Funding diversification

By THOMAS MIROW
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THOMAS MIROW has been president of the EBRD since July 2008. After graduating from the University of Bonn in 1975, Mr Mirow worked as assistant and then as chef de cabinet to former German chancellor Willy Brandt. After serving as director of the press office of the city-state of Hamburg, Mr Mirow held several senior positions within the city administration between 1991 and 2001, including state minister for economics. More recently, Mr Mirow was director general for economic policy in the federal chancellery in 2005 and appointed state secretary at the federal finance ministry of Germany in November 2005.

When the EBRD held its 2007 Annual Meeting in Kazan, the capital of the Republic of Tatarstan some 800km east of Moscow, the choice of the host city was as much determined by the EBRD's desire to express its commitment to Russia's regions as by the wish to celebrate Russia's astonishing economic turnaround after the 1998 crisis.

Between 2000-07 the country's GDP grew by a combined total of 56.2 per cent. Central bank reserves increased from US$28 billion in 2000 to US$476 billion in 2007, from a net exporter of capital (outflow in 2000: US$24.8 billion) Russia was transformed into a magnet for foreign capital inflow, which in 2007 amounted to US$81.2 billion. In the same year, the federal budget recorded a surplus of 5.5 per cent. There was still enough money to set up a Stabilisation Fund which held US$156 billion at the end of 2007.

The EBRD was among those who praised the successful macro-economic stabilisation of Russia, but also warned of remaining underlying weaknesses. For instance, the country's large export income in the period 2000-07 was mainly due to high commodity prices on world markets. The share of oil and gas in export revenues rose from 37 per cent in 1995 to 61 per cent in 2007.

To counterbalance this over-dependence on commodities the EBRD focused its investments in Russia in recent years on the regions outside the two main urban centres Moscow and St Petersburg, on the diversification of the country's economy and investments in much needed-infrastructure. Small and medium-sized enterprises still play a limited role in the country's economy, while the efficient use of resources from raw materials to energy remains far behind industrial leaders.

Over the last three years the EBRD has trebled its investments in Russia from US$1.2 billion in 2005 to US$3.6 billion in 2007. Today we are the largest provider of medium- and long-term finance to the Russian economy. More than 90 per cent of the Bank's investments are outside Moscow and St Petersburg, and 86 per cent of our investments in 2008 went to the private sector. Last year we also completed the establishment of our country-wide network and the EBRD is now represented in all seven federal districts of Russia.

The global financial and economic crisis hit the Russian Federation last autumn and the impact was harder than expected: global deleveraging, the decline in international commodity prices and the reappraisal of emerging market risk led to a serious confidence and liquidity crisis. In the fourth quarter of 2008 alone US$130 billion left the country.

The gravity of the crisis is expressed in the latest statistical data: According to the Federal State Statistics Service, Russia's GDP contracted by 9.5 per cent year-on-year in the first quarter of 2009. Small- and medium-sized enterprises seem to be hardest hit, while credit constraints and the revised outlook for commodity prices has led to a shift in investment plans.

The authorities' response to the crisis has been robust, fast and appropriate. After a process of gradual devaluation the ruble seems to have stabilised. The government is focusing on supporting the banking

EBRD/Richard Bate

Annual meeting of the EBRD's Board of Governors in Kazan, Russia, 20th-21st May 2007 sector and limiting the social costs of the crisis as unemployment is soaring. As a result of the steep decline in output further pressure on the banking sector cannot be excluded. In this situation it is of key importance to turn the crisis into an opportunity to advance the emergence of a modern, diversified and knowledge-based economy. The EBRD is encouraged by the moves of the Russian authorities and is joining their efforts vigorously. In this year alone, we will invest at least US$3 billion in the Russian economy.

Our focus is on the real economy to avoid a further deepening of the crisis and contribute to the transformation of the country's commercial backbone. We are doing this by providing support with working capital, loan refinancing and balance sheet restructuring. We remain committed to attract foreign direct investment. The strengthening of small- and medium-sized enterprises is a core task of the EBRD. And in order to maintain vital trade flows we will double the volume of our Trade Facilitation Programme in Russia this year.

As the current crisis has demonstrated very clearly Russia urgently needs to diversify its economy. The country's potential goes far beyond its natural resources. Russia also has a well-educated workforce and a proud tradition in scientific excellence. Making the best use of the country's rich talent is the first step towards successful diversification. The EBRD is actively looking into ways of supporting efforts to strengthen Russia's high-tech sector.

Economic diversification, however, must also be supported by adequate infrastructure. If there is one continuous theme in Russian literature over the decades it is complaints about the poor state of roads and accommodation. The crisis poses a serious threat to ambitious plans which were drawn up in recent years. On the one hand the capacity for public expenditure has been reduced massively, on the other hand private sector investment is very difficult to attract.

In this situation it is all the more important that ongoing projects such as the construction of the Moscow-St Petersburg motorway or the expansion of St Petersburg's Pulkovo airport are continued. The EBRD is also maintaining its efforts in municipal infrastructure. We are developing a medium term programme with the Russian Railways. In response to the crisis the EBRD is also supporting private transport companies in restructuring their balance sheets and refinancing their short term debt.

In the energy sector the EBRD has been a strong supporter of the restructuring process in order to improve competitiveness, transition and efficiency. Currently, Russia is among the least effective countries in using energy resources. Russia needs 2.3 times more energy to produce one unit of GDP than the world average. According to government evaluations, one-third of Russian fuel-energy resources are lost or consumed inefficiently. The efficiency of gas power units in Russia is 33 per cent, while in Europe this figure is above 55 per cent.

With the second phase of our Sustainable Energy Initiative we have the tools to intensify measures which are beneficial for the environment on the one hand and producers and consumers on the other hand as they are leading to a more efficient use of energy. In recent years the EBRD has paid special attention to the problem of gas flaring and is stepping up its activities in this field.

One of the lessons of the crisis is the need to have a stable financial sector, to avoid excessive reliance on external borrowing and to actively build local capital markets and financial infrastructure. The EBRD is therefore actively supporting medium term funding and consolidation of local banks as well as local currency lending.

Russia is facing serious challenges, but it has the potential and will to succeed in turning today's crisis into an opportunity for tomorrow. The EBRD stands ready to support these efforts with our finance, expertise and know-how. F

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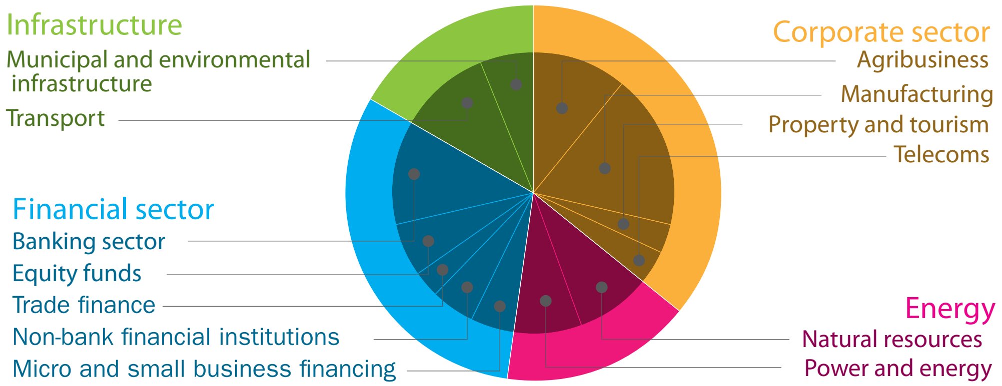
Sector breakdown of current projects



Source: EBRD