Canada at the European Bank for Reconstruction and Development

2007

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

Canada

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

Department of Finance Canada   Ministère des Finances Canada

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Letter From the Minister

I am pleased to present to Members of Parliament and to the Canadian public the Department of Finance's 2007 Report on Operations Under the European Bank for Reconstruction and Development Agreement Act. This report responds to the requirement laid out in Article 7 of the European Bank for Reconstruction and Development Agreement Act that the Minister of Finance "shall cause to be laid before Parliament, on or before March 31 next following the end of each calendar year" a report containing a general summary of operations under this Act, including their sustainable development and human rights aspects. More importantly, it reflects our government's strong commitment to transparency and accountability, and our desire to promote effective and efficient international financial institutions.

Last year's report focused more clearly on Canada's policy objectives at the European Bank For Reconstrcution and Development (EBRD), which can be summarized as:

1. Promoting good governance and accountability.
2. Ensuring institutional effectiveness.
3. Promoting the environmental sustainability of EBRD projects.
4. Advancing Canadian commercial interests.

In the 2007 report, we describe Canada's achievements in meeting these priorities. In addition, for the first time, the report takes a forward-looking view and identifies Canada's future priorities over a three-year period to provide the reader with a better understanding of our objectives with respect to the EBRD. The report also identifies additional actions going forward.

The format of this report draws on improvements made last year. The improvements are based on feedback received from parliamentarians and civil society on this report and its companion report (the Report on Operations Under the Bretton Woods and Related Agreements Act). The 2007 report has been recast with three goals in mind:

1. To make Canada's policy objectives with respect to the EBRD clearer, making it easier to measure the success of Canada's relationship with the institution. To this end, the 2007 report includes specific actions that Canada will advocate at the Board of Directors and the Annual Meetings.
2. To have Canada continue to push the frontiers of disclosure, without violating Canada's requirement to respect the confidentiality policies of the EBRD.
3. To reach out to a wider audience, especially professionals and students with an interest in international development.

It is my hope that this report will provide parliamentarians and all Canadians with a better understanding of the role that Canada is playing in the institution and in helping to ensure that the EBRD achieves its important transition mandate.

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

Mandate and Role of the EBRD

Overview

The European Bank for Reconstruction and Development (referred to in this document as the EBRD or the Bank) was established in 1991. Its aims are to foster the transition toward open, market-oriented economies in Central and Southeastern Europe, as well as in the successor states of the former Soviet Union,[1] and to promote private and entrepreneurial initiative in those countries that are committed to the fundamental principles of multi-party democracy, pluralism and market economics.[2] To deliver on its mandate, the Bank focuses its activities on assisting its 29 countries of operations in implementing economic reforms, taking into account the particular needs of countries at different stages in the transition process. Through its investments, and in line with its Articles of Agreement, the EBRD promotes democratic institutions and human rights in its countries of operations.

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

In promoting economic transition, the Bank acts as a catalyst for increased flows of financing to the private sector, as the capital requirements of these countries cannot be fully met by official multilateral or bilateral sources of financing, and many foreign private investors remain hesitant to invest in the region, particularly the central Asian republics. For example, in 2007, for every euro the EBRD invested, it mobilized an additional 1.7 euros from the private sector and other multilateral and bilateral agencies.

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

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

1 In 2006, all members formally accepted Mongolia as the Bank's country of operations.

2 Article 1, Agreement establishing the European Bank for Reconstruction and Development.

To achieve these priorities the Bank focuses on:

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

Countries of Operations

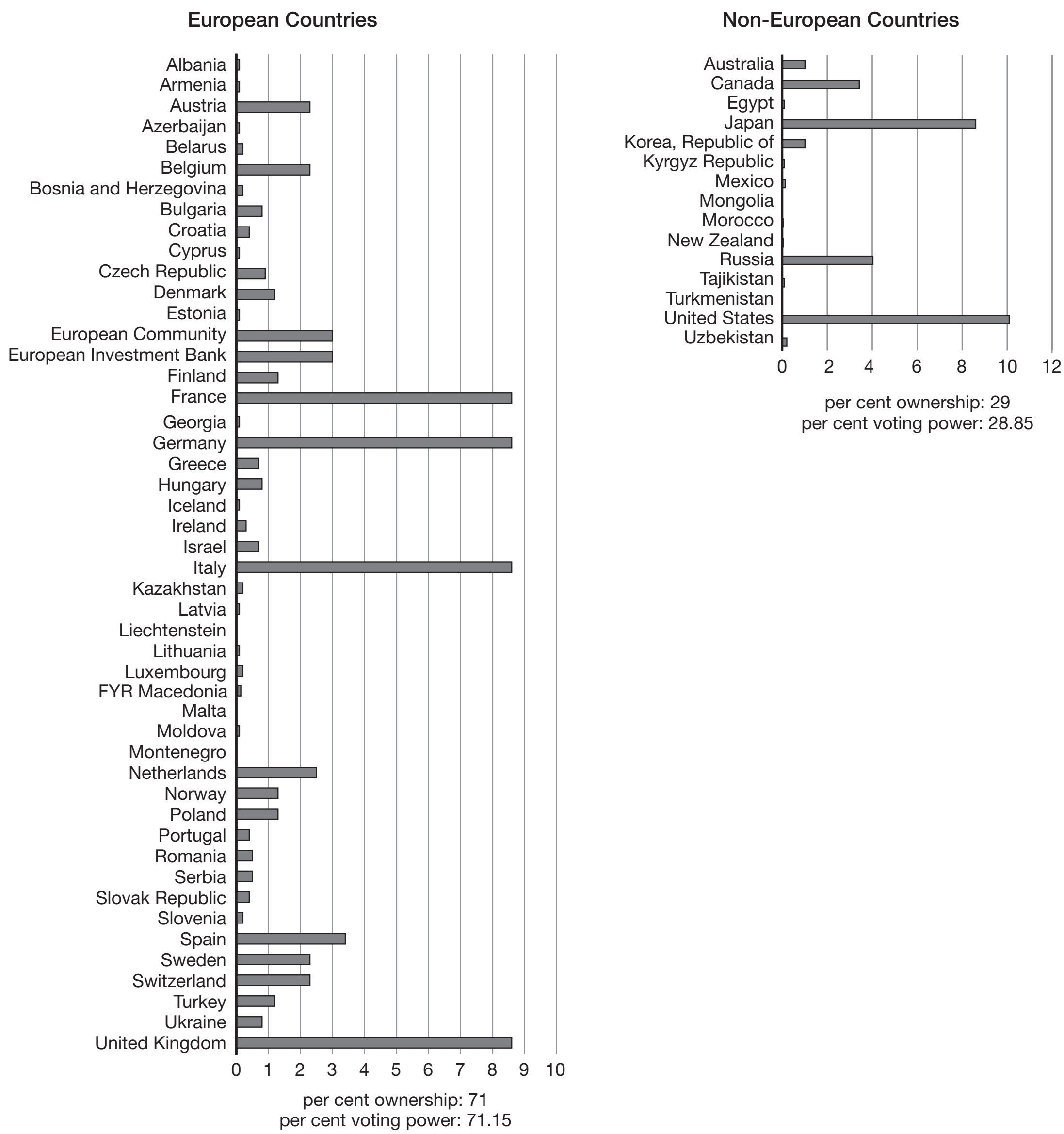
The EBRD has 63 members: 61 countries, the European Community and the European Investment Bank. There were 29 countries of operations last year.[3]

[3] The Czech Republic ceased to be a country of operations in December 2007.

EBRD Membership

The EBRD's share capital is provided by member countries, with proportional voting rights. The EBRD's authorized capital is €20 billion—Canada's capital share is 3.4 per cent.

Chart 1
EBRD Membership



EBRD Governance and Oversight

The highest authority in the Bank is the Board of Governors. It meets annually and approves the institution's annual report, net income allocation, financial statements and independent auditor's report, and the election of the Chair and Vice-Chair for the next Annual Meeting, as well as other items requiring Governors' approval. A Governor and an Alternate Governor represent each of the 63 shareholders.

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

Board Committees

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

The Board Steering Group is responsible for the coordination of the Committees' work programs to avoid overlap and ensure timely completion. The Chair of the Group manages the nomination processes for Committees. The Group is currently chaired by the Canadian Director.

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

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

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

How the EBRD Works

Project Finance

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

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

Eligibility

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

In order to ensure the participation of investors and lenders from the private sector, the EBRD limits the total amount of debt and equity financing for any single project to 25 per cent of total estimated project costs. However, in certain circumstances, it may provide up to 35 per cent of the equity capital for a project, provided it is never the largest shareholder.

