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The activities of the European Bank for Reconstruction and Development (EBRD) in 2013-2014

Report¹

Committee on Political Affairs and Democracy

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Summary

In providing assistance to its member countries in their transition to market economies, the European Bank for Reconstruction and Development (EBRD) contributes to their progress towards democracy and the rule of law.

By regularly debating the activities of the EBRD, the Parliamentary Assembly provides a parliamentary oversight of the Bank's operations.

The expansion of the EBRD's activities to the countries of the southern and eastern Mediterranean (SEMED) is to be welcomed; the experience of the EBRD in helping countries to make the transition to open market economies can be of valuable assistance also in that region.

It is regrettable that many of the EBRD's countries of operations do not seem to be committed to, and are not applying, principles of multiparty democracy and pluralism. It is proposed that the Assembly assist the Bank in a more effective implementation of the EBRD's new methodology to assess the compliance of its countries of operations with the political aspects of its mandate.

1. Reference to committee: Bureau decision, Reference 3956 of 26 April 2013.



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A. Draft resolution²

1. The Parliamentary Assembly has reviewed the activities of the European Bank for Reconstruction and Development (EBRD) for the period 2013-14 in the light of the reports by the Bank. In line with the last report, the Assembly has sought to make the debate more political and to focus more on a political assessment of the work of the Bank.
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 its objectives and should be monitored and promoted by the Bank as part of the process of assisting the transition of its countries of operations to market economies.
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. The Assembly supports the activities of the EBRD by providing a parliamentary oversight of the EBRD's operations.
5. The time period covered by the current overview of the activities of the EBRD (2013-14) has witnessed the beginning of recovery from the financial crisis which had hit especially hard in Europe. The sovereign debt crisis in a number of European States is now under control, but confidence in the single currency of the eurozone has not been fully restored. Austerity programmes have continued to be implemented throughout the review period and the economic slowdown in the euro area, and western Europe in general, has had a negative impact on the countries of the transition region.
6. Political uncertainty is a key factor affecting growth, and the outlook for economic growth in 2014 and 2015 in the transition region has been negatively affected by economic factors and the geopolitical tensions between Ukraine and Russia. While in Russia economic growth is forecast to come to a halt in 2014, and to remain low in 2015, Ukraine is expected to suffer from severe output losses in 2014 and stagnate in 2015. Increased geopolitical tensions between Russia and Ukraine could also impact upon neighbouring countries and no doubt the effect of the latest sanctions on Russia and of Russian sanctions on western economies will figure largely in the next report.
7. The prolonged period of slower growth that has followed the global financial crisis has affected the prospects of the EBRD transition region in achieving convergence with the living standards of advanced market economies. On the other hand, the increase in long-term unemployment brought about by the crisis and the prolonged period of fiscal austerity, often recommended by supranational bodies, is eroding public support for market-oriented reforms and some of the most advanced countries in the transition region even experienced reform reversals. It is possible that support for democracy may also suffer as opposition to the effects of the austerity programmes on growth and jobs mounts.
8. The Assembly welcomes the expansion of the EBRD's activities to the countries of the southern and eastern Mediterranean (SEMED) in the past two years, with Jordan, Morocco and Tunisia becoming full countries of operations and Egypt being a potential country of operations. Although the situation in these countries is very different from that in central and eastern Europe 25 years ago, the Assembly believes that the experience of the EBRD in helping countries make the transition to open market economies can be of valuable assistance also in the countries of the SEMED.
9. The EBRD should seek to share its experience and expertise in supporting transition with other countries as well, including outside its current region of operations. At the same time, regardless of continuing expansion towards south and east, the EBRD should maintain strong support for economies of its "old region".
10. The Assembly took note of the revision and updating by the EBRD of the methodology to assess the compliance of its countries of operations with the political aspects of the EBRD's mandate, notably on the basis of: representative and accountable government; civil society, media and participation; rule of law and

2. Draft resolution adopted unanimously by the committee on 5 September 2014.

access to justice; and civil and political rights. It regrets, however, that many of the EBRD's countries of operations do not seem to be committed to, and are not applying, principles of multiparty democracy and pluralism.

11. The Assembly 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.

12. Finally, the Assembly notes the recent criticism concerning the lack of transparency of the EBRD and encourages it to start publishing more comprehensive information in line with international standards and to inform it of the measures it takes to this effect.

B. Explanatory memorandum by Mrs Cheryl Gillan, rapporteur

1. Introduction

1. The Council of Europe and the European Bank for Reconstruction and Development (EBRD) signed a co-operation agreement in 1992, whereby the two institutions agreed to exchange information with the specific aim of monitoring democratic progress in central and eastern Europe. In June 2011, the Parliamentary Assembly decided on certain reforms of its structures and a new division of labour.

2. 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”.

3. On 22 January 2013, the Assembly held a debate on a report on the activities of the EBRD in 2010-12, presented by Mr Tuur Elzinga (Netherlands, UEL), and adopted [Resolution 1913 \(2013\)](#). On 6 June 2013, the committee appointed me as rapporteur.

4. This report, which is based on a memorandum prepared by Mr Gabriele Ciminelli, economics researcher at the Tinbergen Institute, Amsterdam, reviews the activities of the EBRD in 2013 and 2014. Particular emphasis is dedicated to the economic and political developments that have characterised the EBRD region of operations in the last two years and to the recently announced medium-term strategic directions that will guide the Bank's operations in the second half of the decade.

5. A short survey of the literature investigating the relationship between economic development and democracy and an analysis of how market reform could benefit multiparty democracy in the EBRD transition region are also provided. Special attention is dedicated to the progress achieved by the Bank in the new region of the southern and eastern Mediterranean (SEMED) and the relations of the EBRD with other European Institutions.

6. In preparing this report, the rapporteur held bilateral meetings with a number of EBRD officials and Board Directors who have provided her with useful insights into the running and activities of the Bank. The Sub-Committee on Relations with the OECD and the EBRD held a meeting at the headquarters of the EBRD in London on 4 February 2014.

2. Background

7. In the year that marks the twenty-fifth anniversary of the fall of the Iron Curtain, policy makers around the world are still striving to improve living conditions in the former eastern bloc. In this context, the EBRD has a unique role to play. Established in 1991 with the purpose of fostering transition towards an open market economy, the EBRD is the only financial institution to have a clear commitment to the principles of multiparty democracy, pluralism and market economy in its mandate. In fact, the Bank can only carry out its operations in those countries that are committed to and apply these principles. As of June 2014, the EBRD was the largest single investor in its region of operations.

8. The EBRD promotes transition to market economy by making or co-financing loans, investing in equity capital, and facilitating access to capital markets of private corporations and State-owned enterprises operating competitively in the market economy. The extent of the Bank's engagement with the State sector is however limited to not more than 40% of the amount of its transactions. To finance its operations, the EBRD raises funds in the international capital market. This includes those of its countries of operations, thereby contributing to the development of the local capital markets.

9. The Bank also provides technical co-operation to its clients, with the objective of supporting project preparation and implementation. The EBRD constitutes a unique case among development banks insofar as technical co-operation is paid for via grants financed by donor partners. Parallel to the investment and technical co-operation activities, the EBRD also engages in policy dialogue with recipient countries to foster structural economic reforms. Thanks to the specific knowledge and expertise acquired during more than twenty years of operations, the policy advice provided by the Bank has often proved instrumental in building up the appropriate degree of institutional capacity that is conducive to the development of an open market economy and multiparty democracy.

