



CENTER FOR ECONOMIC ANALYSES (CEA)

Skopje, Macedonia

# THE FINANCING AT THE FRONTIER – EBRD ANNUAL MEETING OF THE BOARD OF GOVERNORS - KAZAN; 19<sup>TH</sup> TO 21<sup>ST</sup> OF MAY 2007

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## BACKGROUND

The Mission of CEA is to continuously research economic development and public policy in the Republic of Macedonia and to offer recommendations, suggestions and measures to the government and non-governmental institutions.

We at CEA share a common vision of the Republic of Macedonia as a new emerging economy integrated with the regional and world markets. We are ready to devote time and the best of our knowledge to see how this vision becomes reality. Our mission is to continuously research economic development and economic policy in the Republic of Macedonia and to offer recommendations, suggestions and measures. CEA is actively participating in all relevant activities related to the economic growth and development of Macedonia. CEA developed comments to the EBRD's strategies (available at: [www.cea.org.mk](http://www.cea.org.mk)) and thus, become an active participant in the EBRD activities. Last year the EBRD-London organized also, a working breakfast with think tanks of Macedonia in which CEA had a useful talk with EBRD's representatives from London's main office.

CEA is aware of the role and importance of the EBRD in Macedonia. EBRD is an important partner of Macedonian government. EBRD has embraced a major new investment strategy which shifts the Bank's focus further to the east and south increasing its activities in Russia, Western Balkans, Ukraine, the Caucasus and Central Asia. This

strategy looks to meet new business challenges with flexible, innovative investment approaches.

CEA will continue to be active as a civil sector organization and monitor the Macedonian development and the role of International Financial Institutions. CEA will try to be as constructive as possible and will offer its expertise to give comments to their strategies and for specific projects as required.

USAID once again have recognized the capacity of CEA and was co-sharing (EBRD covers the registration fee for NGOs) the cost of one CEA member being present at this event.

## **ABOUT THE PROGRAM**

The theme of this year's Business Forum: *Financing at the frontier* was emphasizing the doing business beyond the traditional investment destinations. The point is to hear valuable perspectives on the investment potential of emerging markets in the region especially Russia and Tatarstan.

There were different instruments for exchange of information as discussion sessions, specialist's panels, social events, country promotion programs, receptions and a separate NGO section.

The organization was perfectly done with all day busses running back and forth each half hour between hotel and the Korston Complex. The social events were well organized with high officials making interesting statements for the distinguished guests.



## **FROM RUSSIA WITH LOVE**

Russia is endowed with natural resources. Can this be a curse or a key to economic and geopolitical strength of the country? The main messages from Russia to investors presented by the Chairman of the board of Basic element Mr. Oleg Deripaska, Mr. Sergey Ignatiev Chairman of the CB of the Russian federation, Mr. Vagit Alekpetrov President of OAO Lukoil and many others, in my opinion, were:

1. We grow and we intend to grow in next decades;
2. We want to diversify;
3. The low base of the country in terms of infrastructure, power and energy, new technologies and corporate and banking sectors will require capital investments beyond any scale imaginable;
4. We want partners to co-share the costs and enjoy together the benefits.

Certainly, the respectable international reserves of Russia and the Stabilization fund in amount of 396 billion US \$ and 153 billion US\$ respectively (estimate for 2007); together with positive CA and low budget deficit, puts credibility to the story of possible sustainable growth of the economy but the country still lacks the corporate sophistication, microeconomic efficiency and externalities management followed with obsolete, inefficient processes and technologies.

A good example was the Discussion Session: “Energy of the cities”. It was announced in the program as of Mayors as leaders in cutting emissions and saving resources for the good of the cities and the planet. Certainly an expectation for a noble and in-trend debate, but the discussions never went beyond the purchasing power of the citizens, urban problems, low collection rates, indicative corruptive elements in investment projects etc. I recognize that this is a common problem in the ex-central planned economies and certainly for Macedonia and I had a full understanding for the ambition of this debate and the real world problems.

#### **BOX 1: SOME PRACTICAL DATA ON ENERGY EFFICIENCY**

The EBRD countries remain the world highest emitters of greenhouse gases after USA and China. The energy saving policies can help the economic growth and a decline of carbon dioxide emissions going hand in hand.

Central and Eastern Europe (the 29 countries that EBRD operates in) use up to 7 times more energy to produce each unit of GDP compared to western Europe. Over the next 20 years the transition countries energy needs will rise by 80 % and in most it is the energy efficiency as a potential source of new energy supply. The Russian government calculates that the country can save up to 40% of its current annual energy consumption through improved efficiency. Bulgaria can achieve up to 50 % energy savings just through changing their windows or insulation.

#### **ABOUT THE EBRD AND THE NGOS – A STORY OF THE INTEREST OF THE CAPITAL, EXTERNALITIES AND REDISTRIBUTION OF WEALTH**

The NGOs in the ex Soviet Union countries are strong enough and well positioned to monitor the EBRD’s actions. The CEE bank watch network is working to prevent environmentally and socially harmful impacts of internationally development finance. Their actions are strong and well accepted publicly.