EBRD investments range from €5 million to €250 million.[4] Smaller projects are financed both directly by the EBRD and through local financial intermediaries. By supporting local commercial banks, micro-finance organizations, equity funds and leasing facilities, the EBRD has helped finance over 1 million smaller projects.

Fees

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

Funding of EBRD Activities

The EBRD's equity and quasi-equity investments are funded out of its net worth—the total of paid-in capital and retained earnings. Of the funding required for its lending operations, 100 per cent is borrowed in the international financial markets through public bond issues or private placements. The EBRD's bond issues have been given AAA rating by both Moody's Investors Service and Standard & Poor's.

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4 This amounts to C$7.35 million to C$367 million, based on the 2007 exchange rate.

Policy Dialogue

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

Technical Assistance

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

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

Project Cycle

The EBRD's bankers and their project leaders have the primary responsibility for ensuring a project's compliance with four principles: transition impact, additionality, sound banking and environmental sustainability. However, to ensure that projects continue to generate a significant transition impact, risk management and evaluation groups provide independent advice, lessons learned, and monitoring and review functions throughout the project cycle.

Canada's Representation at the EBRD—The Honourable James M. Flaherty, Minister of Finance, is the Canadian Governor and Mr. Leonard J. Edwards, Deputy Minister of Foreign Affairs, is the Alternate Governor. Canada's representative on the EBRD Board of Directors is Mr. André Juneau. The Canadian Director represents our constituency, which includes Morocco. The Minister (Economic/Commercial) at the Canadian High Commission in London, Ms. Judith St. George, is the non-resident Alternate Director and represents Canada in the absence of the Canadian Director.

Canadian Staff at the EBRD—Canadians are well represented on EBRD staff. At the end of 2007 there were 23 Canadian professionals on the staff of the EBRD, representing 3.4 per cent of total professional positions, equal to Canada's 3.4 per cent share of the institution's capital. Canadians fill the following senior positions: Director of Communications, Deputy Chief Compliance Officer, and Director of the Early Transition Countries Initiative.

For More Information on the EBRD

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

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

Requests for information can be addressed to

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Canada at the EBRD

Benefits of Membership

Canada's membership in the EBRD, and its active participation in the discussion of policy and operational issues, are an important means to help shape regional norms and rules in the EBRD's 29 countries of operations. By supporting continued political and economic reform in Central and Southeastern Europe and the former Soviet Union, Canada is contributing to the region's stability and integration into the world economy.

Canada shares with the Bank the overriding objective of developing a strong private sector in its countries of operations, by mobilizing financing for projects with a high transition impact, and by providing advice and technical assistance to businesses and governments. Through its participation in the EBRD's Board of Directors, Canada has been able to press for greater attention to governance issues in the Bank's operations. Moreover, Canada has been able to help shape the environmental and social safeguards that govern the EBRD's lending. The Bank also provides Canada with a vehicle to reach poor transition countries that are not normally part of our bilateral development assistance programs.

Canada is also interested in raising awareness among Canadian companies about the EBRD. Canadian companies can seek financing for projects undertaken in the Bank's countries of operations. In addition, in order to implement transition projects, the Bank often relies on goods and services from its members through procurement. This allows Canadian firms to have access to different markets and enjoy commercial opportunities they may not have had otherwise. For example, consulting services is an area where Canada has a comparative advantage and where Canadians have been successful in winning EBRD-financed contracts.

Role of Canadian Government Departments

Within the Canadian government, responsibility for oversight of the EBRD's activities resides with the International Finance and Development Division of the Department of Finance. In consultation with the Department of Foreign Affairs and International Trade and the Canadian International Development Agency (CIDA), the Department of Finance regularly reviews the Bank's policy papers and proposed country strategies, and provides advice to the Canadian Director.

Contribution to Ordinary Capital Resources

At the end of 2007, the total authorized capital of the Bank was €20 billion. Canada's share is 3.4 per cent—or €680 million (C$1 billion), of which 25.3 per cent, or C$252.7 million, is paid in. The remainder is callable and would be provided only in the unlikely event that the institution would face severe financial difficulty. Canada's paid-in contribution is treated as a non-budgetary expenditure, as shares in the Bank are considered an asset.

Canada's paid-in capital is being provided in a series of instalments of cash and non-interest-bearing demand notes, which are then encashed over a five-year period. Payments are made in eight equal annual instalments (40 per cent in cash and 60 per cent in non-interest-bearing demand notes encashed over five years). Canada's last note encashment will be made in 2009.

Table 1
Canadian Payments to the EBRD

Year	Total cash payments in US$ (includes note encashment and cash payments)	Total cash payments in C$[1] (includes note encashment and cash payments)
1991	23,807,004	27,278,065
1992	15,871,336	19,177,335
1993	19,839,170	25,588,561
1994	23,807,004	32,517,987
1995	23,807,004	32,677,494
1996	7,935,668	10,821,077
1997	3,967,334	5,492,325
1998	6,315,572	9,366,645
1999	7,773,010	11,549,451
2000	9,230,449	13,709,085
2001	10,687,891	16,549,305
2002	12,145,331	19,072,539
2003	12,145,331	17,021,217
2004	12,145,331	15,807,394
2005	12,145,331	14,715,677
2006	5,829,759	6,611,492
2007	4,372,320	4,699,291[2]
2008	2,914,880	3,132,861[2]
2009	1,457,440	1,566,430[2]

[1] Exchange rates are based on Bank of Canada annual noon exchange rate averages.

[2] 2007 exchange rate used as an estimate.

EBRD Transactions in Canada or in Canadian Currency

The EBRD did not issue debt in Canadian currency in 2007.

Contribution to Special Funds

As part of a loan or equity investment, the EBRD often provides its clients with advice on how to improve the project by ensuring thorough preparation and effective implementation. This advice is often paid for out of special funds, which are set up by donor countries and international institutions and are managed by the Bank. These funds mobilize investment capital and expertise in the EBRD's countries of operations by giving local business access to consultant experts. The consultants assist in the preparation of projects and strengthen local management know-how. They also develop environmental strategies and work to improve the legal framework in which businesses operate. Canada has contributed to the following special funds:

Early Transition Countries Multi-Donors Fund—CIDA is one of 12 donors to this fund, which was launched in 2004 and targets Bank programming in the poorest countries of the EBRD's operations (Mongolia, Moldova, Azerbaijan, Armenia, Georgia, Tajikistan, the Kyrgyz Republic and Uzbekistan). This fund is the first EBRD funding mechanism to be classified Official Development Assistance by the Development Assistance Committee of the Organisation for Economic Co-operation and Development. Canada has contributed C$1.7 million to this untied fund.

Canadian Technical Cooperation Fund—The main purpose of this fund is to provide financing to hire Canadian consultants for EBRD projects across a wide range of sectors and EBRD countries of operations. Canada has transferred C$19 million to the EBRD for technical cooperation since 1992. Canada's contribution was renewed in 2006 for an additional three years, until 2009, and includes technical cooperation in Armenia, Georgia, Russia and Ukraine. The sectors of focus include: environment, private sector development and municipal governance.

Chernobyl Shelter Fund—The main purpose of this fund is to secure the sarcophagus around the destroyed Unit IV nuclear reactor in Ukraine. The total estimated cost of this 10-year project is roughly US$1.1 billion, of which US$716 million has been pledged so far. Canada has pledged US$33 million, including US$0.8 million of bilateral assistance for ventilation stack repair.

Nuclear Safety Account (NSA)—This facility was established in 1993 to help finance the closure of the Chernobyl nuclear power plant and to improve safety conditions at nuclear power plants in countries of operations until the plants can be closed. The NSA complements other bilateral and multilateral efforts to achieve broader energy sector reform in the region. Canada has contributed C$19.5 million to the total fund of US$280 million. Canada's contribution has been completely disbursed.

CIDA-EBRD Cooperation Fund for Southeastern Europe (CFSEE)—By 2002, Canada had contributed C$10 million in support of the EBRD's South Eastern Europe Action Plan, to be used for technical cooperation and co-financing activities. These funds were used in Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Romania, Serbia, and Montenegro, and supported activity by Canadian consultants. In 2003, an additional C$6 million was added to the CFSEE, which focuses on CIDA priority sectors and countries of focus. CIDA is participating, through the CFSEE, in the Western Balkans Initiative, which includes within its scope a multi-donor technical cooperation fund and is intended to improve donor coordination arrangements in the Western Balkans.

TurnAround Management Programme—The TurnAround Management Programme was established in 1993 to match senior industrial advisors from market-driven economies with chief executives of selected firms in the region that are in financial difficulty. The objective is to provide management know-how and develop business skills so that these companies can become competitive and profitable. Canada has contributed C$3 million to this fund.

