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Canada at the European Bank for Reconstruction and Development

2011

Report on Operations under the European Bank for Reconstruction and Development Agreement Act

Canada

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Foreword by the Minister of Finance

I am pleased to present *Canada at the European Bank for Reconstruction and Development 2011: Report on Operations Under the European Bank for Reconstruction and Development Agreement Act*. This report summarizes a historic year for the European Bank for Reconstruction and Development (EBRD) and Canada's ongoing commitment to effective, accountable and efficient international financial institutions.

In producing this report, the Government is providing Members of Parliament and all Canadians with a comprehensive account of Canada's role at the EBRD. The Government continues to focus on ensuring institutional effectiveness and promoting good governance and accountability. In addition to this ongoing oversight role, Canada will be pursuing the following objectives for 2012:

- Support the EBRD's efforts to foster private sector development and inclusive economic growth in the Southern and Eastern Mediterranean region.
- Support sustainable transition in the EBRD's countries of operations while ensuring the effective and appropriate use of shareholder capital.
- Promote appropriate governance and accountability structures at the EBRD.

Nations around the world turn to international financial institutions like the EBRD during times of instability and upheaval. This is why, for example, a key component of the G-8 Deauville Partnership, launched in May 2011, is the expansion of the EBRD's geographic mandate to include the Southern and Eastern Mediterranean region. This report provides a detailed account of how the EBRD has responded to the Arab Awakening, the economic recovery underway in the EBRD's countries of operations, and the Bank's key role in supporting these countries.

Given the fragile global economic recovery, it is clear that the EBRD continues to have an important role to play in both its existing countries of operations and the new region. As a major shareholder and member of the Board of Governors of the EBRD, Canada is committed to support the Bank and its mission in the years to come.

The Honourable James M. Flaherty, P.C., M.P.
Minister of Finance

OVERVIEW

The European Bank for Reconstruction and Development (the EBRD or the Bank), created in 1991, is a unique, project-oriented institution that focuses on developing the private sector and strengthening market-supporting institutions in Central and Southeastern Europe, the successor states of the former Soviet Union, Mongolia and Turkey. In pursuing these objectives, the EBRD operates only in countries that demonstrate a commitment to the fundamental principles of multiparty democracy, pluralism and market economics.[1] For further information see the section entitled "Background on the EBRD."

As a founding member and the eighth largest shareholder of the Bank, Canada actively contributes to the development of Bank policies and provides oversight of its financial activities. It does so primarily through its seat on both the Board of Governors and the Board of Directors (representing a constituency that includes Morocco) and its participation in the work of various committees. Canada's objectives for the Bank are informed by a commitment to the Bank's underlying mandate, Canadian government policy goals and input from civil society. These objectives are described in the sections entitled "Progress Made on Canada's Priorities in 2011" and "Canada's Objectives for 2012."

Canada has a vested interest in seeing that the EBRD remains a strong, effective and accountable institution. The development of market-oriented economies with strong democratic institutions is a critical component to peace, stability and prosperity in the region. Our membership in and financial support for the EBRD provide Canada with the opportunity to advance the transition process in the region.

The Bank's operations are guided by four core principles: transition impact, additionality, sound banking, and environmental and social sustainability. These principles mean that the EBRD's activities should foster transition towards open, democratic societies through the development of entrepreneurship and the private sector. The EBRD should also catalyze additional flows of private sector financing while adhering to principles of good financial governance and ensuring the effective use of capital. Finally, the Bank's operations should be socially and environmentally sustainable.

In 2011, the EBRD continued to implement its strategic objectives through responsible investments, good governance and cooperation with other international financial institutions. In response to the financial crisis of 2008–2009 and the ensuing net capital outflows in emerging Europe, the EBRD significantly increased the number of projects and the volume of investments in the region. Following a record year in 2010 business volume increased further in 2011, with €9.1 billion in commitments and €6.7 billion in disbursements, of which 77 per cent was directed towards the private sector. The EBRD therefore continued to play a key role in developing the private sector as the foundation for sustained economic recovery.

[1] Article 1 of the Agreement Establishing the European Bank for Reconstruction and Development. Where countries do not demonstrate a commitment to these principles, the Bank limits its activities accordingly.

2011 also proved to be a watershed year for the EBRD, one that will shape the direction of its activities for years to come. In response to the historic social and political developments in parts of the Middle East and North Africa (commonly known as the Arab Awakening), the international community called on international financial institutions to increase their support for the region. With its strong resource base, as well as its expertise in supporting the private sector (in particular small and medium-sized enterprises) and the development of financial markets, the EBRD was well placed to contribute to this multilateral effort.

At its Annual Meeting in Astana, Kazakhstan, in May 2011, the EBRD's Board of Governors voted overwhelmingly to proceed with the expansion of the EBRD's geographic mandate to include the Southern and Eastern Mediterranean region. This decision was consistent with the call by G-8 Leaders at Deauville, France, "for an appropriate regional extension of the geographic scope of the EBRD's mandate, in order to support the transition in countries of the region which embrace multiparty democracy, pluralism and market economies."[2] Specific amendments to the Agreement Establishing the EBRD were approved by Governors on September 30, 2011, and are undergoing ratification by the EBRD's shareholders. Further details are provided in the following section.

2 Declaration of the G-8 on the Arab Spring, G-8 Summit of Deauville, May 26-27, 2011.

What Happened in 2011

Expanding the EBRD's Geographic Mandate

For the EBRD, 2011 was a year dominated by unforeseen events. Europe's neighbours in the Arab world initiated a series of political and social changes that saw incumbent regimes toppled and citizens demanding democracy, fairness and economic opportunity. While the full impact and future direction of these historic events remain to be determined, the international community has responded by offering its support to the region.

As part of the G-8 Deauville Partnership, international financial institutions already active in the Middle East and North Africa (MENA) region were asked to dedicate additional resources to help Partnership Countries achieve sustainable economic growth. Although the EBRD does not have a mandate to operate in the region, it was determined that the EBRD could contribute to the multilateral and bilateral efforts underway given its experience with transition economies in Eastern Europe. With the region's large public sectors, poor access to credit and high levels of unemployment, particularly among youth, the EBRD's expertise in fostering entrepreneurship, supporting small and medium-sized enterprises and reforming the financial sector could be of value to the region.

Following extensive discussions, the Board of Governors voted overwhelmingly at the EBRD's Annual Meeting in May in favour of a resolution to complete expeditiously the process of expanding the EBRD's mandate to include the new region. The Bank was tasked with the following objectives:

- Amend Article 1 of the Agreement Establishing the Bank (AEB) to provide for an appropriate regional extension to the geographic scope of the EBRD's mandate, and establish a mechanism to grant recipient country status to members in that extended region.
- Outline possible further steps to allow the Bank's operations to start as early as possible.

Governors made it clear that an expanded mandate was to be pursued with the following conditions:

- The extension should be designed so as not to compromise the agreed scope and impact of the Bank's operations in existing recipient countries.
- The extension should not require additional capital contributions from members.
- The EBRD's involvement in the extended region should be fully coordinated with international financial institutions active in the region.

Following further consultations and discussions among shareholders, on September 30, 2011, the Board of Governors approved a set of resolutions to allow the EBRD to begin a phased expansion of operations into the new region. The expanded mandate has three parts:

1. **Geographic expansion—**Article 1 of the AEB is to be amended to expand the geographic mandate of the Bank to include the Southern and Eastern Mediterranean (SEMED) region. The SEMED region encompasses all countries with a shoreline on the southern or eastern Mediterranean Sea, as well as Jordan. Since the amendments to Article 1 require unanimous ratification by all 65 members of the EBRD, it could take some time before they take effect.

2. **The use of Special Funds in potential countries of operations—**Special Funds are funds set aside to fulfil a specific purpose within the mandate and functions of the EBRD. The EBRD can use its full range of products and services when administering Special Funds. However, Article 18 of the AEB currently specifies that Special Funds can only be used in recipient countries within the EBRD's existing geographic mandate. In order for the EBRD to start operations in the new region on a timely basis, an amendment is proposed that will allow the EBRD to manage Special Fund operations in *potential* recipient countries, defined as any country that is a member of the Bank and in which the Bank intends to operate with its ordinary resources.

   With a lower threshold for ratification (75 per cent of membership representing 80 per cent of total voting power), this amendment will allow the EBRD to begin investment operations in potential recipient countries on a timelier basis, provided the new countries meet the Bank's established criteria of a demonstrated commitment to multiparty democracy, pluralism and market economics.

3. **Cooperation Funds—**The Board of Governors also approved the use of Cooperation Funds in the new region. In contrast to Special Funds, Cooperation Funds are under the Bank's management but do not carry the legal status of EBRD resources. Cooperation Funds can be used for technical assistance and grant support, but not to make loans or investments. They do not require amendments to the AEB and can therefore be deployed more quickly. Funding for Cooperation Funds is expected to come from the EBRD's net income as well as third-party donors. Cooperation Fund activities began in December 2011 in Egypt and Morocco.

