Chapter 5

Geopolitical Tensions

Introduction

Two decades after the fall of the Berlin Wall, the EBRD had begun to invest in a new range of countries located on the borders of the European Union and across the Mediterranean Sea. The addition of these countries—Turkey, Egypt, Jordan, Tunisia, Morocco, Cyprus and Greece—increased the population in the Bank’s ambit by more than two-thirds. The Bank’s operational compass had swung significantly towards the south. But it was events related to Russia that made this shift decisive.

Russia’s share of annual Bank business had already begun to wane by 2007, from a level of just over 40 per cent. After the annexation of Crimea in 2014 and the imposition of EU sanctions on Russia, shareholder guidance interrupted the flow of investments. From that July, new EBRD business in Russia dropped away to zero; and the portfolio shrank from an earlier peak of around €10 billion to little more than €1 billion by the end of the decade.

A series of events linked to Russia contributed to this situation, starting with a conflict in Georgia, followed by the seizure of Crimea and escalating with military engagement involving Russian-backed rebels in eastern Ukraine. It would lead to disputes with Russia at the Board for a number of years and a difficult period for the EBRD’s President and its management.

Although the Bank would survive unscathed in overall business volume terms, which continued to grow steadily, the absence of new activity in Russia represented a radical departure from the EBRD’s previous strong engagement with the Federation. Investment and reform at centre of the former Soviet Union had after all been a key driver of the Bank’s transition mission; and Russia was its biggest client by far.
Resources allocated to help Russia’s development now shifted towards the Mediterranean region. The transition needs of the new countries, especially given their rapidly growing populations, were large. It therefore made eminent sense to redeploy the EBRD’s efforts and ramp up business in this region while also continuing to pay attention to countries where transition progress had been slow, such as in Central Asia.

The demise of Russian operations was undoubtedly a disappointing coda to a relationship that over the years had benefitted both sides well. But circumstances had changed and the growing gap became increasingly unbridgeable.

Russia nonetheless continued to play a significant role as a strong and vocal member of the Bank giving all EBRD members through its Board Director the benefit of its knowledge, especially on transition challenges facing newer countries of operations.

Events in this story begin in the dog days of summer 2008 in Tskhinvali, the capital of South Ossetia, a separatist area of Georgia close to the border with Russia.

1. The Crisis in Georgia, 2008

Around the middle of 2008, the Georgian economy was performing strongly. Under flamboyant President Mikheil Saakashvili, the country had introduced a series of reforms aimed at improving the business climate and attracting more investment. The banking sector had strengthened significantly over the previous two years and a new regulatory agency was beefing up supervision across the financial sector.

Saakashvili was presiding over what was viewed as an unparalleled success story in the region, a paragon of private sector-led transition. Foreign direct investment in Georgia had risen dramatically, reaching almost 20 per cent of GDP in 2007, or nearly US$ 2 billion, and remained vigorous into 2008. In April, Georgia issued its first sovereign Eurobond, raising US$ 500 million, which was heavily oversubscribed. Since Saakashvili took over as President four years earlier, the economy had expanded at an annual rate of over 10 per cent and was running at a robust 8.5 per cent rate in the first half of the year.

This rosy economic scenario, however, belied a more sinister geopolitical backdrop of growing tension between Georgia and Russia over two
breakaway republics in Georgia and Georgia’s desire for membership of NATO. Relationships had long been strained and the tension erupted into war between the two countries on 7 August 2008. There was an immediate impact on the economy, with GDP falling by over 6 per cent in the third quarter, and especially on Georgia’s banking system.

Even before G7 Finance Ministers on 20 August called for a strong response by IFIs—including by the EBRD1—the Bank was on the ground talking to clients, preparing financing packages and coordinating its response with the international community. The EBRD saw its role as particularly important in order to preserve as far as possible Georgia’s private sector-led growth model.

EBRD staffers look back at the occasion as an important moment when the Bank came into its own in defence of the economy and financial system of one of its countries of operations at a time of crisis.

Although small in comparison with other countries of operations, Georgia was significant because it had been very successfully following a reform path, one which the EBRD had been supporting. Bank activities in the country had increased rapidly during this time with the portfolio more than quadrupling between 2004 and 2008 to almost €400 million. The conflict and its consequences threatened these achievements.

For a poor country in the Caucasus, the effects of the war were serious with tens of thousands of its citizens displaced or made homeless. The immediate humanitarian task was for others to deal with. But the Bank could see that failure to stabilise the economy would bring further disaster and there was a need to help reconstruct damaged infrastructure and housing. As an important energy transit region, Georgia’s future depended on a swift restoration of business.

Bank teams were quickly mobilised. UK-based staff were brought back from their summer holidays for meetings at EBRD headquarters to map out a response, with a suitable action plan and communications strategy. The resident office in Tbilisi was on high alert and ready to respond. Some staff evacuated their families. Nonetheless, Bank business carried on, with the office only shutting its doors for one day.

1 “We ... call on the Georgian authorities, other countries, the World Bank, European Bank for Reconstruction and Development, Asian Development Bank, European Investment Bank, and European Commission to promptly identify and support reconstruction needs and the restoration of services that will build a base for future economic growth.” G7 Finance Ministers’ statement, Washington DC, 20 August 2008, Munk School, University of Toronto.
Local and international staff worked round the clock to deal with the immediate challenges—both in the jeopardised banking sector and across the country’s damaged infrastructure. A crisis-response template was created which had lasting benefits—it turned out the global financial crisis was only weeks away.

2. Georgia and NATO

Saakashvili had swept to power aged just 36 in 2004, after the ‘Rose Revolution’ that ousted Eduard Shevardnadze, the former Soviet Foreign Minister whose presidential administration of Georgia was tarnished by allegations of corruption and vote-rigging. After winning the presidential election on 4 January, the reform-minded US-educated lawyer pledged to push for closer ties with the USA and Europe and to stamp out the corruption that had hampered economic progress. He had been determined to radically modernise the Georgian economy and to make it a magnet for external investment.

Lado Gurgenidze, who became Prime Minister of Georgia in late 2007 after heading Bank of Georgia, the largest bank in the country, has no doubts about the success of the policies that were introduced in the wake of the revolution. “The economy was doing phenomenally well,” he said. There had been massive deregulation, aggressive privatisation and a radical simplification of the fiscal regime that produced low and flat taxes. At the same time, the government had been in a position to deliver funding for social assistance, welfare and healthcare on the back of a six-fold rise in tax revenues.

On the external front, since taking power Saakashvili had pursued a dual strategy that sought to reduce the tensions with Russia while he simultaneously wooed the NATO alliance.

Nonetheless, tensions with Russia increased during the four years of Saakashvili’s first term as he guided Georgia towards NATO and because of Russia’s support for the breakaway regions of South Ossetia and Abkhazia, where Moscow stationed peacekeeping troops.

The war of words intensified, partly as Russia linked a bid for independence from Serbia by Kosovo to developments in the two rebel regions in Georgia. Russia was fiercely opposed to independence for Kosovo, making clear that if Pristina could take this step then South Ossetia and Abkhazia could secede from Georgia.
Kosovo formally declared independence on 17 February 2008 (and is still not recognised by Russia). At the same time, Tbilisi was actively pursuing NATO membership, a goal that Moscow firmly rejected both for Georgia and for fellow former Soviet republic Ukraine. These moves worsened relations with the West. A Reuters briefing summarised the picture: “The West’s recognition of Kosovo’s declaration of independence from Serbia in February 2008, over Russian objections, fueled tensions and in April NATO pledged future accession for Georgia and Ukraine, angering Moscow.”

By this stage, a number of former communist countries had signed up to NATO, including Poland, Hungary and the Czech Republic. In another round, in 2004, they were joined by Bulgaria, Romania, Slovenia, and the Slovak Republic—and also the Baltic States. NATO membership was firmly on the agenda for Ukraine and Georgia, but Russia was adamantly opposed. NATO itself was split, with the US and former communist members in favour and some of the western Europeans nervous about antagonising Moscow.

At a NATO summit in April 2008 in Bucharest, the western alliance invited Croatia and Albania to join the alliance, which they did a year later. An invitation to what was then formally called the Former Yugoslav Republic of Macedonia would have to wait until a dispute about the name of the country with Greece was resolved. Neither Georgia, nor Ukraine received the firm invitation accorded to Croatia and Albania. While NATO’s language was strong and supportive, further assessment was put off until the end of the year.

