Parliamentary Assembly
Assemblée parlementaire
https://pace.coe.int

COUNCIL OF EUROPE
CONSEIL DE L'EUROPE

Doc. 13089
07 January 2013

The activities of the European Bank for Reconstruction and Development (EBRD) in 2010-2012

Report[1]
Committee on Political Affairs and Democracy
Rapporteur: Mr Tuur ELZINGA, Netherlands, Group of the Unified European Left

Summary

The Parliamentary Assembly is once again considering the activities of the European Bank for Reconstruction and Development (EBRD). The Assembly has sought to make the debate more focused on a political assessment of the work of the Bank.

This year the Committee on Political Affairs and Democracy is therefore presenting a report which gives particular attention to the new methodology adopted by the EBRD to assess the compliance of its countries of operations with the political aspects of the Bank's mandate, notably on the basis of four criteria: representative and accountable government; civil society, media and participation; rule of law and access to justice; and civil and political rights.

The Assembly should show its readiness to co-operate with the Bank in making and monitoring its assessments.

1. Reference to committee: Reference 3846 of 9 March 2012.

Contents **Page**

A. Draft resolution 3
B. Explanatory memorandum by Mr Elzinga, rapporteur 5
1. Introduction 5
2. Background 6
3. Economic and political developments between 2010 and 2012 7
3.1. The unfolding of the second wave of the economic crisis 7
3.2. Economic highlights in eastern European countries from 2010 to 2012 7
3.3. The political consequences of the crisis: pace of reform and democratisation 9
4. The response of the EBRD: facing the challenges 10
4.1. More resources and new facilities 10
4.2. A new perspective on institutions and transition 11
5. Special issues in the EBRD's activities 12
5.1. The extension of EBRD operations to the SEMED 12
5.2. The food crisis and the EBRD investment in agribusiness 14
6. Conclusions 15

A. Draft resolution[2]

1. The Parliamentary Assembly has reviewed the activities of the European Bank for Reconstruction and Development (EBRD) in the period 2010-2012 in the light of the reports by the Bank and the report prepared by the Committee on Political Affairs and Democracy. Following the reform of the Assembly's structures and working methods, which took effect in January 2012, the Assembly has sought to make the debate more political and to focus more on a political assessment of the work of the Bank and not so much on its actual activities as in the past.

2. The Assembly recalls that the Agreement Establishing the European Bank for Reconstruction and Development includes a significant political element, in that it specifies that the Bank may conduct its operations in countries of central and eastern Europe which are not only proceeding in their transition towards market-oriented economies, but are also committed to and applying principles of multiparty democracy and pluralism.

3. According to the preamble to the Agreement, the successful transition of member countries to market-oriented economies is closely linked to parallel progress towards democracy and the rule of law. Thus, the political aspect of the Bank's mandate extends to all elements of the Bank's objectives and should be monitored and encouraged by the Bank as part of the process of assisting the transition to market economies of its countries of operations.

4. In the co-operation agreement concluded between the Council of Europe and the EBRD in 1992, the two organisations agreed to exchange information, particularly regarding the monitoring and assessment of the development of democracy in central and eastern Europe. By debating the activities of the EBRD, the Assembly provides a parliamentary oversight of the Bank's operations.

5. The time period covered by the current overview of the activities of the EBRD (2010-2012) has witnessed a second wave of the current financial and economic crisis which has hit hard especially in Europe: a sovereign debt crisis in a number of European States and a related trust crisis in the single currency of the eurozone. In an attempt to restore confidence of financial markets in the economic fundamentals of the countries affected, austerity programmes have been implemented throughout the review period and the ensuing economic slowdown in the euro area, and western Europe in general, has had a negative impact on the countries of the transition region. The EBRD has significantly scaled up its operations to support crisis response and recovery in its countries of operations.

6. The Assembly welcomes the new methodology developed by the EBRD to evaluate the transition impact of its projects in the countries of reference, namely the transition scoreboard presented in the EBRD 2010 Transition Report. It notes with regret, however, that the methodology of the scoreboard is still limited, as it does not include progress towards democracy and the rule of law.

7. It notes with interest the new Memorandum of Understanding signed by the Bank with the European Commission and the European Investment Bank (EIB) in 2011, designed to achieve closer co-operation between the signatories. A recent example of such co-operation was the establishment of the Western Balkan Enterprise Development and Innovation Facility, which could have a beneficial impact on the entire region. Another example is the joint Action Plan of 2009-10, where the EBRD and the EIB worked very closely to support banks and credit to the real economy in central and eastern Europe; a new joint Action Plan has been recently announced by the EBRD, the EIB, and the World Bank, covering 2013-14 and pledging 30 billion euros to support economic recovery and growth in central and south-eastern Europe.

8. The Assembly also welcomes the extension, further to the 2011 Deauville Declaration, of the geographic scope of the EBRD's mandate, in order to support the transition in those countries of the south and east of the Mediterranean (the SEMED countries) which embrace multiparty democracy, pluralism and market economics; it notes that operations started in Egypt, Jordan, Morocco and Tunisia in the second half of 2012, through the use of a special fund. Full country of operations status requires the ratification of the amendments to Article 1 of the Bank's statute. This is expected to be achieved in the first half of 2013.

9. The situation in these countries is, however, quite different from that of central and eastern Europe twenty years ago, and so is the global economic context. This should be taken into account. It is therefore of the utmost importance to interact and co-operate with civil society organisations and social partners in order to shape transition policy in a way that is broadly supported, promotes the creation of wealth and social stability and does not cause social injustice. Furthermore, it is important to develop synergy in the wider European

2. Draft resolution adopted unanimously by the committee on 14 December 2012.

efforts to support the emerging democracies in the Arab world. The EBRD should thus step up co-ordination with the Assembly (taking into account its partner for democracy status), the European Commission for Democracy through Law (Venice Commission), but also with other relevant bodies.

10. The Assembly welcomes the recent revision and updating by the EBRD of the methodology to assess the compliance of its countries of operations with the political aspects of the Bank's mandate, notably on the basis of four criteria: representative and accountable government; civil society, media and participation; rule of law and access to justice; and civil and political rights.