Progress Thus Far

As of December 2011, Governors had approved a €20-million transfer of the EBRD's net income for use as Cooperation Funds, and other donors have pledged further contributions. Two new SEMED countries—Jordan and Tunisia—have finalized their membership in the EBRD, with a view to becoming countries of operations in the near future. Egypt and Morocco, already members of the Bank, were authorized to be the first recipients of SEMED-focused Cooperation Funds.

In terms of cooperation with other international financial institutions in the new region, the EBRD has modified its existing Memorandum of Understanding (MoU) with the European Commission, European Investment Bank and European Investment Fund to account for the new region and has signed new MoUs with the African Development Bank and the Islamic Development Bank. The EBRD has also made efforts to increase coordination with other multinational organizations and national development agencies operating in the SEMED region.

Overall, the EBRD has responded quickly to the Governors' request for a timely and appropriate expansion into the new region and is on track to build on this progress in 2012.

Ratifying the Amendments

As noted above, the EBRD's geographic expansion is contingent upon members ratifying the agreed amendments to the AEB. Canada is currently taking the necessary steps to ratify the amendments in accordance with domestic procedures. As of December, 31, 2011, the amendments to the AEB have been tabled in Parliament with the goal of ratifying the amendments by the May 2012 EBRD Annual Meeting. Once the tabling period is completed, the Minister of Foreign Affairs will seek the authority to ratify the amendments.

Other Developments in 2011

A noteworthy milestone in 2011 was the finalization of the EBRD's capital increase from €20 billion to €30 billion, which had been authorized by Governors in May 2010. By April 20, 2011, the EBRD had received enough capital subscriptions from its members for the increase to take effect. For more detail on the general capital increase, see the 2010 version of this report.

As summarized in Annex 4, the economic recovery and transition progress in the EBRD's countries of operations continue, albeit with minor setbacks and ongoing uncertainty. The fragility of the recovery is largely due to the region's dependence on the euro-area economies for much of their exports and foreign direct investment—the sovereign debt difficulties in certain Western European countries continue to affect their trading partners.

For its part, the EBRD maintained a high level of business activity in the region throughout the year. Commitments totalled €9.1 billion in 2011, in line with projections and slightly above the previous year's record €9.0 billion, while disbursements reached a record €6.7 billion (up 11 per cent from 2010). The EBRD's projects attracted some €20.8 billion in additional financing—€10.2 billion from Bank co-financing activities and €10.6 billion from third parties. The private sector share of business volume was 77 per cent in 2011 (up from 74 per cent in 2010), while the overall private sector share of the Bank's portfolio remained at around 74 per cent.

Despite the challenging economic climate, the EBRD had a net profit of €173 million for 2011. This is significantly lower than the €1.4-billion net profit recorded in 2010, largely due to unrealized losses in the Bank's equity investment portfolio resulting from the deteriorating financial climate in Europe over the latter half of 2011. Operational and financial highlights are summarized in Table 1.

Table 1
EBRD Operational and Financial Indicators, 2007–2011
(€ million)

	2011	2010	2009	2008	2007
Number of projects	380	386	311	302	353
EBRD commitments	9,051	9,000	7,861	5,087	5,583
Resources mobilized	20,802	13,174	10,353	8,354	8,617
Total project value	29,479	22,039	18,087	12,889	13,809
Realized profit before impairment	839	927	849	849	973
Net profit/loss for the year before transfers of net income	173	1,377	-746	-602	1,884
Paid-in capital	6,199	6,197	5,198	5,198	5,198
Reserves and retained earnings	6,974	6,780	6,317	6,552	8,676
Total members' equity	13,173	12,977	11,515	11,750	13,874

Overall, the Bank's strong capitalization, coupled with low levels of non-performing loans, low leverage and ample liquidity buffers, suggests that the EBRD continues to be in a strong position to carry out its mandate in the medium term. The EBRD's year-end financial statements are available on its website (www.ebrd.com/pages/research/publications/flagships/financial.shtml).

Canada and the EBRD

Canada's relationship with the EBRD is governed by the *European Bank for Reconstruction and Development Agreement Act*. The Act outlines Canada's responsibilities with respect to the EBRD and sets out that the Minister of Finance shall lay before Parliament by March 31 of each year (or, if the House is not sitting, on any of the thirty days thereafter that it is sitting) a report of operations under the Act for the previous calendar year.

Role of Canadian Government Departments

The principal responsibility for oversight of the EBRD's key activities resides with the Department of Finance. The Department of Finance coordinates Canadian policy advice and manages Canada's strategic interests at the EBRD in consultation with Foreign Affairs and International Trade Canada.

Canada's representation at the EBRD—The Honourable James M. Flaherty, Minister of Finance, is the Canadian Governor and Mr. Morris Rosenberg, Deputy Minister of Foreign Affairs, is the Alternate Governor. Canada's resident representative on the EBRD Board of Directors is Ms. Suzanne Hurtubise. Mr. Brian Parrott is the non-resident Alternate Director. Rob Stewart, Assistant Deputy Minister of the Department of Finance's International Trade and Finance Branch, represented Canada as the Temporary Alternate Governor at the EBRD's Annual Meeting in May.

Our constituency at the EBRD—The Canadian Director also represents Morocco on the Board of Directors.

Canadian staff at the EBRD—Canadians are well represented on EBRD staff. At the end of 2011, there were 29 Canadian professionals on the staff of the EBRD, representing 2.5 per cent of total professional positions. Canadians fill the senior positions of Deputy Chief Compliance Officer, Director of Planning and Portfolio for Financial Institutions, and Director of the Early Transition Countries Initiative.

Benefits of Membership

Canada's membership in the EBRD, and its active participation in the discussion of policy and operational issues, is an important means to help shape regional standards and regulations in the EBRD's 29 countries of operations. By supporting continued political and economic reform, Canada is contributing to the countries of operations' stability and integration into the world economy.

Canada shares with the Bank the overriding objective of developing a strong private sector in its countries of operations by mobilizing financing for projects with a high transition impact and by providing advice and technical assistance to businesses and governments. Through its participation in the EBRD's Board of Directors and Board of Governors, Canada has been able to press for greater attention to governance issues in the Bank's operations. Moreover, Canada has been able to help shape the environmental and social safeguards that govern the EBRD's lending.

The Bank also provides Canada with a vehicle to reach transition countries that are not currently part of our bilateral development assistance programs.

Canada is interested in raising awareness among Canadian companies of opportunities presented by the EBRD. Canadian companies can seek financing for projects undertaken in the Bank's countries of operations. The Bank often relies on the procurement of goods and services from the private sector to implement transition projects. Canadian consultants were awarded 39 contracts in 2011 (down from 68 in 2010) valued at €1,047,941 (down from €1,306,265 in 2010). Canadian companies have also successfully invested in the countries of operations with the EBRD's assistance. While the amount of loans and equity provided by the EBRD to Canadian companies varies from year to year, in 2011 a loan of €19.3 million was provided to a Canadian company.

Canada's Contribution to Ordinary Capital Resources

As noted in last year's report, in May 2010 the Board of Governors voted to temporarily increase the Bank's total authorized capital from €20 billion to €30 billion. €1 billion of the increase consists of a reallocation of the Bank's reserves to paid-in shares. This reallocation took effect on May 14, 2010. As the shares were distributed among members based on existing shareholdings at the Bank, there was no impact on relative voting share.

The remaining €9 billion consists of a temporary increase in callable shares. Canada subscribed to its €306-million share of the increase in early 2011, and enough subscriptions were received for the increase to take effect on April 20, 2011.

Canada is the eighth largest shareholder of the EBRD, with its shares representing 3.6 per cent of the institution's capital. This amounts to €1.02 billion of the Bank's capital, €212 million of which is paid-in capital, with the remaining shares being callable capital.

Canada's Contribution to Cooperation and Special Funds

In addition to a loan or equity investment, the EBRD often supports its clients with advice on project preparation and effective implementation. This advice is often paid for out of Technical Cooperation Funds, which are set up by donor countries and international institutions and are managed by the Bank, or out of the Shareholder Special Fund. These funds mobilize investment capital and expertise in the EBRD's countries of operations by giving local business access to consultant experts. The consultants assist in the preparation of projects and strengthen local management know-how. They also develop environmental strategies and work to improve the legal framework in which businesses operate.

The Canadian International Development Agency (CIDA) has been a major contributor to the EBRD's Technical Cooperation Funds, contributing about €40 million since the EBRD was established in 1991. Canada's support has been channelled through its own regional funds and through multilateral donor initiatives.