Pressure from Russia continued, however. By the middle of April, Moscow was strengthening its ties to South Ossetia and Abkhazia in what Georgian Foreign Minister Davit Bakradze said amounted to a “legalisation of the de facto annexation process” by Russia. The NATO alliance said it was deeply concerned and called on Moscow to reverse the legal ties that had been established.

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3 To this day, Latvia, Lithuania, and Estonia are the only former Soviet states to have become members.
4 North Macedonia became a member in 2020.
3. Conflict in South Ossetia and its Impact

As spring turned to summer, both sides turned up the rhetoric and the build-up of their forces, with fighting erupting between Georgian troops and separatist forces in early August 2008. Georgia launched a campaign against Tskhinvali, on the evening of 7 August. Russia responded by sending tanks into South Ossetia, ostensibly to support Ossetians who were Russian citizens on the basis of their Russian passports.

The Russian assault went beyond the confines of South Ossetia, with a push into Georgia to within just 25 miles of Tbilisi. After five days of fighting, a ceasefire agreement was negotiated on 12 August between Russian President Dmitry Medvedev, Saakashvili, and French President Nicolas Sarkozy, on behalf of the European Union. Following the ceasefire, Russia recognised the independence of South Ossetia and diplomatic ties between Tbilisi and Moscow were severed.

An official EU fact-finding report issued a year later blamed both parties for the conflict, which it said had left nearly 850 people dead and 35,000 Georgians homeless and in which thousands of Georgians had tried to flee to either Armenia or Azerbaijan.5

During the conflict, the EBRD called for a rapid resolution in a public statement that referred to the enormous progress Georgia had made with reforms that had helped the economy develop, attract investment and deliver an efficient, well capitalised and robust banking sector. The Bank reinforced its message, saying: “The EBRD will continue to stand by its partner banks in difficult times and to work on active prospective projects in the Georgian financial sector.”6

The conflict with Russia had an abrupt and severe effect on the economy. The stock market fell sharply and international reserves dropped by one-quarter, tens of thousands of Georgians withdrew cash from their bank accounts threatening the banking system7 while transport routes between Poti, Georgia’s main Black Sea port, and Tbilisi were cut off, creating a

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7 Bank deposits fell by 14 per cent within two weeks according to National Bank of Georgia figures.
bottleneck for many products. Georgia’s vital tourism industry was also badly affected as was confidence in the economy more generally.

Georgia’s fast-growing economy, which had been pulling in very large amounts of FDI in the previous two years, was facing a difficult future. “That FDI disappeared overnight,” Gurgenidze recalls. Georgia was experiencing a domestic recession. “Banks were sitting on a bunch of non-performing loans,” he adds. Gurgenidze pointed further to infrastructure damage worth around US$ 1 billion equivalent to nearly 10 per cent per cent of Georgia’s GDP of just US$ 12 billion.

In the wake of the conflict, the EBRD quickly linked up with the IMF, with whom contacts in the region were particularly good, and engaged with the World Bank and UN in a Joint Needs Assessment (JNA) for Georgia that also involved the Asian Development Bank (ADB), the European Commission, the EIB and the IFC.

The scale of Georgia’s needs was soon established. Budgetary shortfalls, infrastructure and social sector spending were estimated at some US$ 3.25 billion over three years, with additional funding of US$ 700 million needed to keep the banking sector afloat. The IMF provided an exceptional access Stand-By Agreement in September, which helped cover external financing gaps and stem the decline in confidence, while in October international donors pledged support totaling US$ 4.5 billion.

Catarina Bjorlin Hansen, in 2020 the regional EBRD Head for the Caucasus, had been an infrastructure banker based in Tbilisi back in 2008. She was out of the country when the conflict began but took the first flight back to Tbilisi. “There was definitely a fighting spirit,” she recalls, as teams were galvanized into action. “We toured the whole country by car, looking across the cities of Georgia to see what had been damaged, destroyed and what

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9 Spreads on Georgia’s sovereign bonds rose by 240 basis points at their peak, to 775 basis points above comparable US Treasuries. Georgia’s sovereign and banks’ external debt ratings were also downgraded. See ‘Georgia: Request for Stand-By Agreement’, IMF, p. 10.

10 Interview, 2021. Note that the authorities and IMF staff predicted a drop in private inflows—FDI, bank lending and portfolio investment—of over US$ 1 billion in the second half of 2008, of which about half was expected to result from lower FDI. See ‘Georgia: Request for Stand-By Agreement’, IMF, pp. 12–13.

11 An 18-month programme of 317 per cent of quota, worth around US$ 750 million and equivalent to 7.5 per cent of Georgia’s 2007 GDP, was approved on 15 September 2008.

12 Approximately US$ 2 billion in grants and US$ 2.5 billion in loans.
needed to be rebuilt,” she says. “On my birthday, I inspected a bombed-out waste water treatment facility.”

The tour was an opportunity to make an in-depth assessment of the whole infrastructure challenge across Georgia, looking to make improvements in both the conflict areas and the areas which still needed work following the neglect of the Soviet era. It was important to make sure post-conflict reconstruction in the war zone did not lead to regional imbalances. According to Bjorlin Hansen, this exercise laid the ground for many of the infrastructure improvements that are visible in Georgia today.

A major part of the EBRD’s response to the crisis involved decisive support for the banking sector that is still remembered over a decade later by local financial sector leaders.

The JNA report, presented to donors in Brussels in October 2008, said the conflict had dealt a shock to the key pillars of economic growth across Georgia. There had been a weakening of investor, lender and consumer confidence, a contraction of liquidity in the banking system, stress on public finances, damage to physical infrastructure, and increased numbers of internally displaced persons.

The report said the banking sector had weathered the immediate impact of the conflict but referred to near-term post-conflict challenges. Key banks faced external obligations falling due in early 2009. The economy had experienced an increase in the demand for dollars and withdrawal of deposits from the banking system. The report also drew up an assessment of the sector’s financing requirements, estimated at some US$ 700 million in short-term finance in order to allow a rollover of liabilities and to provide support for a moderate growth scenario. It said these could be satisfied by a combination of equity and debt finance as well as guarantees by international financial institutions and by donors.

4. The Bank’s Response

The EBRD was preparing to address these needs well before the publication of the report. Just one week after the Russian invasion, Nick Tesseymann, newly appointed as Managing Director for Financial Institutions, was
in Tbilisi with a team working with the EBRD’s eight partner banks and developing a range of fast disbursing support facilities, in particular for the country’s two leading banks, Bank of Georgia and TBC Bank. The purpose of these facilities was to provide essential liquidity and an important buffer against the effect of a sudden downturn in activity across the economy.

The very fact that the EBRD was in Georgia early on and actively working with the banks was a calming signal. By September the outline of financing for Bank of Georgia had been prepared and the whole process was approved by the Board in November. As one banker active on the deal later commented, “The EBRD’s response was in time to shore up Bank of Georgia’s balance sheet.”

The EBRD together with the IFC provided a US$ 200 million financial package to Bank of Georgia that was made up of subordinated, convertible and senior loans that offered longer-term liquidity and allowed the bank to continue lending to retail clients and SMEs, key drivers of economic growth in Georgia. At the time it was the EBRD’s largest transaction in the financial sector in the early transition countries (ETCs), which are among the poorest countries where the EBRD invests. The financing helped Bank of Georgia recover from the crisis and to promote a stable and healthy banking sector.

TBC Bank, the second largest in Georgia, with which the EBRD had begun a relationship based around trade finance back in the late 1990s, received US$ 70 million in a financing package that comprised two loans and an equity stake worth US$ 36.8 million.

Bank of Georgia and TBC Bank dominated the Georgian banking sector, representing up to 70 per cent of the banking market. For Gurgenidze it was quite clear that not one but both of these banks could have collapsed given the size of the economic shock from the war and the growing global crisis. He said: “Specifically, the EBRD—together with the IFC—in the immediate aftermath of the war were instrumental in helping to avert a banking crisis. They played a very important role.”

This support sent an important signal at a time of investor anxiety caused by the war, especially given the downgrades imposed after the outbreak of hostilities by the rating agencies Fitch and Standard & Poor’s.

