

**DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT**

**STRATEGY FOR
THE RUSSIAN FEDERATION**

**REPORT ON THE
INVITATION TO THE PUBLIC TO COMMENT**

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1. INTRODUCTION

In accordance with the EBRD Public Information Policy (PIP), an invitation to comment on the new Strategy for the Russian Federation, along with a Management Note on this issues to be addressed in the strategy, were posted on the Bank's website on 5 April 2006. The public was invited to submit comments, based on the Note and the previous strategy already on the website, no later than 31 May 2006.

As of 31 May, comments were received from three international NGO organizations - Bank Information Centre, Human Rights Watch and Pacific Environment.

As required by the Public Information Policy, these comments were examined by the relevant Banking teams and Management and responses have been provided in *Strategy for the Russian Federation: Report on the Invitation to the public to comment*. This report becomes an addendum to Strategy. The addendum will be discussed along with the Strategy at a Board Workshop in advanced of the Board discussion, scheduled for 11 July 2006.

2. EBRD MANAGEMENT NOTE

The challenges facing the Russian Federation and the EBRD's new country strategy

Over the past several years, Russia has experienced a strong macro-economic performance with high growth rates in real GDP, a positive trade balance and a substantial accumulation of reserves. Significant economic, political and social changes have gone hand in hand with this successful economic development and Russia today is more stable and prosperous than in the rather volatile 1990s.

Nevertheless, challenges and imbalances persist and need to be addressed in order to create the conditions for sustainable, balanced long-term growth. The structure of exports, with more than 70% concentrated in oil, fuel, gas and metals, gives an indication of the potential vulnerability of Russia in terms global competitiveness.

Major challenges are the competitiveness and diversification of the economy which are key factors for accelerating and improving the quality of the country's economic growth. In this context, the strengthening of the capital base of Russian companies is an important factor. The EBRD is fully prepared to play its part in helping Russia meet these challenges. In particular, given the market conditions in Russia in the current period the EBRD value added would be ensured primarily through:

- focusing on sectors making the strongest contribution to enhancing the competitiveness and diversification of the Russian economy;
- using its full potential in terms of innovative financing products, methods and expertise, e.g. through strengthening companies' capital base with equity financing and through Public-Private Partnerships (PPPs);
- working co-operatively and effectively with the Russian authorities with a prime focus on the designing relevant mechanisms and instruments to foster development of Russian transport and power infrastructure.

Invitation to comment on the Bank's Country Strategy Review for the Russian Federation

The EBRD has started work on the revision of its Strategy for the Russian Federation. Comments are invited to help the Bank in revising its Strategy. Any comments should be submitted to the Bank no later than 31 May 2006 so that they can be taken into account. The current Strategy - which has been available on the Bank's website since November 2004 - is a basis on which to comment.

The first Article of the Agreement Establishing the Bank states that "the purpose of the Bank shall be to 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 multi-party democracy, pluralism and market economics."

In order to achieve these objectives, the Bank primarily provides finance for investment projects, with a special focus on the private sector, carefully selecting projects that promote transition by:

- creating, expanding and improving markets;
- establish and strengthening of institutions, laws and policies that support markets;
- facilitating the adoption of market-oriented skills and sound business practices.

In addition, every Bank project is examined for its environmental impact and the EBRD lays special emphasis on projects that are oriented directly towards environmental improvements and energy efficiency.

The EBRD wishes to hear the views of all those interested on aspects of the proposed strategy whose guiding principles are outlined below and with particular relevance to the following four areas:

1. Issues related to the investment climate

This would include issues concerning (i) the legal environment (the implementation and enforcement of laws); (ii) the regulatory environment for enterprises (such as issues related to taxation, trade protection, price-setting mechanisms etc.); (iii) the functioning of public administration and (iv) corporate governance and integrity. We seek your views on how serious these issues are for business and how you think the EBRD could help bring about improvements.

2. Issues related to the environmental impact of the EBRD activities

This would include issues concerning environmental improvements, energy efficiency and nuclear safety.