CIDA's aid effectiveness agenda is to focus its assistance on fewer countries with greater needs. Therefore, the agency's regional program in Europe will conclude by 2012.

Canada is also a donor to the following Cooperation and Special Funds:

Russia Small Business Fund (RSBF)—The RSBF was established in 1994 with the support of the G-7 countries and Switzerland to provide micro and small enterprises (MSEs) in Russia with financing to fit their particular requirements and to help strengthen the capacity of the Russian banking sector so that it can effectively lend to MSEs on a sustainable basis. The fund was established with a pledged contribution of US$150 million from the EBRD and US$141.7 million from donor countries, comprised of US$71.0 million for co-investment and US$70.7 million for technical cooperation programs. Canada's share of the initial contribution totalled US$8.1 million.

Chernobyl Shelter Fund (CSF)—The main purpose of this fund, which was launched in 1995, is to secure the sarcophagus around the destroyed Unit IV nuclear reactor in Ukraine. The CSF finances the implementation of the Shelter Implementation Plan, which includes the construction of a permanent confinement facility, enhanced radiation monitoring, and general improvements to nuclear and worker safety. Following serious cost and schedule overruns, it was determined that an additional €740 million was required to sustain the CSF and the Nuclear Safety Account (NSA) project (see below). As a result, a final fundraising effort was initiated April 2011. This initiative secured commitments by donors and other countries to make up the shortfall. On May 26, Prime Minister Stephen Harper announced Canada's contribution of an additional C$30 million over up to four years. The EBRD has also contributed significantly to the CSF and the NSA. Under the Shelter Implementation Plan, the permanent confinement facility is scheduled to be completed by October 2015 at an agreed cost of €935 million.

Nuclear Safety Account (NSA)—This account was established in 1993 to help address nuclear safety issues related to Soviet-designed reactors in Central and Eastern Europe. The NSA financed the decommissioning of all the undamaged Soviet-style reactors at Chernobyl following the 1986 accident, and it is now funding construction of an interim spent nuclear fuel storage facility and a liquid radioactive waste treatment facility. As with the CSF, the NSA has also experienced significant cost and schedule overruns and is being replenished as part of the fundraising effort noted above. C$10 million of Canada's most recent C$30-million pledge will be allocated to the NSA.

Northern Dimension Environmental Partnership (NDEP)—The NDEP was created in 2001 to fund the safe and secure management of the spent nuclear reactor fuel and other radioactive wastes generated by the dismantling of Russia's northern submarine fleet. The NDEP's focus on infrastructure is critically important as it fundamentally helps improve the dismantlement process by securing spent nuclear fuel and radioactive material at various sites and increasing storage capacity. By the end of 2006, the NDEP had secured investments of more than US$1.5 billion for environmental projects. In 2003–04, Canada joined a number of other donors by contributing C$32 million to the NDEP. Canada's Global Partnership Program is responsible for monitoring the NDEP.

Progress Made on Canada's Priorities in 2011

The Government of Canada is committed to promoting effective institutions, good governance and accountability both at home and in its relations with the international community. Canadian priorities at the EBRD for 2011, outlined in last year's report, reflected this commitment.

Presented below is a summary of the progress made on the priorities identified in last year's report. These priorities are grouped under three broad objectives: (1) Institutional Effectiveness; (2) Governance and Accountability; and (3) Environmental Sustainability and Gender Equality.

1) Institutional Effectiveness

1.1—The EBRD should promote economic and democratic reforms

Outcome 1.1(a): A limited scope of activities in countries that have been slow in implementing Article 1 and (b) an effective approach for supporting transition in countries whose progress in implementing democratic reforms has slowed

Good Progress

Canada is of the view that the Bank continues to make good progress in monitoring the political situations in its countries of operations, their progress towards multiparty democracy and pluralism, and their progress in instituting economic reforms. Overall, the Bank is using a calibrated approach in three countries: Belarus, Uzbekistan and Turkmenistan. This approach was reconfirmed in 2011.

Throughout the year, the EBRD monitored developments closely in Ukraine in light of political events in that country. While the Bank continues to operate in Ukraine, it exercises careful due diligence when developing projects and is expected to maintain its scrutiny in 2012. While Canada has not opposed any EBRD projects, we continue to express our ongoing concerns with the state of democracy, human rights and rule of law in Ukraine and to underline the necessity for the EBRD to bear these issues in mind while undertaking activities in Ukraine.

1.2—The EBRD should continuously strive to have a strong transition impact

Outcome 1.2(a): The development of a clearly articulated policy for post-graduation and the graduation of EU-7 countries

Some Progress

The EU-7[3] countries were on the path to graduation from the Bank's regular operations during the third Capital Resources Review (CRR3) period (2006–2010), but the financial crisis threatened to set back the transition process and so graduation was delayed. Canada was supportive of the EBRD continuing to do business in the EU-7 during the crisis so as not to jeopardize the Bank's previous efforts to foster transition.

[3] Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia.

The Board of Governors reaffirmed in the CRR4 agreement that the Bank's EU-7 members are expected to graduate during the CRR4 period (2011–2015) and that there should be greater clarity regarding a country's relationship with the Bank post-graduation. Canada supported both of these initiatives. Management worked with the Board of Directors in developing what Canada views as a satisfactory post-graduation operational approach, which the Board discussed but did not finalize during 2011.

Consistent with the view that the EBRD's operations should be shifting East and South as the more advanced transition countries have less need of EBRD financing, annual business volume in the EU-7 was declining until 2009, before increasing sharply due to the financial crisis. Since 2009, EBRD financing to the EU-7 countries has generally declined, although in most cases it remains above pre-2009 levels. The exceptions are Poland and Slovenia, where annual business volume was higher in 2011 than in previous years. In Poland, EBRD financing rose significantly over the past year despite the fact that it fared relatively well during the financial crisis.

Overall, the ongoing fallout from the financial crisis continues to create an uncertain and fragile economic environment in Europe, particularly among members of the euro area. The risk of further setbacks for the EU-7 persists. Progress towards EU-7 graduation therefore continues, but at a slower and more uncertain pace than was expected.

Outcome 1.2(b): The disciplined and selective use of Bank capital in support of activities that are consistent with the EBRD's transition mandate

Good Progress

As the Bank's lending volumes increase to record levels, the Bank should remain disciplined and selective in the use of its capital, and only support activities that are consistent with its transition mandate. Good progress has been made on this priority over the past year. For instance, the Bank aims for a minimum of 80 per cent of projects to have a transition impact rating of "Good" or "Excellent" at project signing. In 2011 it was 91.2 per cent.

In addition, the Bank is following through on its commitment to continue to expand its operations in the Western Balkans (where business volume was close to €1.0 billion in 2011) and the Early Transition Countries (where it was also €1.0 billion, a 10-per-cent increase over 2010). The EBRD is therefore continuing to dedicate an ever larger proportion of its resources to countries in the region with the most complex transition challenges.

1.3—The EBRD should cooperate with other international financial institutions (IFIs)

Outcome 1.3(a): Clear guidelines for co-financing with other IFIs

Good Progress

The global crisis has proven to be an opportunity for the IFIs to work together in a coordinated and comprehensive manner. Canada supported the Bank's approach to IFI collaboration during the crisis and is pleased that it is continuing following the crisis. By identifying its core strengths relative to other IFIs, the EBRD can coordinate with other institutions to minimize overlap and make the most efficient use of resources. Cooperation with other IFIs is also of critical importance as the EBRD begins to work in the new Southern and Eastern Mediterranean (SEMED) region of operations.

In this vein, Canada was pleased that in 2011 the EBRD signed Memoranda of Understanding (MoUs) with the African Development Bank and the Islamic Development Bank and revised its joint MoU with the European Commission, European Investment Bank and European Investment Fund to accommodate activities in the SEMED region. As part of the new G-8 Deauville Partnership, a group formed to coordinate multilateral and bilateral financing support for the new region, the EBRD is in the process of strengthening its engagement with other multilateral development banks and national development agencies, where appropriate.

Outcome 1.3(b): The untying of all donor funds in accordance with CRR4 commitments

Good Progress

Another key issue for Canada has been the untying of donor funds as it increases the effectiveness of technical cooperation and IFI collaboration and promotes competition among suppliers. Around 21 per cent of the Bank's current Technical Cooperation Funds (excluding the EBRD Shareholder Special Fund) are tied to some degree. This is administratively costly and does not always lead to optimum procurement outcomes.

The policy on untying donor funds adopted as part of CRR4 is now in a transition phase until the end of the CRR4 period, by which time procurement based on nationality will cease. Management is working with tied donors to enhance the knowledge of their national consultancy communities of opportunities for working with the Bank. In addition, it is targeting administrative resources at the utilization of remaining tied funds, where feasible.

