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Green Action comments on draft EBRD Country Strategy for Croatia, March 2010

Green Action welcomes the opportunity to comment on the draft EBRD Country Strategy (CS) for Croatia, and thanks the EBRD for the recent consultation workshop organised in Zagreb. Despite the progress made by Croatia towards EU Accession, we believe that there are a number of crucial shortcomings that need to be addressed in the area of environment, and that the EBRD can and must send a strong message to the Croatian government regarding these in its Country Strategy and through its investments.

We are looking forward to see how the EBRD takes our comments into account and hope that the issues we raise will be reflected in concrete changes to the strategy to a greater extent than was the case with the 2007 Croatia Country Strategy.

Executive Summary

Challenges

p.8 *“Corporate governance in the State-owned companies which will not be privatised should be improved by replacing political appointees on supervisory boards with experienced managers from the business community.”*

Green Action does not agree that only the business community should be represented on supervisory boards of state companies, but believes that representatives from civil society and academia also need to be represented.

Suggested change: “Corporate governance in the State-owned companies which will not be privatised should be improved by replacing political appointees on supervisory boards with experienced managers from the business community, along with representatives of civil society and academia.”

p.8 *“to encourage companies and households to invest in energy efficiency through full market pricing of electricity and natural gas sold to all consumers. as well as the removal of non-economic barriers to investment in energy efficiency Increase the role of renewable energy to alleviate climate change.”*

We suggest strengthening the part on renewable energy to show more precisely the nature of the problem.

Suggested addition: “to encourage companies and households to invest in energy efficiency through full

market pricing of electricity and natural gas sold to all consumers, as well as the removal of non-economic barriers to investment in energy efficiency. Reduce unnecessarily complex procedures for the grid connection of sustainable renewable energy generation facilities in order to increase the role of renewable energy to alleviate climate change.”

Investments in Croatia so far

p.11 *“In the infrastructure sector the Bank is preparing three projects for IPA co-financing which are expected to be signed in 2010. These include two regional solid waste projects.”*

The regional solid waste projects in question are presumably the Kastijun waste management centre in Istria and the Rijeka waste management centre in Primorska-Goranska County. Both of these projects suffer from serious deficiencies and may not fulfil their goal of assisting Croatia to meet the requirements of the EU *Acquis Communautaire*.

In the Kastijun case, our main concern is that the project will not provide high quality results in terms of the level of recycling achieved, and that the most effective technologies (source-separated recycling and waste reduction, plus mechanical-biological treatment *with anaerobic digestion*) have been dismissed because of spatial planning restrictions at the site. It therefore appears that the technology has been chosen to suit height restrictions at the site, not to bring good waste management results. This only underlines that an unsuitable location has been chosen for the waste management centre, yet the authorities have stubbornly refused to examine alternative locations in spite of the disadvantages of the proposed one.

In the Rijeka case, the Environmental Impact Assessment study was carried out in 2001, making it already nine years old. Much has changed in the last nine years, including a significant change in the composition of household waste after the Ordinance on Packaging and Packaging Waste resulted in a massive drop in the quantity of PET, glass and aluminium from 2006 onwards. Numerous pieces of waste-related legislation have been introduced since 2001, both in Croatia and the EU, and the proposed Rijeka waste management centre’s contribution to compliance with these has therefore not been assessed in the EIA.

Suggested change: “In the infrastructure sector the Bank is examining three projects for IPA co-financing. These include two regional solid waste projects.”

p.11-12 *“In City Center Split One the Bank has for the first time financed an energy passive building.”*

We welcome the EBRD’s financing of energy passive buildings, which is exactly the kind of value that the bank should be adding to projects. However in the case of City Center Split One the impact is likely to be more than cancelled out by the 2600 parking spaces mentioned in the project summary document, and we urge the Bank to apply more ‘joined-up thinking’ with regard to the transport and waste impact of its projects. (<http://www.ebrd.com/projects/psd/psd2009/40805.htm>) We must also emphasise that we find financing shopping centres an extremely poor use of public money and are disappointed that the EBRD financed two in Croatia in 2009 alone.