One interesting case study is the Tbilisi water supply improvement project. The ministry of healthcare, labor and social protection is planning to give each family per annum 30 US\$ for communal services. The water fee per person is 1.2 US\$ thus, for a 4 members family is almost 10 US\$ per month or 120 US\$ per annum. The monthly salary for a teacher is about 60 US\$ or 720 US\$ per annum and according to studies the affordable level of combined water and waste services should not exceed 4 % of average household

income (thus, 29 US\$ or almost 60 \$ per annum if both parents are earning the same income). Thus, the subsidy from the state of Georgia is covering only 1/4 of the sum of 120 US\$. Taking into account that in Georgia around 50 % of the people live under poverty line it is a high chance that a large part of the population will be without drinking water.

The point of the above case study was also supported by the Legal seminar: “Fostering transition through PPP”. Honestly, I was present only part of the seminar but the PPP to me has two obstacles to be introduced in Macedonia as well as in Georgia. First, the PPP is recognized by the politicians as downloading the complete risk of the investment to the private investor while keeping the turf of power and second, the return for the investment cannot be reached (return over the discount rate) given the quasi-fiscal burden and risk for subsidizing the poverty (that should be government concern). This is the biggest threat to the PPP in the transition countries as Macedonia and Georgia apart from the usual threats of lack of legal requirements, risk analysis, capital investment planning etc. Downloading the redistribution responsibility from the government to the investors is not a PPP but more of a perverse quasi fiscal burden to the potential investor that will create further conflicts in a society.

Similar transparency and disclosure problems regarding PPP one can find regarding the project of the planned motorway – the Western High Speed Diameter as a part of the IX Pan-European transport corridor linking St. Petersburg with Scandinavia. The Save Yuntolovo Public Environment Movement is blaming the EBRD being too easy on the procedures related to proper preparation and disclosure of the EIA for this investment.

The CEE Bankwatch Network’s newsletter makes an analysis of the double standards and the adverse role of the EBRD beside their responsibility related to the environmental impacts and issues in relation to the projects they sponsor. The case study shows how the EBRD withdrawal from the Sakhalin II project is a right decision but for the wrong reasons. Namely, EBRD decided to halt its consideration of Sakhalin II after Gazprom agreed with SEIC shareholders to acquire the controlling stake in the project. This followed months of saber-rattling by the Russian environmental prosecutor. Ironically the EBRD didn’t withdrawn its considerations for Sakhalin II years ago when it was clear that the project was in violation of the bank’s environmental policy instead they were crying crocodile tears after take over from Gazprom. Now, the banks and the SEIC shareholders are praising again Gazprom with the new Area of Mutual Interest-AMI announcement by Shell.

The story supports my view that the foreign investors are going beyond the classical risk assessment and are weighting the future cash flows against the risk at higher levels given the potential of the Russian endowments. The stakes are at such level that the environmental issues are anticipated as a luxury that should be worked over. The weak government institutions and captured regulatory bodies and a public that is near the poverty line is too weak to correct the behavior. The same story holds for Macedonia except for the fact that the situation is even worse given that the NGO sector is much weaker and the public creators (mostly journalists) are willing to pay attention only to

political issues. In an environment such as in Macedonia where journalists want to be politicians and politicians wanting to be journalists environmental issues are at the list of lower priorities.

## **THE PERCEPTION OF THE FOREIGN INVESTORS**

It is interesting, as the Financial Times says that the risks in Russia for investments are brushed aside after the 1998 default and the Wall Street banks are in the race to take a part of the Russian potential. However, Russian bankers are saying that the sudden realization of the Russian importance and the race can engender the risk.

Also, there is no consensus at the informal and formal debates about the Russian society/economy. There were contrasting from one side that Russia is still risky enough reflecting the lack of democracy up to the statement saying that: "Russia will grow in the next 50 years. It is a story worth being part because the Russian people are bringing money back in the Russian economy which is a sign of potential growth in future" (Mr. Jack Barbanel a CEO at Moorgate Capital Management Trust-Banking Group).

I have had the impression that the stereotypical stories and discussions during the bus trips about the Russian society during the Soviet era on the one side and on the other side the concentration of people from the World's financial centers were telling me that the investors were going beyond the usual risk management with a desire to be part of the anticipated Russian business profits not only in the energy and infrastructure sector but in the field of financial services as well (to help and to support their own countries investors) thus, helping indirectly in diversification of the Russian economy.

## **RELEVANCE TO MACEDONIA**

The trip to Kazan was an experience that gave me a clearer view of the world of finances and decisions making in the world of multi billion US\$ businesses. The sophistication of the instruments, the major driving force - the return of the investment – requires credible institutions and a strong public opinion for more fair redistribution intertemporally and cross sectorally.