1.4—The EBRD should continue to implement policies, strategies and tools that develop local currency lending and local capital markets, where appropriate

Good Progress

The EBRD has set out to help address the vulnerabilities resulting from foreign currency borrowing in its countries of operations. Canada supports this work as it demonstrates that the Bank is recognizing and reacting to a possible source of economic volatility in the region. High levels of foreign financing can pose a significant challenge in many countries of operations as they expose borrowers to foreign exchange risks and sudden capital flight. For many EBRD member countries, these downside risks were laid bare during the recent financial crisis. In other cases, however, such risks may be outweighed by other risks associated with the domestic currency, such as uncertainty over monetary policy and inflation.

Following its launch in 2010, the Bank began to expand the Local Currency and Local Capital Markets Initiative during 2011. This initiative aims to identify and support reforms and policies in EBRD countries of operations that contribute to the increased use of local currency and local capital market development. In cooperation with other IFIs (e.g., the International Monetary Fund and the World Bank), the initiative develops and manages policy dialogue with relevant authorities and stakeholders and provides advisory and analytical support to authorities.

During 2011, the EBRD developed an initial set of priority countries and conducted needs assessment missions and working groups, created new tailored tools to assess the legal and regulatory frameworks of these countries, and promoted the increased use of local currencies for EBRD loans or capital market transactions, such as EBRD investments in local currency bonds. In addition, in February 2011, the EBRD launched the Early Transition Country Local Currency Risk Sharing Special Fund, which provides a first loss guarantee to local currency financing, thereby making such financing more affordable to the private sectors of the participating countries.

Canada is therefore of the view that the EBRD is making very good progress in establishing itself as a leader in promoting strong local currency capital markets.

2) Governance and Accountability

2.1—The EBRD should continuously strive for legitimacy, credibility and accountability

Outcome 2.1: A transparent, open and merit-based process for the appointment of the President and senior management

Good Progress

The Government of Canada believes that greater transparency is a key component of good governance. While the vast majority of Bank staff are hired through open and competitive processes, Canada has continued to encourage the EBRD to incorporate a transparent, open and merit-based process for the appointment of senior management.

In 2011, all competitions for senior positions were staffed through open, competitive processes, including the Vice President, Risk & Resources. This demonstrates real progress in the staffing of senior management.

2.2—The EBRD should manage its finances prudently and sustainably

Outcome 2.2: Good financial governance and effective use of the Bank's capital are at the centre of the strategy to implement the Bank's CRR4 commitments

Good Progress

Through its participation in the EBRD's Board of Directors, Canada has advocated that the Bank set clear priorities to ensure that its resources are used in the most efficient and effective manner. The 2012 budget was approved in December 2011 by the Board of Directors and was fully consistent with the priorities and financial projections set out in CRR4.

The preliminary financial results for 2011 show a net profit of €173 million. This positive result, while considerably lower than in 2010, comes as the EBRD's region of operations continues to be affected by economic fragility in the European Union (EU) economies. The performance of the Bank's loan assets remains good with a non-performing loan ratio of 2.6 per cent in 2011, down from 2.9 per cent in 2010. Administrative expenditures remained under budget. The EBRD's cost-income ratio remained low at 25 per cent in 2011.

3) Environmental Sustainability and Gender Equality

3.1—The EBRD should mainstream gender considerations across all operations

Outcome 3.1: The ongoing examination of internal Bank practices and policies with respect to improving gender equality

Good Progress

Canada recognizes that gender equality is an important component of the development and transition processes, particularly better leveraging the untapped potential of women in emerging markets. Through consistent policy and project support, Canada has pushed the Bank to demonstrate its commitment to integrate gender equality in its work with countries of operations.

Canada is of the view that good progress has been made in improving gender equality. The 2010 version of this report outlined the extensive measures taken by the EBRD to improve its practices and policies with respect to gender equality. In our view, the Bank's Gender Action Plan has been successfully implemented.

The Bank's efforts to promote gender equality in the marketplace include improving access to finance for women entrepreneurs, helping women-owned and women-managed businesses to increase their capacity for growth, and promoting gender-balanced lending policies in its financial intermediary clients.

Highlights in 2011 include:

- Millennium Bank Romania launched the Women Entrepreneur Initiative with the help of a €20-million credit line from the EU/EBRD SME Finance Facility.
- A program for the financial inclusion of remittance receivers was expanded to Moldova, Armenia, the Kyrgyz Republic and Tajikistan.

- The EBRD partnered with Turkish banks to provide seminars for women entrepreneurs.
- Women in Business programs were launched in Moldova, Bosnia and Herzegovina, Croatia and Serbia.

The EBRD promotes gender equality in the workplace and in the community. For example, in the workplace it promotes equal opportunities for women and men in areas such as recruitment, retention, promotion, wages and work-life balance, and it enhances the role of women on corporate boards.

The way that municipal services are designed and implemented can mean that men and women do not enjoy an equal share of the benefits that these improved services can bring. By understanding better how men's and women's lives differ, and how they use municipal services, we can ensure that the benefits of these services are more equitably shared.

Following the first two municipal and environmental infrastructure gender pilot projects in the areas of urban rehabilitation and urban transport, a guidance note on integrating gender into the project cycle was prepared.

The EBRD worked closely with the Economist Intelligence Unit (EIU) in 2011 to expand and update the Women's Economic Opportunity (WEO) Index, a benchmarking model and index first launched by the World Bank in 2010.

The first WEO Index initially covered 113 countries, including 21 of the EBRD's existing countries of operations as well as the countries of the Southern and Eastern Mediterranean region. In 2010, the EBRD commissioned the EIU to update and expand its research and to include the Bank's remaining 8 countries of operations, providing a complete overview of the Bank's region.

3.2—The EBRD should link private sector development and sustainable environmental considerations in a manner that is consistent with its transition mandate

Outcome 3.2(a): The implementation of the Environmental and Social Policy, the creation of good practice notes for clients, and internal training for Bank staff on the implications of the policy

COMPLETED

The implementation of the Environmental and Social Policy is well underway. For each project proposal that the EBRD undertakes, Bank staff conduct an assessment of potentially adverse future environmental or social impacts. Where there is a significant potential for adverse effects (Category A), the Bank conducts a detailed impact assessment, and makes the report available to the public both in English and in the relevant local language. The EBRD's portfolio included 49 Category A projects at the start of 2011, and 88 per cent of these were considered by the Bank to meet or exceed the EBRD's environmental and social requirements. Across the entire portfolio, 95 per cent of projects have fulfilled environmental and social reporting requirements within the last two years.

The Bank has introduced new training initiatives that include environmental and social components to the compulsory training for new banking staff. In addition, new guidance and learning tools have been made available to all EBRD staff. For instance, new guidelines published in 2010 require that corporate directors nominated by the EBRD receive training on gender and sustainability issues, thereby allowing them to raise these issues on the company boards on which they sit.

The EBRD also works closely with its financial institution (FI) clients to promote environmental and social risk management in the financial sector. In parallel, the Bank places considerable emphasis on capacity building in order to help FIs to understand and meet these standards. The EBRD's consultants completed responsible investment capacity building assignments with 37 financial intermediaries in 2011, reaching 536 professionals in banks and private equity funds in 10 countries of operations.

The Bank's online e-manual on environmental and social risk management was updated again in 2011. Moreover, a new Environmental and Social Issues module under the EBRD's Trade Finance E-Learning Programme was launched in November. This course is the world's first internationally recognized trade finance training module on environmental and social risk management and has received international recognition through formal accreditation by the International Chamber of Commerce.

Canada considers the core elements of this priority to have been met, and will continue to monitor its ongoing implementation.

Outcome 3.2(b): The implementation of the Environmental and Social Policy and Phase 2 of the Sustainable Energy Initiative

COMPLETED

Canada fully supports the EBRD's efforts to ensure that its investment activities are fostering economic growth that is socially and environmentally sustainable. As part of the Bank's progress in this area, the Sustainable Energy Initiative (SEI) was launched in 2006 to address the challenges of energy efficiency and climate change. Phase 1 of the initiative was completed in 2008, and in May 2008 the Board of Governors approved Phase 2 for the period 2009–11.

As illustrated in Table 2, the EBRD met or exceeded its objectives for SEI 2. SEI2 provided €6.1 billion in financing for 298 projects valued at €32.9 billion. About two thirds of the projects were in the private sector. Overall, these investments are anticipated to deliver 25.6 million tonnes of CO_2 reductions per year. In addition, SEI2 provided €108 million in technical assistance funding and mobilized an additional €332 million in investment grant funding.