Suggested change: No change in the text proposed, however the bank is recommended to avoid investing in shopping centres in Croatia in the future. Indeed such investments would not appear to be in line with the new strategy.

p.12 *“Supporting improvements in security and diversity of energy supply, with a priority on renewable energy projects. In 2009, the Bank signed a loan to Plinacro, the State-owned gas transmission company, to finance the purchase of Croatia’s only natural gas storage facility, an important investment for energy security.”*

The EBRD does not appear to have supported any renewable energy projects in Croatia in spite of it being a priority in the 2007 Country Strategy. This is very disappointing. We call on the Bank to step up policy dialogue with the Croatian government to reduce barriers for sustainable renewable energy projects, and to increase its efforts to support those who are trying to implement projects even in the current difficult circumstances.

Suggested addition: Insert explanation of why no renewable energy projects were supported during the last period and what will now be done differently.

p.12 *“Providing financing to SMEs through the EU SME Finance Facility, focusing on leasing companies. The Bank has provided SME facilities to Raiffeisen Bank and Raiffeisen Leasing under the EU/EBRD SME Finance Facility, and continued working with clients Croatian Post Bank and Erste S-Leasing under this programme. The focus on SME finance shifted as a result of the financial crisis, with EUR 100 million in loans extended to the two largest banks to enable them to continue financing SMEs when liquidity in the system was strained.”*

We welcome the financing of micro, small and medium enterprises, however we are concerned that it is unclear which companies have been the final beneficiaries of such loans and whether they are engaged in any potentially environmentally harmful activities. Beyond this strategy, we call on the bank to review its information disclosure on financial intermediary loans to ensure that the public is able to ensure that such loans do not result in environmentally harmful activities.

Suggested addition: Insert explanation of - at least - how much money was disbursed and which sectors have been financed through financial intermediaries in the last period; ensure that changes are made to the EBRD’s disclosure on such loans.

Transition Impact of the Bank’s Portfolio and Lessons Learned

p.14 *“Another cause for concern is Agrokor’s market dominance. While this increased since the EBRD investment, the Bank has financed Agrokor’s competitor retailers Interspar and Getro. A lesson learned from this project is that EBRD should apply clear standards and sound judgement when assessing and mitigating market dominance and other risks to competition. The EU competition standards are useful guidelines in this regard, especially in countries aspiring to EU membership (PE08-420).”*

The EBRD has made an equity investment in Agrokor and given a total of EUR 100 million loans for its retail operations in Bosnia and Herzegovina and Serbia. As far as we know the Bank still holds an equity stake in Agrokor. If this is the case, it should sell the stake, as public support for such a large and dominant company cannot be justified. The EBRD must not finance any more Agrokor operations.

The Bank’s operational priorities for the coming period on p.27 state:

“The Bank will continue to support regional investment by Croatian companies. As the Croatian companies are better developed and more competitive than many regional counterparts, they are able to bring improved business practices along with investment capital to the Western Balkans markets. Where appropriate, the Bank will provide management assistance to local companies through the TAM programme.”

We would welcome assurance that this does not mean Agrokor or other large companies which are surely able to access financing from other resources.

Suggested addition: Insert explanation of what the EBRD will now do concerning Agrokor as a result of market dominance concerns.

p.15 *“Financing provided to the Zagreb Waste Management Company (ZGOS) resulted in a successful landfill rehabilitation programme in line with EU environmental standards, state of the art treatment facilities as well as best corporate practices.”*

An important lesson learned here, which is not mentioned, is that the EBRD may not take responsibility for only the part of a project that it is directly financing. The PUTO hazardous waste incinerator, which was constructed partly in order to receive the hazardous waste exhumed from the landfill during the rehabilitation,

was built with no Environmental Impact Assessment, caused several air pollution incidents, and burned down in 2002. Some of the waste from the incinerator is to this day still at the site.