10. Originally, the EBRD region of operations not only comprised countries of central and eastern Europe and the Balkans, but it stretched farther east to include the Central Asian republics. Over time, the EBRD region was gradually broadened, and as of June 2014 it encompassed 35 countries. The operations of the EBRD were first expanded to Mongolia (2006) and Turkey (2009). Following the historic changes that occurred in North Africa and the Middle East, in 2011 the Bank's shareholders asked the Bank to extend its geographic remit to include countries in the southern and eastern Mediterranean (SEMED) region, notably Egypt, Jordan, Morocco and Tunisia. Other SEMED countries have already expressed their desire to join the Bank.

11. In November 2012, without prejudice to the position of individual members on the status of Kosovo,^{*3} it was announced that the country would become a member of the EBRD and recipient country.⁴ During its Annual Meeting, held in Warsaw on 15 May 2014, EBRD shareholders agreed on a further expansion of the Bank. Founding member Cyprus was granted the status of recipient country in order to help the government to restructure and rebalance the country's economy in the wake of the financial crisis. The Bank expects its engagement in Cyprus to be of a temporary nature and plans to carry out its operations across the whole island, for the benefit of both communities.⁵

12. In order to benefit from EBRD investments, any country first needs to become a shareholder of the Bank and then receive country recipient status. This is why, following the intention of the authorities to seek EBRD investments, Libya's request to become the 67th shareholder of the Bank has been accepted. The EBRD specified that the decision to grant recipient country status to Libya would be taken separately, following a thorough assessment by the Bank of the political, economic and operational environment in the country, on the basis of Article 1 of the Agreement Establishing the Bank (AEB).

13. The economic and financial challenges that emerged during the global crisis profoundly affected the prospects of achieving transition in the EBRD region. Firstly, the financial crisis has caused the transition region to enter into a prolonged period of slower growth. This, in turn, has significantly slowed down the process of convergence to the living standards of western Europe. Secondly, free markets have often been blamed for the economic malaise. Consequently, the crisis has dented public support for market-oriented reforms in a number of countries.

14. The EBRD is well aware that the challenges posed by the financial crisis and the request for the Bank's expertise and financing coming from the SEMED region have invariably strengthened its role in the post-crisis world. During the 2014 Annual Meeting, EBRD shareholders discussed the new medium-term directions that would guide the Bank's activities over the following years. Building upon its core competencies and the important initiatives developed over time, the EBRD aims to re-energise transition by concentrating its efforts around three key aims: i) supporting governments in hastening transition through policy dialogue and the financing of pivotal projects; ii) promoting economic integration both globally and regionally; and iii) addressing global common challenges. The medium-term directions provide a starting point for the discussion over the Bank's *Fifth Capital Resources Review* (CRR5), which will cover the period 2016 to 2020 and is to be approved at the Bank's 2015 Annual Meeting in Tbilisi.

3. Governance and structure

15. The EBRD has 66 shareholders. These include all the member States of the European Union, and two European institutions, the European Union (represented by the Commission) and the European Investment Bank (EIB). Furthermore, some developed countries, including the United States, Japan, South Korea, Canada and Australia, which are neither European nor countries of operations, are also shareholders of the Bank. Among the member States of the Council of Europe, only Andorra, Monaco and San Marino are not shareholders of the Bank.

16. The overall structure of the EBRD is organised along seven lines, based on shared operational priorities. The division of labour well embodies the Bank's dual nature of being a publicly owned financial institution operating according to private sector principles. All the powers are vested in the Board of Governors, which is composed of one Governor from each shareholder, usually a civil servant from the Ministry of Finance or the President of the Central Bank. The Board of Governors holds a general meeting every year and delegates most of its powers to the Board of Directors. The Board of Directors is responsible

3. *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.

4. EBRD, Kosovo to become a member of the EBRD, 16 November 2012.

5. EBRD, EBRD Shareholders agree to temporary financing for Cyprus, 15 May 2014.

for the EBRD's strategic direction and internal evaluation. The President is elected by the Board of Governors and is the legal representative of the EBRD. Under the guidance of the Board of Directors, the President manages the Bank's operations. In carrying out his tasks, the President is advised by the Executive Committee, which consists of five Vice-Presidents and other senior management officials, including the Chief Economist, General Counsel and Secretary General.

17. The meetings of the Board of Directors are usually held every two weeks and are chaired by the President. The Board makes formal decisions concerning investments, technical co-operation assignments, borrowing and other Bank activities. Importantly, it also has the task of monitoring compliance with the political aspects of the Bank's mandate. Should the Board express serious concerns over a country's compliance, it might decide to limit the Bank's involvement with the State, while remaining engaged in the private sector to support economic transition.

18. This policy, known as the calibrated approach, currently concerns two countries, Belarus and Turkmenistan. The Board of Directors' decisions are determined by majority voting, provided that the said majority represents no less than two-thirds of the subscribed shares in the Bank's capital. The Board is composed of 23 Directors, each representing one or more members. Only a few countries of operations are directly represented in the Board by their own Director. However, in April 2013, some Governors asked for a reconsideration of the composition of the Board of Directors, with the aim of increasing the weight of recipient countries. This process would be concomitant with the Bank's Fifth Capital Resources Review.

19. The Bank's day-to-day business is carried out in 13 departments. Banking, Finance and Risk are responsible for lending, borrowing, and risk-management activities. The provision of legal advice and operational support falls within the competence of the Office of the General Counsel, while the Office of the Secretary General administers the Bank's institutional relations, in particular with its shareholders. Perhaps, however, what most characterises the EBRD as a unique financial institution are the External Action and Political Affairs department (EAPA) and the Office of the Chief Economist (OCE).

20. Although all the Bank's activities are directed towards promoting transition, it is within these two departments that both economic and political progress is monitored and assessed. The OCE is responsible for economic analysis; in particular, it evaluates the potential impact of the Bank's individual projects in fostering transition to a market-oriented economy. The OCE also assesses the degree of economic transition achieved at sector and country levels. Political transition is monitored by the EAPA, which provides regular updates and insights into political developments in the countries of operations. Its advice is instrumental in order for the Bank to carry out its policy dialogue initiatives. Furthermore, the EAPA is also responsible for the management of the donor-funded activities, which include technical co-operation with the Bank's clients and policy dialogue with recipient countries.

21. Alongside the political and economic assessments provided by the EAPA and OCE, the crucial task of evaluating the Bank's effectiveness in delivering transition is carried out at the Evaluation Department (EvD). The EvD operates in complete independence from the rest of the Bank's management and reports directly to the Board of Directors. Through the provision of an independent and evidence-based assessment of its performance, its evaluations contribute to strengthening the Bank's performance and institutional accountability. A relevant part of the EvD activities consists of the *ex post* evaluation of the transition impact of the Bank's projects, with respect to private sector development achieved and improvements at the institutional and policy levels. The activities of the EvD, however, are not confined to the evaluation of individual projects; they also include the evaluation of the Bank's strategies, programmes and policies. A thorough overview of the EvD's work is provided in the Annual Evaluation Review.⁶

22. The Bank also supports transition by promoting the highest standards of corporate governance, transparency, and integrity in its region of operations. The responsibility for overseeing the application of these standards lies with the Office of the Chief Compliance Officer (OCCO). The OCCO, which answers to the President and the Audit Committee of the Board of Directors, evaluates the integrity and transparency of the Bank's clients and assesses the hypothetical reputational risks associated with its investment activities. As part of its tasks, the OCCO investigates allegations of fraud and corruption arising in relation to the Bank's projects. Equally important, it also administers the Project Compliant Mechanism (PCM), which allows individuals and local groups in the countries of operations to raise grievances or complaints in relation to EBRD projects. Moreover, the OCCO is responsible for the application of international best practices and standards also in relation to the Bank's internal conduct.⁷