Technical Assistance in Support of the Ukraine Micro, Small and Medium-Sized Enterprises Line of Credit II—Canada agreed to provide C$3 million for technical assistance services by qualified Canadian organizations to Ukrainian commercial banks receiving loans under the EBRD's Ukraine Micro, Small and Medium-Sized Enterprises Line of Credit II for on-lending to micro, small and medium-sized enterprises. To date, C$2.12 million has been transferred to the Bank for technical assistance that includes risk- and loan-evaluation training. The Fund is now being used in support of the Mortgage Lending Framework focused on local banks' capacity building.

Northern Dimension Environmental Partnership—Canada is the sole non-European contributor to this fund, which provides donor funding to address severe environmental problems in northwest Russia, particularly in the areas of nuclear waste, water and wastewater treatment, and energy efficiency. Canada has committed C$20 million, which is earmarked for the facility's "nuclear window" and counts toward Canada's commitment to the G8 Global Partnership Program.

CIDA-EBRD Cooperation Fund for Central Asia and the South Caucasus—This C$2-million fund was created in 2004 for work on project preparation and implementation activities in Central Asia and the South Caucasus. The fund targets the following sectors: agribusiness, natural resources, infrastructure financing (e.g. transport, telecommunications, municipal finance), and strengthening institutional capacity development of local institutions working in private sector development and micro-lending institutions. This is the first Canadian bilateral fund at the EBRD that untied 100 per cent of Canada's assistance (i.e. procurements are not limited to Canadians).

Canada at the EBRD: What Happened in 2007

Canada's Priorities in 2007

In the 2006 annual report, we identified Canada's priorities for 2007, which were: (1) promoting the highest standard of governance; (2) commitment to Article 1 regarding engagement in Belarus; (3) promoting a strong transition focus and a sound investment climate; (4) environmental stewardship; and (5) advancing Canadian commercial interests. In this section, we describe specific actions that were taken in 2007 in support of Canada's priorities.

1. Governance and Accountability

A key element underpinning the Bank's ability to influence transition in its countries of operations is the demonstration effect of its own governance policies. As a result, Canada has pressed the Bank to adopt the very highest standard of internal governance. In 2006, the EBRD broadened its public disclosure policy, in line with modern corporate governance practices. The Bank now discloses minutes of Board of Directors meetings, posts on its website project summary documents and a list of policies and strategies scheduled for development or review in the year ahead, and provides a summary of the annual staff compensation and benefits proposals. In 2007, as required under the revised Public Information Policy, the EBRD held public consultations on its Hungary country strategy, which defines the Bank's activities in the country over the next three years. Comments received from the public were incorporated into the final strategy. Going forward, Canada will continue to advocate for the Bank to follow the same process for all its country strategies.

2. Commitment to Article 1—Engagement in Belarus

The EBRD has an explicit political mandate, set out in Article 1 of the Agreement establishing the EBRD, which is to foster transition in countries that are committed to and applying the principles of multi-party democracy and pluralism. In countries with poor democratic and human rights records, the Bank limits its scope of activities to the financing of the private sector while continuing to seek ways of improving the investment climate and supporting reform efforts. Canada strongly supports this mandate and has continuously stressed its application. For example, in 2006, during the review of the Belarus country strategy, Canada took a strong stand in favour of a vigorous interpretation of the Bank's responsibilities under Article 1. And, as a result of pressure exerted by the Bank's shareholders, the EBRD's new strategy in the country focuses exclusively on the financing for the private sector. In 2007, the Bank approved only seven projects in Belarus, all focused on small and medium-sized enterprises, as well as the investment enabling framework for the financial sector. Over the coming years, Canada will continue to monitor EBRD activities in Belarus to ensure that they are consistent with the country strategy.

3. Maintaining a Strong Transition Focus

Canada played an active role in the development and discussion of the EBRD's third Capital Resources Review, stressing the need for the institution to move decisively to increase its operations in the early transition economies of the former Soviet Union and Southeastern Europe. At the 2007 Annual Meeting, Canada supported an allocation of 2006 net income to reserves so the Bank could pursue higher-risk projects that are essential for transition in these countries.

In the fall of 2007, the Board of Directors undertook an intense program of analysis reviewing the Bank's business potential until 2010, capital adequacy, possible other uses (i.e. technical assistance and investment grants to support banking, funds for nuclear safety), and distribution of dividends, as possible options for allocating 2007 profits. Ultimately, Directors will recommend a decision on which Governors will vote at the 2008 Annual Meeting. Going forward, Canada will continue to press the EBRD to use its capital base for activities that generate strong transition impact and are consistent with the Bank's mandate.

4. Environmental Stewardship

In 2006, Canada supported an expanded role for the EBRD on the issues of climate change and increased energy security. As one of the fastest-growing parts of the world, the EBRD region has a growing demand for energy. One of the major challenges facing the region is inefficient use of energy—a legacy of the former command economies that causes environmental and economic damage and contributes disproportionately to climate change. In fact, the Bank estimates that the transition region uses up to seven times more energy per unit of gross domestic product (GDP) than Western Europe. In 2007, the Bank approved a first clean-coal project in Mongolia, which will set standards of transparency and sustainable environmental conduct. Specifically, the project will improve corporate environmental management practices through the preparation of the first ever mine closure plan for a Mongolian mining company, in compliance with the EBRD's environmental and social assessment plan. The project will also ensure that the company's business practices are consistent with the Extractive Industry Transparency Initiative. Over the medium term, Canada will continue to support the Bank's efforts in selecting sustainable projects that promote best environmental and social practices.

> At the 2006 Annual Meeting, Governors launched the Sustainable Energy Initiative, which commits the EBRD to investing €1.5 billion in energy efficiency and renewable energy projects over the next three years. It also commits the Bank to strengthening policy dialogue with governments and to working with donors to support sustainable energy projects.

5. Advancing Canadian Commercial Interests

The EBRD offers a number of investment opportunities for Canadian businesses and financial institutions. One of the objectives of the Canadian office is to increase Canadian awareness of these investment opportunities, explain how the Bank's financing mechanisms work, and ensure that EBRD policies and procedures are followed in a transparent and fair manner.

To achieve this objective, the Canadian office provides EBRD market information and intelligence to Canadian firms and advises Canadian project sponsors on EBRD financing options. In addition, the office develops commercial co-financing opportunities with Export Development Canada and other Canadian financial institutions. Together with the Department of Foreign Affairs and International Trade and Industry Canada, the office also identifies EBRD procurement opportunities and, with CIDA, promotes Canadian technical cooperation activities and official co-financing with the EBRD. Going forward, the Canadian office will continue to organize business events that raise awareness among Canadian companies about opportunities with the EBRD.

The following events in 2007 were supported by the Canadian Director's office and promoted Canada's interests:

- The Canadian Director, Business Advisor and the First Vice President, Varel Freeman, met with Canadian oil and gas businesses in Calgary and general corporates, including forestry, in Vancouver to present the work of the Bank and to discuss possible partnerships in February 2007.
- On the Canadian outreach side, the Canadian Director and the Business Advisor organized the visit of EBRD President Jean Lemierre to the Conférence de Montréal in June 2007 and arranged a business program, including additional meetings with Canadian corporates interested in investment in the Bank's region. The President also attended meetings with senior government officials in Ottawa.
- As in previous years, a senior natural resource banker participated in the Prospectors and Developers Association of Canada annual event in Toronto.
- The Business Advisor and a senior natural resource banker participated in a Private Sector Roadshow in Vancouver, Calgary, Toronto and Montréal. This event raised awareness for Canadian companies interested in investing and doing business in the region.
- The EBRD's Deputy Chief Economist and Director, Strategy and Analysis and the Canadian Policy Advisor travelled to Toronto and Ottawa to present to business, academics and government officials key findings of the Bank's 2007 *Transition Report* on developments in the business and economic environments of the Bank's countries of operations.
- In addition, the Canadian office at the Bank in London received a steady stream of business visitors from Canada and supported them in their dealings with the EBRD.

Canada's Voting Record in 2007

Canada and other shareholders typically raise concerns and questions about specific Bank operations before they get to the Board of Directors. As a result, decisions at the Board are generally taken by consensus. Directors may, however, abstain or vote against projects or policies in consultation with their constituencies. The Canadian Director supported all policies in 2007, as well as the vast majority of the 262 projects approved by the Board. There were 14 exceptions, which reflected four main reasons.