Table 2
SEI2 Results

	SEI2 Targets	SEI2 Results
Financing	€3 billion-€5 billion	€6.1 billion
Total project value	€9 billion-€15 billion	€32.9 billion
Carbon emission reduction	25-35 million tonnes/year	25.6 million tonnes/year[1]
Technical cooperation funding	€100 million	€108 million
Investment grant funding mobilized	€250 million	€332 million[2]

1 Based on *ex ante* estimates.
2 Includes the Clean Technology Fund allocation.

In our view, Phase 2 of the SEI has been successfully implemented. Phase 3 of the SEI was approved by the Board of Directors in February 2012, and Canada will continue to engage on this initiative as it develops further.

CANADA'S OBJECTIVES FOR 2012

As part of its ongoing leadership and oversight role at the EBRD, Canada supports the Bank in delivering on its core transition mandate as effectively and efficiently as possible. Canada also works to ensure the financial stability of the institution and that it follows through on commitments made as part of CRR4. Whereas previous reports combined Canada's priorities with elements of this oversight role, in the interest of greater accountability this year's report focuses entirely on Canada's priorities for the year ahead. Consequently, this section describes actions the Government of Canada intends to take during 2012 to achieve measurable progress in key areas, above and beyond its engagement in the overall management of the institution. In pursuing these objectives, Canada will engage the EBRD through a number of different channels, including through active coordination with its Executive Director.

1. Support the EBRD's efforts to foster private sector development and inclusive economic growth in the Southern and Eastern Mediterranean (SEMED) region

- Advocate for the appropriate and timely use of Cooperation Funds in the selected SEMED countries.
- Support the implementation of Special Funds and full EBRD lending activities in the SEMED region, once the amendments to the Agreement Establishing the EBRD have been ratified and an assessment of compliance with Article 1's political and economic criteria has been completed.
- Encourage stronger cooperation with other international financial institutions operating in the SEMED region, including by establishing or updating Memoranda of Understanding.

2. Support sustainable transition in the EBRD's countries of operations and the effective and appropriate use of shareholder capital

- Advocate for a larger share of EBRD resources to be dedicated to the countries with the largest transition gaps, including through the graduation of the EU-7 in the medium term, in accordance with CRR4 commitments.
- Encourage EBRD leadership in key areas of the transition process, including:
  - Continued support for countries demonstrating a commitment to multiparty democracy and pluralism.
  - Continued progress in promoting the development of local currency capital markets.
  - Implementing a larger number of projects that support innovation in the real economy.

3. Promote appropriate governance and accountability structures at the EBRD

- Advocate for EBRD leadership positions to be staffed through open, transparent and merit-based selection processes.

BACKGROUND ON THE EBRD

Mandate and Role of the EBRD

The EBRD began its operations in 1991. Its aims are to foster the transition towards open, market-oriented economies in Central and Southeastern Europe, the successor states of the former Soviet Union, Mongolia and Turkey and to promote private and entrepreneurial initiative in those countries that are committed to the fundamental principles of multiparty democracy, pluralism and market economics.[4] Where countries are not committed to these principles, the Bank develops a strategy for limited involvement. To deliver on its mandate, the Bank focuses its activities on assisting its 29 countries of operations in implementing economic reforms, taking into account the particular needs of countries at different stages in the transition process.

The Bank's overriding focus is the private sector, with a strong operational emphasis on enterprise restructuring, including the strengthening of financial institutions, and the development of the infrastructure needed to support the private sector. The EBRD's charter stipulates that not less than 60 per cent of its financing commitments should be directed either to private sector enterprises or to state-owned enterprises implementing a program to achieve private ownership and control. All of its financing projects have to demonstrate environmental sustainability, as per the Bank's Articles of Agreement. The Environmental and Social Policy is reviewed every three years to help ensure the Bank adopts state-of-the-art best practices in all projects.

In promoting economic transition, the Bank acts as a catalyst for increased flows of financing to the private sector, as the capital requirements of these countries cannot be fully met by official multilateral or bilateral sources of financing, and many foreign private investors remain hesitant to invest in the region, particularly the Central Asian republics.

The EBRD's operations to advance the transition to a market economy are guided by four principles: transition impact, additionality, sound banking and environmental sustainability. Financing is provided for projects that expand and improve markets, help to build the institutions that underpin a market economy, and demonstrate and promote market-oriented skills and sound business practices. EBRD financing must also mobilize additional sources of financing and not displace them. Bank projects must be sound from a banking perspective, thus demonstrating to private investors that the region offers attractive returns. Adherence to sound banking principles also ensures the financial viability of the EBRD and hence its attractiveness as a co-investment partner for the private sector. Integrity is another important aspect of the Bank's due diligence in selecting projects.

The Bank's medium-term operational priorities are premised on: the central importance of creating and strengthening those institutions that ensure markets work well; the key role that small businesses can play in creating dynamic, competitive and more equitable economies; and the key role the transition process plays in supporting the principles of multiparty democracy and pluralism.

[4] Article 1 of the Agreement Establishing the European Bank for Reconstruction and Development.

To achieve these priorities the Bank focuses on:

- Developing market-based and commercially oriented infrastructure.
- Developing sound financial sectors linked to the needs of enterprises and households.
- Providing leadership for the development of lending to micro, small and medium-sized enterprises.
- Demonstrating, through selected examples, effective approaches to restructuring viable large enterprises.
- Diversifying the economic base and developing knowledge-based industries.
- Taking an active approach in its equity investments to improve corporate governance.
- Engaging governments in policy dialogue to strengthen institutions and improve the investment climate.
- Tackling energy efficiency, climate change and energy security.
- Promoting transparency and accountability in public sector management.
- Taking a regional approach where appropriate.
- Promoting sustainable development and environmental due diligence.

The EBRD differs from other regional development banks in several ways:

- The Bank's overriding focus is on the private sector. Its charter stipulates that at least 60 per cent of its financing commitments, on both a portfolio-wide and country basis, should be directed either to private sector enterprises or to state-owned enterprises that are being privatized.
- The Bank's mandate gives it an explicit focus on the promotion of democratic institutions in its countries of operations. The EBRD is the only international financial institution with this charter requirement.
- The EBRD does not provide concessional financing and poverty reduction is not specifically part of its mandate, although development of the private sector in its countries of operations should lead to increased employment and thus help reduce poverty. The Bank's work in financing micro, small and medium-sized enterprises is important in this regard, as is the work on gender equality.

How the EBRD Works

Project Finance

The EBRD offers a full array of financial products and services, including:

- Longer-term loans.
- Equity investments.
- Quasi-equity instruments (subordinated loans, preferred stock, income notes).
- Guarantees and standby financing.
- Working capital and trade finance facilities.
- Risk management (intermediation of currency and interest rate swaps, provision of hedging facilities).

Eligibility

Eligible projects must be supported by a strong business case, benefit the economy and the transition process of the host country, and comply with the EBRD's environmental guidelines. Projects in all industries are eligible for EBRD financing, except those producing military equipment, tobacco and distilled alcohol. Although it is primarily a financier of private sector projects, the Bank may provide financing to state-owned companies, provided they are operating competitively and, in particular, that such financing facilitates or enhances the participation of private and/or foreign capital in such enterprises. The EBRD can finance private companies that are wholly locally owned or foreign owned, as well as joint ventures between foreign and local shareholders.

In order to ensure the participation of investors and lenders from the private sector, the EBRD generally limits the total amount of debt and equity financing for any single project to 30 per cent of total estimated project costs. However, in certain circumstances, and particularly in the current environment, where the syndications market is closed to most of the Bank's clients, the Bank provides a larger share of the project costs. In rare cases, such as when a project is in corporate recovery, the Bank may become the largest shareholder in order to turn the company around and sell it.

Smaller projects are financed both directly by the EBRD and through local financial intermediaries. By supporting local commercial banks, micro-finance organizations, equity funds and leasing facilities, the EBRD has helped finance over 1 million smaller projects.

Fees

The EBRD charges market rates for its private sector financing and provides uniform loan pricing for sovereigns of LIBOR (London Interbank Offered Rate) +100 basis points. In addition, fees vary according to the nature of the project and the amount and complexity of the work required of the EBRD.

Funding of EBRD Activities

The EBRD's equity and quasi-equity investments are funded out of its net worth—the total of paid-in capital and retained earnings. Of the funding required for its lending operations, 100 per cent is borrowed in the international financial markets through public bond issues or private placements.

The EBRD's bond issues have been given AAA ratings by both Moody's Investors Service and Standard & Poor's.

Policy Dialogue

The Bank uses its close relationship with governments in the region to promote policies that bolster the business environment. The EBRD advises governments on promoting a sound investment climate and stronger institutional framework, which are important for the functioning of the private sector. This dialogue is typically supportive of projects in which the Bank invests. Specifically, the EBRD works with government officials to promote sound corporate governance, anti-corruption practices, fair and predictable taxation policies and transparent accounting standards. In addition, a dedicated legal team advocates for an effective legal and regulatory framework which is not directly tied to a project.