6. EBRD, Annual Report 2013, 14 May 2014.

7. Ibid.

23. As part of its commitment to democracy and good governance, the EBRD regularly engages with a variety of civil society organisations. Dialogue with the civil society concerns both individual projects and more encompassing initiatives, including the review of the Bank's key policies and strategies. In December 2013, the EBRD approved the new Energy Sector Strategy, which will govern the Bank's investments in the energy sector from 2014 to 2018. Crucially, its approval followed an extensive consultation process with more than 1 000 organisations, during which the Bank incorporated and responded to comments from external stakeholders.⁸ The President and members of the Board of Directors also hold meetings with civil society organisations and other key stakeholders during their visits to the countries of operations.⁹

24. Soon after his election, in 2012, President Chakrabarti unveiled a modernisation agenda, which aims to make the internal organisation more responsive to the ever-changing challenges that the Bank will face in the future. The initiative, which was denominated *One Bank*, focuses on the need to streamline the Bank's internal procedures and modernise its management culture. The Bank foresees achieving further efficiency gains through the adoption of several measures, including the reduction of underperforming staff and of allowances for travel and missions. The most concrete result of the Bank's modernisation initiative was perhaps the creation of two new vice-presidencies in 2012, one for policy and one for human resources and corporate services. In this context, in 2013 the EBRD identified a set of core values – professionalism, integrity, leadership, innovation, diversity and teamwork – which could contribute to improving the management of the Bank's staff. This led the EBRD to enhance inclusion and diversity among its staff by joining diversity programmes and networks and by introducing compulsory training on inclusive leadership. The Bank also expanded the project selection criteria, with the aim of becoming more effective in areas of social inclusion and equal opportunities.¹⁰

25. The establishment of the Vice-Presidency for Policy had highly symbolic and operational relevance, since it constituted an important part of the Bank's overall effort to re-energise transition via enhanced policy dialogue. The aim is to use policy dialogue to achieve transition impact going beyond individual projects by, for example, strengthening the link between the Bank's investments and the economic reforms to be adopted at the broader sector and country levels.¹¹ In this respect, in May 2014 the Bank accomplished a remarkable achievement by signing the Partnership for Re-energising the Reform Process in Kazakhstan with the Kazakh authorities. The partnership enables the EBRD, together with other international financial institutions, to channel US\$2.7 billion provided by the government into strategic sectors of the economy. This will increase the Bank's critical mass in the country, thereby providing enhanced opportunities for policy dialogue and technical co-operation. According to the EBRD Managing Director, Olivier Descamps, the partnership may become an important way to boost market reform and, if successful, it may constitute a blueprint to re-energise transition in other middle-income countries.¹²

26. The EBRD has been criticised recently for its lack of transparency. In 2013, the EBRD was ranked by the Aid Transparency Index (ATI) as the lowest among 67 International Financial Institutions and multilateral organisations in respect of transparency. According to the ATI, the Bank “lags on commitments indicators and on organisation and activity financial information”. The Parliamentary Assembly should therefore encourage the EBRD to join the International Aid Transparency Initiative (IATI) and to start publishing data to IATI standards.

4. Political and economic developments in 2013 and 2014

27. In its 2013 Annual Report, the EBRD noted that since the early 2000s a number of countries in the transition region had seen a levelling off of democratic progress.¹³ Later, the financial crisis triggered a sense of resentment towards market economy, which had delayed the implementation of reforms. The intertwining of the two processes led the EBRD to define some of its countries of operations as stuck in a lower-than-optimal level of political and economic reform.¹⁴ In the second half of 2013 and the first half of 2014, episodes of public discontent calling for better governance occurred in several countries across the transition region. Social unrest has temporarily increased political uncertainty, which in some countries is hindering economic activity. On the other hand, however, these episodes offer an important window of opportunity to rekindle the

8. EBRD, Energy Sector Strategy, 10 December 2013.

9. EBRD, Annual Report 2013, 14 May 2014.

10. Ibid.

11. Ibid.

12. EBRD, EBRD and Kazakhstan agree historic partnership to boost reforms and investments, 23 May 2014.

13. EBRD, Annual Report 2013, 14 May 2014.

14. EBRD, Transition Report 2013, 20 November 2013.

reform agenda. Crucially, the chances of success in unleashing a new wave of political as well as economic reforms also depend on leadership and external support. It is in these areas that the EBRD maintains an instrumental role.

4.1. The EBRD region between democratic progress and geopolitical tensions

28. In 2013 and 2014, political developments in the EBRD region have seen mixed results. While the escalation of geopolitical tensions between Russia and Ukraine and the challenges in the political transition of Egypt and Tunisia dominated events, democratic progress in a number of other countries was tangible. On 1 July 2013, Croatia officially became the 28th member of the European Union. Georgia and the Republic of Moldova signed an Association Agreement with the European Union in 2014. Notable democratic progress was also evident in countries of the Central Asia region, particularly in Mongolia and in the Kyrgyz Republic. In April 2014, the Parliamentary Assembly granted Partner for Democracy status to the Parliament of Kyrgyzstan.

29. In the Western Balkans region, the process of reconciliation between the different countries continued, although significant challenges stemming from inter-ethnic issues remained. In February 2014, a series of demonstrations and social unrest rapidly spread in Bosnia and Herzegovina, with the population demanding an end to the political inertia that had characterised the country since the end of the war. The deep-rooted causes of the government's failure to act could be found in the fragile constitutional equilibrium that had emerged from the pacification process following the war in the former Yugoslavia. This provided the country with a complex system of checks and balances which hampers an efficient functioning of the State. In the Country Strategy adopted in January 2014, the EBRD indicated the reform of the country's constitutional set-up as a pivotal step to progress towards a more efficient and democratic State.¹⁵

30. In Turkey, the government reacted firmly to manifestations of public discontent following the demolition of Istanbul's Gezi Park in May 2013. This caused a wave of protest, mainly against alleged limitations to the freedom of expression and assembly, to spread around the country. In December 2013 and in the first months of 2014, a corruption scandal involving associates of some government ministers unleashed new public protests, to which the government responded by temporarily limiting access to social media. In March 2014, however, the ruling party won local elections in the most important cities of the country, and the level of social unrest gradually decreased. The EBRD remains firmly committed to addressing the remaining transition gaps in the country.

31. Apart from the progress in the Republic of Moldova, developments in the Commonwealth of Independent States (CIS) raised concerns, particularly with respect to corruption, weak adherence to the rule of law and instances of human right violations reported by international organisations. The lack of democratic progress in Belarus and Turkmenistan was especially noted as a cause of serious concern in the 2013 Annual Report.¹⁶ The scope of the Bank's engagement in those two countries is limited to specific sectors of the economy and is defined against a well-specified set of both political and economic benchmarks, in the context of the so-called calibrated approach.