On 5 September, EBRD management presented to its Board proposals for a response to the challenges to growth from the conflict and its negative impact on investor confidence. The Bank made clear it would continue
to support its partners and help the local economy regain its momentum, so Georgia could again become a stable and attractive location for foreign investments. In accordance with its three governing principles, the EBRD outlined a three-pronged approach that entailed maintaining the higher level of investments already envisaged in the 2008 business plan, as well as offering co-financing in new infrastructure funds and actively participating in the IFI/donor needs assessment steering group with the specific aim of making sure responses did not crowd out the private sector.

Another positive that arose out of this difficult period was enhanced cooperation among the donor community and development organisations like the EBRD in Georgia. “This conflict paved the way for donor coordination in Georgia,” said Bjorlin Hansen, “raising it to a completely different level and resulting in the excellent cooperation that we have in this country today.”

The EBRD’s response to the conflict in Georgia was underway as the global financial crisis was escalating and just days before the collapse of Lehman Brothers on 15 September 2008 sent emerging economies into a tailspin. The experience was put to good use in this new context. The combination of IFI and donor efforts and the effective response of the Georgian authorities to their predicament was decisive in ensuring Georgia’s situation stabilised and that the economy returned to a steady growth path further ahead, one that outperformed its peers in the longer term.

5. Ukraine and Russia, 2014

On 23 July 2014, the EBRD issued a short statement that would test relations for years to come with the very country that until then had been the largest single recipient of its investments. The Bank was being drawn into a geopolitical crisis that was reverberating around the globe.

It was a development that would also radically change the EBRD’s investment portfolio, signalling and sealing a further dramatic shift in the

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14 Transition impact, additionality, and sound banking. In the latter case the IMF US$ 750 million macro-economic stabilisation package was seen as key by providing vital external finance and liquidity to the heavily-dollarised Georgian economy.

geography of the Bank’s activities away from the cradle of its inception, the former communist countries of eastern Europe

On that day, the EBRD effectively ceased new financing in Russia—not as a management decision but following guidance from a majority of its Board of Directors that they would “for the time being” be “unable to approve new investment projects in the Russian Federation”.16

Annexation of Crimea and armed conflict in eastern Ukraine

The guidance followed an angry response by the EU and the USA to the escalating tensions between Russia and Ukraine. In March 2014, Russia had annexed Crimea, which had been part of Ukraine since the 1950s. Shortly afterwards Russian-backed separatist rebels and Ukrainian forces were waging an increasingly violent war in eastern Ukraine.

On 16 July, the EU called on both the EBRD and the EIB to halt financing to Russia when it announced a series sanctions aimed at Moscow.

Western anger against Russia rose dramatically just one day later when a Malaysian airliner en route to Kuala Lumpur from Amsterdam was shot down over Ukraine. All 283 passengers, the overwhelming majority of whom were Dutch citizens, and 15 crew were killed. A Dutch-led investigation team concluded that flight MH17 had been hit by a Russian-made Buk missile fired from a field in eastern Ukraine controlled by the rebels.

The halt to new EBRD financing was perhaps just one small piece in the complex mosaic of fraught relations between Russia and Ukraine and between Russia and the West. It was, however, a step that some at the Bank initially feared might prove existential.

The importance of Russia to EBRD business

Russia was a crucial integral part of the EBRD’s operations. By far the largest economy within its region, Russia consistently received the highest annual share of EBRD investments and the Bank was the most important international investor in the country outside of the oil and gas sector.

By 2013, the EBRD had invested over €23 billion in Russia in more than 700 individual projects. Concerns had been expressed during the latter part of the first decade of the 21st century that the EBRD was becoming over-dependent on Russia. In absolute terms, the peak of EBRD investment had been in 2011, when Bank financing was some €2.9 billion out of a total of just over €9.0 billion. As a share of investment, however, Russia had taken over 40 per cent of total financing in 2007. The share had been steadily and deliberately reduced in subsequent years. One of the arguments for entering the Turkish market in 2009 had been to create a more balanced portfolio as a counterweight to the dominance of Russia.

In 2013, however, the Bank was still expressing a strong commitment to its continued presence in Russia. “We are proud of the role we play here and will continue to play in the further long-term development of the Russian economy,” Chakrabarti told a meeting of the Russia-Singapore Business Forum in September of that year.

The EBRD strongly believed that its private sector-focused investments could support the growth of a burgeoning middle class in Russia that ultimately would build a counterweight to the pervading role of the state in the economy. It aimed to bolster the reformers, strengthening the role of private sector players that would keep demanding a level playing field, respect for property rights and the rule of law.

The EBRD strategy at the time made this clear:

The Bank will pay particular attention to projects that increase economic opportunities for the emerging middle class in the regions through increasing access of regional SMEs to finance, supporting urban renewal, and improving the quality of jobs and services.17

Bank financing was overwhelmingly in the private sector. Of its investments in the six months up to the financing halt in July 2014, 88 per cent had been private sector projects.

There were undoubted challenges to investment in Russia, not least of which was corruption. Nevertheless, Chakrabarti made clear in his speech to the forum that the EBRD was going to stay in Russia and was there for the long haul.18

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18 EBRD Press release, 23 September 2013. Speech transcript, ‘EBRD is fully committed to Russia’.
The halt in financing to Russia in 2014 starkly underscored the shift in the EBRD’s activities that had been signalled in 2008 when shareholders agreed that the Bank would invest in Turkey, meaning for the very first time the EBRD would venture beyond the confines of the former communist east.

At the end of 2013, before the financing halt the Bank’s portfolio of investments in Russia stood at €8.9 billion, by far the largest individual holding. Just one year later, annual investment to Russia would fall to €608 million from €1.8 billion in 2013. In that same year, Turkey became the Bank’s single largest country of operations by annual investment volume, with a total of just under €1.4 billion.

Six years later, with no new investments since July 2014 in Russia, and as loans were repaid and shareholdings wound back in the normal manner of business, that portfolio had shrunk to just under €1.2 billion, dwarfed by the relatively newer geographic investment destinations. Turkey now accounted for the lion’s share, with a portfolio close to €7 billion. The holdings in Egypt had risen to close to €4.5 billion.

6. Deep and Persistent Corruption

The Yanukovych era

For all the later tensions with the Moscow authorities that would emerge from the halt to investments linked to events in Ukraine, a year earlier in 2013, it was in fact Ukraine that was causing the EBRD the most problems.

In 2010, Viktor Yanukovych had taken over the Presidency of Ukraine from Viktor Yushchenko. It was Yanukovych’s second shot at leadership. An earlier election victory in 2004 against Yushchenko had been overturned amid allegations of fraud and voter intimidation that triggered the ‘Orange Revolution’ from which Yushchenko emerged as a hero.

During his period in office, Yushchenko pinned his colours firmly to the mast of closer integration with the West. He regularly stressed the importance of Ukraine joining both the EU and NATO, a position that Moscow continued to resist. He criticised Russia’s incursion into Georgia in 2008 and annoyed Moscow by insisting that Russia remove its Black Sea fleet from Crimea by 2017.
When Yanukovych assumed power in 2010, primarily with the support of Russian speakers in the industrial east of Ukraine as well as in the south including in Crimea, he was determined to mend the relations with Moscow that had soured significantly under Yushchenko. Equally, he knew he had to play both sides of the geopolitical equation.

In a low-key inauguration ceremony that was boycotted by his 2010 election rival Yulia Tymoshenko and most of her party, Yanukovych pledged to steer a balanced line between Russia and Europe. His first trip abroad was not to Moscow, but to Brussels where he told EU leaders, “For Ukraine, European integration is a key priority of our foreign policy”. His aim was also, he said: “Friendly and constructive relations with the Russian Federation and developing friendly relations with strategic partners such as the United States.”

The real change in relations would nevertheless be with Moscow, to where Yanukovych flew just three days after his visit to Brussels. “The new government in Ukraine will change relations with Russia, so that they will never again be like they were for the last five years,” Yanukovych told Russian President Dmitri Medvedev. The Russian leader responded: “I hope that with your arrival and your work as president this black page in relations between Ukraine and the Russian Federation will be turned over, and we will see completely new conditions for cooperation.”

During his inauguration speech, in what would be viewed with bitter irony following his ignominious departure from office and from his country four years later, Yanukovych had made a pledge to combat corruption, in a country where this social and economic curse remained endemic.

From the point of view of the EBRD, Yanukovych failed signally to deliver on his anti-corruption pledge. Towards the end of 2012, the Bank was becoming increasingly agitated about persistent reports of illegal raiding on businesses that were having a negative impact on business confidence. In internal meetings, management reported that public governance had continued to deteriorate and corruption had worsened significantly.