Technical Cooperation

Technical cooperation improves the preparation and implementation of the EBRD's investment projects and provides advisory services to private and public sector clients. It increases the impact of EBRD projects on the transition process by supporting structural and institutional changes, and it assists legal and regulatory reform, institution building, company management and training. Technical cooperation is important to the Bank as it allows thorough preparations for investments, more effective investments in general and investment opportunities in higher-risk environments in particular.

Technical cooperation projects are funded by governments and international institutions and are managed by the EBRD.

EBRD Governance and Oversight

The highest authority in the Bank is the Board of Governors. It meets annually and approves the institution's annual report, net income allocation and financial statements, the independent auditor's report, the election of the Chair and Vice-Chair for the next Annual Meeting, as well as other items requiring Governors' approval. A Governor and an Alternate Governor represent each of the 65 shareholders.

The Board of Directors is responsible for the general operations of the Bank. It is composed of 23 members, with each representing either one member country or a constituency of member countries. The Board helps to set the strategic and financial course for the Bank, in consultation with management.

Board Committees

The Board has established four committees that are responsible for overseeing the activities of the Bank: the Board Steering Group, the Audit Committee, the Budget and Administrative Affairs Committee, and the Financial and Operations Policies Committee. This division of labour is consistent with good corporate governance practices and provides an appropriate system of checks, balances and incentives. In addition, the structure ensures a more effective discussion by the Board, once initiatives are ready for approval.

The Board Steering Group is responsible for the coordination of the Committees' work programs to avoid overlap and ensure timely completion. In addition to some administrative duties, the Chair of the Group is the main liaison between the Board and management. The Group is currently chaired by the Canadian Director.

The Audit Committee's primary objective is to ensure that the financial information reported by the Bank is complete, accurate, relevant and timely. The Committee oversees the integrity of the Bank's financial statements and the compliance of its accounting and reporting policies with the requirements set out in the International Financial Reporting System. It also reviews the EBRD's system of internal controls and its implementation, as well as the functions of the internal audit, evaluation and risk management teams. The Committee is currently chaired by the Swiss Director.

The Budget and Administrative Affairs Committee is responsible for ensuring that the Bank's budgetary, staff and administrative resources are aligned with its strategic priorities. To this end, the Committee reviews the medium-term resource framework, annual budgets and the business plan. It also oversees the Bank's human resources policies, including ethics and the Code of Conduct. The Committee is currently chaired by the Turkish Director. The Canadian Director is currently a member of the Committee.

The Financial and Operations Policies Committee oversees the Bank's financial and operational policies, including the annual borrowing plan prepared by the Treasury Department. The Committee is responsible for the transparency and accountability of the Bank's operations, as laid out in the 2006 Public Information Policy. Since 2007, the Committee has also been charged with overseeing the net income allocation process. As well, it is responsible for the renewal of the Bank's Environmental and Social Policy. The Committee is currently chaired by the U.K. Director.

For More Information on the EBRD

The Bank releases considerable information on its various activities. Bank publications include information guides (such as *A Guide to EBRD Financing*), evaluation reports, special reports (such as the *Annual Report* and *Transition Report*), country strategies and assorted fact sheets.

Information can also be obtained on the Bank's website (www.ebrd.com).

Requests for information can be addressed to:

Publications Desk
European Bank for Reconstruction and Development
One Exchange Square
London, EC2A 2JN
United Kingdom

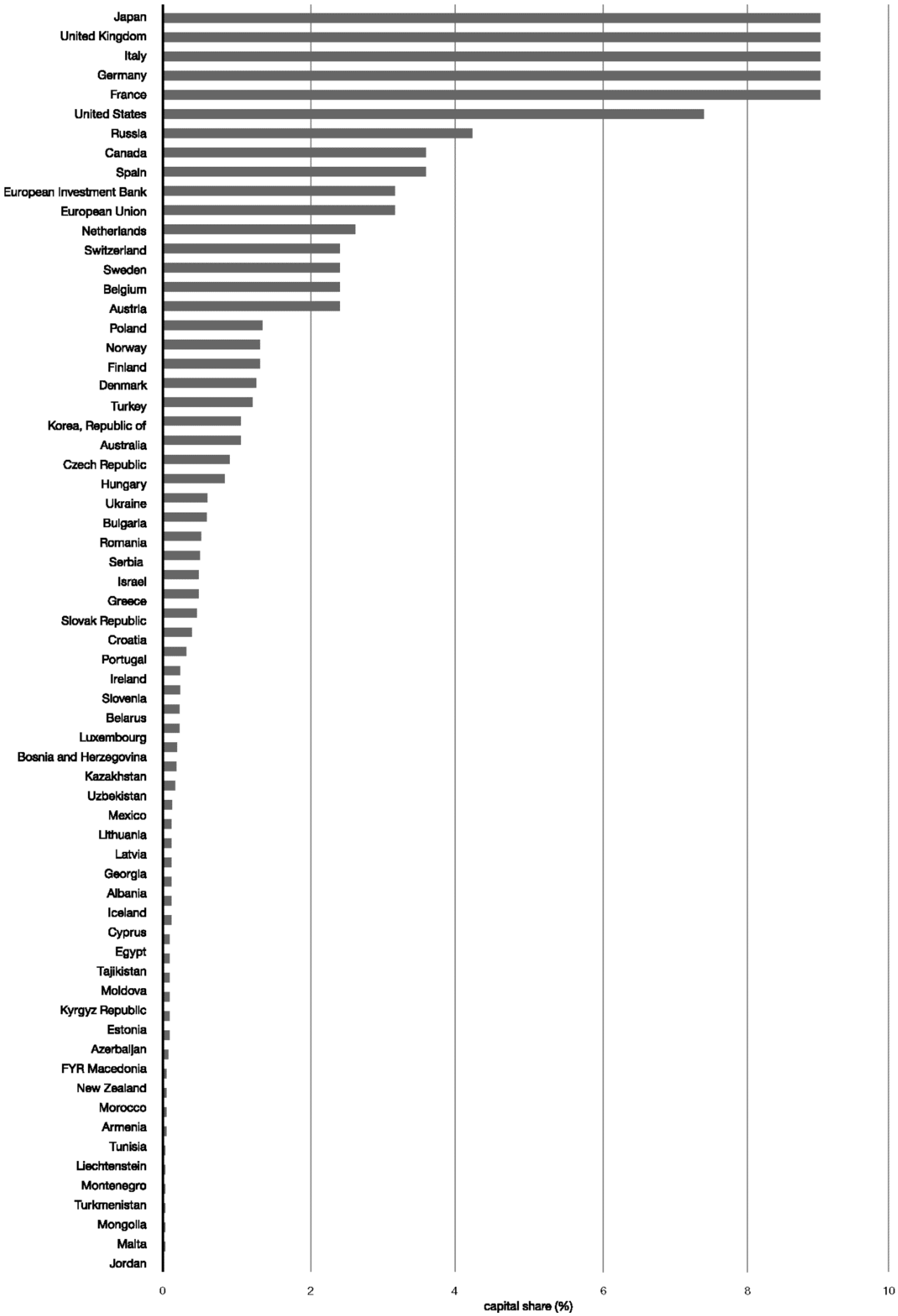
Or to: Office of the Director for Canada and Morocco
canadaoffice@ebrd.com

ANNEX 1—EBRD MEMBERSHIP

The EBRD's share capital is provided by member countries, with proportional voting rights. As a result of the capital increase that took effect on April 20, 2011, the EBRD's authorized capital increased to €30 billion, or 30,000,000 shares valued at €10,000 each. At the end of 2011 there remained 1,638,420 unallocated shares, meaning that some members had not yet subscribed to their portion of the increase. Until these shares are allocated, the shareholding of members who have subscribed will be slightly higher than usual, and vice versa. Chart 1 provides shareholdings as at December 31, 2011.

Chart 1

EBRD Membership



ANNEX 2—COUNTRIES OF OPERATIONS

The EBRD has 65 shareholders: 63 countries, the European Community and the European Investment Bank. There were 29 countries of operations in 2011.