32. The EBRD responded to the developments which occurred in the first part of 2014 in Ukraine by stating its readiness to step up both its financial engagement to the country and its policy dialogue initiatives with the authorities. The Bank's investments in the country are expected to increase to €1 billion per year, as part of an international financial assistance programme.¹⁷ In May 2014, the EBRD signed a Memorandum of Understanding with the government for the Ukrainian Anti-Corruption Initiative. At the heart of the initiative, which aims to monitor corruption and increase transparency, is the creation of an independent Business Ombudsman Institution, to which businesses can bring their complaints of unfair treatment.¹⁸

33. As for its engagement in Russia, the EBRD did not make any formal decision regarding the scope of its operations in the country following the Crimean crisis. However, the Russian economy is expected to decelerate as a consequence of the escalation of the geopolitical tensions. This might cause the volume of EBRD investments in the country, which had already slumped from €2.6 billion in 2012 to €1.8 billion in 2013 because of deteriorating investment conditions, to decline further. During his address to the 2014 Annual Meeting, President Chakrabarti emphasised the concept of managed flexibility, which allows the Bank to reallocate to other countries the spare capacity resulting from lower investments in one region.¹⁹

15. EBRD, Strategy for Bosnia and Herzegovina, 15 January 2014.

16. EBRD, Annual Report 2013, 14 May 2014.

17. EBRD, EBRD steps up lending in Ukraine as part of international support package, 6 May 2014.

18. EBRD, Memorandum of Understanding for the Ukrainian Anti-Corruption Initiative, 12 May 2014.

19. Suma Chakrabarti, The EBRD's "focus is clear", 14 May 2014.

34. In the SEMED, political reforms proceeded steadily, albeit with some difficulties. In Jordan and Morocco, the role of elected parliaments was strengthened by the adoption of further reforms. Following a period of stalemate, in February 2014 Tunisia approved the new Constitution, which was seen as an important step in the country's transition to democracy. In Egypt, progress was more uneven. The political transition following the 2011 uprising was interrupted by mass demonstrations against elected President Mohamed Morsi. Following his deposition in June 2013, a prolonged period of political tensions and social unrest ensued. A new road map for the transition process was finally agreed upon in December 2013. This resulted in the approval of the new Constitution in a referendum in February 2014, and in the election, at the end of May 2014, of Abdel Fattah el-Sisi as the new President of the Republic. Parliamentary elections are to be held in October 2014. Despite the period of political uncertainty, the EBRD made significant progress in carrying out its operations in the SEMED region. Although Egypt maintained the status of potential recipient country, the Bank had been investing in the economy through the ad hoc EBRD SEMED Investment Special Fund. Meanwhile, Jordan, Morocco and Tunisia were granted recipient country status in November 2013. The Parliament of Morocco was granted Partner for Democracy status by the Parliamentary Assembly in 2011 and the Parliament of Jordan has also submitted a request for such status.

4.2. Heightened uncertainty and the risks to the outlook for growth

35. With the exception of Russia, Turkey and Poland, the transition region is formed of countries of a relatively small economic size, which makes them vulnerable to external developments. This was evident in the aftermath of the financial crisis, as the region was hit particularly hard by the collapse in global trade and by the withdrawal of foreign capital. Whereas trade rebounded in 2009-2010, the process of cross-border deleveraging, in which foreign-owned banks withdraw funding from the transition region, was still ongoing, albeit at a slower pace. Overall, economic output expanded by less than 3% in both 2012 and 2013. In May 2014, partly as a consequence of the tensions between Russia and Ukraine, the Office of the Chief Economist forecast it to further decline to 1.4% in 2014.²⁰

36. Analysing the dynamics of growth in closer detail, it appears that in 2013 the decrease of financial tensions in the Euro Area benefited countries with close links to the monetary union. The gradual recovery in economic activity in the Euro Area was reflected in substantial higher growth rates in the South East Europe (SEE) region, averaging 2.7% of Gross Domestic Product (GDP) in 2013 compared to 0.4% in 2012. This was despite the fact that cross-border deleveraging had not come to a halt in the SEE region and in central Europe and the Baltic States (CEB), thus further delaying the resumption of credit growth. On the positive side, however, deleveraging mostly took place in the form of foreign currency lending, while local currency lending, which does not expose the borrower to exchange rate fluctuation risks, increased in a number of countries, including Poland, Hungary, Bulgaria and "the former Yugoslav Republic of Macedonia". Political uncertainty, however, was a key factor in affecting growth in other regions of EBRD operations. In Ukraine, the beginning of social unrest in the last months of 2013 contributed to further deteriorating the already weak consumer and business confidence, with output stagnating in 2013. Output growth in the SEMED region in 2013 was slightly below expectations, due to a mix of domestic and regional turmoil.

37. Economic expansion was dampened in eastern Europe and the Caucasus (EEC), as the worsening of the external environment, which before was confined to the western part of the transition region, expanded eastwards. This was mostly due to developments in the global economy. In May 2013, the American Federal Reserve Bank announced that it would soon start to scale down the so-called quantitative easing, a large-scale asset purchase programme that it had carried out during the five preceding years in response to the financial crisis. As quantitative easing had contributed to increasing short-term capital flows to emerging market economies, the mere announcement of its scaling down, known as tapering, caused volatility in the financial markets of these countries to increase, and financial flows to reverse. Partly as a result of heightened uncertainty about future swings in global monetary policy, key emerging markets, including China, India and Russia, experienced a slowdown in economic activity, thereby contributing to weakening external demand in neighbouring countries. In the third quarter of 2013, net private capital flows turned negative in the EBRD region. Increased volatility and the reversal of capital flows were particularly evident in the depreciation of the currencies of those countries that were dependent on capital flows from abroad, such as the Turkish lira and the Mongolian tögrög, which lost about 15% of their value against the US dollar in the seven months between 13 May and 13 December 2013.

38. With the exception of the SEE and the SEMED regions, which should benefit from the recovery in Europe, the outlook for economic growth in 2014 and 2015 in the transition region has been negatively affected by the geopolitical tensions between Ukraine and Russia. As the Crimean crisis escalated, volatility in

20. EBRD, Regional Economic Prospects in EBRD Countries of Operations: May 2014, 14 May 2014.

the financial markets heightened. Capital flights out of Russia in the first quarter of 2014 reached the overall level registered in the whole of 2013. The downward pressure on the Russian rouble intensified, while the domestic stock market plunged. As a result, investor and business confidence has worsened, and economic growth is forecast to come to a halt in 2014, and to remain low in 2015. In Ukraine, the depreciation of the currency and the jump in the country-risk indicators only became subdued in early May 2014, after the government signed a preliminary agreement on an international macroeconomic adjustment programme led by the International Monetary Fund (IMF). As a result of the implementation of the structural reforms envisaged in the programme, Ukraine is expected to suffer severe output losses in 2014 and stagnation in 2015.

39. Increased geopolitical tensions between Russia and Ukraine are also likely to impact neighbouring countries. The EEC region is forecast to suffer from direct negative financial and economic spill-over from the crisis. In May 2014, the Office of the Chief Economist revised its forecast for growth in the region for 2014 to -2.6% of GDP, from +2.0%.²¹ In the CEB region, increased geopolitical tensions are likely to neutralise the positive effects stemming from the pick-up in external demand coming from the Euro Area and the first sign of recovery of private investment. The Crimean crisis could affect growth in the region, mostly through trade links with Russia and due to energy security concerns, resulting from gas supply uncertainty. The EBRD forecasts growth in the CEB region to be 2.2% of GDP in 2014. In the Central Asia region, the outlook was dampened by two factors: the slow-down in remittance growth coming from Russia and the contagion in the financial and currency markets, which was already evident in the devaluation of the currencies of countries with close links with Russia, such as the Kyrgyz Republic and Kazakhstan. However, the EBRD still expects growth in the Central Asia region to average 6.2% in 2014.²²

40. As far as macroeconomic policy is concerned, developments in the transition region in 2013 and 2014 reflect broader global trends. Monetary policy remains accommodative in most EBRD countries of operations, also thanks to declining inflation rates. Declining inflation, in turn, is caused by lower commodity prices, weaker growth in key emerging markets and high unemployment in developed economies. Notable exceptions are Russia and Turkey, where inflation remains above the central bank's goal. Evidence on fiscal policy is more mixed. Consolidation efforts continue in all European Union member States, with the aim of complying with the European Union fiscal rules. However, the primary balance, a measure of the fiscal stance of the government, deteriorated in some countries as a result of the decrease in revenues caused by slowing economic activity. Primary balance deteriorated also in a number of commodity exporting countries, due to lower commodity-related revenues. Fiscal deficits remain relatively high in Egypt and Tunisia, due to an increase in spending and the failure to reform energy subsidy schemes.