The EBRD was concerned that the Ukrainian administration had no real commitment to tackling this issue.

In 2013, an expose from the openDemocracy website indicated that friends and family of the political leadership were the primary beneficiaries of the rent-seeking structures that dominated the Ukrainian political system and state.

An article, entitled ‘Yanukovych’s “Family” spreads its tentacles’, referred to the President’s recent political appointments, “all of which have gone to close associates of his elder son”. Yanukovych was now dependent on his own inner circle, connected to him by the ties of “Family” business.22

Later, immediately after Yanukovych had been removed from office in 2014, Saakashvili, by then the former Georgian President revealed how the Ukrainian would openly boast to other heads of state how corrupt he was.

In an interview with the Guardian newspaper, Saakashvili said Yanukovych bragged at length about how his corrupt government worked, at a 2011 UN meeting in front of a group of leaders from post-Soviet countries. “He would talk very loudly about how he had corrupted senior officials, in the supreme court and the constitutional court,” Saakashvili said. “He didn’t care who he was talking to; the guy did not have any idea about morality.”23

Anti-corruption efforts

Chakrabarti flew to Kyiv in February 2013 with a high-ranking management team for talks with the Ukrainian leadership where these concerns would be put firmly on the table. Reporting to the Board on his return, Chakrabarti said he had reinforced the EBRD’s underlying commitment to investment in Ukraine, but this commitment would not come without strings attached.

The scale and the scope of future activities would depend on the government’s success in securing macroeconomic stability, preferably through an IMF programme and by pushing further structural reform in certain sectors, particularly in the energy and local capital markets sectors. Crucially, the level of investment would depend on “seriously fighting corruption and unfair business practices”.


It was unusual for the EBRD to play out its political discussions with its countries of operations or its other shareholders in the public arena. Though diplomatic messages had always tended to be confined to face-to-face, closed-door meetings. Open criticism of the Uzbek regime at the EBRD’s Annual Meeting in Tashkent in 2003 led to an almost total freeze on EBRD activities in the country until after the death of Uzbekistan’s long-term President Islam Karimov 13 years later.

In Ukraine, however, Chakrabarti was determined to go public and did not hold back in a news conference with international and local media. Just as Jean Lemierre had done in Tashkent, so Chakrabarti laid down a gauntlet to Yanukovych.

At the news briefing, the EBRD President said Ukraine needed to step up its fight against corruption to improve its deteriorating business climate. He spoke openly about the increasing number of complaints the EBRD had received from companies working in the country. Businesses had raised concerns about their treatment by tax and customs officials and courts. “The scope and scale of our investment will depend on the business climate,” Chakrabarti said. “In recent months, as you all know, the business climate has deteriorated.”

Businesses were complaining that tax authorities were trying to plug the growing budget deficit by forcing companies to make advance tax payments. Complaints about straightforward corruption were also common. Chakrabarti said: “We want to see much more action to tackle corruption at all levels. It is not just about passing laws, of course. Implementation is needed. We need concrete steps on these issues.”

The Ukrainian authorities—in public at least—responded positively to the EBRD’s pressure. Yanukovych said Ukraine had been implementing reforms for over three years, and the country would hold to this course. He believed Ukraine should be given more time to implement these reforms, but he also stressed that Kyiv remained committed to closer ties with Europe: “Several things contribute to the effective cooperation between Ukraine and the EBRD. I mean, first of all, a stable partnership, in which the bank never lets Ukraine down, while Ukraine, its government, does its best to fulfil its obligations.”

25 ‘Yanukovych satisfied with Ukraine’s cooperation with EBRD’, Interfax, 5 February 2013.
One of the goals that the EBRD wanted to help Ukraine achieve at this time was getting into the top 100 countries of the World Bank’s Doing Business ranking. It had crept up in the previous year to stand in the 137th position but it had much more work to do.

Just three days after the top-level meeting between the EBRD and Ukrainian presidents, concrete measures were made public that would support Ukraine’s reform ambitions. One key element was the establishment, at the suggestion of the EBRD, of a business ombudsman that would aim to settle disputes between Ukrainian business and the authorities. Investors and other business people, both domestic and foreign, would be able to turn to the ombudsman to seek redress in response to their complaints.

The creation of the ombudsman was part of a larger anti-corruption initiative that the EBRD was developing, in conjunction—it was hoped—with the political leaders in Kyiv. In April, Chakrabarti told the Wall Street Journal that the EBRD was aiming to launch a plan to tackle corruption in Ukraine in the summer of 2013: “Until they do something about corruption, it’s difficult to get foreign investors to go near the country.”

At the same time, the EU, while reporting progress on the creation of Association Agreements, including a Deep and Comprehensive Free Trade Area (DCFTA) with its eastern European neighbours in the Eastern Partnership (EaP), was also putting pressure on Kyiv. In order to proceed in Ukraine, the EU wanted to see further steps to make sure parliamentary elections were compliant with international standards, on addressing the issue of ‘selective’ justice and in implementing agreed reforms.

When Chakrabarti made a speech in Paris in June 2013 about the pervasive problem of corruption across the EBRD regions, he singled out Ukraine for a special mention. He also actively coaxed the Ukrainian authorities into action by pre-empting their own commitment to the EBRD’s plans for the anti-corruption initiative. In a keynote speech to the Annual Anti-Corruption Conference of the International Bar Association, he said: “We are very pleased that the Ukrainian authorities have fully embraced the Initiative at the very highest political level and are determined to make it bite.”

But that confidence was misplaced as long as Yanukovych remained in charge in Kyiv. By November, there were clear signs of backtracking and

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27 EBRD Press release, 14 June 2013. ‘EBRD steps up fight against corruption’.
Chakrabarti cancelled a trip to Kyiv after hearing that the Ukrainians were not ready to sign up to the initiative.

7. Yanukovych Suspends EU talks

Later in the month, the plans seemed back on again. But on 21 November 2013, Yanukovych dropped a political bombshell that would very quickly end his political career and change the face of Ukraine.

On 28 and 29 November, the third summit of the EU’s Eastern Partnership was scheduled to be held in the Lithuanian capital of Vilnius, bringing together the heads of state or government from the 28 EU member states and the leaders of Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine. The partnership had been established in 2009 to reinforce the political association and economic integration of the six eastern European and south Caucasus partner countries.

EU Commission President José Manuel Barroso said the summit would deliver “change and a new perspective to citizens” of those six countries. It was, he said, part of a much bigger transformation taking place on the European Union’s borders. “Ultimately Europe and the Eastern partners can only flourish as an integrated continent without dividing lines,” Barroso said.28

The plan was for the EU to sign in Vilnius a far-reaching association and free trade agreement with Ukraine, as well as with Georgia and Moldova. The EU had been working hard to secure the accord, while at the same time prodding Ukraine ahead of the meeting to pursue legal reforms and work on human rights.

One particular pressure point was a call for the release from jail of the opposition leader, Tymoshenko, who had been imprisoned on what many in the West believed were trumped up political charges and who was seeking medical treatment in Germany.

At the same time, Moscow was making its own views clear about steps by Ukraine to move away from its sphere of influence, threatening retaliation and raising the spectre of a rerun of the “gas wars” between Moscow and Kyiv. In 2009, Russia had abruptly cut off the flow of gas through Ukraine

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for 13 days, depriving much of south-eastern Europe of energy supplies during the height of winter. Similar action had been taken in 2006, with both sides blaming the other for the escalating tension.

Just as the EU had been courting Ukraine, Russia had been beckoning Ukraine to the Eurasian Economic Union, building on a customs union of Belarus, Kazakhstan and Russia that had been formed in 2010.

The pressure from Moscow proved irresistible and the hopes of the EU—and of an increasingly large number of Ukrainians—of forging closer ties were dramatically crushed when Yanukovych abruptly changed track. The Ukrainian government said on 21 November that the talks on a trade pact with the EU would be suspended and that it would pursue closer ties with Russia.