11. It looks forward to the effective implementation of this new methodology and encourages the EBRD to strengthen its co-operation with the Council of Europe – and in particular with the Assembly – in making and monitoring its assessments.

B. Explanatory memorandum by Mr Elzinga, rapporteur

1. Introduction

1. In June 2011, the Parliamentary Assembly decided on certain reforms of its structures and a new division of labour. The new terms of reference of the Committee on Political Affairs and Democracy state that "the committee shall prepare reports on the activities of the Organisation for Economic Co-operation and Development (OECD) and the European Bank for Reconstruction and Development (EBRD). For the preparation of the reports and the debates in the Assembly, the committee maintains relations with the OECD and the EBRD …".

2. Before the reforms, it was the Committee on Economic Affairs and Development which had the task of preparing these reports on an annual, and then biennial, basis. I was appointed rapporteur for that committee and kept that function within the Committee on Political Affairs and Democracy. An outline for a report had been prepared in November 2011. However, given the workload of this committee, it was not feasible to prepare the report for an Assembly debate in 2012 and I agreed to have it debated in 2013. As in the past, the Assembly debate should follow a presentation by the President of the EBRD.

3. In the debate on the reform of the Assembly, some members of the Committee on Economic Affairs and Development proposed that the reports on the activities of the OECD and of EBRD should be prepared by the Committee on Social Affairs, Health and Sustainable Development (which inherited other competencies of that committee) and not by the Committee on Political Affairs and Democracy, to which Mr Walter replied: "The logic in putting this with the Political Affairs Committee is that the work of these two institutions is basically political. It is the scrutiny of these institutions that we are talking about … and this fits very logically with the Political Affairs Committee."

4. Within the framework of preparations for my report, I attended the EBRD Annual Meeting and Business Forum on 18 and 19 May 2012 in London. I attended, in particular, sessions of the Bank's Board of Governors, the discussion panel on "Transition under pressure: change in the face of economic turbulence" and several networking activities. I also had exchanges of views with Mr Oleg Levitin and Mr Stefano Bertozzi, EBRD staff members, and with several representatives of civil society. In this context, I also wish to thank Mr Luca Marcolin,[3] who assisted me in the preparation of the more technical aspects of this report.

5. The EBRD Board of Governors elected Sir Suma Chakrabarti, a British senior civil servant, as the new President of the Bank, who succeeds Mr Thomas Mirow. One of the issues most discussed was the extension of the Bank's activities to the Southern and Eastern Mediterranean (SEMED) following the Arab Spring. Egypt, Jordan, Morocco and Tunisia are already shareholders of the EBRD.

6. As was pointed out by the EBRD's Chief economist in one of the discussion panels, the EBRD is the only financial institution with democracy in its mandate. Indeed, Article 1 of the Agreement Establishing the Bank states that the EBRD seeks to assist only those countries that are "committed to and applying the principles of multi-party democracy [and] pluralism". It is therefore surprising to find countries such as Belarus or Turkmenistan among the Bank's countries of operations. On the other hand, it does not seem necessary for a country to be democratic to become a shareholder of the EBRD, which explains why Egypt and Morocco could be among the founding countries of the Bank in 1991.

7. On 5 September 2012, an Ad hoc Sub-Committee on Relations with the European Bank for Reconstruction and Development (EBRD) (of the Committee on Political Affairs and Democracy) met in London at the EBRD headquarters, where it exchanged views with: Sir Suma Chakrabarti, President of the EBRD, on the strategic vision of the EBRD; Ms Piroska Nagy, Office of the Chief Economist of the EBRD, on global economic trends and the impact of the situation in the eurozone on the countries of operations; Mr Hans Peter Lankes, Managing Director, Institutional strategy, and Acting Vice-President of the EBRD, Operational Polices, on EBRD's expansion to the Southern and Eastern Mediterranean (SEMED); Mr Joseph Eichenberger, Chief Evaluator of the EBRD, on evaluating the progress and impact of the EBRD's projects; and Mr Joachim Schwarzer, Vice-Chairperson of the Steering Group of the Board of the EBRD, on the role of the Board of Directors of the EBRD in the governance of the institution.

8. The President of the Bank confirmed the importance of co-operation with the Parliamentary Assembly and agreed to take part in the Assembly debate on the activities of the EBRD during the January 2013 part-session.

---

3. Luca Marcolin is a research assistant at VIVES – Flemish Institute for Economics and Society, Catholic University of Leuven, Belgium.

2. Background

9. The Council of Europe and the EBRD signed a co-operation agreement in 1992, whereby the two organisations agreed to exchange information, particularly regarding the monitoring and assessment of the development of democracy in central and eastern Europe. Since then, the Parliamentary Assembly has provided a forum enabling parliamentarians from different European countries to monitor the activities of the Bank in support of transition to market economy, democracy and the rule of law.

10. The EBRD has 65 shareholders, split between 63 countries and two European institutions (the European Union and the European Investment Bank). It is the largest single investor in the transition region covering central and eastern Europe and central Asia, officially operating in 29 countries in September 2012. Four additional countries (Egypt, Jordan, Morocco and Tunisia) are soon to become countries of operations, although technical co-operation already began in 2012. While Egypt and Morocco were among the founding countries of the Bank in 1991, Jordan and Tunisia requested and obtained access to the Bank's ownership only in 2011. On 16 November 2012, it was announced that Kosovo[4] was to become a member of the EBRD as a recipient country.

11. Over the last twenty years, the EBRD's mission in central and eastern Europe has largely been accomplished, the region having made a more or less successful transition towards a multi-party democracy and a market-based economy, in which the activities and technical co-operation of the EBRD have played a substantial role. In response to the accomplishments in eastern Europe and central Asia, the Bank is developing "graduation" and "post-graduation" policies to phase out its operations in countries that are furthest advanced in this transition. According to the Bank's Third Capital Resources Review medium-term strategy,[5] the eight countries which joined the European Union in May 2004 were expected to graduate by 2010. This, in turn, fuelled the discussion over the long-term appeal of the Bank's operations. Events between 2008 and 2012 halted the discussion: the economic crisis strongly affected the economies of the transition region, restricting the availability of funding for private investments, reducing trade and growth, and pushing up unemployment. Of the eight countries mentioned above, only the Czech Republic graduated in 2007, while in the remaining seven the Bank has stepped up its support to minimise the impact of the economic crisis. The deadline for graduation was postponed to 2015, and the Bank has maintained a central role in promoting the private sector in the transition region.