5. Transition fatigue and the response of the EBRD

5.1. The legacy of slower growth: declining public support for market-oriented reforms

41. The prolonged period of slower growth that has followed the global financial crisis has profoundly affected the prospects of the EBRD transition region to achieve convergence with the living standards of advanced market economies. The main economic reason that has caused growth in the transition region to slow and remain below pre-crisis levels is well understood and lies in the persisting decline of international capital flows to the region. According to the Office of the Chief Economist, however, the cure for the economic malaise should not be a return of capital flows to pre-crisis highs, since in many cases these reflected unsustainable investment bubbles. Rather, a more pressing concern is the lack of political resolve to implement those structural reforms that are crucial to improve market-supporting institutions and rekindle growth. As noted in the 2013 Transition Report, reforms had already been losing momentum since the mid-2000s, before the financial crisis hit, and the period of slower growth following the financial crisis further exacerbated this structural problem.²³

42. The increase in long-term unemployment brought about by the crisis and the prolonged period of fiscal austerity, often recommended by supranational bodies, is eroding public support for market-oriented reforms. Some of the most advanced countries in the transition region even experienced reform reversals. For instance, Hungary and Bulgaria have seen administrative tariff reductions, pushing energy prices below cost-recovery levels. This risks deterring investment in the sector, thus undermining economic competitiveness. Delays in privatisations, the re-nationalisation of banks and increased State interference in the economy

21. Ibid.

22. Ibid.

23. EBRD, Transition Report 2013, 20 November 2013.

occurred in a number of countries, including Russia, Ukraine, Kazakhstan and Latvia. In Poland and Hungary, capital market development suffered from a setback when the governments passed legislation *de facto* eliminating the fully-funded private leg of the pension system.

43. The Office of the Chief Economist has developed the so-called transition indicators, in order to assess progress in transition to an open market economy. At country-level, there were 11 downgrades across the EBRD transition region between 2010 and 2013, of which six concerned European Union members. During 2013, downgrades outnumbered upgrades across the EBRD transition region for the first time since the Bank's establishment.²⁴ The fact that the majority of downgrades affected the most advanced countries comes only partially as a surprise. Due to the close links with western Europe, the crisis is felt the most in the CEB and SEE regions. In addition, in many of these countries the crisis appears to have been blamed on the economic institutions prevailing at the time, thus denting support for free markets. However, structural reforms are seen as a crucial element for achieving convergence. According to long-term forecasts made by the Office of the Chief Economist, if countries did restart reforms, yearly growth could increase between 0.8% and 1.5% of GDP over the longer term. The policy challenge lies in the fact that, in order to rekindle growth, it is necessary to whet the appetite for structural reforms. However, this needs to be accomplished during a period in which the support for reforms has declined, precisely because of slow growth.

5.2. Re-energising transition: medium-term directions and the Fifth Capital Resources Review

44. During the 2014 Annual Meeting, President Chakrabarti unveiled a three-pronged approach jointly devised by the Board of Directors and Senior Management to re-energise transition in the EBRD region. This approach is part of a more comprehensive strategy defined as "medium-term directions", which constitutes the basis for the discussion over the *Fifth Capital Resources Review*, covering the period 2016 to 2020. In presenting the medium-term directions, President Chakrabarti noted that in order to deliver most effectively the Bank has to fine-tune its business model and he made an explicit reference to the need to enhance the Bank's risk-taking capacity.²⁵

45. The new strategy develops around three key points: the first one concerns the need to build resilience in the transition process, especially in terms of institutions and economic structures. At the EBRD, the necessity to revitalise the appetite for market reform in order to rekindle transition is well understood. Ultimately, however, it is the role of governments to adopt the policies that are necessary to foster transition. Despite that, the Bank still has a decisive role to play in formulating and bringing forward those policies. Furthermore, thanks to its long experience in the region, the Bank is in a privileged position to pinpoint and provide finance to those projects that could have a sustainable impact on transition, because the right policies and institutions are in place. The medium-term directions regard precisely these two elements, the formulation of policy reforms and the financing of pivotal projects, as the way forward for the Bank to contribute to improving economic structures and institutions.²⁶

46. The second aim of the medium-term directions consists of developing further economic integration in the transition region. Besides raising growth, integration could also help to prevent reversals in the transition process, as the costs of undoing reforms are higher in more interconnected economies. Concretely, the Bank could intervene in this sector in two ways, by providing financing to projects aimed at developing cross-border infrastructures and by introducing new international investors to the region.

47. Finally, the need to address common global challenges, such as food security, climate change, water scarcity and energy security constitutes the third main point of the strategy.²⁷ The EBRD has already been tackling these challenges and aims to further strengthen its engagement. For example, the Bank reacted to the increase in food prices between 2010 and 2012 by increasing its investments in the agribusiness sector. Furthermore, with the objective of reducing carbon emissions and making the countries of operations more energy efficient and independent, in 2006 the EBRD launched the Sustainable Energy Initiative, through which it invested €13.5 billion in sustainable energy projects between 2006 and 2013.

48. The medium-term directions are not confined to the three points referred to above. An important aspect of the new strategy concerns the Bank's geographic planning. In this respect, the medium-term directions present a consensus view on gradually phasing out investments in the seven EBRD recipient countries that joined the European Union in 2004, in the context of the so-called "graduation" policy. It is not yet clear, however, whether graduation is foreseen to take place within the period of the Fifth Capital Resources

24. Ibid.

25. Suma Chakrabarti, The EBRD's "focus is clear", 14 May 2014.

26. Ibid.

27. Ibid.

Review. In order to make the graduation process smoother and politically attractive, the Bank is also working to devise a new Post-Graduation Special Fund to which countries can access after graduating to get financing for cross-border investment projects. This fund will also benefit the Czech Republic, which is the only EBRD member to have already effectively graduated in 2007. Whereas the Bank expects to gradually scale down its operations in the western part of the transition region, the medium-term directions maintain the general orientation towards increasing operations in the east and south of the region. Finally, the new approach to geographic planning also aims to increase the Bank's flexibility in responding to changes in the business environment across the region. Importantly, the scope of increased flexibility would always be determined under the guidance of the Board of Directors.

49. The Bank is also working to modernise its planning process. Concretely, this consists of the introduction of a Strategic Implementation Plan (SIP), on a three-year rolling basis. Currently, the guidelines for the activities of the Bank over the medium term are outlined in the Capital Resource Review (CRR), which covers a five-year period, whereas implementation is defined in the Annual Business Plan (ABP). A drawback of this approach is that it does not leave much room for changes in the Bank's strategic direction. As a result, in some cases the Bank had to deviate from the original plan set out in the CRR. The most notable example was the postponement of the graduation of the recipient countries that joined the EU in 2004, which was expected to take place within the period covered by the Third Capital Resources Review (2006-2010). The intention of the reform is to make the planning process more flexible by allowing the SIP to draw some of the work out and ease the burden of the CRR and the ABP. This would make the CRR less prescriptive, thereby contributing to improving the alignment between the Bank's priorities and the constraints posed by the environment in which it operates.

6. Democratic progress of recipient countries

50. In February 2013, the EBRD updated the processes and procedures concerning the implementation of the political aspects of its mandate. The Bank's operations, which are designed to foster private sector development and narrow economic transition gaps, are only indirectly targeted to the promotion of democratic transition. It follows that the Bank neither assesses the potential contributions nor evaluates the impact of individual projects for the development of multiparty democracy. Nevertheless, democratic progress is recognised as being closely interrelated to the main purpose of EBRD operations, namely to foster transition to an open market economy. For this reason, political assessments are an integral part of the triennial Country Strategies and of the annual Country Strategy Updates.