An order issued on the government website said Ukraine was suspending the “process of preparation” for the agreement “with the aim of adopting measures to ensure national (economic) security”. It said Ukraine would “renew active dialogue” with Russia, other members of the (Moscow-led) customs union and the Commonwealth of Independent States with the aim of strengthening trade and economic links.29

Carl Bildt, who was Swedish Foreign Minister at the time, tweeted: “Ukraine government suddenly bows deeply to the Kremlin. Politics of brutal pressure evidently works.”30

The Vilnius summit recorded the fact initially in typically neutral officialese: “The participants of the Vilnius Summit take note of the decision by the Ukrainian Government to suspend temporarily the process of preparations for signature of the Association Agreement and Deep and Comprehensive Free Trade Area between the EU and Ukraine.”

The next sentence was less sanguine: “They also take note of the unprecedented public support for Ukraine’s political association and economic integration with the EU.”31

The reaction to the setback within Ukraine was as rapid as it was dramatic. The opposition said Yanukovych’s failure to sign the deal was grounds for impeachment and called for the resignation of Prime Minister Azarov.

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Putin’s spokesman, Dmitry Peskov, said Russia welcomed Kyiv’s desire to improve trade ties with Moscow, signalling satisfaction with a Ukrainian government decision to suspend preparations for the landmark trade pact.

EU foreign policy chief, Catherine Ashton, said in a statement: “This is a disappointment not just for the EU but, we believe, for the people of Ukraine.”

8. The Maidan Revolution and Annexation of Crimea

Ukrainians quickly responded. The following weekend, thousands of demonstrators took to the streets of Kyiv to protest against the government’s decision to turn its back on the EU deal. The protestors staged a series of weekend demonstrations through the winter months that grew week by week in numbers, intensity and violence—climaxing in the ‘Revolution of Dignity’ that was played out primarily on Maidan Nezalezhnosti, or Independence Square.

Ten years earlier, the Maidan had been the focal point of the largely peaceful Orange Revolution that had pitched Tymoshenko and Yuschenko against Yanukovych and overturned his contested election victory. The 2014 revolution was anything but peaceful.

The months of protests across the country culminated in five days of conflict between 18 and 23 February that turned the Maidan into a battleground of smoke and fire. More than 100 protesters were killed, the victims now remembered as the ‘Heavenly Hundred’.

Sevki Acuner was head of the EBRD’s Ukraine operations at the time. He remembers the very fast eruption of extreme violence on the main city square. The previous couple of days had been relatively quiet. Acuner was living in his apartment, close to the centre of all the action:

I remember the first shots. It was a calm and beautiful morning. When I woke up there was absolute silence. I heard one gunshot and then several gunshots and then all hell started breaking loose. I couldn’t go out. I started watching the news on television of the snipers. I stuck my head

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out of the window to look and in that second a bomb went off. I pulled back in but there were dead people and people being shot on the corner of my street. It was a very shocking experience.33

An EU-mediated deal finally brought about a peace that saw Yanukovych removed from power, Tymoshenko released from jail and preparations for a new administration. By 23 February, Yanukovych had fled Kyiv, travelling ultimately to Russia, leaving behind a bruised nation, a trail of corruption and cronyism and a residential estate that was as opulent as it was tasteless.

Annexation of Crimea and sanctions

Significantly in the context of subsequent events, many of the largely ethnic Russian and Russian-speaking citizens in Crimea, who supported Yanukovych in the 2010 election, had condemned the protests in Kyiv. And very soon the peninsula itself was the scene of violence between those who supported the new post-Yanukovych interim Ukrainian administration and those who wanted to maintain close ties with Moscow.

In Sevastopol, opponents of the new government in Kyiv voted to establish a parallel administration in Crimea and pledged their allegiance to Putin. By 17 March, a referendum, declared illegal by the western powers, decided overwhelmingly in favour of a return of Crimea to Russia. The USA and the EU prepared to impose sanctions on Moscow.

The sanctions targeted Russian individuals, businesses and officials and Russia responded with tit-for-tat action, including a ban on food imports to Russia which had a direct impact on a number of EBRD countries of operations.

9. A Halt to Operations in Russia

New sanctions on Russia were on the agenda of a Special Meeting of EU leaders on 16 July 2014. According to the conclusions of the Council:

33 Interview, December 2020.
The signature of new financing operations in the Russian Federation by the EIB will be suspended; member states will coordinate with the European Bank for Reconstruction and Development to adopt a similar position.34

The wording referring to the EIB and the EBRD differed, as the EU could not decide unilaterally to suspend EBRD financing to Russia, as it could in the case of the EIB, an entity solely controlled by the EU. The EBRD’s unique shareholder structure took into account the concerns of all shareholders, which at the time comprised 64 countries as well as the EU and the EIB themselves.

However, it was clear that a sufficient number of Directors were in a position to deprive any project of the requisite majority needed to approve financing. As the statement issued by the Bank at the time said:

A majority of Board of Directors of the European Bank for Reconstruction and Development (EBRD), including all EU member states and several non-EU shareholders, have given clear guidance to the EBRD management that, for the time being, they will be unable to approve new investment projects in the Russian Federation.35

Operational implications

EBRD management could not avoid becoming part of the sanctions, even if the EBRD’s shareholder base and legal status precluded that.

It became an exercise in pragmatism. There was a large team in Russia—and not just in Moscow—backed by departments at the London headquarters who were dedicated to originating investments in the country. There would be no point in their determinedly pursuing viable transactions and preparing them for presentation through all the EBRD’s internal vetting mechanisms, only for them to land in the boardroom and be rejected.

While no new projects would be presented, the EBRD would continue to manage its portfolio of existing projects and client relationships in Russia and it would maintain its physical presence in the country. It would also do whatever was necessary to protect existing investments.

35 EBRD Statement on operational approach in Russia, 23 July 2014.
In the first six months of 2014, Russia had accounted for just under one-fifth of the EBRD’s total investments in the period of €3.6 billion—down from the heady heights of just a few years earlier but still a substantial share. Natasha Khanjenkova was managing director for Russia at the time of the new guidance on EBRD investment in the country. She and her team had been hoping that any action that might be taken would not prevent financing to the private sector. The news of the blanket ban came as a shock. Looking back, she said: “Uppermost in our minds was fulfilling the commitments we had to our clients and how we could remain a good partner, even if we weren’t in a position to engage in new projects.”

It was particularly important that, however disappointed clients were, relations between the business world and the EBRD remained strong. Khanjenkova added: “We tried to be as constructive as possible given the circumstances.” The Bank continued to honour its obligations and disburse on signed contracts, as well as managing the existing portfolio.

Khanjenkova was reassured by the fact that the geopolitical tensions and the official rhetoric did not spill over into any problems or practical issues for the EBRD’s operations in Russia or for its staff.

At its peak, the EBRD had a team of some 160 in Russia as a whole. Most of the staff—around 125—were in Moscow and the remainder spread across six regional offices outside Moscow spanning Russia’s 11 time zones: Ekaterinburg, Krasnoyarsk, Rostov-on-Don, St Petersburg, Samara, and Vladivostok.

Many were needed to manage the still very large portfolio. Others were sector specialists who could apply their experience in other countries or be relocated there. Moscow was a very convenient hub for travel to other areas—especially Central Asia, the Caucasus or destinations like Belarus or Moldova. Khanjenkova was pleased with the results of the team effort: “One of the things I am most proud of is the way we were able to support our staff and to give them the opportunity to apply their skills and expertise in other countries of operations of the Bank.”

The regional offices were closed down in the coming years with the last one shutting in St Petersburg in August 2018. Towards the end of 2020, there were still some 45 staff in Russia in the Moscow office.

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36 Interview, December 2020.
Tensions rise

If the relations for the EBRD in Russia remained as cordial as possible in the circumstances, the tensions rose on an institutional level.

Russia responded quickly to the EBRD statement. In a news conference in London, the day after the announcement, Russia’s ambassador to the UK, Alexander Yakovenko, said Western sanctions against Moscow over its role in the crisis in Ukraine were “illegal, unreasonable and counterproductive”. Yakovenko called the EBRD investment ban “unacceptable and harmful to all parties”.37

Two days after new investment came to a stop, Chakrabarti was in Moscow for face-to-face meetings with the Russian authorities. The Economic Development Ministry issued a statement, reported in Russian media, quoting its minister Alexei Ulyukayev as telling the EBRD President that the financing halt contradicted the goals of international development institutions. He questioned the legitimacy of the steps taken at the EBRD and criticised what he called the political instrumentalisation of the institution. According to the reports, the statement said:

For the last few months, Russia has repeatedly stated the inadmissibility of using the EBRD as an instrument of political pressure. Such actions are unconstructive and inconsistent with the goals of international development institutions. They can cause serious harm to the bank itself, clients, as well as the long-term interests of all its shareholders.38

The EBRD steadfastly separated the issue of its inability to pursue investments in Russia from the question of retaliatory EU measures, emphasising that the decision to halt new projects was not a matter of compliance with EU sanctions.