Suggested change: “Financing provided to the Zagreb Waste Management Company (ZGOS) resulted in a successful landfill rehabilitation programme in line with EU environmental standards, state of the art treatment facilities as well as best corporate practices. However, a lesson learned is that the EBRD needs to ensure that all connected facilities, even those not financed by the EBRD, meet the same standards. The Bank’s 2008 Environmental and Social Policy has been developed to take account of this.”

p.15 “Another Highly Successful project was an EBRD syndicated loan, co-financed with KfW to **the Zagreb Waste Water Treatment (ZOV)**. The excellent transition impact of this operation is a result of the first private sector participation in utility services and the competitive tendering that led to the selection of a concessionaire.”

We cannot agree that this is a highly successful project. Its costs have constantly risen and the final figure is still unclear. Zagreb clearly needs wastewater treatment facilities, but this project has resulted in the city being locked into an unfavourable contract for an oversized and overpriced project until 2028.

The original project cost in 2001 was EUR 176 million, but by the end of 2007 had risen to EUR 326.7 million (according to the EBRD - the City of Zagreb later gave a lower figure), not even including final treatment and disposal of the resulting sludge. Anaerobic digesters are part of the project, but have been built to be insufficient to completely process the sludge. This seems to have been done on purpose to justify the construction of a waste incinerator proposed by EVN on the same site.

The questionable functionality and tariff framework of the project has resulted in several companies refusing to pay their increased bills. In 2006 the City Council started to cover some of the companies’ debts using the city budget (ie. taxpayers’ money), after ZOV threatened that it would not be able to continue with the works it was carrying out.

According to the state auditor, between April 2004 and the end of 2006 the City of Zagreb had already paid ZOV 75.5 percent of the basic fixed costs of the plant’s construction. Although some running costs are most likely included, they are presumably not a great proportion of the total and it appears that the full fixed costs were paid off within just a few years of the plant’s construction, raising the question of why the city could not have carried out the project through normal public procurement.

If such a project contributes to ‘*excellent transition impact*’ then we believe that the EBRD needs to revise how it measures its success. Introducing the private sector into utility services cannot be considered as an end in itself, but only if it achieves good results for residents, the public budget and the environment.

Suggested change: “Another project was an EBRD syndicated loan, co-financed with KfW to **the Zagreb Waste Water Treatment (ZOV)**. This involved the first private sector participation in utility services and competitive tendering that led to the selection of a concessionaire. A lesson learned is that the EBRD needs to be more proactive in ensuring that the least cost solution is selected and that good value for the public sector is achieved.”

Business environment

p.18 “A number of concrete steps have been taken in the fight against corruption. A revised anti-corruption strategy was adopted in June 2008, together with a detailed action plan. A new inter-ministerial coordination system for monitoring anti-corruption efforts is also in place.”

We would like to emphasise that while anti-corruption efforts have indeed been more visible during the past year, much remains to be done. Examples include the well-known case of the Minister of Environmental Protection, Spatial Planning and Construction owning shares in IGH, which regularly takes part in construction projects permitted by the Ministry, and the multiple complaints brought against the Mayor of Zagreb, which have brought disappointingly few results. The Law on Golf Courses and the fact that it was approved through a fast-track procedure is an example of a piece of legislation where special interests have been given undue privileges in legislation.

Suggested change: None needed in the text, however it would be useful if the EBRD raises these issues with the Croatian authorities.

Physical environment

p. 18 We would suggest an addition pointing out that environmental protection in Croatia is weakened by having the Ministry for Environmental Protection as part of the same Ministry as construction. In practice, where there is a conflict between the two this tends to lead to construction taking precedence over the environment, rather than being resolved through the appropriate processes.

p.18 "Implementation of the horizontal acquis, not least strategic environmental assessment and access to justice in environmental matters, needs to be improved"

We welcome the EBRD's recognition of these important problems and hope that the bank will pay special attention to these issues during project appraisal and in its discussions with the Croatian authorities.

Suggested change: None

p.20 "Major developments have occurred in policy, as well as in legislative, regulatory and institutional frameworks. This is highlighted by the approval in late 2008 of the Public Private Partnership Act and the Concessions Act. These represent an important new step in promoting PPP in Croatia."