- **Lack of additionality.** Additionality is one of the EBRD's core operating principles, whereby project investments support private investors without crowding them out. Typically, concerns are raised if it is possible that an investor might have access to private sector funding on reasonable terms. The Canadian Director abstained or voted against five projects on these grounds.
  1. An EBRD loan to a Russian bank (MDM Bank) to support its lending activities.
  2. An EBRD loan to Kaufland Romania to enable expansion of its store chain throughout the country.
  3. An EBRD loan to a Kazakhstani bank (Kazkommertsbank) for on-lending for residential mortgages and for construction projects outside the oil and gas sector.
  4. An EBRD investment in class C and D notes to be issued by a special purpose vehicle as part of the securitization of the Erste Leasing auto loan portfolio in Hungary.
  5. An EBRD equity investment in a Russian company to construct a power cable company in Russia.

- **Lack of transition impact.** Helping to move a country closer to a full market economy (the "transition impact") is another of the EBRD's core operating principles. As per Article 2 of the Agreement establishing the EBRD, transition is fostered through various measures including: promoting the establishment, improvement and expansion of productive, competitive and private sector activity and the mobilization of capital and experienced management to this end; fostering productive investment, including in the service and financial sectors, and in related infrastructure where necessary to support private and entrepreneurial initiative; providing technical assistance; and supporting multinational projects and/or projects with more than one donor country. Concerns are raised whenever it is anticipated that an investment will not achieve an incremental transition impact on these terms. The Canadian Director abstained or voted against three projects on these grounds.

  6. An EBRD equity investment to support a capital increase to a Slovenian bank.
  7. An EBRD equity investment in a Russo-Ukrainian property partnership to develop a mix of office, retail, industrial and residential properties.
  8. An EBRD equity investment in BaltCap Private Equity Fund L.P. to enable equity and equity-related investments in companies headquartered, incorporated or having a majority of their assets, sales or operations located or generated primarily in Estonia, Latvia and Lithuania.

- **Inconsistency with Canada's policy on steel.** Canada does not support steel projects at multilateral development banks that contribute to excess global capacity, given there is already global oversupply. The Canadian Director abstained or voted against two projects on these grounds:

  9. An EBRD loan to a Russian company (Chelyabinsk Tube Rolling Plant) for the construction of a steel mini-mill to produce billets for seamless pipes.
  10. An EBRD loan to a Polish company (Celsa Huta Ostrowiec) for expansion of its existing plant.

- **Concern over the business environment in countries of operations.** Country strategies describe the Bank's three-year plan of engagement in its countries of operations. Specifically, they provide an assessment of a country's progress towards transition and identify key areas where the Bank can provide assistance. The country strategy for Bulgaria was being reviewed in 2007. The Canadian Director had concerns with aspects of the business environment in the country and did not want to vote on projects in Bulgaria until the new strategy was adopted (properly noting the problems). The Canadian Director abstained or voted against four projects on these grounds:

  11. An EBRD loan to a state-owned Bulgarian company (Plovdiv Regional Water Company) for the rehabilitation of the water supply and wastewater infrastructure.
  12. An EBRD loan to a Bulgarian power company (Vez Svoghe) for the construction and operation of nine small hydro plants along the river Iskar.
  13. An EBRD loan to the Fund for Energy and Energy Savings that will enable the purchase of receivables under energy saving contracts in Bulgaria.
  14. An EBRD equity investment in a Bulgarian pulp mill company (Svilosa A.D.) for expansion of its business.

Summary of the EBRD's Operations in 2007

2007 marked the second year of the Bank's operations under the new business model, the third Capital Resources Review (CRR3), which focuses EBRD operations in the East and South of Europe[5] and commits the institution to a gradual phase-out of Central European countries. By 2010, the 8 countries that acceded to the European Union in 2004[6] (the EU8) will graduate from the Bank's lending program, and the remaining 21 EBRD countries of operations will be from the East and South of Europe. The Bank's operations in these countries differ significantly from its involvement in the EU8: major projects centre on the energy sector and more of the portfolio is oriented toward smaller projects that require greater oversight and more proactive capacity building.

CRR3

CRR3 was approved by Governors at the 2006 Annual Meeting and covers the period between 2006 and 2010.

CRR3 mapped out how the Bank could best meet the needs of its clients within its mandate. It identified the tools that the EBRD could use to ensure strong development results and also prescribed the financial discipline that was required to guarantee sustainability of the Bank's operations. Given the growing demand for EBRD services in the early and intermediate transition countries, the emphasis was placed on shifting the Bank's core activities to the South and East of Europe and gradually phasing out the eight countries in Central Europe that benefited from EBRD support early in their transition process.

The operational objectives of CRR3 are to develop the portfolio in line with a base case target of €21.9 billion by 2010, and to achieve an annual business volume of around €3.6 billion. The geographical composition of the annual business volume is projected to shift in line with the strategic direction of CRR3, as the portfolio share of early and intermediate transition countries and Russia is set to grow to around 87 per cent by 2010.

Recognizing that the new group of clients faces different challenges than the EU8, the Bank has begun to develop new approaches to doing business. In particular, greater emphasis is being placed on good governance and the need for companies to follow best practices. To ensure effectiveness of meeting its transition objectives, the Bank, in addition to improvements to its own internal policies and strategies, is including corporate governance plans as part of the project preparation and is encouraging its clients to disclose company information. The Bank has also increased its financing for technical capacity building to enable the development of the regulatory and legal frameworks necessary for private sector development. In 2007, the Bank spent a98 million7 on technical assistance, on:

- Consultancy services for feasibility studies as part of project preparation.
- Procurement assistance during project implementation.
- Development of management skills under the Bank's TurnAround Management Programme.
- Legal advice to improve legislation and corporate governance and to promote regulatory development.

5 East: Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Mongolia, Russia, Tajikistan, Turkmenistan, Ukraine, Uzbekistan. South: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Montenegro, Romania, Serbia.

6 Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic, Slovenia.

7 This amounts to C$144 million, based on the 2007 exchange rate.

The number of projects in non-EU8 transition countries now represents 56 per cent of the Bank's portfolio and Russia accounts for 29 per cent. By 2010, the non-EU8 region and Russia will represent 87 per cent of the Bank's operations. Despite the increase in higher-risk projects (now accounting for almost 23 per cent of all operations), in 2007 the share of new stand-alone signings with a transition impact potential rated "good" or "excellent" totalled almost 90 per cent. To further minimize reputation and integrity risks, management—and increasingly the Executive Board—is relying on the Office of the Chief Compliance Officer to ensure that the highest levels of ethical standards are maintained in all of the Bank's operations. In 2007, the Office prepared 240 integrity reports. In addition, the Evaluation Department published 10 reports on the Bank's participation in sectors where the EBRD is becoming more involved, and which will be the core of its activities going forward (e.g. water supply and sewage services, energy sector, micro and small enterprises sector). The key findings should further assist management in improving the effectiveness and efficiency of projects.

To support the ongoing shift in operations, the 2007 operating budget of €293.6 million enabled the Bank to hire additional staff to further strengthen its presence in regional offices, prepare new sustainable projects in key sectors where the Bank has increased its participation, and improve analysis and knowledge of horizontal issues such as climate change and clean energy. These resources will enable the Bank to further align its operational needs with its mandate.

Yet, transition is a complex, demanding and lengthy process. A market economy has to be supported by an effective institutional framework and a functioning state. In the new regions of the EBRD's operations, there are basic weaknesses in key institutions—particularly concerning finance, regulation and competition, corporate governance, and the rule of law and its enforcement. The main challenges for the transition process in the coming years lie in creating a reliable institutional and policy environment that attracts investment flows; encourages the growth of the new private sector and the restructuring of the old; improves the functioning of markets; fosters entrepreneurial and market skills; and strengthens the confidence of the population in the reform process. To better understand the attitudes of clients toward democracy and economic reforms, the Bank conducted—with partial funding provided by Canada—a Life in Transition survey, which measures peoples' satisfaction with democracy and economic outcomes of transition. The key findings could assist the Bank in fine-tuning the tools it uses to develop a sustainable private sector (see Annex 2 for details).

Many transition challenges remain in the Bank's countries of operations in the South and East. While the Bank has a strong record of success, going forward it will be crucial that the institution remains focused, selective and driven by strong transition results.