However, external comments in the media and even official comments from EU officials conflated the two. A statement issued by the European Commission on 29 July included a reference to the EBRD financing halt when it announced some additional measures targeting sectoral cooperation and exchanges with Russia:

This package reinforces the recently expanded listing of persons and entities undermining Ukrainian territorial integrity and sovereignty, including the so-called ‘cronies’, the suspension of EIB and EBRD financing, the restriction of investment and trade with Crimea and Sevastopol and the reassessment of the Russia EU bilateral cooperation with a view to reducing the level of the cooperation.39

Economic and financial consequences

The end to EBRD financing in Russia led a series of increasingly bitter attacks on the EBRD including threats of legal action—and a robust defence from the Bank itself.

There was no doubt that the sanctions overall had a significant impact on the Russian economy while the impact of the crisis was felt right across the EBRD’s regions.

In an economic report published in September 2014, the Bank’s economists were predicting stagnation for the Russian economy that year and a contraction in 2015. The Russian economy was under pressure, both from the sanctions imposed from abroad as well as from counter sanctions with which it had responded.

The escalation of military turbulence in eastern Ukraine was weighing heavily on Ukraine’s economy and its external financing needs, with a sharp GDP contraction of 9 per cent forecast for the year. Against a backdrop of increasing military spending, Chief Economist Berglof referred to an erosion of the “peace dividend” from which the post-communist EBRD countries had been benefiting for close to 15 years. In its economic report, the EBRD said: “Permanently higher military spending in the transition region over the medium term, in response to the renewed geopolitical risks, could erode the peace dividend from the dissolution of the Soviet Union.”40

The stagnating economy in Russia was bad news right across the EBRD’s regions, affecting many of its neighbours that depended on growth there to support their own economies. Remittances from workers in Russia back to their families in Central Asia, the Caucasus and eastern Europe contracted

40 EBRD Press release, 18 September 2014. ‘Russia/Ukraine crisis casts shadow over emerging economies’.
in the first quarter of 2014 for the first time since the height of the global financial crisis in 2009.

The grim economic scenario took its toll on the EBRD’s financial results—just as it had during the earlier global crisis. Amid the political backlash, a steep fall in the rouble depressed the value of the Bank’s Russian equity stakes. At the same time, EBRD provisioning rose in response to the deteriorating economic performance of Ukraine.

The result was a net loss of €568 million, a substantial shortfall, even though it was largely on paper, and a significant swing from the 2013 net profit of €1.0 billion.

10. Russian Reactions

The Annual Meeting in Tbilisi

When Chakrabarti reported to the Board of Governors at the 2015 Annual Meeting in Tbilisi on the 2014 activities of the Bank, he said the disappointing operating environment was behind the losses, referring to the “impact of currency and market valuations of our Russian equity book and the deterioration in the quality of the Ukraine portfolio”.41

For the Russian authorities, the Tbilisi meeting provided a very public platform upon which to vent their anger at the financing stop and to launch a sustained attack on what they perceived to be the failings of the EBRD’s strategy.

In his remarks to the opening session of the Annual Meeting, the Russian Deputy Finance Minister Sergei Storchak blamed the losses on the financing suspension. The results “could partly be attributed to the Board of Directors’ informal decision to suspend the Bank’s operations in the Russian Federation,” Storchak said. He added that in the view of the Russians, the action was politically motivated and totally lacking any economic rationale:

We are surprised and disappointed that the EBRD, being a major and prestigious international financial institution, found itself involved in the sanctions polemics and was used to ramp up political and economic pressure on our country, which is contrary to the operating principles of

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41 Opening speech to the Board of Governors, 2015 EBRD Annual Meeting.
multilateral development banks and above all contradicts the mandate of the EBRD.

He complained that the EBRD had failed to deliver on goals set from the previous 2011–2015 planning period, in terms of operating assets, the size of the portfolio in the Bank’s traditional region of operation, and its profit. He said agreements on the geographical distribution of investments had also not been observed.

What was more, Storchak said, the EBRD was now searching for new geographical and operational priorities, with business activity shifting to the new region for the Bank—the southern and eastern Mediterranean—and towards financing projects in Ukraine. It could not be said in every instance that the Bank’s clients were observing the EBRD’s strict internal rules and policies regarding projects’ rates of return, the priority for investments into the private sector and the transparency of operations:

It is essential that the EBRD remains a depoliticised transition institution. ... We hope that the Bank will not be guided by temporary political trends, but will instead adhere to the basic principles of its operation stipulated in the Agreement Establishing the Bank.42

This became the standard tenor for Russian commentary about the EBRD for years to come, whether in the fortnightly Board meetings or in public arenas such as speeches or Annual Meetings.

Legal questions

Storchak continued in similar vein a year later at the 2016 Annual Meeting in London, referring to the adoption by the EBRD of a “political management” of Russian projects which he said was essentially an interpretation of the anti-Russian sanctions applied by some shareholders of the EBRD. He said the EBRD had in fact gone further than the EU and some other countries whose sanctions were aimed at Russian state companies and specific individuals.

Just two months later the Russian response was tightened a notch further, with a letter from the Russian authorities to the chairman of the

42 Russian delegate speech to 2015 EBRD Annual Meeting.
EBRD’s Board of Governors which warned of potential legal steps aimed at challenging the guidance on Russian investments.

Russian media leapt on news of the letter from Alexei Ulyukayev, the Russian economy minister, to the Luxembourg finance minister Pierre Gramegna, interpreting the statement as a sign the Bank was going to be sued, even though the Bank’s status precluded that possibility. In the letter, Ulyukayev wrote that Russia’s representatives on the EBRD’s Board of Directors “will shortly take legal steps ... to restore the rights of the Russian Federation that have been infringed”.

The EBRD’s Managing Director for Communications, Jonathan Charles, made clear in external comments to the media that there was no question of the Bank being sued, saying: “It is not about taking external legal action against the bank, it is about internal interpretation of EBRD procedures.”

At the EBRD’s Annual Meeting in 2017 in Cyprus a line was drawn under the Russian charges, with a resolution put to Governors on whether the Bank had indeed abided by its own rules.

The Russian delegation came to the meeting fully equipped and determined to repeat the standard position. This time it was left to Russian Governor and Economy Minister Maxim Oreshkin to regret the “long-term unsustainability of the profitability of the Bank’s operations”, a “decline of the Bank’s operational effectiveness”, an “erosion of the Bank’s operational mandate” and its “questionable risk management policies”. Oreshkin concluded: “In the circumstances, having exhausted other ways of resolving the issue and to protect the interests of the Russian Federation as an EBRD shareholder and country of operations, Russia has no option but to take steps to identify a legal solution to the situation.”

Oreshkin said the implementation of the “political guidance” violated legal norms, including the Agreement Establishing the Bank. He quoted widely from the AEB, including Article 8.3 on the possible suspension or modification of a member’s access to EBRD resources: “Any decision on these matters must fall within the sole jurisdiction of the Board of Governors and may not be delegated to the Board of Directors.”

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43 Letter from the Governor for the Russian Federation to the Chair of the Board of Governors, Moscow, 5 July 2016.
44 Quoted in Buckley, ‘Russia seeks to overturn EBRD lending ban’, https://www.ft.com/content/f1fd15c5-e462-11e6-b22f-79eb4891c97d.
In addition to other references to the AEB, he also cited Articles 32.2 and 32.3 on the international character of the Bank and the inadmissibility of attempts to exert influence over management in the interests of individual shareholders or groups of shareholders: “In essence, it amounts to discrimination based on nationality, and is inadmissible as part of the activities of a multilateral development institution.”

But when it came to a vote, the Governors exercising their powers under Article 57.2 of the AEB agreed overwhelmingly to support the view that the Bank had not violated its own rules in its dealings with Moscow.

Shareholders accounting for 96 per cent of its equity voted against the Russian challenge, with only Armenia, Belarus, Kyrgyz Republic and Mongolia understood to have sided with Moscow.