12. Furthermore, the geographical mandate of the Bank's operations was enlarged in 2011 to include the southern and eastern Mediterranean (SEMED) countries (Egypt, Jordan, Morocco and Tunisia). Following the Arab Spring, the Deauville Partnership called for the intervention of the EBRD in this region in recognition of the Bank's previous results with the transition towards democracy and a market-oriented economy. The Partnership recognised that the financial strength of the Bank and its expertise in the promotion of private sector investments would be fundamental for the improvement of the region's business climate and ultimately its growth perspectives. The EBRD, while acknowledging the challenges posed by the new scope of its activity, already started the operations in the second half of 2012 by using a dedicated investment fund amounting to 1 billion euros. The Bank cannot use its own resources until all its shareholders have completed ratification of the amended Articles 1 and 18 of the Agreement Establishing the Bank (AEB).

13. The EBRD's interventions have been focusing in particular on three sectors: i) the financial sector, so as to lessen credit constraints and capital outflows hitting the region as a consequence of the 2008 financial collapse and the 2010-2012 euro crisis; ii) the infrastructure sector, where the scope of intervention is great and so is the multiplier effect of efficient and sustainable infrastructure onto other sectors of the countries' economies; iii) agribusiness, in response to the food crisis and the peaks in prices of soya beans and grains registered in 2008, 2010 and 2012. In several cases, the EBRD has operated together with other international financial institutions (IFIs) as well as with the European Commission in areas of common interest. The EBRD contributes to such co-ordinated initiatives with its extensive expertise in supporting the private sector towards greater efficiency, competitiveness and sustainability.

14. At the same time, the crisis has impacted on the perception of the people on democracy and the free market in the transition region. In countries where the crisis hit most strongly, public support for institutional change substantially declined, which in turn tended to slow down the pace of reforms. More restrictions to free media access, political participation and business competition were also imposed in some of the countries of operations. The EBRD addressed these concerns by adapting its methodology for the evaluation of the

4. All references to Kosovo, whether to the territory, institutions or population, in this text shall be understood in full compliance with United Nations Security Council Resolution 1244 and without prejudice to the status of Kosovo.

5. EBRD: Third Capital Resources Review 2007-2011, and Background Material on Capital Resources Review 4, 2011-2015.

transition impact of its projects. In the new Scoreboard for Transition impact evaluation, institutional changes imputable to the Bank's activity are now as important as financial performance. The new Scoreboard provides a clearer picture of the institutional changes that occurred in the countries and periods of reference, in the belief that a market economy cannot function properly without appropriate supporting institutions.

3. Economic and political developments between 2010 and 2012

3.1. The unfolding of the second wave of the economic crisis

15. The time period covered by the current report on the activities of the EBRD (2010-2012) witnessed the unfolding of the second wave of the economic crisis, which has hit Europe and the world hard.

16. The first wave of the crisis (2008-2009) left Europe with double digit unemployment in several countries, and a highly indebted public sector (over 80% of gross domestic product (GDP) on average for the euro area). Serious concerns have emerged about the sustainability of debt levels of some countries in a stagnating economic scenario, which is unlikely to witness the correction of fiscal and competitive imbalances. Since 2010, European Union member States have worked on elaborating bailout packages to support Greece, Ireland and Portugal, while growing fears are mounting with regard to Spain and Italy. In order to restore confidence of financial markets in the economic fundamentals of those countries, austerity programmes have been implemented since 2010. These measures included the "Euro Plus Pact" consisting of a package of political reforms to restructure fiscal and competitive performance of the countries, as well as the "Six Pack" and its complementary "Fiscal Compact", requesting member States to include a balanced budget amendment in their constitutions, among other provisions.

17. As a consequence, the deflationary effect on both public and private expenditures of fiscal contraction has had an adverse impact on private investment due to increased uncertainty of the macroeconomic scenario in the eurozone. The expansionary monetary policy of the European Central Bank (ECB) has not yet proved sufficient to support credit expansion and growth. The balance sheets of European Union banks are still suffering from the sharp decline in value of their assets and investments. The moderately optimistic economic forecasts for the European economy in 2009 were hence disproved by the surge of the second wave of the crisis – what is known as the European sovereign debt crisis.

18. The slowdown in the euro area and western Europe in general impacted on the countries of the transition region as well, like the first wave of the crisis.[6] EBRD countries of operations witnessed the beginning of the recovery from the 2008-2009 economic downturn and its reversal from 2010 onwards. What is more, while it appears that a mechanism of resolution for the euro area's fiscal imbalances has been put in place, the economic outlook remains today clouded with substantial uncertainty, which makes the "muddle-through" scenario the baseline for the EBRD operations. The probability of a second shock to the transition region due to new negative developments in the euro area crisis remains persistently high.[7]

3.2. Economic highlights in eastern European countries from 2010 to 2012

19. EBRD countries of operations started to recover at various speeds in 2009, although growth still remained below the 2005-2008 average almost everywhere. According to EBRD analysis, three factors contributed to recovery: the rebound in demand for local goods from abroad and, in particular, western Europe thanks to improved global economic conditions; the phasing out of capital outflows from the transition region due to the less stringent liquidity needs of western banks investing in the region; the attentive use of fiscal and monetary policies in the transition countries.[8] A contraction in real GDP was instead experienced in Bulgaria, Croatia and Romania (in South-East Europe (SEE)) until mid-2010, as well as in the Kyrgyz Republic, Ukraine and Lithuania. The deeper recession in SEE and the lagged recovery in the Baltic countries translated into persistent high levels of unemployment and low growth of domestic demand.