We are disappointed that the EBRD is concentrating on promoting PPPs rather than regulating them. From what we have seen so far of this model there are a relatively narrow set of circumstances under which it functions effectively, and these are not likely to be met in countries like Croatia facing challenges of corruption and low public administration capacity.

Suggested change: "Major developments have occurred in policy, as well as in legislative, regulatory and institutional frameworks. This is highlighted by the approval in late 2008 of the Public Private Partnership Act and the Concessions Act. These represent an important new step in regulating PPPs in Croatia."

p.23 "Sustainable Energy: Legislation supporting renewable energy has been implemented in 2007 based on a feed-in tariff. Further incentives for energy efficiency are needed in the form of increases in tariffs. In addition, Croatia needs to ensure compliance related to high-efficiency cogeneration (CHP), energy end-use efficiency and energy services, and transpose the EU acquis related to the energy performance of buildings."

We believe that the barriers to sustainable energy are even greater than indicated here.

Suggested addition: "Sustainable Energy: Legislation supporting renewable energy has been implemented in 2007 based on a feed-in tariff. However the permitting process for renewable energy generation facilities needs to be simplified considerably. Further incentives for energy efficiency are needed in the form of increases in tariffs and the fitting of thermostats and control switches in individual flats where these do not exist. In addition, Croatia needs to ensure compliance related to high-efficiency cogeneration (CHP), energy end-use efficiency and energy services, and transpose the EU acquis related to the energy performance of buildings."

p.26 "While the Bank responds to market demand, it will be guided by the following priorities:

- Privatisation and restructuring of State enterprises (e.g., tourism);
- Improving competitiveness and supporting regional expansion of enterprises;
- Investments in renewable energy and energy efficiency to alleviate climate change and improve energy security by reducing demand and diversification of energy supply;
- Financing priority infrastructure including regional transport networks through the WBIF;
- Preparing environmental (water, solid waste) projects for cofinancing with EU funds;
- Improve access to finance for SMEs including availability of private equity."

We agree that investing in sustainable renewable energy and energy efficiency should be a main priority of the EBRD in Croatia during the coming period.

Financing water and sustainable waste management systems is also necessary. However we are concerned that in the waste sector the EBRD has so far not been discerning enough - with the exception of its non-participation in the Zagreb incinerator, which we welcome - in ensuring that Croatia does not end up with a second-class waste management system that is insufficient to fulfil EU requirements and requires expensive upgrading again in a few years.

We also hope that 'regional transport networks' does not mean yet more motorways. Croatia has in the last few years become extremely car-dependent and action is urgently needed to ensure that pricing and the level of service makes it more attractive to use public transport. It is also unclear why the strategy refers to 'regional' transport networks, when many of the measures are needed at local level. Some of the actions needed are relatively simple measures such as ensuring that public transport has its own lanes, physically separated from other road vehicles and installing systems that ensure that traffic lights prioritise public transport.

As mentioned above, we hope that 'supporting regional expansion of enterprises' does not mean that the EBRD will extend further support for Agrokor or other companies where concentration is an issue, and that the bank will in future pay more attention to assessing potential market concentration issues in the future.

Suggested change:

- Financing priority infrastructure including public transport through the WBIF;

Enterprise Sector

p.26 *"Transition goals: Encourage investments in energy efficiency. Support privatisation and restructuring of state-owned enterprises, with a focus on the **tourism** sector which is under-invested. Support **regional expansion** and development of local companies and strengthen their competitiveness for the EU internal market. Improve corporate governance and transparency in the corporate sector."*

The EBRD needs to make its ultimate social and environmental goals clearer. What does it want to achieve by investing in the tourism sector and regional expansion of local companies?

In addition, while it is clear that action needs to be taken with regard to existing facilities owned by state companies, we would caution against EBRD investment in new construction of hotel facilities, firstly because this is an area which should be supported through private financing, and secondly because the Croatian coast is already becoming very built up and it would not be beneficial for the EBRD to send signals to the market that more new-build hotels are desirable.

Suggested addition: Insert explanation of ultimate goals to be achieved by investments in the enterprise sector.