Chakrabarti said the Governors’ decision was “final and binding” and there had been no discussion of what it would take to restart lending to Russia. Referring to the Governors’ resolution, Chakrabarti nonetheless tried to offer some hopes for the future:

However, I want to stress once again...that Russia is a member with which we have a special and deep relationship. The EBRD has continued to engage with Russia since July 2014, even though we have not been able to begin any new projects. Looking ahead, I want to continue to try to engage with the Russian authorities. As you know, we have a 25-year track record in the country, and I think that that should continue going forward. It is a very, very important relationship for me, for the Bank and for the region.

Limbo continues

Six years later there was no change in the position of the shareholders, despite intermittent signals that some countries might be looking for a way out of the impasse. In March 2018, for example, Italy’s ambassador to Moscow was quoted in an interview with Reuters as saying Italy would propose to other shareholders a resumption of lending in Russia to small- and medium-sized enterprises.

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45 Statement to the 2017 Annual Meeting by Maksim Oreshkin, Governor for the Russian Federation.
To the very end of his eight-year period in office, Chakrabarti would reflect regularly on the question—frequently posed by Russian media—whether the EBRD might resume lending to its once most important country of operations. His answer would be this was not a question for management but for shareholders and he saw little chance of any consensus developing for any change in the position.

Chakrabarti’s hopes here as President of the EBRD did not come to pass. In the week he left the Bank in July 2020, he was quoted by the UK’s The Guardian newspaper as saying there was “more chance of the organisation extending its operations to sub-Saharan Africa than of resuming lending to Russia”.48

11. Ukraine after the Revolution of Dignity: A New Drive for Reform

In the wake of the overthrow of Yanukovych, the EBRD rapidly threw its weight behind the country once again, pledging publicly to step up funding as part of a coordinated programme of international assistance that would put Ukraine’s reform programme back on track.

A statement released on 5 March 2014, said the EBRD was ready to provide investments of at least €5 billion over the period until 2020—and said that level could be higher depending on economic circumstances. It again stressed the need for Ukraine to make progress on corruption, and said it was looking forward to making real progress on the anti-corruption initiative that had been in the works for a year.49

It was putting support for reform at the heart of its activities in Ukraine. In many ways, the country became a test bed for Chakrabarti’s increasing conviction that policy reforms and financial investment had to go hand in hand—right across the EBRD’s regions.

Supporting reform and investing in Ukraine

The following day, 6 March, Chakrabarti issued a strong personal call to action, to help put Ukraine back on its feet with a public statement


49 EBRD Press release, 5 March 2014, ‘EBRD statement on financing for Ukraine’. 
proclaiming “Why we must support Ukraine”. As the European Council in Brussels voiced its support for Ukraine that same day, stating “We stand by Ukraine”, Chakrabarti mapped out scaled up financing commitments by the EBRD and reform goals the Bank would pursue together with the Ukrainian authorities.

There was an urgent need for a shift in the economic policy mix to ensure sustainable development. Ukraine had to make clear there was no doubt in its commitment to the private sector. “For far too long, Ukraine had not used its resources efficiently and for a very narrow circle of beneficiaries only,” Chakrabarti said.

Ukraine needed a radical break with the past, taking a cue from its western neighbours in building up small and medium-sized enterprises.

Most crucially, Ukraine needed the right institutional framework and a level playing field in order to allow its private sector to flourish. Good governance could no longer be overlooked. Now was the moment to make real progress on the business ombudsman proposals that Ukraine had failed to sign up to in 2013.

Chakrabarti was encouraged by the new administration’s announcement that a purge of corruption would be a priority and he ensured the EBRD stood ready to contribute. The EBRD President put support for Ukraine in the context of the country becoming part of the European family, the very notion that had been so actively opposed by Russia and the dashed dreams of which had been the trigger for the weeks of protest that eventually ousted Yanukovych.

Restoring the rule of law to Ukraine was, he said, not only critical to restore order but to make the country attractive as a business destination again.

It is also what it essentially means to be a part of Europe, a variety of nations with complex histories, shared values and a bright future. Ukraine has embarked on a new path. It is our duty to stand by this important country’s side and we are ready to do so. Our help would be significant and we, together with the international community, are ready to deploy it, because we are all united in the determination that we want Ukraine to succeed.

51 EBRD Press release: Statement by Suma Chakrabarti, 6 March 2014. ‘Why we must support Ukraine’.
Later in March, the EBRD lifted its restrictions on sovereign financing that had been in place since the previous year in response to the administration’s refusal to take reforms and the fight against corruption seriously. This step allowed the Bank to announce a major investment in May into road transport infrastructure improvements.

The financing was delivered as part of a joint package with the EIB and the decision to proceed was made contingent on an IMF programme, underscoring just how firmly the EBRD’s response to Ukraine was entrenched within a context of closer cooperation with other IFIs and development banks.52

It was Arseniy Yatsenyuk, the first Prime Minister after the ousting of Yanukovych, who launched the anti-corruption initiative with Chakrabarti at a ceremony in May in Kyiv.

A former economy and then foreign minister in the 2000s, Yatsenyuk had famously become the centre of a controversial leaked conversation between senior US state department official Victoria Nuland and the US ambassador to Ukraine Geoffrey Pyatt as they discussed who they thought should take senior roles in any new administration. In the conversation, Nuland was heard to back Yatsenyuk, saying: “I think Yats is the guy who’s got the economic experience, the governing experience.”53

Yatsenyuk held the position for two years.

At the launch of the anti-corruption drive, attended by Yatsenyuk, Chakrabarti praised the new administration’s commitment to taking on the challenges. He described corruption as a scourge, “hollowing out the economy, eating away at political life and undermining democracy”. Chakrabarti noted that signing the memorandum and launching this initiative would not stop corruption but, he added: “We salute the government of Ukraine for its determination to tackle this fundamental problem regardless of the adverse geopolitical situation in the country.”54

The EBRD turned to a number of national governments to secure financing to help promote policy reform across the country. Grant money from the EBRD’s Stabilisation and Sustainable Growth Multi-Donor Account (MDA) Fund was quickly applied to financing the administration of the

52 EBRD Press release, 6 May, 2014. ‘EBRD steps up lending to Ukraine as part of international support package’.
54 EBRD Press release, 12 May 2014. ‘Ukraine and EBRD launch initiative to combat corruption’.
office of the new business ombudsman that had been created as part of the anti-corruption initiative. Former Lithuanian Finance Minister and EU Commissioner Algirdas Šemeta took up the role of business ombudsman towards the end of the year.\textsuperscript{55}

The EBRD closed the year with a 50 per cent increase in investments to Ukraine in 2014 to €1.2 billion and underlined this renewed commitment with the opening of a second office in the country, in the western city of Lviv, where an emphasis would be placed especially on support for small and medium-sized business in that region. Two years later it would expand eastwards with a second regional office outside Kyiv in Kharkiv.

In eastern Ukraine in early 2015, however, war was still raging between Ukrainian government forces and Russian-backed separatists who had declared ‘people’s republics’ in the disputed region. The nine-month long conflict that erupted after Russia’s annexation of Crimea had claimed the lives of over 5,000 people.

Peace talks built around the Minsk Protocol, devised in the Belarusian capital three months earlier and bringing together Ukraine, Russia and the Organisation for Security and Cooperation in Europe (OSCE), collapsed at the end of January 2016. The violence continued and there was still no peace six years after the initial outbreak of fighting.

The timing for making real progress on reforms was not propitious, with the new administration under President Petro Poroshenko having to focus on an increasingly bitter and costly war. But progress was indeed made with a government that Chakrabarti was to call later that year “one of the most professional administrations that we in the EBRD have ever worked with”.\textsuperscript{56}

The EBRD had already been an important backer, with financial support from its MDA fund, of Ukraine’s National Reforms Council. The Council, founded in December 2014, created a platform for political consensus-building around key national reforms, stretching across all departments of government with the aim of making coordination of the reform process more systematic.

\textsuperscript{55} EBRD Press release, 3 November 2014. ‘EBRD establishes multi-donor fund to support reforms in Ukraine’.

\textsuperscript{56} EBRD Press release: Speech transcript, 9 June 2015. ‘The way forward for Ukraine’.
The Ukraine Reform Architecture project

Later the EBRD, jointly with the EU, would embark on an even more ambitious plan, a ground-breaking and transformational state-building project that aimed to put in place a new home-grown generation of professional and highly qualified reform experts—dubbed “local change agents”—to drive the transformation needed from the inside.