Challenges Going Forward

- For the last two consecutive years, a high growth in the Bank's portfolio has exceeded the projections of CRR3.[8] The increasing demand for EBRD services requires that the Bank be more selective in the projects it finances and that it continue to focus on the importance of choosing quality over quantity. Going forward, the Bank's activities must be realigned with its core mandate of fostering the transition to market principles in its 28 client countries. This may include a greater focus on projects that promote environmental standards and good labour practices.
- The 2007 *Transition Report* indicates that the commitment to democratic reforms in the region has weakened. It remains both a priority and a challenge for the EBRD to encourage adherence to good governance in line with the principles of Article 1 regarding multi-party democracy and pluralism. In countries where the commitment to Article 1 remains weak, the Bank should continue its narrow scope of operations. In countries where governments are entering the most difficult stages of reform, the Bank should develop high transition impact projects with broader social benefits.
- At the 2006 Annual Meeting, Governors approved the Bank's plan for a gradual withdrawal from the EU8 countries by 2010. After the graduation process is completed, the Bank will stop doing new business in those countries, while monitoring existing projects for compliance with Board decisions. The graduation of the Czech Republic signalled the country's progress in achieving transition to a full market economy and democracy. As well, the EBRD has closed three offices in Estonia, Latvia and Lithuania. Over the next two years, shareholders will continue to support the Bank's direction of phasing out its operations in the EU8 countries.
- At the 2007 Annual Meeting, Governors allocated the 2006 net income to strengthen reserves, thereby increasing the Bank's financial capacity to support higher-risk initiatives in the South and East. At that time, Governors also asked that, going forward, the Bank develop other options prescribed by the EBRD's Articles of Agreement,[9] specifically, funding for other purposes, such as technical assistance/cooperation and a "distribution" to shareholders (i.e. payment of a dividend). Achieving agreement among shareholders on income allocation and capital adequacy will remain an ongoing challenge for the EBRD.

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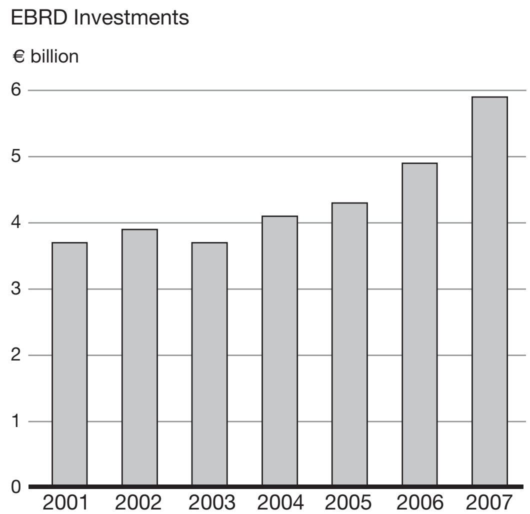
8 The Bank's actual operations have been much higher than projected in CRR3, mainly due to an increase in the number of projects. The portfolio is now forecast to reach €26.2 billion in 2010, with an annual volume of €6.3 billion. The geographic composition is expected to increase even further in favour of Russia (43 per cent of the Bank's portfolio in 2010). The reported portfolio is currently estimated at €20.2 billion, up 14 per cent from 2006. The number of active portfolio operations increased by 5 per cent to 1,341 at the end of 2007. Following Board approval to revise downward the planning €/US-dollar exchange rate to reflect the US-dollar depreciation against the euro, the Bank's capital utilization, with no allocation of net income to the Bank's reserves, is estimated at 87 per cent, relative to the 82 per cent set in CRR3.

9 In 2006, the EBRD's unrestricted reserves increased above 10 per cent of its authorized capital stock. As a result, in accordance with Article 36 of the Bank's Articles of Agreement, Governors now annually consider and decide among three net income allocation options: (i) to strengthen reserves; (ii) to fund "other purposes"—such as technical assistance/cooperation; and (iii) to make a distribution to shareholders.

Chart 2

EBRD Annual Investments and Gross Disbursements



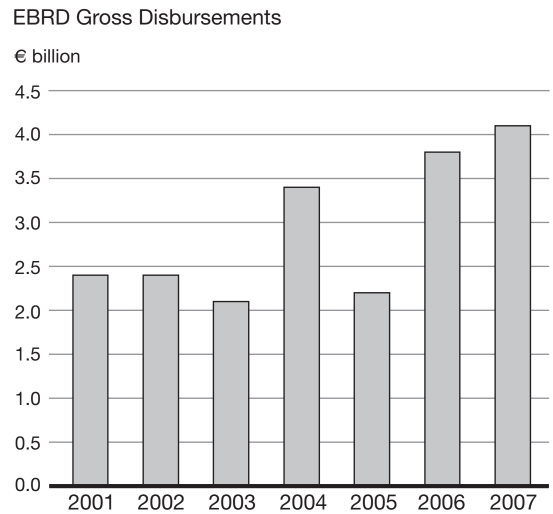


Table 2

Financial Results (2004–2007)

	2007	2006	2005	2004
Number of projects	353	301	276	265
EBRD financing (€ million)	5,583	4,936	4,277	4,133
Resources mobilized (€ million)	8,467	8,915	6,211	8,799
Total project value (€ million)	14,050	13,851	10,499	12,932
(€ million)				
Operating income	1,934	2,667	1,543.9	658.6
Expenses and depreciation	(251)	(225)	(218.9)	(189.8)
Operating profit before provisions	1,683	2,442	1,325.0	468.8
Provision for impairment of loans and guarantees	201	(53)	200.6	(67.2)
Net profit for the year	1,884	2,389	1,525.6	401.6
Reserves and retained earnings	8,676 [1]	6,974	4,656.1	1,686.0
Provisions for impairment of loans and guarantees (cumulative)	124	341	351.6	539.5
Total reserves and provisions	8,800	7,315	5,007.7	2,225.5

[1] A decision regarding the allocation of the Bank's 2007 net income will be taken by Governors at the 2008 Annual Meeting. For presentation purposes, the report has included net income in the reserves and retained earnings figure.

Canadian Policy Priorities in 2008–2010

Between 2008 and 2010, the Government of Canada has three priorities for the EBRD. These priorities respond to the challenges identified in the previous section. The rationale behind Canada's priorities for 2008 to 2010 is that strong results should inform and guide the Bank's activities to ensure consistency with the EBRD mandate of:

1. Promoting good governance and accountability, and effective use of the Bank's capital base.
2. Ensuring that the EBRD maintains a strong transition focus and is highly selective in its programming.
3. Promoting environmental sustainability and gender equality of EBRD projects.

1. Governance and Accountability

Greater Transparency in the Appointment Process of the EBRD President

Canada continues to support the Bank's commitment to enhance the transparency of its own activities, which is in line with modern corporate governance practices. This focus is also consistent with efforts at other international financial institutions (IFIs).

President Jean Lemierre will step down as the President of the EBRD in July 2008. The 63 Governors, who are responsible for electing the head of the EBRD, will be asked to vote for his successor. The new President will be elected at the Annual Meeting in Kiev in May 2008 by a majority of Governors' votes. An open and transparent nomination and selection process for the President of the EBRD is a priority for Canada. This will ensure that any member country can nominate a candidate, that the process is guided by publicly available rules and procedures, and that a majority vote or consensus decision should be reached based entirely on the merit of the candidate. The EBRD should move towards these types of clear and public rules.

Action in 2008: Push the Bank to develop a transparent, open and merit-based process for selection of the President that is in line with the standard developed by other IFIs.

Action in 2009–10: Encourage the Bank to consider officially incorporating the new process into the EBRD by-laws.

Sustainable Finances

Canada strongly supports good financial governance at all IFIs. It ensures the development and implementation of sound administrative budgets and an adequate capital base that supports the IFIs' mandates.

Sufficient Administrative Budget in Support of the EBRD's Mandate

As mentioned earlier, in the South and East projects require greater oversight and capacity building. In line with CRR3, over the last two years the Bank's budget was increased by a total of 7.5 per cent to enable the EBRD to achieve the right skill mix and staff level. As transition proceeds at different paces across the South and East, the Bank will need to ensure that it is effective and efficient in its allocation of funds and that the budget is aligned with its strategic directions. This means that the Bank will need to look at an internal reallocation of resources from less relevant activities to fund emerging priorities.

A Sustainable Capital Base

For the last two consecutive years, the Bank's results, driven mainly by high portfolio growth, have exceeded the projections of CRR3. The high growth in the EBRD's portfolio has put pressure on the Bank's capital adequacy and risk ratios. The Board is currently considering options aimed at rebalancing portfolio growth in line with the capital base that supports Bank activity. It is important that the Bank use its limited resources to focus effectively on its core mandate. The decision taken by the Board must ensure adequate discipline and selectivity in the use of capital. It must also set a target for a sustainable portfolio size and, as a result, the scope of activities and their consistency with the mandate.

Action in 2008: Advocate for a reformed process for preparing the Bank's budget and work plan (such as a three-year rolling plan), similar to requirements of the Canadian Financial Administration Act.

Action in 2008: Advocate for a decision on the 2007 net income allocation which ensures discipline and selective use of the Bank's capital in support of activities that are consistent with the EBRD's mandate.

