RUSSIAN FEDERATION

Statement by the EBRD Governor for the Russian Federation
Minister for Economic Development of the Russian Federation
Mr M S Oreshkin

Annual Meeting of the EBRD Board of Governors
Sarajevo (Bosnia and Herzegovina, 7–9 May 2019)

The delegation of the Russian Federation would like to thank Bosnia and Herzegovina for organising the Annual Meeting and for its hospitality.

The strategic matters that the Board of Governors are to consider for approval this year lay the foundations for responsible and effective mapping of the EBRD's future. The decisions we take will ultimately have a systemic impact on the Bank's role in its current region and within the overarching IFI architecture.

This is not the first time that we have discussed the EBRD's struggles with articulating its identity, which are now more acute than ever. Recently, the Bank has often focused on issues outside its mandate and announced its involvement with various global development trends. This erodes the Bank's unique business model and leads to a loss of its expertise.

In recent years, the EBRD has seen an increasingly large share of its business in the financial institutions sector. These have crowded out infrastructure investment – the most complex, but most significant aspect of the Bank's work. We are concerned about the growth of the Bank's exposure to large international financial groups. We know what this growth is driven by: the fastest and cheapest way of generating business that maintains reasonable profitability. And that already leaves aside the value of those transactions compared to the Bank's statutory objectives.

The overall quality of the EBRD's projects in terms of transition impact is particularly unsettling. Involvement in largescale projects is still on the rise, where the Bank's role is far more about political imperatives than any notion of its mandate. Working with regional private business is being displaced in favour of financing the subsidiaries of international companies, which clearly have no problems securing funds on the market.

The EBRD still has profitability problems caused by a slump in margins within the debt sector as well as by astonishingly low equity returns. We should note that, over the last two years, the Bank has effectively made a loss on new equities, despite its newly announced enhanced equity approach. As a result, the EBRD’s realised profit for 2018 has fallen to an historic ten-year low, while cost-to-income ratio has continued to grow and exceed its established operational limit. At this stage, Management’s proposal to blame performance on overall market conditions is unlikely to hold water.

The Strategic Review of the Bank’s work in its current region was drafted in response to a request from the shareholders last year. We regret that the Review has largely turned out to be an emasculated formality of an exercise. It made no new proposals for how the EBRD could develop and has ended up with the Bank planning to carry out its standard set of activities through its current country strategies. The question of how the Bank could change to step up its effectiveness and increase its operations remains unanswered.

The EBRD’s mandate in its current region of operations is also far from complete. In many countries, market development could be described as having experienced a setback or a marked slowdown in economic reform, even after the Bank had been established. We are clear that the future of the EBRD as an effective and independent development institution can and must be substantiated by delivering results and solutions in the very region in which we know how to operate.

In this context it is above all premature to discuss expanding our current southern and eastern Mediterranean (SEMED) region to take in new countries that are currently not even members of the Bank. EBRD performance in SEMED countries could, at best, be described as mixed. Excessive exposure to the public sector, a preponderance of largescale sovereign infrastructure projects in the portfolio that could clearly be delivered without EBRD involvement, low returns, and sometimes losses in operations – all this militates against growing our portfolio any further in the region.

We understand the EBRD's proposed expansion beyond its current geographical remit to be driven by the political interests of certain shareholders. We would like to counsel the Bank against making flawed decisions when the issue at stake is the EBRD's strategic position and its role in the international development agenda. We must take into account that prospective EBRD recipients do not always show commitment in working jointly on the Bank's agenda, and that the Bank has no experience of this new region. A change of geographical focus therefore seems to be premature, opportunistic and designed to satisfy short-term political expediency. The impact of such a move for the Bank's financial status would be unpredictable.

In terms of drafting a new Strategy for the Bank, we note that the document would not be complete, and would in some ways be devoid of meaningful content, unless it includes a comprehensive discussion of a scenario under which the EBRD resumes operations in Russia. We remind colleagues that Russia was the largest beneficiary of Bank resources for many years, and that Russian business was pivotal to creating the Bank's business model and establishing its current level of expertise.