This Ukraine Reform Architecture (URA) project, launched in 2016, was built around the concept of embedding reform-minded Ukrainians in ministries within the Ukrainian government.

Bojana Reiner, a Senior Governance Counsellor at the EBRD, who helped design and implement the project described it as “a gene therapy for the state”. The local element—local doers and change agents—was a crucial part of the programme, ensuring that Ukrainians themselves had ownership of dealing with the challenges. It was not just a top-down exercise where foreign experts would come in and dispense wisdom. Reiner said: “It was innovation in state design, built around three core principles: local genes for local problems; incubate then integrate; and experiment, learn, adapt.”57

A vital aspect of the programme was to make sure civil servants were adequately compensated, reducing the temptation of seeking financial backhanders for favours and helping to eradicate corruption. It also stayed away from the typical recipe of paying fees at ‘western’ consultant levels since these costs were unsustainable on a large scale. Instead, a new pay grade was designed that would afford a decent living in Ukraine, comparable to other countries, but which did not alienate those working there already.

Among the many projects rolled out to promote the reform process in Ukraine, two stand out particularly: one in the energy sector and another in banking.

Naftogaz

A combination of financial investment and efforts to raise business standards and drive forward reforms was applied to the Ukrainian gas industry, long seen as a quagmire of inefficiency and corruption. This was much more than the simple provision of finance for infrastructure projects.

57 Interview, December 2020.
The investments sought to transform the quality of governance at the two companies that were at the heart of the Ukrainian gas industry: NJSC Naftogaz, the national oil and gas holding company, and its subsidiary, Ukrtransgaz, which operated pipelines and storage facilities. Negotiations to deliver these investments took place at the highest levels of the Ukrainian administration, with the clear intent of ensuring strong government backing.

According to Francis Malige, then EBRD Managing Director for Eastern Europe and the Caucasus, and based in Kyiv: “The transformation of Naftogaz was a litmus test for the government’s resolve to reform in those years. The company was one of the darkest corners of the country’s web of corrupt interest.”

The EBRD was a driving force behind the reforms that were at the very heart of this project. “Working with the government and the company’s new management, we designed a structure that would create and sustain the incentive to reform.”

The EBRD took on the problems of the Ukrainian gas industry with a package of two closely intertwined investments: a long-term loan to refurbish the most critical sections of the main transit pipeline, and a short-term loan to finance winter gas purchases at a time when access to foreign financing was problematic for Ukraine.

The short-term loan was re-issued every year, coinciding with important transformation milestones and making sure that the reform process maintained momentum. The long-term loan was a €150 million credit to Ukrtransgaz to allow it to carry out crucial upgrades to the key energy transit facility, the Urengoy-Pomary-Uzhgorod pipeline.

The pipeline transported Russian gas to European markets and also provided for reverse gas flows from the EU back into Ukraine. The modernisation of the pipeline was an important step in increasing energy efficiency in the industry, reducing the perennial problem of gas leakage during the transit process.

Most crucially, the EBRD’s loan came with a series of conditions that would improve corporate governance of both Ukrtransgaz and its Naftogaz parent and contribute to the overall transparency of Ukraine’s energy sector. It was important too that links were made to IMF programmes and

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58 Interview, December 2020.
59 See Chapter 8.
advice and that the Ukrainian government committed to reforms aimed at delivering best practice in the development of market-based principles and liberalisation of the sector.

When the EBRD signed its US$ 300 million loan agreement with Ukraine to finance gas purchases over the following winter, it was amid much fanfare at a ceremony in Berlin attended by German Chancellor Angela Merkel and Ukrainian Prime Minister Yatsenyuk. The EBRD funding allowed Ukraine to buy up over 1 billion cubic metres of gas that would fill its storage facilities ahead of the winter.

The loan would not just provide a short-term response that would tide Ukraine over possible energy shortages over the coming months. It was part of longer-term efforts by the international community to strengthen Ukraine’s energy security by supporting diversification of suppliers and delivery routes. And, again, at its core was the EBRD’s commitment to driving forward the reform process in Ukraine.

The loan was conditional upon a programme of corporate restructuring at Naftogaz. This included the creation of a supervisory board of independent and qualified directors. Naftogaz would have to introduce internal audit, compliance, anti-corruption and risk management functions and an ownership and governance structure in line with best international practice.

In any country where reforms are introduced there is opposition, especially from those with a vested interest in maintaining the status quo. By its very definition, the creation of a level playing field implies taking something away from one quarter and sharing it with another. The reform proposals for Naftogaz were no exception.

Even when Malige was asked by Yatseniuk to present the project to his entire cabinet—in itself a signal of the EBRD’s role in delivering real change at the heart of the administration—there were murmurings of dissent:

Before the cabinet meeting, I was taken aside by Yatseniuk for a brief discussion with the EU ambassador, and the ministers of economy and finance. The ministers both said their own departments had come up with objections. But they both said they knew this was the right thing to do for the sake of the country.

Yatseniuk was then happy to proceed.
We moved from the ante-room into the ornate grandeur of the cabinet meeting room. I then presented the whole EBRD concept to the assembled ministers, assuaging any further concerns and making sure the project was finally delivered.

PrivatBank

The other standout intervention during this period was the decision by the EBRD to support and encourage the Ukrainian authorities with the nationalisation of the country’s largest bank, PrivatBank, after the discovery of a US$ 5.5 billion hole in its balance sheet.

Control of the bank was taken away from its oligarch majority co-owners Igor Kolomoisky and Gennady Bogolubov. Announcing the decision in a televised news conference, National Bank of Ukraine Governor Valeria Gontareva said PrivatBank had been undermined by widescale lending to entities close to the owners.

Kolomoisky has consistently denied any wrongdoing and continued to reject the way the central bank characterised the state of PrivatBank’s finances at the time of the nationalisation.

This was the latest in a series of steps under Gontareva to clean up the banking sector, including closing down over 80 of the country’s 180 banks. Many of these banks had been purely used for money laundering. Others were called “zombie banks” by the central bank chief, and had only liabilities and no assets, while a third category, she said, were used just for the benefit of investment in the business of their owners.

The EBRD was very vocal in its support for the nationalisation, on the face of it not the typical economic stance from an institution with a mandate to promote the private sector and which had spent decades helping to transfer assets away from the public sector.

It chimed very clearly, however, with the EBRD’s view that the private sector could only flourish against a backdrop of good governance. In a statement, Chakrabarti said:

The long-term stability of PrivatBank... is crucial to the country’s economic health. We believe the decision to nationalise it is the right one and have offered our expertise to the authorities whenever it is needed. We strongly
support the National Bank’s continuing efforts to reform the banking system in Ukraine and ensure good governance across the industry.\textsuperscript{60}

Malige was in close touch with the authorities in the run-up to the nationalisation. He subsequently became a non-executive member of Privat-Bank’s supervisory board. Appointed later as managing director for financial institutions at the EBRD, Malige has no doubt that the EBRD’s support for the nationalisation and its backing for other reforms in Ukraine was the right step to take:

I would do it again. There is no way the country would have progressed so far without the support, from the EBRD and the coalition of IFIs, the US, the EU and other countries such as France, Italy, Canada, that we put together. It was this backing that helped improve the standard of governance at Naftogaz. Without this support, would they have dared to have closed down so many banks and nationalised PrivatBank? I don’t think so.

But he stressed emphatically that the real heavy lifting at this time was done by the Ukrainians themselves:

The reform of the banking system was certainly driven by the Ukrainians. We have to pay homage to the courage and determination of the Ukrainian people who did it and who paid a price for it.

One of those people was Gontareva herself, who left the National Bank in 2017, and who later said she feared for her life after becoming a victim of intimidation and harassment. She was injured when a car drove into her in central London and then her son’s car was torched in Kyiv. Her house was later burnt down in an arson attack.

Malige said the creation of the ombudsman and the EBRD’s anti-corruption initiative were important steps for Ukraine. The ombudsman was clearly a great success. Many companies were now able to resist the demands of corrupt officials. And the support for bank reform also meant that many banks were no longer conduits for corrupt money.

\textsuperscript{60} EBRD Press statement, 18 April 2019, ‘EBRD statement on PrivatBank’.
Speaking in 2020, he made clear there was still more work to be done. There had been clear determination to tackle the problem. But laws that had been made had to be implemented. “The biggest issue in Ukraine is and unfortunately will continue to be the weak rule of law and the high level of corruption.”