2. Institutional Effectiveness

Article 1

Canada is a strong proponent of the Bank's ongoing efforts to improve and strengthen governance and accountability in its countries of operations (through technical assistance programs and dialogue with national and local authorities); to promote increased transparency, optimal use of investment funds, the rule of law, human rights, safety and equality; and to encourage mechanisms of multilateral cooperation on democratic issues. EBRD analysis shows that the establishment of strong, democratic institutions is a key transition success factor. The need for good governance in all recipient countries will continue to figure prominently in the period ahead, and the EBRD will need to promote sound institutions, more efficient tax collection and improved legal and regulatory frameworks. It must ensure not only that appropriate legislation is developed, but also that it is properly implemented and enforced. Canada has maintained that the Bank's fundamental priority for private sector development is to create an enabling environment for investment supported by sound regulatory frameworks. Good governance helps ensure that corporations integrate into the international financial system and strengthens their international competitiveness.

In keeping with its mandate to promote economic and democratic reform, the Bank regularly reviews its countries' political and economic progress toward transition. In countries where the commitment to core democratic principles is particularly weak (such as Belarus, Turkmenistan and Uzbekistan), the EBRD has limited its operations. In countries where the willingness of governments to move forward with reforms is diminishing, the Bank should focus on identifying projects where it has the potential to effect "bottom-up" change by championing best business and environmental conduct. Specifically, the Bank should select private sector clients that are likely to lead the rest of the industry to adopt best practices in the area of environmental and business conduct.

Action in 2008: Actively participate in Board discussions on the Uzbekistan and Turkmenistan country strategies. If the analysis indicates that these countries have been slow in implementing Article 1, continue to support limited scope of Bank activities (i.e. support small EBRD operations with private sector entities that address basic human needs).

Action in 2008: Press the Bank to identify effective approaches for supporting transition in countries whose commitment to democratic and economic reforms is waning. For example, the Bank should consider focusing on engagement with companies that can demonstrate to the rest of the industry the benefits of environmental and business best practices.

Strong Transition Impact

Canada has a strong interest in ensuring that nascent democratic regimes have access to the financing and advice they need to make successful and sustainable transitions to market-oriented democracies. The EBRD has an important role to play in these efforts. The entry of eight EBRD borrowers into the European Union in May 2004 marked a significant milestone in the transition process. The EBRD played no small part in this process, as it assisted the countries in building the right conditions to attract private sector financing.

As the Bank begins to fund increasingly higher-risk projects in the South and East and pushes governments to continue with more difficult reform efforts, greater importance will be placed on reviewing operations to assess their effectiveness, learn from past experience and improve the development of future projects. The Evaluation Department, an independent group reporting directly to the Board of Directors, will play an even more essential role in assessing the EBRD's performance and providing advice on how to improve it.

The current system of assessing transition impact was developed 10 years ago and was mostly focused on advancing and measuring transition in the EU8. Now, as the Bank shifts its focus to the East and South, there is a need to modify the ratings to better account for the characteristics of its new clients. Specifically, the current criteria should include indicators such as development, poverty alleviation, institution building or sustainability, which indirectly affect transition to a market economy.

Action in 2008: Encourage the Bank to continue its analysis of indicators to ensure a better assessment of its transition impact.

Action in 2008: Encourage the Bank to calculate the financial and economic rate of return for projects to better capture the viability of the EBRD's investments.

3. Environmental Sustainability and Gender Equality

Environmental and social issues are increasingly regarded as fundamentally interconnected with long-term economic and political sustainability, as well as the quality of life for a region's inhabitants. Canada has an interest in promoting sustainability in the region as a means of fostering a strong global economy. Canada is therefore a strong proponent of sustainable best practices with respect to the EBRD's investments.

The current Environmental Policy was approved by the Board in April 2003. In 2006, the Bank decided to review the policy to better respond to the environmental and social challenges in its countries of operations, and to reflect emerging best practice among the IFIs and the private sector. For example, the standards adopted by the International Finance Corporation have become a point of reference with respect to environmental and social sustainability.

The policy revision process took place throughout 2007. A round of public consultations outlining key topics was held with non-governmental organizations, other financial institutions, the World Health Organization, the International Labour Organization and indigenous peoples' representatives. The Bank is currently working on draft language for the new policy, which is expected to be ready for public discussion in the first quarter of 2008.

Gender equality is a cross-cutting theme of Canada's development assistance throughout Eastern Europe. The EBRD made a commitment to mainstream gender equality in its programming. Much work will be required in the coming year to reach this objective and Canada, in collaboration with other like-minded donors, will continue to make it a priority in our relationship with the institution.

EBRD environmental and social priorities include:[10]

- Fully integrating environmental and social considerations (e.g. health and safety, labour and community issues) into the project cycle and ensuring that each project considered for financing undergoes environmental and social appraisal.
- Promoting environmental investments across a variety of sectors to achieve resource efficiency, cleaner production processes, biodiversity and best practice in environmental management.
- Financing projects with clear environmental objectives, such as better water and waste water management, energy efficiency and renewable energy; and working in partnership with other institutions to address regional and global environmental issues.

Action in 2008: Advocate for a timely adoption of the Bank's Environmental and Social Policy, with a target date of the summer of 2008.

Action in 2008: In collaboration with other donors, encourage the Bank to develop and implement gender policy, similar to what is being done at other international financial institutions.

Action in 2009–10: Encourage the Bank to develop a methodology to collect sex-disaggregated data and include gender equality in project assessment. Over time, as more data become available, press the Bank to consider mainstreaming gender equality into its Environmental and Social Policy.

[10] EBRD Sustainability Report, 2005.

Annex 1—2007 Governor's Speech

Statement by Diane Ablonczy, Temporary Alternate Governor for Canada, at the EBRD Annual Meeting Kazan, Russia, Monday, May 21, 2007

It is a pleasure to address you today in Kazan, and I thank the Government of the Russian Federation and the authorities of the Republic of Tatarstan for hosting our meeting this year. We hope that this meeting will spur investor interest in the tremendous commercial opportunities offered by the region. The Republic of Tatarstan, like Canada, is a testament to the prosperity that can be achieved when people of diverse religious and cultural backgrounds strive to achieve common goals. I am particularly encouraged by the engagement of the Government of my province, Alberta, and Canadian and Tatar private sector partners in a heavy oil knowledge and technology dialogue. I hope that the seminar will lay the foundation for further exchange of experience and expertise related to technological advancements in the development of heavy oil and will result in a strong commercial partnership between the Republic of Tatarstan and the Province of Alberta.

The location of this year's meeting, in this dynamic region of the Russian Federation, is a concrete expression of the Bank's role as the catalyst for increased flows of financing to the private sector. It also is a testament to the EBRD's medium-term strategy approved at the 2006 Annual Meeting, centered on shifting Bank operations further south and east—to South East Europe, the Commonwealth of Independent States, including Russia and Central Asia, and Mongolia—regions where the largest transition challenges remain. We trust that this gathering will encourage these regions in their transition efforts.

A Stronger Focus

Consistent with this geographical shift, the Bank has been working hard to support the efforts of the less advanced countries in furthering their transition. Today, we are talking about the EBRD's renewed mission in these countries, aimed at assisting them to reach a path of sustainable growth based on market and democratic principles. Canada values measuring results and in this vein, we welcome the practical steps the Bank has taken to close three offices in Central Europe this year and to redeploy resources into areas where transition is less advanced.

The Bank's increased focus on the "South and East" requires a continuing assessment of both challenges in the region and the means of addressing them with the right product mix and policy dialogue. Improving the investment climate and enabling environment in countries and regions where the EBRD operates is critical for the success of the Bank's projects and private sector development more generally. The EBRD is well placed, through its technical cooperation programs and policy dialogue, to help countries improve their investment and business climates, transfer knowledge and build the right institutions. Canada is pleased to financially support the Bank's capacity building efforts, through bilateral and multi-donor funds. Given the EBRD's impressive financial performance, we look forward to the Bank contributing some of its net income to the same purpose.

Strengthening the Bank's focus on the core transition challenges requires focus on measurable results. Measuring the impact of its projects is critical for results-based business planning and is key to ensuring that the Bank plays to its comparative advantages. With the new framework approved at last year's Annual Meeting in London, Canada is looking to the Bank to sharpen its priorities and focus in the South and East where the Bank can best facilitate transition.

A Strong Institution

2006 marked the first year of the Bank's operations under its new medium-term strategy. The financial results for 2006 were exceptional—for the first time since the Bank's founding, EBRD's unrestricted reserves increased above 10% of its authorized capital stock. As a result, in accordance with Article 36 of the Bank's Articles of Agreement, from now on, Governors will annually consider and decide amongst three net income allocation options: (i) to strengthen reserves; (ii) to fund "other purposes"—such as technical assistance; and, (iii) to make a distribution to shareholders. We support the prudent approach of using the 2006 resources to strengthen reserves this year, thereby increasing the Bank's financial capacity to support initiatives in riskier regions. However, moving forward we would want to see a full and timely evaluation of all options for allocation of net income within the framework of supporting the institution's core mandate.