20. A major economic change that emerged as a result of the crisis was in fact the switch from internal to external demand as the main driver of the economy. In the pre-crisis period, the transition was accompanied by structural economic changes that caused substantial re-evaluations of property prices and a dramatic increase of purchasing power of consumers and inflows of foreign capital. The crisis stopped these developments, while increasing unemployment and reducing inflows of capital in particular.[9]Exports, on the

6. EBRD: Transition Report 2009 and "The activities of the European Bank for Reconstruction and Development (EBRD) in 2009: facilitating economic integration in Europe", Assembly Doc 12349.
7. EBRD: Regional Economic Prospects in EBRD Countries of Operations: July 2012.
8. EBRD: Transition Report 2010.

contrary, surged once again starting from 2009 after the great trade collapse of 2008, picking up from the remarkable performance between 2000 and 2007 (the region's share of world export doubled from 2000 to 2007 – from 5% to 10%). According to the EBRD Transition Report 2010, this switch towards a new growth model has had three main determinants: a) the surge in real imports of trading partners (doubling in almost all countries of central and eastern Europe and of the Community of Independent States (CIS)); b) the average decrease in trading tariffs, especially in certain sectors, thanks to the accession of some transition countries to the European Union between 2004 and 2007 and the signing of Free Trade Agreements between the European Union and several countries in SEE and southern and eastern Mediterranean (SEMED) regions; c) the low unit labour costs in the transition region, at least at the beginning of the new century.

21. By the second quarter of 2011, almost all countries of the transition region had returned to positive growth and pre-crisis levels of real output, although were still underperforming with respect to Latin America and emerging Asia. If countries in the region followed different growth trajectories, on average, growth was driven by external demand until mid-2010, while high commodity prices and a revived credit growth due to easy monetary policies in the region fuelled domestic demand in 2011.[10] However, the free trade model that helped the region to profit from external boost factors became a boomerang when its main trading partner, the euro area, entered into a new phase of uncertainty over its macroeconomic stability. This depressed expectations of growth in the region and worldwide. As a consequence, both demand for exports from the transition region and prices of raw materials declined substantially, the latter impacting on the export revenues of several of the EBRD countries of operations (in particular Azerbaijan, Kazakhstan, Russia, Uzbekistan, Mongolia). The beneficial effects of the one-off reduction of tariffs from Free Trade Agreements are also bound to diminish over time, while competitive cost advantages have already expired especially in the central and eastern European and Baltic countries.

22. At the same time, government fiscal consolidation, persisting high levels of unemployment, the acute drop of both wages and remittance flows further constrained domestic demand. This has proved especially problematic in the SEMED region, where high youth and general unemployment are forecast to persist. Persistent cross border bank deleveraging, especially in the CEB and SEE regions, and stagnant credit supply from western Europe, have further limited domestic demand in this region.

23. Growth is projected to fall from 4.6% in 2011 to 2.7% in 2012 over all countries of operations.[11] This of course hides substantial divergences from region to region: a slowdown is expected in eastern European countries due to the decreasing stimulus of exports towards western Europe, and especially in Croatia and Hungary, which are projected to enter a recession. The Baltic countries, Poland and the Slovak Republic would on the contrary represent exceptions, with annual growth exceeding 2.5% thanks to the resilience of their manufacturing production to the negative economic cycle in western Europe. Growth in central Asia is also expected to abate somewhat essentially due to declines in commodity prices, but it will still remain firmly in positive territory. Forecasts for the SEMED region displayed moderately positive growth rates (1.8%-2.7%) for 2012, but they were threatened by high levels of political uncertainty, which weakens investors' confidence. The reduction in tourism, foreign direct investments (FDI) inflows and trade are expected to depress employment further (-2.5% in Egypt and -5% in Tunisia since mid-2010 with respect to 2004-2007 averages). The forecasts for performance of the world economy and in particular the eurozone economy have deteriorated since the above figures have been produced by the EBRD. Therefore it is likely that most figures are still too optimistic even.

24. The baseline scenario for these forecasts is a slow resolution of the euro area sovereign crisis which assumes long-lasting fiscal contraction and low credit growth. Hence it cannot be excluded that a worsening of the sovereign crisis, together with the long-lasting economic challenges of the euro area (aging, migration and switch to a greener economy) would have longer lasting and deeper negative consequences on the transition region.

---

9. In the 2010 Transition Report, Chapter 2, one can read that in 2008 cross-border assets present in CEB and SEE fell by 9%, and did not increase again at a comparable rate with respect to Asia or Latin America, mostly due to the fact that substantial cross-border banking to the region came from European banks, which were experiencing difficulties even in their home countries of operations.

10. EBRD: Transition Report 2011; Annual Report 2011.

11. EBRD: Regional Economic Prospects in EBRD Countries of Operations: July 2012.

3.3. The political consequences of the crisis: pace of reform and democratisation

25. Article 1 of the EBRD's mandate states that the Bank can only support the transition process in countries committed to developing a democratic and plural political system, as well as an open-market economy. As a consequence, the evolution of the political reality in the countries of operations is continuously monitored by the Bank, and a country-by-country assessment is produced every three years. It is not clear to the rapporteur to what extent such an assessment indicates that the country involved is indeed sufficiently democratic and/or enhancing its level of democracy.

26. The analysis of data collected by the EBRD in the 2010 Life in Transition Survey highlights that the economic difficulties experienced in the transition region have significantly changed the perception of market economy and of democracy among the people in the countries of reference with respect to the previous survey in 2006. Households were asked several questions on the impact of the crisis on their lives and their perception of democracy, and in particular: i) if they perceived the economy and the political system to be in a better condition than before the crisis; ii) if they voted in the last elections; iii) what their degree of trust in their presidency and different governmental levels was; and iv) to choose whether in some circumstances a planned economy may be preferable to a market economy or if it does not matter, and if an authoritarian regime can be preferable to democracy in some circumstances or if this does not matter either. The survey also investigated how much households had been affected by the crisis and through which channel (job loss, job loss of the partner, reduction of working hours, bankruptcy of family business, etc.).