3. Issue related to the social impact of EBRD investments

This would include issues concerning (i) small and medium-sized enterprises that enhance opportunities for entrepreneurship, job creation and social flexibility; (ii) banking and non-banking financial institution that improve access to credit and (iii) investment in large natural resources and infrastructure projects, with particular attention to issues relating to social and environmental impact, tariff reform, affordability and environmental improvements.

4. Issues related to the draft strategy outline

EBRD's activities would be less concentrated than the recent past, on financial institutions and debt instruments. In terms of priorities, the strongest contribution to enhanced competitiveness could be made in the following priority sectors:

- modernisation of transport and power sector infrastructure;
- energy efficiency
- supporting the country's high-tech sectors and helping commercialise the results of Russia's scientific research and development
- supporting the development of Russia's capital and banking markets

In addition, the modernisation of enterprises in key manufacturing sectors (e.g. automotive, chemicals and agribusiness) should be supported by EBRD debt and equity financing, when the market does not provide adequate support.

Depending on the sector, innovative financing solutions would be used including PPPs, wider use of equity and quasi-equity financing, increased funding in the Russian bond market and securitization.

Cooperation with Russian authorities will be based on policy dialogue working together to:

- Promote good corporate governance and business conduct among Russian businesses and the foreign investor community with an emphasis on improving transparency;
- Develop and implement legislative acts and regulations that create a favourable environment for private sector development and are conducive to an increased use of on-shore companies and a phasing out of transfer pricing;
- Develop robust legislative and regulatory basis for public co-financing of the transport, municipal services and power infrastructure development; create a Joint Coordinating Task Force to review the progress of cooperation in this group of sectors.
- Continue promoting dialogue between authorities and investors within the framework of the Foreign Investors' Advisory Council (FIAC).

Priority sector opportunities

For the modernization of the country's transport infrastructure, a special emphasis will be put on promoting private sector participation. The Bank has already been actively involved in a policy dialogue with the Government over the new Concession Law which represents an important step forward for the introduction of Public-Private Partnerships (PPPs) in infrastructure. The Bank would also welcome working with the Russian Investment Fund on infrastructure projects under suitable conditionality and jointly with the Government identify other appropriate sources of the public co-financing of the privately-managed infrastructure projects.

As Russia's Power sector embarks on the third and crucial stage of its reform, the Bank is ready to assist by stepping up investments in the newly emerging generating companies and to finance works to modernize and refurbish Power infrastructure.

Energy efficiency will be a key priority cutting across many sectors and businesses. The Bank will seek to expand its reach in industrial energy efficiency by targeting large energy users. It intends to develop energy efficiency credit lines aimed at industrial SMEs and the residential sector. The Bank will also support municipal projects, in particular the refurbishment of district heating systems on a more ambitious scale than before.

The Bank will offer its support for the development of the country's high-tech sectors and commercializing the results of Russia's scientific research and development; innovative financing instruments could be particularly relevant for this. Targeting

innovative technology-intensive sectors would be sought in co-investments alongside equity funds in Russia.

As part of its contribution to developing Russia's capital and banking markets as source of funding for both banks and enterprises, the Bank intends to continue supporting securitization, using its risk-taking capacity to participate in innovative risk-sharing structures. It will also mobilise external sources of Tier-2 capital for banks by sponsoring and taking mezzanine risk in structures designed to give access to capital markets.

The Bank will seek to increase its funding in the Russian bond market and broaden the investor base for triple-A Rouble-denominated credits. In addition, it will strive to expand its co-financing and loan syndication activities with Russian banks by providing finance in Rouble.

Other sector opportunities

In Natural Resources, the Bank will focus on supporting competitive market developments with the involvement of the private sector in the midstream and downstream sectors for oil and gas, including LNG.

The Bank will increase its efforts to promote renewable sources of energy both through investments and by helping the development of the fledgling regulatory and legal framework for the sector in Russia – with an immediate focus on hydro and wind power.

The Bank will continue to offer de-centralised financing solutions so as to assist reform-minded local administrations in turning their utilities (e.g., urban transport, water sector) and other assets/services (e.g., social housing) into viable commercial entities. .