Article 1 Challenges Remain

As the geographic focus of the Bank's operations continues to shift, the EBRD's strong commitment to the political requirements of Article 1 remains imperative. As shareholders, we have a responsibility to ensure that the institution's activities respect Article 1. More than a decade of the EBRD's transition experience has demonstrated that pluralism and democracy are essential to mobilizing both internal and external resources for investment and remain a key transition success factor.

Canadians have experienced the value of the Article 1 principles first hand. Our commitment to promotion of human rights, our steadfast support for multi-party democracy, pluralism, and market economics has produced concrete socio-economic benefits. Canada therefore strongly supports the EBRD's decision to limit operations in countries where commitment to these core principles remains weak. The Bank needs to remain vigilant in applying Article 1 principles, and constantly encourage countries of operation to commit fully to those principles. Going forward, the Bank needs to ensure that its activities reinforce good corporate governance and strengthen the investment climate.

Raising Standards

Good governance helps locally-owned companies in its countries of operations compete regionally, and even globally. By holding business partners to the highest standards of business practice, transparency, and accountability, the EBRD demonstrates that sound corporate behaviour, which is environmentally sensitive and promotes sustainable development, is consistent with profitability and the promotion of growth and prosperity. The EBRD must continue to promote good governance as a cornerstone of its work with the public and private sector partners.

This year, the Bank will make a further contribution to raising business standards in the renewal of its Environmental Policy, which will be broadened to embrace more social aspects of financial transactions. We welcome the review and look forward to having social issues more systematically addressed in the region. The inclusion of gender in the new Policy should recognize the important contribution that women make to growth and prosperity.

This renewal builds on the Bank's "Sustainable Energy Initiative" and work promoting energy efficiency. The Bank's increased efforts in this area respond to the G-8's call for international financial institutions' leadership in helping address the interrelated issues of long-term energy security and climate concerns. By financing the transition to cleaner energy and energy efficiency, the EBRD is making an important contribution to helping the region reduce its carbon footprint. Reducing a region's footprint is a challenge that my Government knows well, as we are working hard to reduce Canada's.

Of course, to achieve a sustainable, broad-based increase in standards, international financial institutions must work together. Such cooperation is essential, not only to avoid a "race to the bottom", but also to ensure that each plays to its comparative advantage in delivering its mandate. We ask President Lemierre, management and the Board of Directors to work with other institutions to this end, and promise that Canada will do its part at the other international financial institutions in which it is a shareholder.

Conclusion

In closing, I would like to thank President Lemierre and his staff for a productive year. Challenges certainly remain. However, Canada has every confidence that the Bank will continue to achieve progress in the coming year.

Annex 2—Summary of the *Transition Report*

The *Transition Report* is an annual publication of the EBRD that charts the progress of transition from a centrally planned to a market economy in each of the Bank's 29 countries of operations. The *Transition Report* is recognized as the leading publication analyzing the progress of transition in the former Soviet bloc. The 2007 report gauges peoples' attitudes toward transition and ongoing reforms. The report presents key findings of the 2006 EBRD/World Bank Life in Transition survey, which provides unique insights into how the transition has affected peoples' standard of living as well as their expectations about the future.

Macroeconomic Overview and Reform Progress

The EBRD reports that the transition region continues to catch up with Western Europe and other mature market economies. It finds that transition is being driven increasingly by competitive markets rather than by governments. The 2006 average economic growth reached 6.9 per cent, the highest level since the transition started in 1991 (as compared to 5.8 per cent in 2005).

The report explains that growth was partially due to strong domestic demand (supported by rapid expansion in lending by domestic and foreign banks), high foreign direct investment and significant remittances from workers abroad. Export growth was also up, mirroring strong global demand. These factors put upward pressure on inflation throughout the region, to which many central banks responded with anti-inflationary measures, such as raising interest rates and stricter regulations on minimum reserves. Against this backdrop, the EBRD reports fiscal policy as being too loose to stem domestic demand. In fact, a number of countries plan high increases in their budgets to fund social security, pensions and public sector wages. In addition, political instability continues to hamper prospects of far-reaching fiscal consolidation, which the Bank believes necessary given the long-term implications of aging populations.

In resource-poor countries, booming consumption and investment in 2006 resulted in wider current account deficits. For example, Ukraine recorded its first current account deficit in eight years, while in Latvia it has doubled to 21.3 per cent of GDP. On the other hand, Russia and the Commonwealth of Independent States continued to benefit from high oil revenues. For example, in Kazakhstan, the 2006 current account surplus was 18.2 per cent of GDP.

The global liquidity crisis that began in the summer of 2007 has had a limited effect on the transition countries so far. Nonetheless, the report forecasts that the re-pricing of risk and higher costs for inter-bank lending will reduce demand for bank credit and lower consumption and investment, and may lead to slower economic growth in the region.

In the context of these macroeconomic challenges, the Bank reports progress in the reform process. As shown in the following table, the Bank reports 20 transition score upgrades in 14 countries and no downgrades in 2007. The Bank tracks reform developments in 29 transition countries through a set of nine transition indicators. These cover four main elements of a market economy—markets and trade, enterprises, financial institutions and infrastructure. Market liberalization—or initial-phase reform—was reported to be virtually complete in the advanced countries of Central Europe and the Baltic region and in much of Southeastern Europe, but there is still room for improvement in the Western Balkans, the Commonwealth of Independent States and Mongolia. Second-phase reform—building market-supporting institutions, such as large-scale privatization, governance and enterprise restructuring, competition policy, financial sector development and infrastructure—is far from complete.

Table 3

Progress in Transition in EBRD Countries of Operations

Countries	Population (millions, mid-2007)	Private sector share of GDP in %, mid-2007 (EBRD estimate)	Enterprises: Large-scale privatization	Enterprises: Small-scale privatization	Enterprises: Governance and enterprise restructuring	Markets and trade: Price liberalization	Markets and trade: Trade and foreign exchange system	Markets and trade: Competition policy	Financial institutions: Banking reform and interest rate liberalization	Financial institutions: Securities markets and non-bank financial institutions	Infrastructure: Infrastructure reform
Albania	3.2	75	3	4	2+	4+	4+	2	3-	2-	2+↑
Armenia	3.2	75	4-	4	2+	4+	4+	2+	3-	2	2+
Azerbaijan	8.4	75↑	2	4-	2	4	4	2	2+	2-	2
Belarus	9.7	25	1	2+	1	3-	2+	2	2↑	2	1+
Bosnia and Herzegovina	3.8	60↑	3↑	3	2	4	4-	2↑	3-	2-	2+
Bulgaria	7.7	75	4	4	3-	4	4+	3-	4	3	3
Croatia	4.4	70↑	3+	4+	3	4	4+	3-↑	4	3	3
Czech Republic	10.3	80	4	4+	3+	4+	4+	3	4	4-	3+
Estonia	1.3	80	4	4+	4-	4+	4+	4-	4	4-	3+
FYR Macedonia	2.0	65	3+	4	3-	4+	4+	2+↑	3-	2+	2+
Georgia	4.6	75↑	4↑	4	2+	4+	4+	2	3-	2-	2+
Hungary	10.1	80	4	4+	4-	4+	4+	3+	4	4	4-
Kazakhstan	15.1	70↑	3	4	2	4	4-	2	3	3-	3-
Kyrgyz Republic	5.1	75	4-	4	2	4+	4+	2	2+	2	2-
Latvia	2.3	70	4-	4+	3	4+	4+	3	4↑	3	3
Lithuania	3.4	75	4	4+	3	4+	4+	3+	4-	3+↑	3
Moldova	3.4	65	3	3+	2	4	4+	2+↑	3↑	2	2+
Mongolia	2.7	75↑	3+↑	4	2	4+	4+	2+↑	3-↑	2	2
Montenegro	0.7	65	3+	4-	2	4	4↑	2-↑↑	3-	2-	2
Poland	38.1	75	3+	4+	4-	4+	4+	3+	4-	4-	3+
Romania	21.7	70	4-	4-	3-	4+	4+	3-	3+↑	3-↑	3+
Russia	144.1	65	3	4	2+	4	3+	2+	3-	3	3-
Serbia	8.3	55	3-	4-	2+	4	3+	2↑	3-	2	2
Slovak Republic	5.4	80	4	4+	4-	4+	4+	3+	4-	3	3-
Slovenia	2.0	70↑	3	4+	3	4	4+	3	3+	3-	3
Tajikistan	6.5	55	2+	4	2-	4-	3+	2-	2+	1	1+
Turkmenistan	6.5	25	1	2	1	3-	1	1	1	1	1
Ukraine	47.1	65	3	4	2	4	4-	2+	3	3-↑	2+
Uzbekistan	26.0	45	3-	3+	2-	3-	2	2-	2-	2	2-

Note: The classification of transition indicators uses a scale from 1 to 4, where 1 implies little or no progress with reform and 4 implies a market economy. A rating of 4+ indicates the country has achieved standards and performance typical of advanced industrial economies. An arrow indicates change from the previous year. One arrow indicates a movement of one point (from 4 to 4+, for example) and two arrows a movement of two points.