27. In this survey, much as in the last one, Albania, Mongolia, Montenegro, Tajikistan, Turkey and Uzbekistan remained among the strongest supporters of democracy in the region, while democracy's appeal increased the most in Armenia, Belarus, Georgia and Kazakhstan. Armenia scored the highest increase in the transition region, attaining comparable levels of support for democracy to the average western country. Support substantially declined in all the new European Union countries except Bulgaria, although support was already low in 2006 in the latter. The decline in support of democracy is especially clear for Hungary, the Slovak Republic and Slovenia, which were important supporters in the last survey. On the other hand, in some CIS countries approval of democracy increased. The general level of trust in government institutions in the transition region varied greatly by country, while in only two countries (Tajikistan and Uzbekistan) people reported an improvement in the political climate in the period 2006-2010. In most other countries of the region, people perceived a deterioration of the political situation, in particular in Croatia and Romania.

28. A more thorough statistical analysis of this evidence showed that economic performance was positively correlated with changes in the perception of market institutions and democracy from 2006 to 2010. In particular, it was shown that being hit extraordinarily hard by the crisis decreased by 10% the probability of favouring democracy and markets over any alternative. Another result suggested that support for political and economic institutions was stronger if the pre-crisis conditions in the countries were worse. In other words, what also seemed to matter for support for democratic and market institutions was the relative change imposed on the population by the crisis with respect to the pre-crisis condition. This could possibly explain why support did not substantially decrease in CIS countries, where the consequences of the crisis might have seemed less severe compared to the difficulties imposed by the transition process from the soviet system.

29. The mixed but somewhat negative perspective on democratic and market-oriented reforms registered by the Life in Transition Survey was reflected also in the EBRD's indicators of market reform in both 2010 and 2011. Major reversals of reform were avoided, but the more severe economic conditions and the implemented austerity programmes increased social tensions in the countries of operations. On the one hand, this resulted in the "Arab Spring". On the other hand, the worsened living conditions in the transition region produced a shift towards more nationalistic and authoritarian governments in several countries. Special attention was devoted by the Bank to the involutions in Hungary, Russia and Ukraine, and no considerable improvement was registered in the South Caucasus and the central Asian Republics, which remain characterised by strong presidencies and weak parliaments. Corruption worsened in almost all countries of operations, while changes in the freedom of the media scored a somewhat mixed result, with greater access to social media being balanced out by stricter controls imposed on the same media and on journalism in some countries of the region.

4. The response of the EBRD: facing the challenges

4.1. More resources and new facilities

30. The ultimate goal of the EBRD is the creation of prosperity and stability in the countries of operations. In order to do so, the Bank facilitates the transition towards market economies, promotes private and entrepreneurial initiative, and assists institutional reform both at the economic and political level. The dire consequences of the global crisis, as well as the Arab Spring and the food crisis, provided EBRD with both demand and opportunities for new activities. A breakdown of the bank investments is contained in the table below.

	2009	**2010**	**2011**
Annual investment forecast 2013-2015 (average)	7.86 billion	9.00 billion	9.05 billion 8.5 billion
Additional co-financing	10.35 billion	13.17 billion	20.8 billion
Number of operations	311	386	380
Private business operation (% of total annual investment)	83%	74%	77%
Available capital	20 billion	20 billion	30 billion
Annual investment by sector:			
Financial sector	3.1 billion	3 billion	2.9 billion
Industry, commerce, agribusiness	1.56 billion	2.3 billion	2.7 billion
Natural resources	671 million	693 million	571 million
Infrastructure	479 million	486 million	596 million
Transport	1.2 billion	1.3 billion	1 billion
Power and energy	836 million	1.2 billion	1.2 billion

31. The year 2010 in particular exhibited an important increase in the number of new projects financed (from 311 to 386) with a rise in their value from 7.8 billion euros in 2009 to 9 billion in 2010. This remarkable effort follows the steep 50% rise in available funding which took place between 2008 and 2009. Annual investment figures then remained more or less unchanged until 2011, although their multiplier effect on private complementary funding substantially increased: each euro the EBRD invested in new projects was met by 2.3 euros of external donors' financing in 2011, up from 1.3 euros per invested euro in 2009. These figures suggest an improvement of the Bank's operations in both quality and quantity of invested capital. In order to overcome the challenges imposed by the economic crisis in eastern Europe and central Asia, as well as to extend the Bank's operations to the SEMED area, the Bank's shareholders approved a request for capital increase from 20 billion to 30 billion euros in May 2010. This should permit the Bank to commit to an annual average of 8.5 billion euros in new business projects from 2013 to 2015.

32. The increase in new investments per year was especially concentrated in four areas of great expertise of the Bank, namely the financial sector, infrastructure, transportation and energy production. This is coherent with the Bank's strategy aimed at developing the "backbone" of the production sector, so as to facilitate a further autonomous development of private entrepreneurial initiatives in the countries. Investments in these areas address some of the constraints imposed by the crisis.

33. First, the mismatch between internal vs external finance. The transition region experienced massive outflows of non-FDI capital in the first phase of the crisis, due to the increased uncertainty over the economic outlook of the region and the global liquidity scarcity following the collapse of Lehman Brothers.[12] As a consequence of most macroeconomic developments in the euro area, a wave of cross-border bank deleveraging hit the transition region in 2011 and 2012. Faced with liquidity constraints in the home countries of operations, as well as with higher capital requirements to increase credibility vis-à-vis the markets, western banks have been withdrawing substantial amounts of funding from their local subsidiaries in the transition region. The effects have been especially dire in the CEB and SEE regions, where the degree of foreign ownership was large. To counter this phenomenon, in 2009 the EBRD entered the "European Bank Co-ordination ("Vienna") Initiative" which gathers IFIs, the ECB, the European Commission, regulators of countries hosting major banking groups, and exponents of the same banking groups. The first phase of the

12. EBRD: Transition Report 2009.

Initiative, which expired at the beginning of 2011, was successful in providing secure capital and liquidity to the affiliates of western banking groups in the transition region.[13] The extension of the initiative ("Vienna 2.0") has refocused interventions from stopping deleveraging of western banks' affiliates in the region to making sure that this process is not harmful for the local economies. The initiative also aims at promoting policy dialogue among bank supervisors in western Europe and the transition countries so as to limit systemic consequences of economic and financial shocks in the regions.