Despite the reputational damage sustained on the Russian market after the "political guidance" of 2014, and the possible difficulties of rebuilding Russian customers' trust in the EBRD, we believe the Bank could still find its niche in the country. Investment opportunities in Russia could be the solution to the Bank's current financial woes, primarily through the profitability and high quality of projects there. These opportunities could also be crucial to repositioning the Bank in its traditional region. The opportunities that would be open to the Bank if it restarted operations in the region's largest economy merit particularly detailed consideration as the Bank develops its strategic directions for the next five years.

It is worth noting that the latest trends in the Russian economy saw GDP rise to 2.3 per cent in 2018 (compared to 1.6 per cent the previous year). Consumer demand was the main factor contributing to this growth. Accelerated GDP growth was also driven by sectors such as the extractive industries, transport and storage, construction, finance and insurance.

Infrastructure investment in the Russian Federation for 2018 stood at 3.1 per cent of GDP. There has been a recent resurgence of infrastructure investment after a low point in 2015 (2.9 per cent). However, in relative terms, infrastructure investment remains lower than it was between 2010 and 2013 (when the average was 3.6 per cent of GDP).

Fundamentals have remained favourable, which has determined the exchange rate of the rouble against foreign currencies (balance of payments, public spending and economic performance). Also in 2018, the current account surplus reached a historic high (US$ 113.8 billion) due to growing exports in physical terms, including in non-oil-and-gas sectors. The 2018 federal budget recorded a surplus of 2.6 per cent of GDP.

Overall, Russia's macroeconomic policy is currently structured to limit the responsiveness of key macroeconomic indicators to external change. As a result, the Russian rouble was a growth leader among the currencies of emerging market countries from January to April 2019.

We are interested by the proposal of some shareholders that the Bank should carefully evaluate its crisis capability to be able to respond to external shocks. However, we would prefer to consider this issue in terms of improving current policies and approaches on the management of statutory and economic capital, risk and prudential limits, rather than setting up additional regulations.

In various forums, we have repeatedly said that shareholders should be seriously concerned about the gap between the Bank's operational activities and its capital capacity made available by the shareholders. Indeed, throughout the current Strategic and Capital Framework period (approved in 2015), the EBRD has never achieved the operational targets that it announced when the Framework was being drafted. Calculations underlying the shareholder decision to maintain the previous level of callable capital were overestimated and the Bank is still operating with surplus capital.

For us, it would be unacceptable and ill-founded for this situation to continue into the next strategic period. The Bank's surplus capital should be addressed with the utmost seriousness. In our opinion, examining options to return surplus capital to shareholders merits the closest scrutiny. Apart from the clear financial arguments supporting this solution, it would also benefit the Bank's reputation. Paying a dividend would confirm the EBRD's commitment to sound banking practice as enshrined in its founding documents; it would demonstrate the strength of the principles underpinning the Bank's mandate and business model; and it would also confirm the EBRD's commitment to the commercial principles that it promotes through its operations.

As we have done previously, we would like to reiterate that diverging from the principle of graduation is unwarranted. It is now untenable to further avoid having a substantive discussion about scaling back the EBRD's presence in countries where our objectives have clearly been achieved. Avoiding the issue undermines the Bank's reputation and more generally calls into question the Bank's *raison d'être*. Without a strategic position on graduation, the Bank is yet again playing out its identity crisis, which it has so far been unable to resolve.

In conclusion, we hope that, during this Meeting of the Board of Governors, the EBRD, supported by its shareholder representatives, will be able to soberly and objectively consider the path it has taken – its achievements as well as the problems that have accumulated. And we hope the Bank can conceive of a path along which it can further develop in the interests of its members, laying down a sustainable and effective basis on which the Strategic and Capital Framework for 2021–2025 can be adopted next year.