An overarching objective of the Bank's work in the corporate sector will be to strengthen the capital base and foster modernization of the domestic enterprise sector, contribute in improving governance by enhancing transparency, and encouraging good business conduct and compliance with higher business standards. The Bank plans to make a more active use of equity to support Russian companies in improving their corporate governance and strengthening their capital base, including by providing pre-IPO equity financing and participating in the IPOs of Russian companies. The Bank will also aim to act as a catalyst for local and foreign investments in Russia's regions.

In the financial sector, in addition to providing debt financing, the Bank's emphasis will be on working with Russian-owned entities and taking equity stakes in banks. It will consider taking minority equity stakes in large banks at the pre-IPO or IPO stage and is ready to assist in the privatisation of banks owned by the state or regional governments. The Bank is also ready to help the banking sector's consolidation.

As regards Non-Bank Financial Institutions, the Bank will provide debt and equity, as well as capital market products, to underpin the development of mortgage, leasing finance, insurance operations and, to a lesser extent, consumer finance.

Conclusion

The Strategy will provide guidance for EBRD activities in Russia, identifying key challenges which the Bank can help to address with its main objective being transition

impact. It will have to be selective in identifying those areas where the Bank has the experience and ability to play a constructive role.

The Bank will take into account all comments received. A summary of these comments, together with EBRD staff responses, will be posted on the Bank website following Board approval of the revised Strategy. A Country Strategy is, however, a Bank document and the responsibility for its content rests with the EBRD.

3. COMMENTS RECEIVED

3.1 Submitted by Bank Information Centre (BIC)

Bank Information Center appreciates the opportunity to comment on the EBRD's new country strategy for the Russian Federation. Our comments are intended to encourage the EBRD to consider new approaches to a more sustainable pattern of economic development, to put greater emphasis on improving the environmental and social impacts of its activities in Russia, and to make aspects of its activities in Russia more transparent.

Promoting a more diversified economy and sustainable pattern of development:

Comment 3.1.1: The EBRD should rapidly phase out its financing of projects involving the development of raw materials in Russia and channel its resources into other sectors that could contribute to a more diversified economy.

Comment 3.1.2: The EBRD should end its financial support for fossil fuel developments in Russia. In particular, it should not participate in financing the Sakhalin II oil and gas project, which threatens to increase significantly Russia's dependence on the production and export of fossil fuels.

Environmental and social impacts of EBRD activities:

Comment 3.1.3: The EBRD should substantially increase its goals for investing in renewable energies and improvements in energy efficiency. Commercialization, privatization, changes in tariff structures, and other reforms of public utilities should take place only after an effective regulatory structure is put in place.

Comment 3.1.4: Because of the high environmental risks posed by Sakhalin II, the EBRD should not lend its financial support to the project.

Governance problems and transparency:

Comment 3.1.5: The EBRD should systematically publish documents related to all stages of a project's implementation, using the internet and other media, and translating all documents into Russian, to ensure maximum accessibility.

Comment 3.1.6: The EBRD should encourage full disclosure to the public of all investment contracts, such as production sharing agreements, host government agreements and concession agreements, between companies that receive EBRD loans and host governments.

Country Strategy review process:

Comment 3.1.7: We welcome the Bank's commitment, undertaken as part of the new Public Information Policy approved on May 16, 2006, to provide an opportunity for the public to comment on draft country strategies. We hope that this policy will be applied to the new country strategy for Russia, so that the public can comment on the Bank's proposed strategy.

3.2 Submitted by Human Rights Watch (Europe & Central Asia Division (HRW))

We write to urge you to use the upcoming country strategy review for Russia to express strong concern about the plight of Russia's civil society, whose autonomy is jeopardized by a new law allowing for unprecedented government oversight and interference. It is of paramount importance that the new strategy place adequate emphasis on this pressing concern, making clear that the new law raises questions about the Russian authorities' commitment to the principles of Article 1 of the Bank's founding agreement, and calling for concrete steps to address it.

In January, President Putin signed into law sweeping new restrictions on NGOs in Russia. The law, which amends four existing laws governing NGOs, has the potential to dramatically obstruct the work of civil society in Russia.

Under the law, new organizations must register, existing organizations must inform the authorities about their existence and the grounds for refusal of registration are expanded. The law also paves the way for unfettered scrutiny of NGO operations and veto over the proposed work programme of individual NGOs.

