner or later also attract the attention of foreign investors.

### **3. Infrastructure development**

For the recovery and diversification of the Russian economy the development of the country's infrastructure remains a key precondition. We all know the laments about the terrible state of transport which run like a thread through centuries of Russian literature. And the warnings are just as valid today: without a functioning transport infrastructure there can be no physical flow of goods, hence our large investment into the modernisation and reform of the railway system. This is equally true for utility services and energy supply. And infrastructure development goes beyond the needs of the economy: no modern municipality can exist without water, heating, electricity and communication facilities.

Due to its vastness and its spread over areas with extreme climatic conditions infrastructure development will always remain a challenge in Russia. The situation has certainly been exacerbated by the current crisis and the drying up of funds. The immediate challenge is to ensure the availability of public and IFI financial support for critical infrastructure projects and to support viable private companies and municipalities in the sector. We welcome the progress the Russian government is making in increasing the attractiveness of private public partnership projects, which will be further bolstered by additional improvements in the legal framework, for instance in regards to concessions.

To assist Russia in meeting its medium-term transition and development goals, the EBRD will continue to provide investment in the transport and municipal infrastructure sectors. Tied in with our energy efficiency-focus we also intend to finance investments in generation and transmission capacity, support the momentum of liberalisation and renew ageing and inefficient power infrastructure. In the oil and gas sectors we will support projects that promote energy efficiency, good governance and best environmental practices.

### **4. Financial sector**

The crisis has forced the Russian authorities last year to take immediate steps to stabilise the banking sector. Similar action has been necessary in many other countries of the world and we believe the Russian authorities handled the challenges well.

However, longer-term issues remain: For the recovery it will be crucial that bank lending resumes and the banking sector can again fulfil its crucial role as intermediary for financing the real economy. This question arises against the backdrop of rising non-performing loans and uncertainty over the amount of possible defaults. Again, as you know only too well, this is a problem not only the Russia Federation is confronted with.

Under our crisis response package we have addressed this issue together with other IFIs with substantial loans to systemic banks in the region for on-lending to the real economy. In Russia we are focusing on the support of our existing clients as well as of consolidating initiatives. As a systemic solution to the current crisis we will give new prominence to domestic capital market development and local currency funding to help address the excessive reliance of the Russian economy on external sources of funding.

#### **IV.**

Although the challenges are enormous allow me to conclude my remarks by reminding you that so is Russia's potential. For too long the country, but also we foreign investors, have based this assessment almost exclusively on the country's vast natural resources.

The current crisis will not have been wasted if we use it as an opportunity to broaden our view and discover the hidden potential of this fascinating country. Anton Chekhov once said: "Knowledge is of no value unless you put it into practice." If we look at what newly-established Russian pharmaceutical, engineering or high-tech companies have to offer to the country's development and future, we can take great encouragement from that.

Thank you for your attention.