34. Second, borrowing in foreign currency. In the period considered, the EBRD launched the "Local Currency and Local Capital Markets Development Initiative" in co-ordination with other international financial institutions. The goal of the initiative is to develop funding of activities in the currency of the country of operations, so as to free the recipients from the exchange risk imposed by lending in hard currencies. Local currency lending also increases the transparency of the project, and ultimately spurs the development of the local financial market. The Bank thus created a Local Currency Lending Facility in 2011 with which it financed 18 loans to financial intermediaries in Armenia, Georgia, the Kyrgyz Republic, the Republic of Moldova and Tajikistan, as well as 30 loans to the production sector in Russian, Kazakh, Turkish and Polish currencies.

35. Third, energy and infrastructure efficiency. The diffusion of public–private partnerships (PPPs) in the period of reference managed to attract considerable resources to the transition region for the development of the infrastructure sector. The EBRD doubled its investment volume with respect to the pre-crisis years by investing more than 3.3 billion in infrastructure and transportation between 2010 and 2011; projects were concentrated especially on water supply, wastewater treatment, solid waste management and the development of railways. Special attention was devoted to energy efficiency and the fight against climate change, while promoting the competitiveness of the production sector in the transition region. The Bank thus developed the Sustainable Energy Initiative, aimed at reducing CO_2 emissions by up to 35 million tons per year through direct investment in the energy sector and indirectly through support to local partner banks involved in energy-related projects. 2.1 billion were invested in 2010 and 2.6 billion in 2011 under this initiative. In addition, in 2010, the first Environmental Sustainability Bonds of the EBRD were launched. They were designed to finance environmental projects and ultimately reduce CO_2 emissions in the countries of operations: the collected capital was invested exclusively in projects promoting clean technologies for the improvement of energy efficiency and water distribution, environmental services, public transportation and waste management.

36. In this sectoral perspective of the EBRD investments one cannot forget the resources devoted to the fight against food price volatility, especially through support for agribusiness. We refer to the specific paragraph addressing the subject in section 5 below.

4.2. A new perspective on institutions and transition

37. A more attentive reflection on the consequences of the crisis in the EBRD countries of operations has highlighted a disenchantment of the population towards democracy and market institutions. The results of reforms in the transition region were mixed in geographical terms but pointed at a generalised slowdown in the reform process. The crisis has thus revealed a weakness in the institutional setting and policy commitments to democracy and free market in the EBRD countries of operations. The Bank has tried to overcome these setbacks by improving the assessment of the transition impact of its projects, and by increasing collaboration with other international institutions.

4.2.1. A new scoreboard

38. The EBRD 2010 Transition Report presented a new methodology to evaluate the improvement of countries towards a market economy and democratic institutional setting. The Bank's traditional transition indicators, which were introduced in 1994 and amended several times since, enjoyed great success in the academic and policy-making environments, but proved to be insufficient in assessing the sustainability of projects and reforms after the crisis. On some occasions, the evaluation of financial soundness included in the transition indicator proved to be completely wrong in the light of events. Moreover, the previous scoreboard design implicitly assumed that a higher score in transition could be achieved by removing State support to the economy in favour of private initiative and market development. In the previous transition scoreboard, the importance attached to the privatisation process and private investment inflows in the country of reference exaggerated the country's progress towards a free market economy. In particular, it belittled the importance of regulation and law enforcement for the development of a competitive and efficient business environment.

13. EBRD: Vienna Initiative, moving to a new phase (2012).

39. The new transition scoreboard assigns almost equal weight to market-based information and the quality of institutions in the country. Furthermore, these weights are now derived more transparently from public data available and the country's market and institutional characteristics. Thirdly, the score is attributed on the basis of outcome indicators (changes to market structure or market-enhancing institutions in the period considered), and no longer on the basis of input variables (the amount of money invested). Finally, from the original five infrastructure and two financial sector indicators, the new scoreboard switched to 16 indicators grouped by sector (corporate, energy, infrastructure and financial). Financial sector classification distinguishes now between bank and non-bank (already existing) activities, insurance, private equity, capital markets, micro-, small and medium enterprise finance and other financial services. As a result of these changes in the scoreboard, the evaluation of the transition impact of the financial sector changed with the new methodology. What is more, the picture of the country emerging from the scoreboard is now more articulated. Policy makers might be able to rely more closely on the power of the scoreboard to match the country's reality.

4.2.2. Strengthened institutional co-operation

40. In 2011, the Bank signed a new Memorandum of Understanding with the European Commission and the European Investment Bank (EIB), which replaced the pre-existing 2006 Memorandum. The Memorandum stresses the need for further close collaboration between the signatory institutions, based on the common interest in accompanying the countries of operations in their transition towards a market-based economy. The institutions share a number of areas in which co-operation can be enhanced: strengthening of market and democratic reforms, energy efficiency and green technological upgrade, infrastructure development, and support to small and medium-sized enterprises (SMEs). In projects where both the EBRD and the EIB are operative, each Bank uses the output of the other institution while carrying out independent credit and project evaluation. The co-operation between the EBRD, the EIB and the European Commission has concretised in particular in the areas of financial and corporate development. A recent example is the establishment of the Western Balkan Enterprise Development and Innovation Facility, which should collect 141.2 million euros in capital from the three institutions and be able to lend about 300 million to SMEs in the Western Balkans over the years 2011-2015. The Facility was created within the Western Balkan Investment Framework, which was launched in 2009 by the three institutions to favour investment in energy, environment, transport, social infrastructure and private sector development.

41. In 2009, the EBRD also partnered with the EIB and the World Bank to create the Joint IFI Action Plan to support financial intermediaries in Eastern Europe during the second wave of the crisis. The three institutions provided 33 billion euros (up from the initially forecasted 25 billion) in funding to both the financial and corporate sector. They thus contributed to restoring market confidence in the region and ensured that important western private financial institutions did not withdraw their engagements from the region despite the tight conditions of the liquidity market.

42. A partnership between the EBRD and other IFIs (African Development Bank, Asian Development Bank, Inter-American Development Bank, World Bank) was created to support the fight against global warming. In particular, under the partnership, the IFIs committed to invest 8.4 billion euros annually to support cities in adapting to and mitigating climate change.