The level of discretion in these provisions is manifestly inconsistent with Russia's obligations under Article 11 of the European Convention on Human Rights to respect the right to freedom of association, and goes far beyond Council of Europe standards for government oversight of NGOs. The Russian Foreign Ministry has argued that the new NGO law is not substantially different from its counterparts in the US, Israel, and several European countries. But a comparative study by the International Center for Not-for-Profit Law (ICNL) shows that the most restrictive aspects of the Russian law are absent from the legislation of these states.

The new NGO law must also be seen in the context of the Putin government's systematic efforts to dismantle checks and balances on the executive's power. NGOs are the last remaining civic institution independent of the Kremlin.

Comment 3.2.1: We hope the Bank will use the opportunity of the country strategy review to candidly convey concerns at the highest level about the predicament of Russia's civil society. Specifically, we recommend that the EBRD: send a clear message that it considers the future of Russia's civil society a priority issue, and call on the Russian leadership to annul those articles of the new NGO law that grant state officials the right to excessive interference into the work of NGOs.

Comment 3.2.2: We want also to draw attention to number of other concerns about the Russian government's human rights record, including: continued impunity for serious abuses in Chechnya; violent hazing and other abuses in the army; HIV/AIDS-related abuses; racism and intolerance, including homophobia; the fate of Uzbek citizens in Russia whose extradition the Uzbek government has requested.

3.3 Submitted by Pacific Environment

The 2004 Revised Russia Country Strategy presents critical observations on the environmental and civil society challenges in Russia. Based on years of lessons learned with the Bank's involvement in the natural resources sector, Pacific Environment recommends the following revisions:

Comment 3.3.1: Extend the objective of maintaining Bank leverage over clients, high standards of transparency and corporate governance, and increased due diligence to encompass contractually-related state-owned companies and subcontractors.

Comment 3.3.2: Expand the Bank's contribution to legal transition to include the improvement of environmental law and enforcement.

Comment 3.3.3: End the Bank's role in impeding legal transition by ensuring that its projects do not violate Russian environmental and social law and that contractually override and weaken environmental and social laws. The Bank's achievements in legal transition are laudable. Most of these achievements appear to be in the realm of corporate governance and regulation, and promotion of private entrepreneurship. We wonder, given the Bank's environmental mandate, why it does not likewise contribute to a transition toward improvement in environmental law and enforcement.

Comment 3.3.4: Given the commitments to the respect of human rights in the Bank's Establishing Agreement, and its inclusion of civil society in much of its activities, the Revised Strategy should lay out a strategy for the Bank to respond to the new NGO law and the potential impact it could have on the development of independent civil society in Russia. Include benchmarks to monitor the development of civil society organizations amid the growing concerns about President Putin's actions to constrain the activity of human rights and other civil society organizations.

Comment 3.3.5: Include further analysis and action steps to help Russia counter the negative impacts of its areas of deficiency in environmental governance, including the ongoing restructuring of Russian environmental monitoring and enforcement agencies.

Comment 3.3.6: Articulate the role of the Bank, and particularly its regional offices, in bringing about economic diversification in regions where the negative impacts of natural resources dominance is most pronounced (particularly the Urals, Siberia and the Russian Far East);

Comment 3.3.7: End the Bank's emphasis on mega-projects in the extractive industry sector (like Sakhalin II) and amplify the call for diversification, including investment in more economically, socially and environmentally sound sectors.

Comment 3.3.8: Include an articulated strategy with regards to the Bank's treatment of Export Credit Agencies in its cooperative relationships with multilateral donors and aid agencies.

Comment 3.3.9: Why the Bank continues to refer to "good international practice" rather than striving to achieve "best international practice".

Comment 3.3.10: EBRD must decline support for projects when prospective clients fail to meet the Bank’s environmental policies and otherwise do not adequately respond to the leveraging influence the Bank is supposed to bring.

Comment 3.3.11: We urge the EBRD to demonstrate its commitment to the action steps in the previous Country Strategy section 2.1.5. “Physical Environment” by articulating more specifically its plans to respond to the impacts of Russia’s deficient environmental management systems.