6.1. Does market reform promote democracy? Theory and evidence from the transition region

51. Market reform is typically thought to have both broad political and institutional implications. More specifically, economic development is often associated with the consolidation of democratic institutions and institutional capacity building. However, economic transition and democratic progress do not always come together. In particular, whereas the correlation between economic development and democracy is significant, such correlation does not need to imply a causal relationship.

52. To the extent that the EBRD mandate is to foster transition to an open market economy in those countries committed to the principles of multiparty democracy, the nature of the relationship between economic and political development acquires a critical relevance. If economic and political transition were known to be two unrelated processes, the EBRD could be expected to operate only in those countries that were already applying the principles of multiparty democracy. On the other hand, in the case that market reform was to benefit political transition to more democratic systems, the EBRD could be legitimately thought to carry out its operations also in non-democratic countries. In reality, the Bank is active both in fully democratic countries, such as those belonging to the European Union, and in less democratic ones, such as Belarus and Turkmenistan, suggesting that political transition is to benefit from economic development.

53. When the Sub-Committee on Relations with the OECD and the EBRD met at the headquarters of the EBRD in February 2014, we asked in particular how the Bank handled the fact that it was helping countries which were not working towards democracy, and bringing credibility to certain countries which did not deserve it. We were told that although the aim of the Bank was not to foster democracy and experience had shown that democracy and market economy did not always go together, it was nevertheless hoped that they would converge in the long term. We were also told that the EBRD Board had felt that walking away from such countries would not help them.

54. The 2013 Transition Report dedicates an entire chapter to reviewing the literature explaining the relationship between markets and democracy and tests whether its main findings apply to the transition region. A large strand of the literature finds wealth, industrialisation, urbanisation and education to be statistically associated with the development of democratic systems. Building upon this finding, the well-known modernisation theory regards economic development, as measured in per capita income level, to be critical for the creation of a wealthy and politically active middle class, which demands and supports democratic reform. Another important channel through which economic development is thought to benefit democratisation consists of the higher level of educational achievement that typically characterises countries with higher GDP per capita, the reason being that education positively influences the perception of individuals about democracy.

55. On the other hand, another strand of literature holds the view that it is economic equality, rather than economic development per se, that makes democratic systems more likely to come about and later survive. In particular, in an unequal country the small minority controlling most of the wealth would prefer an authoritarian regime acting in favour of the minority, rather than a democratic one operating in favour of the majority. Of course, this is contingent upon the assumption that the less well-off majority would seek redistribution through the ballot box and the tax system if it were given the possibility to do so, as in the case of democratic systems.²⁸

56. Using international data, the 2013 Transition Report empirically investigates the relationship between economic and democratic development and concludes that market reform and economic growth globally appears to benefit democratisation in the long term and reduce the chances of democratic regression. Specific evidence from the transition region is more mixed. Over a longer period, the impact of economic growth on democratic development was not significant. This is not surprising, however, since most countries in the EBRD region experienced economic development but remained part of undemocratic States or empires as late as 1989. The picture changes considerably when only the period between 1989 and 2012 is considered. The 2013 Transition Report finds that democratic development depended strongly on lagged economic growth, and perhaps more importantly on the adoption of market reforms. Note that the level of economic equality, as measured by the GINI coefficient, does not seem to have played a decisive role.²⁹

57. There are, however, a few caveats. Globally, countries with large endowments of natural resources are found to be less likely to develop a democratic system even when economic development is achieved. This also applies in the EBRD region. There, countries having a high share of GDP stemming from natural resource extraction are substantially less democratic than their level of economic development would otherwise predict. The large revenues generated by extractive industries make the authorities less dependent on a fiscal system that taxes the general population, which in turn decreases the pressures to enhance accountability to the taxpaying population through the development of more democratic institutions.

58. Furthermore, the large revenues related to natural resource extraction allow the authorities to maintain consensus by redistributing subsidies to the population, thereby reducing the demands for political reform. Since some of its recipient countries are endowed with large stocks of natural resources, the fact that this might impede democratic development is particularly relevant for the Bank's policy. The Bank's engagement in such countries is particularly focused towards institutional capacity building, via increased policy dialogue and economic diversification. The latter, which is promoted by financing projects in sectors other than those related to natural resource extraction, is crucial to develop other sectors of the economy, thereby making the population less dependent on the subsidies distributed using revenues related to extraction. The development of sound institutions is essential to guarantee that the windfall revenues stemming from resource extraction are used to finance productive investments that are beneficial for economic growth, rather than for consensus-seeking redistribution.

59. The 2013 Transition Report also finds that the effects of economic development on democratisation are likely to take between one or two decades to materialise. In the short term, economic growth could even increase the chances of survival of non-democratic regimes. Therefore, the international development community needs to act with patience and persistence in supporting market reform, as this would only gradually promote democratic progress.³⁰

28. EBRD, Transition Report 2013, 20 November 2013.

29. Ibid.

30. Ibid.

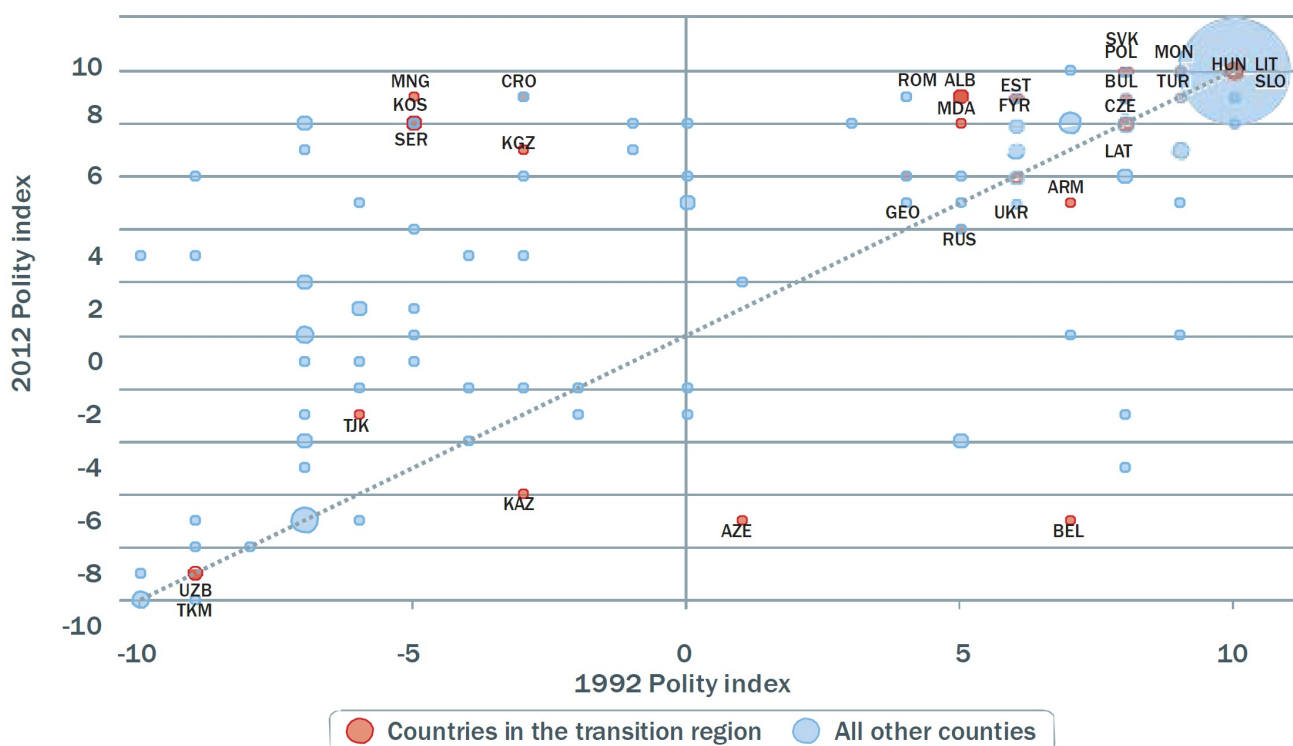
6.2. Degree of achieved transition in recipient countries relative to quantity of EBRD investments

60. The lack of an assessment of the potential contribution of individual projects in fostering democracy increases the difficulty in establishing a causal relationship between the volume of the EBRD investments in a recipient country and the degree of democratic transition achieved. On the other hand, a simple comparison of relevant democratic governance indicators between 1992 and 2012 suggests that a few countries in the EBRD region have made significant progress in their level of democratic development.