Central Europe and the Baltic states
01 Croatia
02 Czech Republic
03 Estonia
04 Hungary
05 Latvia
06 Lithuania
07 Poland
08 Slovak Republic
09 Slovenia

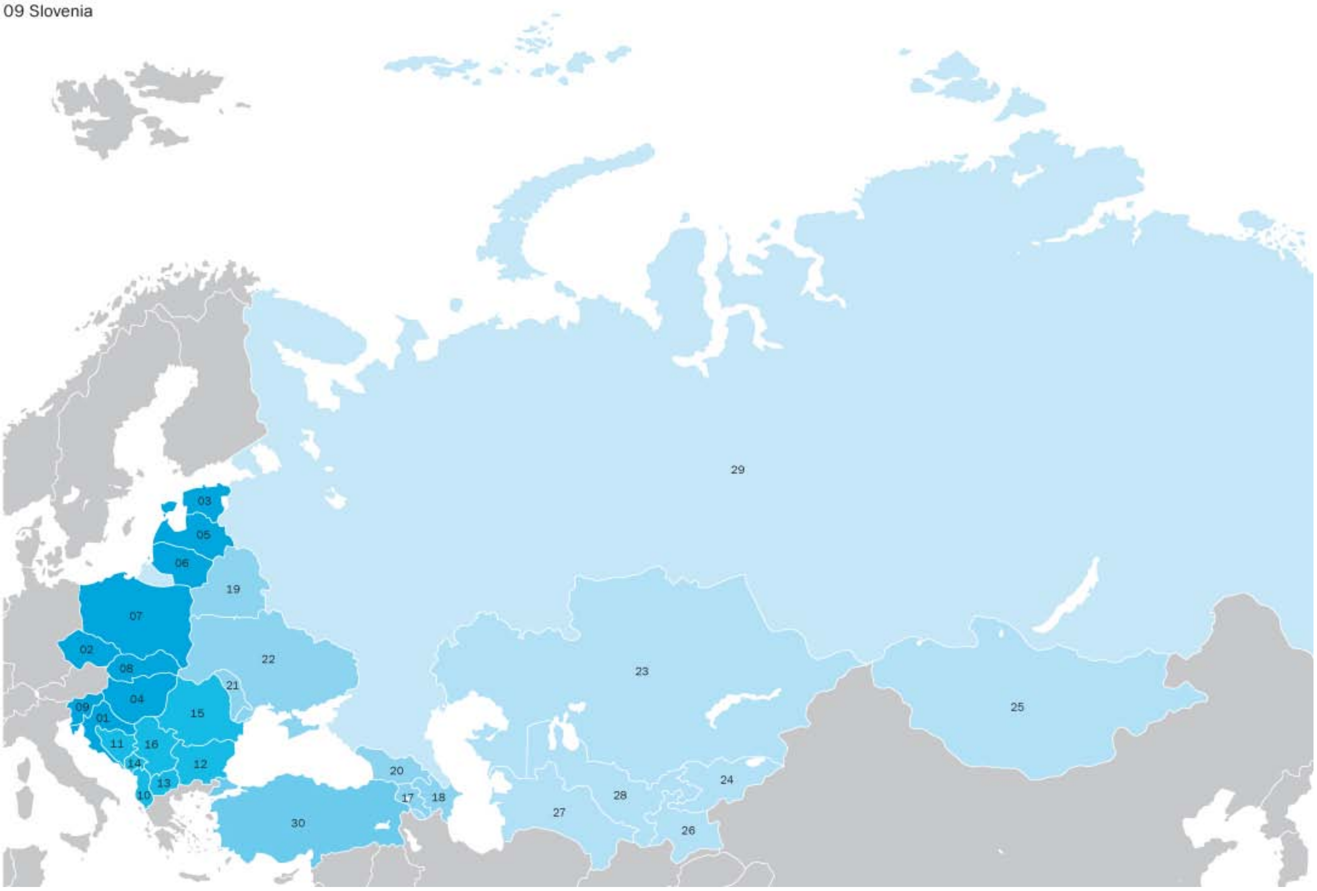
South-eastern Europe
10 Albania
11 Bosnia and Herzegovina
12 Bulgaria
13 FYR Macedonia
14 Montenegro
15 Romania
16 Serbia

Eastern Europe and the Caucasus
17 Armenia
18 Azerbaijan
19 Belarus
20 Georgia
21 Moldova
22 Ukraine

Central Asia
23 Kazakhstan
24 Kyrgyz Republic
25 Mongolia
26 Tajikistan
27 Turkmenistan
28 Uzbekistan

29 **Russia**

30 **Turkey**



Note: As of the end of 2007, the EBRD no longer makes investments in the Czech Republic.
Source: EBRD.

ANNEX 3—2011 GOVERNOR'S SPEECH

Statement Tabled by Rob Stewart, Temporary Alternate Governor for Canada, at the EBRD Annual Meeting

Astana, Kazakhstan, May 21, 2011

Canada would like to thank the Government of Kazakhstan and the City of Astana for graciously hosting the 20th Annual Meeting of the European Bank for Reconstruction and Development.

As a founding member of the EBRD, Canada is a proud partner of this institution and believes strongly in the Bank's core mission to foster the transition towards market-oriented economies and to invest in countries that are committed to economic and democratic reforms.

The EBRD's countries of operations were among those that were the hardest hit by the recent financial crisis. Over the past year, however, signs of recovery began to appear. Although the situation differs from country to country, these early signs of improvement are encouraging.

The EBRD itself had a remarkably successful year in 2010. In addition to increasing its annual business volume to record levels, the Bank returned to profitability with a net gain in excess of €1 billion. This positive performance took place despite what was a very challenging investment climate.

Canada is also pleased to see that the Bank continues to work to ensure that growth is sustainable in the long run. For instance, investments under the EBRD's Sustainable Energy Initiative increased to nearly a quarter of total Bank financing.

However, the legacy of the crisis continues to weigh heavily on the region and significant challenges remain. It will therefore be important for countries in the region to apply sound fiscal and monetary policies in order to foster economic growth and generate employment opportunities. For some this includes greater fiscal consolidation and taking steps to reduce reliance on foreign currency funding.

While the fallout from the crisis has also affected the speed of reform in the region, we are encouraged that it has not led to any strong backlash to the core principles of the EBRD of open and market-oriented economies supported by strong institutions and robust supervision. We are confident that the EBRD will continue to play a valuable role in ensuring that the region returns to strong, sustainable economic growth.

Looking Ahead

Events over the past few months have once again reinforced the importance of the core elements of the EBRD's mandate. Making the transition to a market-oriented and democratic society is an objective shared by the people of many countries, not simply those in the EBRD's current countries of operations.

It is for that reason that we support the work to build consensus around amending the Agreement Establishing the Bank in order to extend the EBRD's operations into the Middle East and North Africa region, provided that any expansion is conducted in a manner consistent with the Bank's current capitalization and mandate to foster economic transition and democracy.

To manage its broader geographic mandate, the Bank should continue to focus on its core competencies: targeting the private sector through project-based investments which are guided by the four principles of transition impact, additionality, sound banking, and environmental sustainability. It will be equally important to follow through on the commitments made as part of the CRR4. Even as the Bank's lending volume reaches record levels, Canada encourages the Bank to remain disciplined and selective in the use of its capital, and support activities with a strong transition impact.

As the Bank's shareholders discuss expanding operations on to new continents, it will be important to recognize and follow through on the EBRD's successes in its current region of operations. Canada therefore encourages the Bank to explore ways to ensure the graduation of EU-7 countries from the EBRD's regular operations by 2015.

We encourage the Bank to continue its collaboration with other international financial institutions. By focusing on its core competencies and identifying its areas of strengths, the EBRD can coordinate its work with other institutions to minimize overlap and make the most efficient use of shareholders' capital.

The financial crisis has highlighted the importance of greater use of local currency in financial transactions and the development of local capital markets, both to reduce unhedged foreign currency borrowing and to encourage domestic savings. We therefore applaud the Bank's efforts to work with stakeholders including regulators and central bankers, other IFIs and private sector players to develop and deepen local capital markets.

In closing, I would like to thank President Mirow, all EBRD staff and management, and the Board of Directors for a remarkable year of achievement.

As a fragile global recovery takes hold, it is important that the EBRD continue to play a central role in its countries of operations. As we look to review the Bank's possible role in the MENA region, Canada looks forward to working with the EBRD and its shareholders to agree on measures that will create a strong and sustainable future for the transition mandate of the Bank. The Bank can continue to count on Canada's support for its mission in the years to come.

ANNEX 4—SUMMARY OF *TRANSITION REPORT 2011: CRISIS AND TRANSITION: THE PEOPLE'S PERSPECTIVE*

The *Transition Report* is an annual report published by the EBRD on the state of economic, political and social developments taking place in the EBRD's region of operations. In addition to providing an overview of the region's difficult path to recovery from the recent economic crisis, this year's report, entitled *Crisis and Transition: The People's Perspective*, analyzes the results from the second Life in Transition Survey (LiTS II), conducted jointly by the EBRD and World Bank in early 2010. LiTS II attempts to capture the changes in people's attitudes towards democracy and market economics that have occurred since the original LiTS was completed in 2006, a period that includes the recent crisis.

The following is a brief overview of the 2011 *Transition Report*. The full report is available on the EBRD's website (www.ebrd.com/pages/research/publications/flagships/transition.shtml).