5. Special issues in the EBRD's activities

5.1. The extension of EBRD operations to the SEMED

43. The democratic uprising in North Africa and the Middle East, which is identified as "Arab Spring", was first backed by the G8 through the Deauville Declaration in May 2011. The Declaration launched the multilateral Deauville Partnership aiming at supporting democratic and economic transition in the Arab Spring countries. The Declaration also called for the "extension to 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 economics", in view of the parallels between the transition experience of eastern European and central Asian countries and that of North African countries, and the years of cumulated experience of the EBRD in the development of the private sector and entrepreneurship.

44. The EBRD was thus asked to intervene thanks to its demonstrated capacity to deliver support to countries in transition to democracy and stronger market economy. The Bank would be key to the fast mobilisation of financial resources both directly and indirectly, providing funding and expertise to cash

constrained financial intermediaries and guarantees to other western corporations willing to invest in the region. Sectors of priority investment are energy production, municipal services for water treatment and delivery, infrastructure and support to SMEs.

45. The EBRD started operations in Egypt, Morocco, Jordan and Tunisia in 2012. The first two countries were already shareholders of the Bank and expressed the interest to become countries of operations. Jordan and Tunisia requested both membership and access to operations. Amendments to the EBRD statutes (Articles 1 and 18) allowing the Bank to extend its mandate were approved in September 2011 by the Board of Governors of the Bank, but full operational capacity was granted only in September 2012. In the meantime, the Bank started technical co-operation with the SEMED countries thanks to the 59 million Transactional Facility established in Deauville with the contribution of Australia, Finland, Germany, France, Italy, the Netherlands, Norway, Sweden and the United Kingdom. Further resources of 1 billion euros were obtained using the Bank's net 2011 income in May 2012. At full capacity, the Bank is expected to commit 2.5 billion euros per year in the SEMED region alone, thus potentially raising a total of 7-8 billion euros of funding per year, thanks to private investors' contributions.

46. Further support to the transition process in Northern Africa is provided by the Bank through its T2T Initiative, that is a framework for exchange of knowledge between old and new countries of operations, as well as through the Bank partnership with other international financial institutions in the region. The EBRD signed a Memorandum of Understanding with the African Development Bank and the Islamic Development Bank in September 2011. The Memorandum recognises the expertise of the EBRD in trade finance, support to SMEs, privatisation programmes, management and evaluation of projects. The African and Islamic Development Banks will contribute to the partnership by sharing their networks of relations with local institutions and their knowledge of the countries of operations. The institutions will co-ordinate investment and due diligence, so as to avoid duplications of efforts.

47. Transition from authoritarian regimes to democratic ones in Tunisia and Egypt, as well as from economic systems based on heavy political economic intervention to market-oriented economies poses numerous challenges. The first of them is the capacity for the countries to involve the private sector in the economy, making sure the economic system keeps on being operational as State interventions would be reduced. This is especially difficult because of high levels of uncertainty on political and economic stability. In countries where the private sector had a marginal role in economic development, a priority of the EBRD has been capacity building for SMEs (accounting and management skills, business contacts, trade partnerships, etc.). At the same time, the Bank has concentrated its attention on the improvement of economic institutions which favour both internal and international competition, as well as a transparent privatisation process, so as to avoid the creation (or help the dismantling) of collusive and inefficient centres of economic power.

48. The EBRD's focus on privatisation should be handled with care. Its former chief economist, Willem Buiter, had already noted, in 2003, regulatory challenges resulting from privatisations in eastern Europe, mostly due to the fact that, in contrast to western Europe, regulatory agencies were not in place before privatisation.[14] In more general terms, privatisation policy meets with much more criticism at present, both from a scientific point of view as well as from a societal point of view. Civic society organisations, such as NGOs and trade unions, are rather sceptical as a result of social injustices caused by rash privatisations,[15] [16] especially with regard to sectors such as water, since access to water is a fundamental human right. Civil society organisations in Egypt have expressed more general fears that the founding values of the EBRD are of less importance than the Bank's push for the liberalisation and privatisation of public services, for example the provision of potable water and energy.[17]

49. If it is true that there are multiple similarities between the transition process in the SEMED and in eastern Europe and the CIS, the EBRD has nevertheless recognised that differences in economic, social and political institutions and development may challenge its expertise while operating in the SEMED. In particular, the number of private companies present in the region is about a third of those which were active in the EBRD countries of operations in 1991. These firms are not concentrated in the heavy industry and medium technological sectors which helped the countries of the former Soviet block to integrate global supply chains relatively soon after the beginning of the transition process. In addition, greater cultural distances between northern Africa and western Europe as opposed to Eastern Europe, as well as an average lower level of human capital in the SEMED region, will mitigate against offshoring from western Europe, thus potentially

14. www.willembuiter.com/bv.pdf.
15. http://bankwatch.org/bwmail/51/ebrd-plans-egypt-slammed-human-rights-group.
16. www.jadaliyya.com/pages/index/5453/critical-perspectives-on-ebrd-transition-investment.
17. www.eipr.org/en/pressrelease/2012/09/11/1479.

lowering the speed of the transition towards sustainable economic growth of the SEMED. Non-tariff barriers are still binding in the region and their reduction will expose the production sector of the region to further major challenges. The Sustainable Impact Assessments of the Free Trade Agreement that the European Union is seeking with countries in the region show that major economic sectors may be totally wiped out. In the food, beverages and tobacco sector, production is predicted to fall by 96.9% in Egypt, 98.5% in Morocco and 94.1% in Tunisia. In the textile, clothing, leather and footwear sector, production falls by a staggering 99.7% in both Egypt and Tunisia.[18]

50. Finally, the current global economic context is different now from the early nineties. The protracted economic crisis has reduced the availability of funding from independent country donors, in particular from the euro area, as well as the corporate sector's appetite for risk. What is more, the appeal of the market economy among the people is much less widespread today than twenty years ago, thus potentially raising the resistance of the SEMED population to the inevitable costs imposed by the transition. The EBRD will have to acknowledge these changing perspectives and take them into account when designing its investment strategy in the SEMED region. The EBRD should step up its dialogue and collaboration with trade unions and local civil society organisations in order to do justice to the aspirations of the Arab Spring. In order to make use of synergy in the European support for the emerging democracies in the Arab world, co-ordination should be stepped up between the EBRD, the Parliamentary Assembly (partner for democracy status), the Venice Commission, but also the OECD and other relevant bodies.