61. Figure 1 presents a chart showing changes in the level of democracy, as measured by Polity scores, between 1992 and 2012, both for countries in the transition region and others. The Polity project provides a series of data widely used in social sciences research. Its analysis focuses on the most formal class of polities, that is States operating within the modern world's State system. Democracy is conceived as the presence of three interdependent elements: the existence of institutions and procedures through which citizens can express effective preferences about alternative policies and leaders; constraints on the exercise of power by the executive; and the guarantee of civil liberties.

62. Polity's conclusions about a State's level of democracy are based on an evaluation of: i) competitiveness of executive recruitment; ii) openness of executive recruitment; iii) constraints on the chief executive; and iv) competitiveness of political participation. A Polity score ranging from -10 to +10 is determined for each year and country. Values from -10 to -6 are used to classify autocracies, -5 to 5 for anocracies, and 6 to 10 for democracies. Countries above the dotted line experienced improvements in democracy, those below worsened. Turkmenistan and Uzbekistan were already so undemocratic in 1992 that they could not get any worse and maintained their position at the bottom. Belarus, Azerbaijan and Kazakhstan, by this order, had the worse evolutions, with Belarus dropping 15 points from +7 to -7. Kyrgyzstan had one of the more positive changes, rising from -3 to +7.

Figure 1: Changes in the level of democracy between 1992 and 2012



Source: EBRD 2013 Transition Report, p. 26

63. By 1992, democracy had already developed in most of the countries that would join the European Union in 2004, which prevented them from experiencing further significant improvements in the period considered. It is not surprising that democracy had sprung up in the western part of the transition region soon after the fall of the Berlin Wall; thanks to a well-educated population and a largely manufacturing-based economy, the right environment for democratic development to flourish was already in place in these countries. The fall of the wall then constituted the right window of opportunity for an orderly political transition

to take place. A similar story holds for the countries of southern and eastern Europe, whose transition to democracy mainly came about following a large shock, such as the dissolution of the former Yugoslavia. On the other hand, Russia and Ukraine started with relatively high democratic indicators in 1992 but failed to develop further. This possibly reflected how a combination of the old elite and a new class of political entrepreneurs managed to preserve or take control of strategic sectors of the economy, including those involving natural resource extractions.

64. The Central Asian republics perhaps constitute the most interesting case to analyse. These countries started their transition with a relatively low level of democratic development and had a largely agrarian and resource extraction-based economy. Some, like Uzbekistan and Turkmenistan, have experienced virtually no change, whereas in other countries democratic indicators either substantially improved (as in Mongolia and the Kyrgyz Republic) or declined (as in Kazakhstan and Azerbaijan). With the exception of the Kyrgyz Republic, the rate of EBRD investment in the central Asian region seems to be somehow correlated to the countries' democratic performance.

65. Crucially, Mongolia had the highest EBRD investment rate in the transition region, as the Bank invested on average €32 per year per person in the eight years of operations in the country. The same figure is only €1 and €2 for Uzbekistan and Turkmenistan, respectively. High annual per capita investment rates, between €18 (in Slovenia) and €29 (in Montenegro), also characterise countries in the SEE region, which all realised improvements in their democratic indicators between 1992 and 2012. In Belarus, Azerbaijan and Kazakhstan, the countries with the most negative changes in democracy indicators, the EBRD investment rate is respectively €7, €10 and €14 per year per person.

66. To some extent, these numbers indeed suggest the existence of a positive correlation between the Bank's investments in recipient countries and the degree of democratic progress achieved. It should be noted, however, that these are very rough figures and do not take into account important aspects, such as country's economic size and potential reverse causality issues.³¹ They are therefore not meant to infer a causal relationship between EBRD investments and democratic progress.

7. Special issues regarding EBRD activities

7.1. Operations in the southern and eastern Mediterranean region: an early review

67. The political breakthrough in the SEMED countries in 2011 was the result of a home-grown process rather than of external developments. After a long period of non-democratic rule, mass protests calling for more equality of opportunities initiated an era of change. The events that followed offer a unique window of opportunity to foster both economic and political development.

68. The success of the transition process, however, depends on several factors. Issues in the new transition region are quite different from those in east European countries in the 1990s, which makes the SEMED a unique case for the EBRD. The stock of human capital in the region is slightly below that of CEB and SEE countries when they started their transition. This could increase the time needed to develop those political, legal and economic institutions that are crucial to foster development. Moreover, the young unemployed constitute a large share of the population in the SEMED, which makes political reform more susceptible to regression in the event that they do not feel sufficiently included in the transition process.

69. On the other hand, private sector development, particularly that of small and medium-sized enterprises (SMEs), and the modernisation of the infrastructures and energy distribution systems constitute two areas with large transition impact potential where the EBRD could play an important role. Another area where transition gaps are evident relates to female participation in the labour market and more specific gender issues. In this connection, the Bank recently added economic inclusion as one of the areas to be considered in its assessment of transition. Economic inclusion, intended as the extension of opportunities to individuals regardless of their circumstances or social background, could contribute to increasing female and youth participation in the labour market.

70. Following the shareholders' agreement to extend the Bank's geographic remit to include Egypt, Morocco, Tunisia and Jordan, the EBRD has carried out preliminary work to understand country priorities and, since 2011, develop first contacts with stakeholders. In 2012, the Board of Governors allocated €1 billion from

31. These figures were obtained by dividing total EBRD investments up to 2013 in one country by its average population during the years of the Bank's operations and the number of years in which the Bank operated. Data source: EBRD and World Bank.

the Bank's net income into the SEMED Investment Special Fund, to implement early investments in the region. Following the approval of potential recipient country status for Egypt, Tunisia, Jordan and Morocco, the first project in the SEMED was approved in December 2012. In November 2013, Tunisia, Jordan and Morocco were granted the status of recipient country, while Egypt still remains a potential recipient country. Furthermore, the Bank opened resident offices in Tunis, Cairo, Casablanca and Amman, to cultivate relationships with the respective authorities and business communities.

71. Three years after the events of the Arab Spring, the EBRD is fully engaged in the new transition region and intends to significantly expand its financial and institutional commitments. Crucially, the EBRD is also engaged with the authorities in policy dialogue activities, with the particular aim of developing the legal environment. Overall, in 2013 the Bank invested €449 million in 21 operations in the region. The EBRD, however, expected its investment volume to increase up to €2.5 billion by 2015. The EBRD identified five main priority areas consisting of: i) supporting SMEs development, in order to achieve a major impact on growth and job creation; ii) enhancing the agribusiness value chain by improving yields, logistics and resource efficiency; iii) assisting financial institutions through capacity building and product innovation; iv) supporting the governments in gradually liberalising the energy sector and introducing energy efficiency and sustainability practices in the economy; and v) modernising the infrastructure system, also via decentralisation of municipal services and the involvement of the private sector.