4. STAFF RESPONSES

Comment 3.1.1 (BIC): *The EBRD should rapidly phase out its financing of projects involving the development of raw materials in Russia and channel its resources into other sectors that could contribute to a more diversified economy.*

Comment 3.3.6 (Pacific Environment): *Articulate the role of the Bank, and particularly its regional offices, in bringing about economic diversification in regions where the negative impacts of natural resources dominance is most pronounced (particularly the Urals, Siberia and the Russian Far East);*

Comment 3.3.7 (Pacific Environment): *End the Bank's emphasis on mega-projects in the extractive industry sector (like Sakhalin II) and amplify the call for diversification, including investment in more economically, socially and environmentally sound sectors.*

Staff response: In the strategy for the Russian Federation, the EBRD recognises the challenges of competitiveness and diversification of the economy and makes a priority of addressing those issues. At the same time, it is obvious that, in the Russian Federation, the natural resources sector represents a significant part of the GDP and even larger portion of export revenues. The Bank believes it has a positive role to play in helping address the main challenges in the sector. The most important of these are: security of supply and increased energy fuel mix in the region and its further integration in the world economy; corporate governance and transparency standards and restructuring of the state-owned companies; policy dialogue on transparent revenue management, accountability of licensing agreements and revenue flows between corporations and the state; regulatory reforms, including accounting separation of upstream from mid-stream and downstream activities, competitive and transparent allocation of licenses, and development of crude quality accounting; development of internal gas market and independent gas producers;

Large scale projects, especially in the energy sector of the Russian economy, potentially may act as a focal-point for a cluster of Bank operations in a variety of areas, including: environmental and municipal infrastructure development; provision of SME finance, business training and capacity building; and a joint EBRD/Foreign Investment Advisory Services (FIAS) investment climate study with associated policy dialogue aimed at reducing impediments to business development. This should help maximise, sustain, and broaden the benefits of the projects to wider private sector development.

By participating in the projects like Sakhalin II the Bank can make a significant contribution to the economic development of the regions located far from the developed Western part of the country, through, for example, increasing competitive pressure and business standards among Russian contractors/subcontractors. Participation of the Bank helps focusing the structure of transactions on high environmental and social standards, secures the engagement of all stakeholders in the development of the projects.

The necessary contribution of EBRD to the diversification of the Russian economy sector-wise must be accompanied by the building of a balanced regional investment portfolio, as was recognised already prior to the previous Strategy period. A series of federal reforms, clarifications in the area of fiscal federalism, and rule-of-law reforms delivered major improvements and greater predictability in relations between the

Federal centre and the regions. These changes have made it possible to develop business opportunities in a wider cross-section of regions, rather than focusing on priority regions selected on the basis of *a priori* criteria. While it is impossible for the Bank to maintain a meaningful presence in all of Russia's regions, the creation of a common economic and legal space has enabled the Bank to look at the investment potential of regions across the entire Federation. The EBRD's portfolio now comprises 253 projects and sub-projects in 47 regions. More than 65 percent of the Bank's projects are in the regions. The Bank's operations are supported by the on-going implementation and expansion of its network of resident offices in Moscow, St Petersburg, Ekaterinburg and Vladivostok. The emphasis on regional presence and diversification is shown in the decision to add to the existing network two new offices in Rostov-on-the-Don and Samara.

Comment 3.1.2 (BIC): *The EBRD should end its financial support for fossil fuel developments in Russia. In particular, it should not participate in financing the Sakhalin II oil and gas project, which threatens to increase significantly Russia's dependence on the production and export of fossil fuels.*

Comment 3.1.4 (BIC): *Because of the high environmental risks posed by Sakhalin II, the EBRD should not lend its financial support to the project.*

Staff response: It should be noted that, at this stage, the Sakhalin II project has not yet been considered by the Board of Directors for Bank financing.

The Bank pays special attention to promoting the ongoing integration of the Russian energy sector into the international economy. The Sakhalin II project will open up the entire Asia-Pacific market for the Russian gas sector. This will stimulate inter-regional and cross-border transactions with Russia's Asia-Pacific neighbours. At the same time, the Bank fully recognizes that, in giving consideration to the project, full account must be taken of its potential environmental and social effects and measures put in place to mitigate these.