Infrastructure

p.27 *"Transition goals: Support regional trade and investment through infrastructure development. Support Croatia's investments in environmental infrastructure and ability to successfully invest EU funds for this purpose. Improve energy efficiency in all sectors. Give priority to investments in renewable energy. Support investments to improve the diversity and security of energy supply. In the gas sector, organize the market on the basis of third party right to access the gas system, including upstream pipelines, the transmission and distribution system, gas storage, and the planned LNG facility."*

During the last period the EBRD has not invested in renewable energy in Croatia but only in new infrastructure for fossil fuels. Here too, although only renewable energy and energy efficiency are mentioned in the priorities

above, the EBRD intends to invest in gas facilities. We believe that scarce public financing should not be used for this, but instead to encourage the struggling new renewables and energy efficiency market in the country.

Suggested change: “Transition goals: Support regional trade and investment through infrastructure development [Insert explanation of ultimate goals to be achieved]. Support Croatia’s investments in environmental infrastructure [Insert explanation of concrete goals to be achieved] and ability to successfully invest EU funds for this purpose. Improve energy efficiency in all sectors. Give priority to investments in renewable energy [Insert explanation of concrete goals to be achieved] [Cut out references to gas investments].”

Operational priorities

p.28 “Through the Western Balkans Investment Framework, the Bank will prepare important infrastructure investments together with EIB. The Bank will support tendering of concessions in the airport and other sectors, including the port sector, where the Bank is already encouraging the use of concessions.”

The EBRD should not support the growth of the already heavily subsidised aviation sector, which is an increasingly important contributor to greenhouse gas emissions. In addition in the Zagreb airport case the future capacity needs are very unclear as Croatia has a very outdated national transport strategy (from 1999).

Suggested change: “Through the Western Balkans Investment Framework, the Bank will prepare important infrastructure investments together with EIB, including the port sector, where the Bank is already encouraging the use of concessions.”

Annex 1 - Political Assessment

Croatia has no overall development strategy, which means that its sectoral strategies are often incoherent with one another. In reality it is highly dependent on tourism, yet reading its energy strategy, one gets the impression that it mainly aims to become an energy exporter. Reading its transport strategy, one gets the impression that it mainly aims to become a transit country, and so on.

Suggested addition: Insert somewhere in political assessment section: “Croatia would benefit from developing a medium- and long-term development strategy to bring more coherence to its policy planning”.

Rule of law

p.36 “Recent indictments against some former members of the government, resignations of some serving members, and a number of investigations and arrests in the management of some public companies highlighted problems in the sphere of high level corruption. At the same time, these initial results of the anti-corruption efforts reflect intensification of the fight against corruption following the appointment of the new Prime Minister and may be seen as a practical demonstration of the authorities’ commitment in this respect.”

We agree with what is written but as mentioned above believe that the remaining issues with the Ministry of Environmental Protection, Spatial Planning and Construction have particular importance for the EBRD’s work and would suggest an addition emphasising this.

Suggested addition: Insert “Potential conflict of interest issues also exist due to the sometimes conflicting roles of environmental protection and construction being under the responsibility of one Ministry, as well as due to the personal business interests of the Minister.”

p.38 “There is a favourable legal framework for civil society organisations, which are particularly active in the areas of protection of minorities and socially vulnerable persons, women’s and children’s rights, and environment.”

During the last year as Green Action has succeeded more and more in bringing the weaknesses of the Ministry of Environmental Protection, Spatial Planning and Construction and the City of Zagreb into the public eye, there have been clear moves to put financial pressure on the organisation. The first attempt - a court case for an absurdly inflated charge related to an advocacy action carried out by Green Action - carries a EUR 50 000 - 110 000 fine if Green Action is found guilty, which would close the organisation down. The second - the imposition of retrospective - and extremely high - fees by the city council for the use of a storage area adjacent to Green Action's office, by the end of November 2009 totalled EUR 17 200 and the figure keeps growing.

Suggested addition: Insert "However there is some evidence of financial pressure being put on the most vocal organisations by the institutions which have been subject to their campaigns".