7.2. The relations between the EBRD and the European institutions

72. Ever since it was set up, the EBRD has dedicated itself to cultivating its relations with other international organisations, and European institutions in particular. The Bank has regular contacts with the Council of Europe, the Council of Europe Development Bank (CEB), the European Investment Bank (EIB) and the European Commission. The relationship between the EBRD and the Council of Europe is directed at monitoring democratic progress in central and eastern Europe. Additionally, in October 2013 the EBRD and the CEB updated an existing bilateral agreement which foresees regular exchanges of information in order to facilitate collaboration in areas where their mandates overlap and enhance impact in common countries of operations. When we met at the EBRD, Sir Suma Chakrabarti expressed his appreciation for co-operation with the Assembly's Monitoring Committee.

73. The relation between the EIB and the EBRD has a unique characteristic, insofar as the EIB is an EBRD shareholder, but not vice versa. The two banks have shared interests in several of the EBRD countries of operations and often co-finance the same projects. In 2011, the EBRD, the European Commission and the EIB updated an already existing Memorandum of Understanding, aimed at supporting the fulfilment of European Union external policy objectives in the countries where both banks operate.

74. The European Union is itself a shareholder in the EBRD, as are all EU member States. Furthermore, both EU member States (such as Bulgaria, Croatia, Cyprus, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia), and EU candidate and potential candidate countries (such as Albania, Bosnia Herzegovina, Montenegro, Serbia and "the former Yugoslav Republic of Macedonia") are also EBRD recipient countries. European partners, such as the European Commission, the EIB, and some EU member States, are among the largest donors for crucial EBRD activities, such as technical co-operation with the Bank's clients and policy dialogue with the governments of recipient countries. Through these activities, the Bank improves standards in corporate governance and transparency and promotes the development of market supporting institutions in key transition sectors of the economy. A new development in the EBRD activities was the establishment in 2013 of an External Policy Coordination Team and the opening of an office in Brussels, which aim to further enhance collaboration with the European institutions and other key external partners.

8. Conclusions

75. Before the recent financial crisis of 2007-2008, the transition to market economy was considered to have been broadly achieved throughout a significant part of the EBRD region. The severe recession that followed jeopardised the convergence process and challenged the results achieved in previous years. Due to the diminished availability of foreign capital and the related credit crunch, investments and consumption suffered, which had a negative impact on economic growth. The crisis and the continued efforts towards fiscal adjustment in the European Union countries also dented public support for free markets. In this context, it would be wise to reconsider the extent of the fiscal adjustment to be sustained by those countries. Furthermore, the lack of political resolve to implement structural reforms, which had already lost momentum since the mid-2000s, is evident. Moreover, since the early 2000s a number of countries in the transition region have seen a levelling off of democratic progress.

76. Recent developments in some countries in the SEMED region, however, have been encouraging. In Morocco and Jordan the role of elected parliaments has been further strengthened. After a period of uncertainty, in Tunisia the new constitution was finally approved in 2014, which can be seen as a positive development in the country's transition to democracy. Challenges in the political transition in Egypt are still present, and the country maintains the status of potential recipient. Nevertheless, despite the political uncertainty, the Bank made considerable progress in the region. In November 2013, Tunisia, Jordan and Morocco were each granted the status of recipient country. The Bank also opened resident offices in Tunis, Cairo, Casablanca and Amman, to cultivate relations with the respective authorities and business communities. The EBRD invested €449 million in 21 operations in the region in 2013 and expects its investment volume to increase up to €2.5 billion by 2015. Social issues in the new transition region relate to the high unemployment rate among young people and low female participation in the labour force. With this in mind, the expansion of the Bank's project selection criteria to include social inclusion and equality of opportunity should be welcomed.

77. The developments in Ukraine in the latter part of 2013 and first part of 2014 offer an important window of opportunity to foster transition. The EBRD is in a position to play an instrumental role by providing leadership and external support. In this connection, the stated intention of the Bank to support Ukraine by augmenting its financial engagement in the country and increasing policy dialogue with the authorities should be supported and further encouraged. The new drive towards increased policy dialogue already resulted in the signing of a Memorandum of Understanding with the government for the Ukrainian Anti-Corruption Initiative.

78. The EBRD is well aware that the case for its operations has considerably strengthened in the post-crisis world. During the 2014 Annual Meeting, the EBRD shareholders discussed the new medium-term directions that will guide the Bank's activities over the following years. These include a three-pronged approach to re-energise transition in the EBRD region, a new focus on the Bank's geographic vision and a modernisation of its planning process. The medium-term directions provide a starting point for discussion of the Bank's Fifth Capital Resources Review (CRR5), which will cover the period 2016 to 2020 and is to be approved at the Bank's 2015 Annual Meeting in Tbilisi.

79. In an attempt to better align the Bank's priorities and the constraints posed by the environment in which it operates, the EBRD aims to introduce a Strategic Implementation Plan (SIP). This is to be welcomed as it would make the planning process more flexible and less prescriptive by easing the burden of the Capital Resources Review and the Annual Business Plan. Finally, the Bank's Fifth Capital Resources Review is also expected to propose a reorganisation of the composition of the Board of Directors, with the aim of increasing the weight of the countries of operations. The strategic directions also include a consensus view on the expectation of graduation from the Bank's operations of the seven EBRD recipient countries that joined the European Union in 2004. Furthermore, they maintain a general orientation towards increasing operations in the east and south of the region, also in accordance with recent geopolitical developments.

80. The EBRD aims to re-energise transition by concentrating its efforts around three key aims: i) supporting governments in hastening transition through policy dialogue; ii) promoting economic integration both globally and regionally; and iii) addressing globally common challenges, such as climate change, energy and food security and water scarcity. Increased emphasis on policy dialogue is to be supported, as it is crucial to re-think institutional capacity. In this connection, the signing of the Partnership for Re-energising the Reform Process in Kazakhstan constitutes a significant achievement and its progress should be carefully monitored. If successful, it may constitute a blueprint to re-energise transition in other middle-income countries. Concretely, the Bank could promote regional economic integration by introducing new international investors to the region, and by financing projects aimed at the development of cross-border infrastructures. In this respect, the Bank is also devising a new Post-Graduation Special Fund, to which countries can access after graduating in order to finance cross-border infrastructure projects. The establishment of such a fund should be welcomed, insofar as it has the potential to deepen regional integration and increase the palatability of graduation.

81. In the meantime, the Bank has already experienced relevant changes concerning its internal structure, in the context of the modernisation agenda initiated by President Chakrabarti. The initiative, which was denominated *One Bank*, focuses on the need to streamline the Bank's internal procedures and modernise its management culture. This resulted in the creation in 2012 of two new vice-presidencies, one for policy and one for human resources and corporate services. The establishment of the Vice-Presidency for Policy should be seen as an effort to strengthen the link between the Bank's investments and the economic reforms to be adopted at the broader sector and country levels. Meanwhile, the Bank's expansion has continued. During its 2014 Annual Meeting, EBRD shareholders granted the status of recipient country to Cyprus, in order to help the country to rebalance its economy. Moreover, Libya's request to become the 67th shareholder of the Bank

was accepted. Any further decision to grant recipient country status to Libya would be taken separately, following a thorough assessment by the Bank of the political, economic and operational environment in the country, on the basis of Article 1 of the Agreement Establishing the Bank.