Comment 3.1.3 (BIC): *The EBRD should substantially increase its goals for investing in renewable energies and improvements in energy efficiency. Commercialization, privatization, changes in tariff structures, and other reforms of public utilities should take place only after an effective regulatory structure is put in place.*

Staff response: As outlined in the Strategy, in the field of renewable energy the Bank will increase its efforts to promote these energy sources in Russia, both through its own investments and with the support of TC funding for the development of the sector's nascent regulatory and legal framework. The immediate focus will be on hydro and wind power.

On the energy efficiency front, the Bank will seek to expand its reach in the industrial sphere through more systematic targeting of large energy users, in particular through the use of TC-funded energy audits. It will also develop energy efficiency credit lines, targeting industrial SMEs and the residential sector. The Bank will support municipal projects with significant energy efficiency benefits in particular the refurbishment of

district heating systems. Moreover, the Bank is ready to assist clients in monetising, through the sale of carbon credits, the emission reductions arising from Bank-funded projects. Russia will be the key focus of the recently announced Sustainable Energy Initiative.

Comment 3.1.5 (BIC): *The EBRD should systematically publish documents related to all stages of a project's implementation, using the internet and other media, and translating all documents into Russian, to ensure maximum accessibility.*

Staff response: While the Bank must be able to develop its projects in a climate conducive to client trust, it does inform the public before a project is approved by the Board of Directors. In the case of environmentally sensitive projects, the public has an opportunity to have information and is consulted on environmental plans and programmes during the consultation process. The Project Summary Document (PSD), which contains a summary of associated environmental and social issues is updated at key stages in a project's life cycle: at Board approval; signing; and completion or cancellation, or when there are material changes in the project. As provided by the new Public Information Policy, PSDs on projects in the Russian Federation will be translated into the Russian language.

Comment 3.1.6 (BIC): *The EBRD should encourage full disclosure to the public of all investment contracts, such as production sharing agreements, host government agreements and concession agreements, between companies that receive EBRD loans and host governments.*

Staff response: In the revised EBRD Energy Operations Policy the commitment to the principles of the Extractive Industries Transparency Initiative (EITI) was stressed again. The Bank will finance projects designed to yield a lasting benefit for the local population and adhere to best international transparency and revenue management standards. Going forward, the Bank will require project sponsors to publicly disclose their material project payments to the host government as a minimum revenue transparency condition. However, as stated in the EBRD Public Information Policy, the Bank needs to strike a balance between its obligations to its clients in respect of their confidential commercial information and that the protection of such information will co-exist with the presumption of disclosure and should not lessen accountability.

Comment 3.1.7 (BIC): *We welcome the Bank's commitment, undertaken as part of the new Public Information Policy approved on May 16, 2006, to provide an opportunity for the public to comment on draft country strategies. We hope that this policy will be applied to the new country strategy for Russia, so that the public can comment on the Bank's proposed strategy.*

Staff response: When the new Public Information Policy was approved by the Board of Directors on 16 May 2006, it was agreed that the new provisions in the policy would come into effect on 1 September 2006. This applies to the provision for the posting of draft Country Strategies on the Bank's website for public comment. Therefore the provisions in the previous Public Information Policy for the posting of an "Invitation to

Comment” based on a “Management Note” apply to this revision of the Strategy for the Russian Federation.

Comment 3.2.1 (HRW): *We hope the Bank will use the opportunity of the country strategy review to candidly convey concerns at the highest level about the predicament of Russia’s civil society. Specifically, we recommend that the EBRD: send a clear message that it considers the future of Russia’s civil society a priority issue, and call on the Russian leadership to annul those articles of the new NGO law that grant state officials the right to excessive interference into the work of NGOs.*

Comment 3.2.2 (HRW): *We want also to draw attention to number of other concerns about the Russian government’s human rights record, including: continued impunity for serious abuses in Chechnya; violent hazing and other abuses in the army; HIV/AIDS-related abuses; racism and intolerance, including homophobia; the fate of Uzbek citizens in Russia whose extradition the Uzbek government has requested.*