Annex 4: Environmental and social developments

p.49 "Good progress has been made in the area of climate change. Implementing legislation on Kyoto flexible mechanisms has been enacted. The National Allocation Plan for greenhouse gas emissions allowances was adopted for the period 2010-2020. Preparations for Croatia's participation in the EU Emission Trading Scheme (EU ETS) are well advanced. Further work is required in the areas of GHG emission allowance trading, establishment of a national GHG registry."

We cannot agree that good progress has been made in the area of climate change, particularly given the increasing urgency of the problem. As noted above, investments into renewable energy are still extremely difficult and energy efficiency still also suffers from several barriers. In addition the Croatian government has adopted a new energy strategy - with no strategic environmental impact assessment - which in our opinion is extremely poor for the following reasons:

- It involves building two new coal thermo power plants, even though Croatia has very little coal.
- It opens the door for highly unpopular new nuclear capacity and radioactive waste facilities, even though none of the economic, waste and risk problems with nuclear have been satisfactorily solved.
- It includes large hydropower plants in a target of 20% renewable energy by 2020, which means that Croatia would not have to increase its renewables at all.
- It is based on an annual GDP growth of 5%, which is hardly likely.
- It does not take into account the EU target on increasing energy efficiency by 20% by 2020

Suggested change: "Some progress has been made in the area of climate change. Implementing legislation on Kyoto flexible mechanisms has been enacted. The National Allocation Plan for greenhouse gas emissions allowances was adopted for the period 2010-2020. Preparations for Croatia's participation in the EU Emission Trading Scheme (EU ETS) are well advanced. Further work is required in the areas of GHG emission allowance trading, establishment of a national GHG registry. However, barriers to renewable energy and energy efficiency remain a significant problem. The new Croatian National Energy Strategy is also insufficient to assist the country in meeting the EU's 2020 targets on renewable energy and energy efficiency."

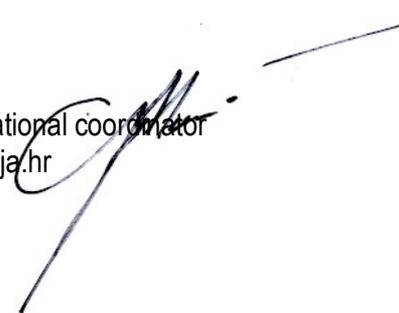
p. 49 "There has been some progress with waste management. The Waste Act has been amended. Implementing legislation related to management of construction waste, categories and operating conditions for landfills and the management of sewage sludge in agriculture have been enacted. The Environmental Protection and Energy Efficiency Fund is financing the remediation of illegal landfills and sites containing hazardous waste. Ten further landfills have been remedied. Full alignment with the acquis in management of waste from extractive industries, hazardous waste and shipments and trans-boundary movement of waste is still required. Preparations in this area are advancing."

This section does not mention the national waste management plan 2007 - 2010, which was approved with no public consultation and no strategic environmental impact assessment. Unfortunately this is symptomatic of

the way waste issues are handled by the Croatian government, although there are some much brighter initiatives going on at the local level. Waste, as a particularly sensitive sector, is one where public participation should be taken most care of, yet rather the opposite is true. In official communications with Green Action it has been clear that the Ministry of Environmental Protection, Spatial Planning and Construction has sometimes carried out presentations for local authorities and then attempted to pass them off as public consultations.

Suggested addition: "There has been some progress with waste management. The Waste Act has been amended and a national waste management plan for 2007-2010 approved. Implementing legislation related to management of construction waste, categories and operating conditions for landfills and the management of sewage sludge in agriculture have been enacted. The Environmental Protection and Energy Efficiency Fund is financing the remediation of illegal landfills and sites containing hazardous waste. Ten further landfills have been remedied. Full alignment with the acquis in management of waste from extractive industries, hazardous waste and shipments and trans-boundary movement of waste is still required. Preparations in this area are advancing, however special attention should be drawn to the need to ensure adequate public participation in the development of programmes, plans and projects at an early stage when all options are still open."

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