A Fragile Recovery

The past year represented a period of economic consolidation for the transition region, with growth resuming in almost every country by the summer of 2011. The economic expansion was driven by strong performance in core euro-area economies (a major export market for the transition region), as well as by high commodity prices. Many transition countries have reached or surpassed pre-crisis output levels, but the economic recovery has been slower than that of other emerging markets in Latin America and Asia.

Economic expansion has led to an increase in core inflation—partly due to the looser monetary policies adopted by the countries in the region—but has not yet reduced unemployment to a significant degree. Whereas a somewhat rigid regional labour market cushioned the blow to employment during the crisis, it now appears to be holding back the recovery.

Similarly mixed progress is being made in capital markets: while there has been positive foreign direct investment (FDI) to much of the region since mid-2010, it remains well below pre-crisis levels, particularly in countries where pre-crisis investments predominantly targeted financial intermediation. Non-FDI flows have been slow to recover, as has private sector credit growth.

The higher and more volatile food prices seen in 2011 also pose a challenge to the region. According to the EBRD, it does not appear that the region's central banks have the tools to handle the impact of such price fluctuations, and certain domestic policy responses aimed at protecting domestic food prices (temporary export grain bans, for example) may have made global food price volatility worse. Transparent and predictable policies would be better suited to increasing investment and providing long-term solutions in this area.

There remain a number of risks to the economic recovery of the region. Fiscal deficits and public debt increased significantly during the financial crisis, leaving public sectors more vulnerable to a downturn. Moreover, due largely to financial market volatility and the uncertain economic prospects of the euro area, the outlook for regional growth worsened significantly near the end of the year. The region is heavily exposed to and dependent upon the euro-area economy, a significant export market, source of FDI and other financing, as well as a key player in the banking systems in emerging Europe.

Overall, assuming a gradual but eventual containment of the euro area's current problems, the EBRD predicts that the region as a whole expanded by about 4.5 per cent in 2011 and will expand by 3.2 per cent in 2012.

Progress in Transition

Each year the EBRD reports on progress being made in transition by evaluating sectors in each of its countries of operations on a scale of 1 to 4+. The EBRD looks at 16 sectors in four categories: corporate, energy, infrastructure and financial. At the national level, countries are evaluated on 6 sectors within two categories: enterprises, and markets and trade.

At the sectoral level, the scores are broadly the same as last year, with the gaps between sectors and regions remaining largely unchanged. Of the four categories, infrastructure saw the most upgrades due to significant progress in the roads, water and wastewater sectors. Other sectors saw only isolated changes. At the country level, a significant number of countries have been upgraded for competition policy. This is due to an increase in the implementation and enforcement of anti-monopoly and anti-cartel laws in Central Europe and the Baltics, Southeastern Europe, Russia and Turkey.

Several others countries have shown a reversal in the areas of price liberalization (Armenia, Belarus and Kazakhstan) as well as trade and foreign exchange systems (Belarus and Uzbekistan). Further details are provided in the 2011 *Transition Report*.

The Crisis from a Household Perspective

The 2011 *Transition Report* looks at the impact of the economic crisis on people and compares it to the experience of those living in Western European countries.

As a whole, the transition region was harder hit than Western Europe, with the Baltic region and Southeastern Europe suffering the most. The crisis led to a large reduction in consumption, particularly essentials such as staple foods and health expenditures.

Employment, wages and remittances all fell in the transition region during the crisis. Official safety nets were not very effective, with unemployment and housing benefits largely failing to mitigate the effects of the decline in consumption. Interestingly, access to formal sources of borrowing helped to soften the impact of the crisis, but pre-crisis borrowing left some households across the transition region in a vulnerable situation. This speaks to the somewhat ambivalent role of access to finance in helping the region deal with the crisis.

By contrast, Western European countries saw a greater reduction in hours worked, rather than job losses, and official safety nets played a much more influential role in mitigating the impact of the crisis.

Support for Markets and Democracy after the crisis

As noted above, the LiTS is a combined household and values survey that was undertaken for a second time in 2010. Judging from the changes in responses to the LiTS from 2006 to 2010, the financial crisis had a significant impact on support for markets and democracy in the transition region. The impact was not uniform, however. Support declined in many of the more advanced transition countries—including all the new EU members except Bulgaria—but increased in countries that are not as far along the transition path, such as those in Central Asia.

The *Transition Report* finds evidence in support of three theories that help to explain this discrepancy. The first is that the more people were personally hit by the crisis, the more they turned against democracy and free markets. Indeed, the more advanced transition countries suffered more than other members during the crisis. Also, interviewees who had experienced a more severe economic event in the recent past (more common in non-EU countries) were less likely to have their support for democracy and markets swayed by the recent crisis.

However, neither of these findings explain why support for markets and democracy increased in a large number of countries. The third part of the explanation is that people appear to "turn against the status quo" during a period of economic crisis. Those who lived in freer societies were therefore less favourable to democracy and markets following the crisis, whereas those living in more authoritarian environments became stronger supporters of freer systems after the crisis had hit them. This latter effect was magnified in countries with both limited freedom and high levels of corruption.

The LiTS finds that this reaction against the status quo can be mitigated to a certain extent by access to benefit programs. While no benefit program had a significant direct impact on attitudes to political and economic systems, those interviewees in new EU countries who received social assistance generally increased their preferences for markets and democracy. This suggests that safety nets can help governments maintain support for the existing political and economic systems. It is important to note that this phenomenon was observed in less-free countries as well; even in countries with less political and economic freedom, authorities can—to a certain extent—buy support for the existing system.

Overall, these results suggest that benefit programs can play a role in mitigating the impact of an economic downturn on people's attitudes towards markets and democracy.

Entrepreneurship in the Transition Region

The EBRD also used the LiTS to look at entrepreneurship in the transition region, given that entrepreneurship is an important ingredient in structural change, particularly in economies in the early stages of transition—new businesses create new industries and revitalize old ones, providing an important source of new jobs and sustainable growth.

In brief, their findings suggest that the development of the financial sector and access to credit are important drivers of entrepreneurial success. This should therefore rank highly on the public policy agenda. Looking at entrepreneurship from an individual perspective, there is evidence that more education is associated with a higher propensity to start a business, though not necessarily with success. The survey also shows that women are less likely to try to start a business, but no less successful if they do try. These results point towards greater support for women as a possible way to stimulate entrepreneurship in the transition region.

See the 2011 *Transition Report* for a country-by-country analysis of the EBRD's countries of operations.

ANNEX 5—CIDA PROGRAMMING IN EBRD COUNTRIES OF OPERATIONS

In order to increase the effectiveness of its programming, the Canadian International Development Agency (CIDA) is focusing its efforts on a limited number of countries. In the EBRD region, efforts are therefore concentrated in Ukraine, which is one of CIDA's 20 countries of focus. CIDA also has limited bilateral programming in the Balkans (Bosnia and Herzegovina, Serbia, Montenegro and Albania), Tajikistan and Russia, mainly through the Canada Fund for Local Initiatives (CFLI). Responsibility for the CFLI will transfer from CIDA to Foreign Affairs and International Trade Canada effective April 1, 2012.

Other EBRD countries of operations can benefit from CIDA support through multilateral funds, such as the Global Fund to Fight AIDS, Tuberculosis and Malaria, and through contributions to Canadian and international civil society partners, which are mostly engaged in support of governance and human rights. For instance, CIDA currently supports the training of citizens and capacity development of institutions in EBRD countries on issues such as human rights (Equitas, Disabled Peoples' International) and anti-corruption (the U4 Anti-Corruption Resource Centre, Transparency International). Since 2009, CIDA has provided $2,942,577 in support to CANADEM for the deployment of 353 Canadian observers who joined Organization for Security and Co-operation in Europe election observation missions in Ukraine, Tajikistan, Kyrgyzstan, Belarus, Russia and Kazakhstan.

The highlights of CIDA's programming in EBRD countries of operations can be found below.

Ukraine—Since 1991, Canada has contributed more than $383 million in bilateral official development assistance. The goal of CIDA's bilateral Ukraine Program is to improve economic opportunities for Ukrainians in a strengthened democracy. Current programming builds on past efforts and focuses on Ukraine's sustainable economic growth. This is being pursued through improvements to the business-enabling environment and by promoting entrepreneurship to increase the competitiveness of small and medium-sized enterprises, especially agricultural producers, in domestic and international markets. To accelerate economic development, CIDA will also be focusing on rule of law and improving accountability of public institutions.

Europe Regional Program—The Europe Regional Program, which will end in December 2012, was established in 2007 to further refine CIDA's interventions, address ongoing transboundary issues in the region and meet the specific needs of the South Caucasus. Canada's twin objectives of democratic and economic reform have guided CIDA's programming direction. CIDA has supported initiatives aimed at facilitating the transition to a free market economy through the EBRD.