5.2. The food crisis and the EBRD investment in agribusiness

51. Food export prices almost doubled from the beginning of 2007 to mid-2008, with especially high growth rates for grains and fat and oils. This historical peak in prices was however reached and surpassed in 2011 and 2012. Although prices decreased again during the winter season, global prices remained volatile.[19] The dynamics of prices in the period 2010-2012 suggest that a repeat of the 2008-2009 food crisis cannot be excluded, and that volatile prices will remain a reality in the foreseeable future. The continuously rising demand for agricultural products, in particular animal protein and biofuel, coupled with low levels of food stocks, creates alarm in the global community. Further constraints to export capacity are represented by climate change and the availability of arable land, as well as the lack of effective transportation infrastructures in many producing countries. Therefore the United Nations Special Rapporteur on the Right to Food, Olivier de Schutter, concludes that "Food and other basics must not be left to the mercy of economic cycles".[20] Projections suggest that global agricultural production will need to increase by about 70% over the next 40 years to support current consumption patterns.[21] One could argue that new regulations and co-ordination mechanisms are needed in food production and distribution.

52. The EBRD has placed the phenomenon high on its agenda because its countries of operations have been affected by the food crisis on both the consumption and the production side. In many of these countries, food represents 40% or more of the average consumption basket, so that further increases in prices may translate into inflation and severe subsistence constraints. Governments in countries of operations have already reverted to export bans and price caps in order to contain the surge in food prices of recent years. At the same time, the food crisis could represent a great opportunity for some of the transition countries. Russia and Ukraine produce today 18% of world grain exports, but they can potentially reach 50% of world exports.[22]

53. The EBRD can assist these developments, offering its technical expertise in the sector and in public-private dialogue, as well as its capacity to raise funds for private sector support. Priority sectors of investments are infrastructure, energy efficiency, and SME development so as to improve agricultural trade logistics and the management of risk. As a consequence, the EBRD stepped up its intervention in the agribusiness sector from 2010 to 2012 to reach 945 million euros in 2011 alone. In the same year, it also created the Agribusiness Sustainable Investment Facility to improve energy efficiency in the sector and support socially and environmentally sustainable projects. Through this facility, the Bank invested a further 200 million euros in the sector. Finally, the Bank launched the "Private Sector for Food Security Initiative", together with the Food and

18. This is based on Sustainability Impact Assessment of the Euro-Mediterranean Free Trade Area: Final Report of the SIA-EMFTA Project (revised November 2007), SIA-EMFTA Consortium, 2007, and Sustainability Impacts of the Euro-Mediterranean Free Trade Area: Final Report on Phase 2 of the SIA-EMFTA Project (March 2006 (Revision)), SIA-EMFTA Consortium, 2006.
19. WB Food Price Watch – several reports (2011-2012).
20. www.srfood.org/index.php/en/component/content/article/1-latest-news/2513-underwrite-the-poor-like-we-underwrote-the-banks-un-experts-propose-global-fund-for-social-protection.
21. EBRD: Private Sector for Food Security Initiative (2011).
22. EBRD: Private Sector for Food Security Initiative (2011).

Agriculture Organization (FAO) of the United Nations, in 2011. The two organisations agreed to share their research knowledge and contacts with the agribusiness sector to address the food crisis through greater private sector involvement, which is the key expertise of the EBRD. However, enhanced private sector involvement also risks losing public authority over its land.[23]A balanced approach is thus needed.

6. Conclusions

54. The transition region experienced a considerable economic adjustment between 2010 and 2012. The economic recovery fuelled by increased exports to the European Union did not last long. The worsening of the euro crisis reduced growth expectations and the availability of capital from western Europe. What is more, the long-lasting effects of the crisis and of the consequent austerity programmes on unemployment and the well-being of the population in the countries of operations has on average reduced the appeal of democracy and a market oriented economy among the people. Therefore the pace of reforms towards such institutional settings has slowed down. It would be wise to review these reforms in the light of the new political and economic situation.

55. The EBRD has reacted to the effects of the crisis by increasing its capital by 50% to 30 billion and maintaining a high level of investment in the countries of operations, especially in the financial, infrastructure and energy sectors. The Bank's valuable expertise in the financing and development of the private sector in a context of transition was recognised by the call for the extension of the geographical mandate of the Bank to the SEMED by the G8 and the Deauville Partnership. The key challenge of the Bank in the near future will most likely be adapting its investment strategy to this new context characterised by important political, social and economic uncertainties which do not necessarily correspond to those the Bank faced while investing in eastern Europe and central Asia.

56. The fight against the food crisis also represents a new challenge for the Bank: although investment in agribusiness has always been part of the Bank's portfolio, support to the sector has reached an historic high record, making the Bank the biggest investor in the sector in the transition region. In this new role, it will invest in the improvement of the whole supply chain, and in particular in storage and transportation infrastructure, so as to facilitate a greater participation of the region in global trade in food. At the same time, the EBRD has yet to incorporate the critique of the United Nations Special Rapporteur on the Right to Food.

57. The EBRD will have to make sure that its operations bring the region further in the transition process towards more democracy and the creation of prosperity and stability. Under the new scoreboard for the benchmarking of the transition requirements of countries of operations, greater attention should be devoted to the institutional developments related to the projects financed. In particular, the Bank will have to support more inclusive growth and contrast the setbacks in corruption, media and political freedom which were registered in some of the countries of operations during the crisis.

58. In December 2012, the EBRD adopted a new methodology to assess the compliance of its countries of operations with the political aspects of the Bank's mandate. Reports by the Council of Europe are mentioned, together with those by the United Nations and the OSCE, as references for the Bank's assessments. The four criteria for the political assessment are: representative and accountable government; civil society, media and participation; rule of law and access to justice; and civil and political rights. The effective implementation of this new methodology – which should be welcomed – will lead to concrete measure being taken concerning those countries which do not apply the principles of democracy and the rule of law. The Council of Europe – and in particular the Assembly – should be ready to co-operate with the EBRD in making and monitoring its assessments.

23. www.tni.org/sites/www.tni.org/files/download/landgrabbingprimer_0.pdf.