Comment 3.3.4 (Pacific Environment): *Given the commitments to the respect of human rights in the Bank’s Establishing Agreement, and its inclusion of civil society in much of its activities, the Revised Strategy should lay out a strategy for the Bank to respond to the new NGO law and the potential impact it could have on the development of independent civil society in Russia. Include benchmarks to monitor the development of civil society organizations amid the growing concerns about President Putin’s actions to constrain the activity of human rights and other civil society organizations.*

Staff response: The HRW and Pacific Environment comments touch on a number of human rights issues – regarding abuses in Chechnya, racism and intolerance and others. With reference to the above-mentioned issues, these have been addressed in Annex 1 of the Country Strategy for the Russian Federation. Pacific Environment have called on the Bank to “lay out a strategy...to respond to this disturbing trend” and to “include benchmarks to monitor progress – or regress – of civil society organizing in Russia”. However, the Strategy does not include specific benchmarks to monitor progress or lay out a strategy to respond to these developments. Benchmarks have been used in Country Strategies only where questions regarding a country’s commitment to and application of Article 1 are of a fundamental nature. The staff assessment at this stage does not place Russia in that category. Ultimately, it will be a matter for the Board to decide whether this is correct.

Specifically, some comments are focused on the restrictions contained in the new law on non-governmental organisations and the obstacles they could pose to the development of civil society in Russia. HRW recommends that the Bank, through its new Russia Strategy, should “send a clear message that it considers the future of Russia’s civil society a priority issue” and should “call on the Russian leadership to annul those articles of the new NGO law that grant state officials the right to excessive interference into the work of NGOs”.

The current draft of the Strategy takes account of the recent changes to the NGO law and the reaction of international and domestic rights groups. There are references in the main text – in particular in Section 2.1.1 – and in the Political Assessment in Annex 1 to the changes and their implications for civil society development. The Bank does send a

clear message that it considers the development of civil society an important issue in Russia's transition.

However, the Strategy does not call on the Russian leadership to annul part or all of the new NGO law. This does not fall within the mandate or expertise of the Bank. This is a domestic legal matter for the Russian Government and Parliament to decide; EBRD can only comment on what it may imply for the development of civil society, which is an important aspect of democratic transition. At the moment, while the law has raised concerns in the international community and among domestic NGOs, there is insufficient evidence of indiscriminate or selective application of the law to muzzle civil society organisations on which to base claims that the situation has deteriorated dramatically in the past Strategy period.

Comment 3.3.1 (Pacific Environment): *Extend the objective of maintaining Bank leverage over clients, high standards of transparency and corporate governance, and increased due diligence to encompass contractually-related state-owned companies and subcontractors.*

Staff response: The comment is a general one and not specific to Russia. The importance of having leverage over clients, high standards of transparency, etc. and the challenge of contractor management are all issues of concern shared by the Bank. These issues will be considered during the forthcoming EBRD's Environmental Policy revision. We are aware of the way these issues have been addressed by the IFC in their new Performance Standard 1, for example.

Over the years the Bank has built up a substantial portfolio in all key sectors of the Russian economy and has had - through its investments, policy dialogue and mobilisation of other investors - a tangible impact on several dimensions of Russia's transition process. The transition benefits generated by the Bank's operations and policy dialogue have been positively influenced by Russia's strong post-crisis recovery and the adoption and implementation of the Government's comprehensive modernisation and reform agenda in 2000.

A major source of the Bank's transition impact has been its contribution to the ongoing institution-building process in a wide range of sectors and reform areas. The Bank has provided assistance for developing the legal framework: among others, for secured transactions, joint stock companies, bankruptcy proceedings and concessions. The Bank has been involved through several transactions in sector reform programmes such as power sector restructuring, road sector financing and the railway sector. New areas of active policy dialogue include the tariff system for different types of renewable energy, implementation of PPPs in specific sectors, as well as securities market regulations.

Comment 3.3.3 (Pacific Environment): *End the Bank's role in impeding legal transition by ensuring that its projects do not violate Russian environmental and social law and that contractually override and weaken environmental and social laws. The Bank's achievements in legal transition are laudable. Most of these achievements appear to be in the realm of corporate governance and regulation, and promotion of private entrepreneurship. We wonder, given the Bank's environmental mandate, why it*

does not likewise contribute to a transition toward improvement in environmental law and enforcement.