I was present at the country presentations of the Baltic countries. Their presentation was joint, no need for political rhetoric and EU/NATO phraseology. In contrast, the Macedonian government represented by the Minister Trajko Slaveski still feels the need to stress how we are progressing toward EU/NATO and how the government changed to central-right wing last year. Whereas the visitors at the Macedonian presentation were more interested at the practical issues like what is the tax rate of the inheritance tax, are they allowed to buy land in Macedonia, how will Macedonia celebrate the possible Mother Teresa's canonization<sup>1</sup>.

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<sup>1</sup> In 1999, the pope announced that the traditional five-year waiting period for the start of the beatification process had been waived for her. Since then, research into Mother Teresa's life verified at least one miracle attributed to her intervention. A second must be proven before she can be named a saint, a step that that Vatican experts say could happen by 2010.



I was reading the country's presentations in Microsoft Word from the Slovak Republic, Croatia, France, UK, Russia. I have the impression that our presentation was burdened with a lot of stories about reforms and with less info for the investors what that means for them. Also, I don't agree that the ultimate goal of the reforms in Macedonia (as stated in the PM's statement) should be to achieve full EU and NATO membership. The ultimate goal should be better services to its citizens and better living standards. Not

surprising that Macedonians measure life in transition with low trust in society and with a general dissatisfaction.

The current problems that Macedonia has, the conflicting statements from the so-called international community about how the country should be organized in a set up when the credibility of political and economic agenda is imported from the foreigners are main determinants of the Macedonians being disappointed by the transition, the status they have these days, their wealth, mental health etc.

**BOX 2: LIFE IN TRANSITION AND ITS DISCONTENTS OF PRACTICING IT IN MACEDONIA**

This was well documented by the EBRD report: "Life in Transition"-published in May 2007, in which Macedonians are the most disappointed nation of the transition among the 29 countries where EBRD operates.

On the question: "The economic situation in Macedonia is better today than around 1989", 70 % to 80 % of the respondents answered that they strongly disagree. More than 80 % of Macedonians believe there is more corruption now than in 1989. Around 60% agree that people could've been trusted in 1989 and only around 15% agree that people could be trusted today.

Just to mention that Kolodko, the architect of the reforms in Poland, says that the main lessons of the Polish experience of economic transition is that neoliberalism – the orthodox free market economy advocated within the Washington consensus – is failing significantly in Eastern Europe and the former Soviet Union.

The discontents of the transition are a well known life story in Macedonia. The Russian's First Deputy Prime Minister Mr. Sergei Ivanov had it right saying that the majority of population in Russia as before relies on the Tsar as the civil society is weak. To who are Macedonians relying on is a nice question to study.

In terms of new instruments for utilizing the best of the government and the private sector as the PPP, one can think it is story of trying to walk on the surface of water but Macedonia is not Jesus Christ. This was confirmed with the “public business negotiation” between the Public transportation enterprise at the city of Skopje and the private bus producer from Skopje a while ago. This was a sad story of how the public administration both at central and local level is trying to keep their inefficient over-employment, hidden over-employment through skills that don’t match the requirements of the new way of doing things. And still the both level governments are talking about PPP and having not a percent trust in the private sector. What is their definition of PPP is obvious a one of downloading the risk to the private investor and to continue to work as in “the old days”.

I was trying to talk with some of the potential investors in Kazen. I was presenting them the potential of investment opportunities at local level, the need for credit ratings for LGUs, the low base of infrastructure in Macedonia but the usual answer was that at local level 10 to 15 million of EUR is a small amount. Thus, beside the “usual” transition problems Macedonian government should start to focus to investors in accordance with what we want to achieve and to whom to talk to. It is one thing to reach the “Big Brand Names” just for the sake of bringing them in Macedonia and it is other thing to fit them to our needs.

Consider for example the new trend of the so-called structured products where the investors are becoming more sophisticated and demanding. Banks are tailoring investments to meet the client’s every wish. This is diversification of products from banks. It is not diversification and different products saying that you have loans to offer with different maturity and different interest rates. The low interest rates and low inflation have reduced the returns in the debt markets in the developed countries and that is why they are more interested at the emerging markets at the moment. Investors either want to reduce risk or want to increase it. The desire for yield is pushing them to look at a much wider classes of assets even including alternative assets. Macedonia can offer more esoteric and tailor-made products in order to enhance and leverage the yield. The trends in the Macedonian stock-exchange are part of this story (and not only Macedonia; consider the boom in Columbian stock-exchange for example). But why to stop there? The government can be proactive and offer for example alternative energy projects as tailored products.



At the outset, Macedonia should try to understand the global movements; it must position itself proactively and should shift its strategy toward ultimate goal for better standards to its citizens.

#### **ADVERTISEMENT OF CEA AND USAID**

Marjan Nikolov distributed to visitors and at the NGO section:

- CEA leaflets
- CEA bulletins
- CEA Journal of Economics
- The National competitiveness report prepared by CEA for the NCEC

And have had working meetings with different people in Kazen. At the meeting Marjan Nikolov explained the current economic developments of Macedonia, CEA's role in Macedonia and the role of donors in Macedonia especially the one of USAID when possible.