PSSI PERSPECTIVES — 9

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The ongoing diplomatic crisis between the Czech Republic and Russia, sparked by the April, 17th, 2021 revelation by Czech intelligence that Russian GRU agents were responsible for an attack on an ammunition depot on Czech sovereign territory in 2014 and may have coordinated the attack through agents working at the Russian Embassy in Prague, has led to the expulsion of 18 Russian diplomats from the Embassy. Many across the Czech Republic, including the Prague Security Studies Institute (PSSI), feel that this expulsion was an insufficient response to this heinous act, which killed two civilian bystanders. That said, with sanctions already in place against Russia over its continued occupation of Crimea and the low level of bilateral trade and travel due to Covid, one might be left wondering, what credible response options remain?

Following up on our previous Perspective on the International Investment Bank (IIB), PSSI believes that the Czech government should use this opportunity to promptly and fully withdraw Czech membership in this Moscow-controlled, scandal-ridden institution. First established in 1970 and then dormant between 1991 and 2012, the IIB is nominally a United Nations-registered intergovernmental organization, but is largely controlled by the Russian government (which contributes 47% of the bank's paid-in capital). It moved its headquarters from Moscow to Budapest, Hungary in 2019.

The institution ostensibly exists to promote development and cooperation among its predominantly Central and Eastern European members (i.e., former Comecon member states). PSSI argues that the IIB is, at best, a vehicle for Russian evasion of European Union sanctions and, at worst, an instrument of Russian economic and financial warfare. The Czech Republic derives no appreciable economic benefit from membership in the IIB whatsoever – indeed, it is a net drain on resources – and its continued membership in the bank is a glaring blight on the country's reputation.

According to IIB's 2020 Annual Report, the Czech Republic was the Bank's fourth-largest contributor of paid-in capital after Russia, Hungary, and Bulgaria, accounting for 9.87% of total capital, approximately EUR 37.4 million. Nearly all of IIB's limited investment activity in the Czech Republic has been directed toward Russian nationals with interests in marginal, outdated components of the country's manufacturing sector. This includes guaranteeing loans extended by the Czech bank ČSOB to a number of small Czech manufacturing enterprises primarily reliant on exports to post-Soviet states, particularly Belarus.

The IIB has issued one loan to a Czech Republic-based company, the now-bankrupt Pilsen Toll, in the amount of some EUR 50 million. As a tolling company[1], Pilsen Toll essentially operated as the financial arm

1 A tolling company is a legally separate entity that sells raw materials to a manufacturer and buys finished products back from them, a structure not uncommon in metallurgy as it generally allows for faster and more flexible fulfillment of orders. However, as this case illustrates, it creates an opening for corrupt business practices.

of Pilsen Steel, a financially troubled metallurgical production complex purchased in 2011 by Russian-born Israeli national Igor Shamis. Despite the purchase and new credit inflows, the company fell into bankruptcy in 2012, then went through a restructuring and recapitalization, only to return to bankruptcy in 2014.

Throughout this period, however, Pilsen Toll strangely remained highly profitable despite continued losses at Pilsen Steel, its parent company. The case is made more suspicious given the fact that Shamis had a known history of attempted purchases of financially distressed metallurgical enterprises, including in Serbia and Latvia, and went on to purchase TLM, an aluminum facility in Croatia, in 2015. TLM went bankrupt later that year after failing to secure new loans.

It was only then, in December 2015, that IIB decided to loan EUR 35 million to Pilsen Steel, IIB's single largest loan to date. Though Pilsen Steel continued to struggle financially, IIB announced that it would loan Pilsen Toll another EUR 15 million in September 2017. It is at this point that IIB's activity goes from highly suspicious to an unequivocal breach of fiduciary duty.

Given the continued losses at Pilsen Steel (notwithstanding bankruptcy and multiple reorganizations) and the deteriorating state of relations between Pilsen Steel/Pilsen Toll and the local government of Plzeň Region, it would have been clear to any financial analyst or accountant that the collapse of the entire group of companies was likely imminent. Indeed, the company once again went bankrupt in 2018, and in January, 2019 fired all 500 of its production workers.

Meanwhile, Shamis has apparently been arrested in Croatia on a warrant related to his embezzlement of funds from TLM. His current status is unclear. Our forthcoming, more detailed case study of IIB's activity in the Czech Republic indicates that a significant portion of IIB funds directed to the country through the Pilsen Toll loan may have been embezzled by its recipients.

The bizarre Pilsen Steel loan, and troubling track record of IIB activity in the country, should come as no surprise. U.S. Government representatives and the Czech intelligence service have issued repeated warnings to the Czech Republic regarding the security-related risks associated with IIB, particularly regarding its activities in the nuclear energy sector. IIB and Rosatom, Russia's state-owned nuclear power company, signed a Memorandum of Understanding for general cooperation in 2017.

Notwithstanding this troubling backdrop, Alena Schillerova, Czech Minister of Finance and the Czech governor at IIB, has been one of the only Czech officials to defend IIB publicly, calling membership in the bank "beneficial and profitable" for the Czech Republic. She also stated that the bank's move to Budapest is a useful step to manage the bank's compliance with EU sanctions on Russia.

A key reason for official Czech hesitancy to leave the bank appears to be the concern that the government will not receive compensation for the Czech Republic's existing paid-in capital, resulting in political embarrassment. This worry stems from Poland's experience, which left the IIB in 2000 and, as of this writing, has not received any financial compensation for its shares. Nonetheless, IIB's disastrous reputation and the presence of valid national security risks argues strongly for the Czech Republic to follow Poland's lead and leave the bank without delay, particularly in light of the Kremlin's utter contempt for Czech sovereignty.

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