Comment 3.3.10 (Pacific Environment): *EBRD must decline support for projects when prospective clients fail to meet the Bank's environmental policies and otherwise do not adequately respond to the leveraging influence the Bank is supposed to bring.*

Comment 3.3.9 (Pacific Environment): *Why the Bank continues to refer to "good international practice" rather than striving to achieve "best international practice".*

Staff response: The 2003 EBRD's Environmental Policy of the Bank already states under Section 21 that "... the EBRD will require that projects be structured so as to meet applicable national environmental law..." Any deviations in this respect need to be brought to the Board's attention and they will take into account such information in their decision-making process.

Broadening the scope of EBRD's Environmental Policy to additional issues relating to social matters will be considered during the Environmental Policy review in 2006 and revision in 2007. Likewise, the question of *good* versus *best* international practice will be discussed at that occasion.

Comment 3.3.2 (Pacific Environment): *Expand the Bank's contribution to legal transition to include the improvement of environmental law and enforcement.*

Comment 3.3.5 (Pacific Environment): *Include further analysis and action steps to help Russia counter the negative impacts of its areas of deficiency in environmental governance, including the ongoing restructuring of Russian environmental monitoring and enforcement agencies.*

Comment 3.3.11 (Pacific Environment): *We urge the EBRD to demonstrate its commitment to the action steps in the previous Country Strategy section 2.1.5. "Physical Environment" by articulating more specifically its plans to respond to the impacts of Russia's deficient environmental management systems.*

Staff response: All three comments are relevant for the Bank's region of operations, not just Russia. Section 10 of the 2003 EBRD's Environmental Policy states the following: "The EBRD believes that to achieve environmentally sound and sustainable development, structural change needs to be implemented by individual countries. The EBRD believes that progress towards sustainable development can best be achieved by working within a sound regulatory and policy framework that uses market mechanisms to promote environmental protection and provides suitable social safety nets for vulnerable members of the community. In recognition of the strong links between good environmental performance, commercial efficiency and competitive advantage, the EBRD encourages and supports governments to provide the right signals to individuals and businesses, particularly through Bank-financed projects and selected technical cooperation initiatives."

The Bank is facing many environmental and social challenges within the framework of its diverse activities in Russia and addresses those accordingly, making sure that

appropriate safeguards are being built into every project to minimise any negative environmental and social impacts and to maximise potential benefits. The Bank has pursued a number of TC initiatives to support practical identification of the best environmental solutions and capture environmental opportunities within its projects, as well as supported institutional capacity building in, for example, waste management or oil spills response planning in line with applicable international standards.

However the EBRD has the ability to manage only a select and limited number of environmental technical cooperation projects over a given year. While requirements for environmental management systems are built into projects during the due diligence stage of the project appraisal, the Bank does not have the resources to manage technical cooperation projects in every country in its region on a particular topic.

To address deficiencies, it is clearly necessary to strengthen further the legal and regulatory framework for the environment, make the regulatory setting clearer and less complex; foster intergovernmental cooperation, build effective compliance and enforcement programmes, encourage meaningful public participation, and in particular participation of indigenous peoples, invest in environmental management and control, incorporate technology-based standards for pollution control, strengthen monitoring systems and adopt better environmental indicators, enhance programmes with better scientific, and policy analysis. EBRD alongside other international organisations and financial institutions, will continue to assist Russia in addressing these issues by encouraging international good practices through the Bank's environmental due diligence process and by engaging in a dialogue with relevant Russian authorities and public.

The issue of how the EBRD is implementing Environmental Policy commitments to environmental management systems, environmental monitoring and laws will be reviewed in the forthcoming policy review. We will take into consideration the suggestion that Russia be a priority for initiatives in this area and we would welcome discussion with stakeholders on specific opportunities.

Comment 3.3.8 (Pacific Environment): *Include an articulated strategy with regards to the Bank's treatment of Export Credit Agencies in its cooperative relationships with multilateral donors and aid agencies.*

Staff response: It is not clear what question is being asked here.