Source: EBRD, *Transition Report 2007: People in Transition.*

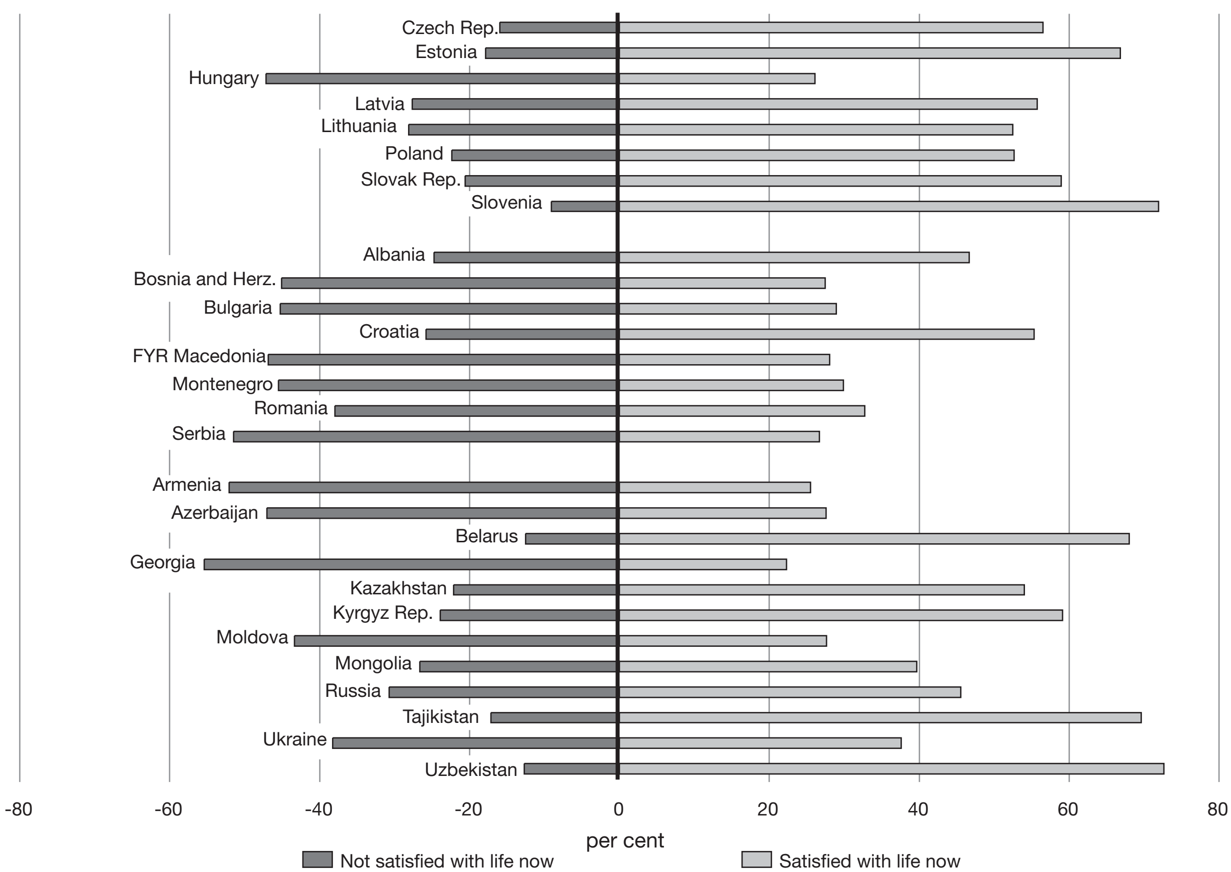
Report Focus: "People in Transition"

The EBRD reports that the favourable changes that have swept across many transition countries have brought everlasting improvements to many aspects of life. Democracies and market economies have taken root, businesses and entrepreneurship have flourished and much of the physical infrastructure has been renewed. However, despite high growth rates, across countries and cities, there are large variations in levels of income and opportunities. The survey has found evidence that levels of life satisfaction are lower in the region than in other parts of the world, and in some cases there is a pervasive sense of dissatisfaction with some of the outcomes of the transition process. Support for democracy is fairly strong in the transition countries.

The following charts[11] summarize peoples' attitudes toward democracy and a market economy. They are based on interviews with 29,000 people in 29 countries.

Chart 3

Satisfaction With Life



[11] Source: EBRD, *Transition Report 2007: People in Transition.*

Chart 4

Views on Living Standards Compared With 1989

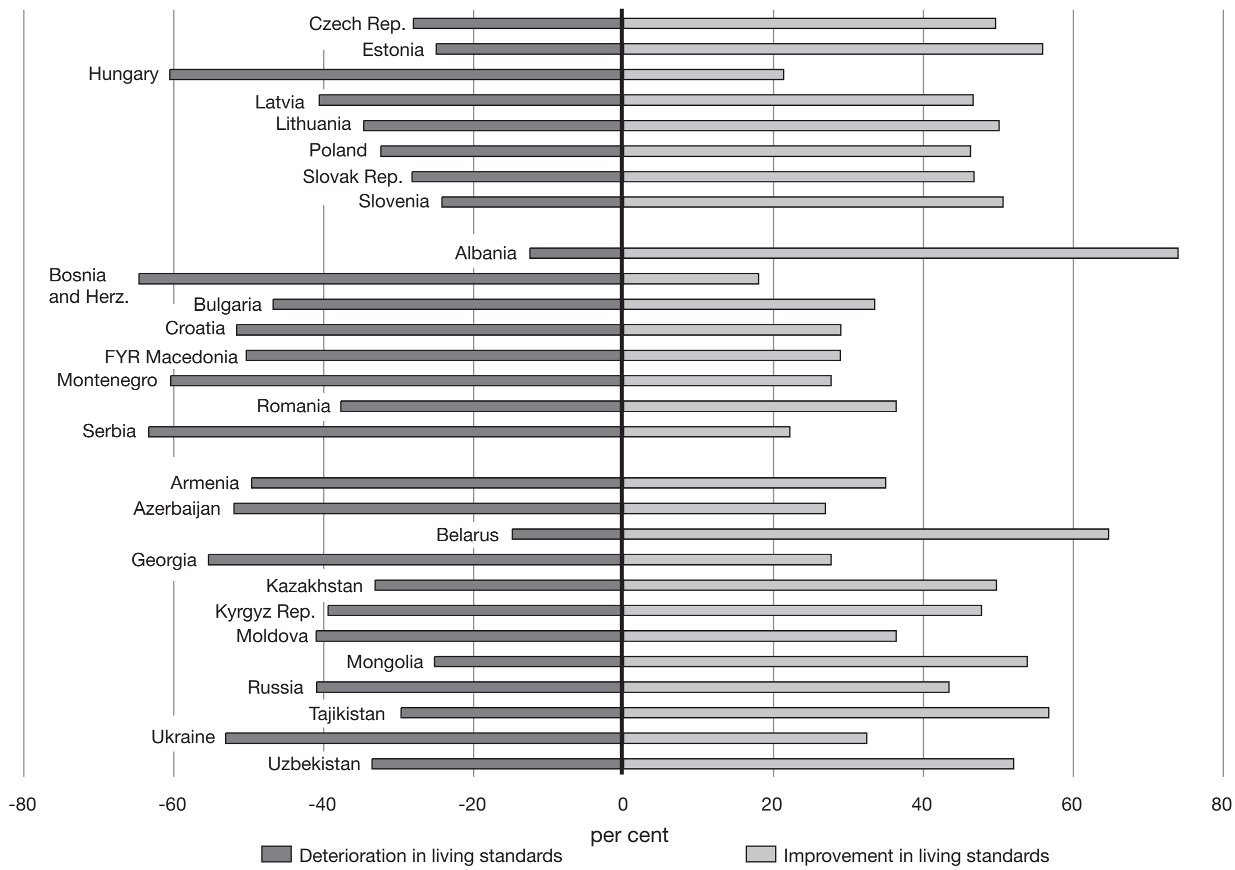


Chart 5
Views on Changes in Household Wealth Since 1989

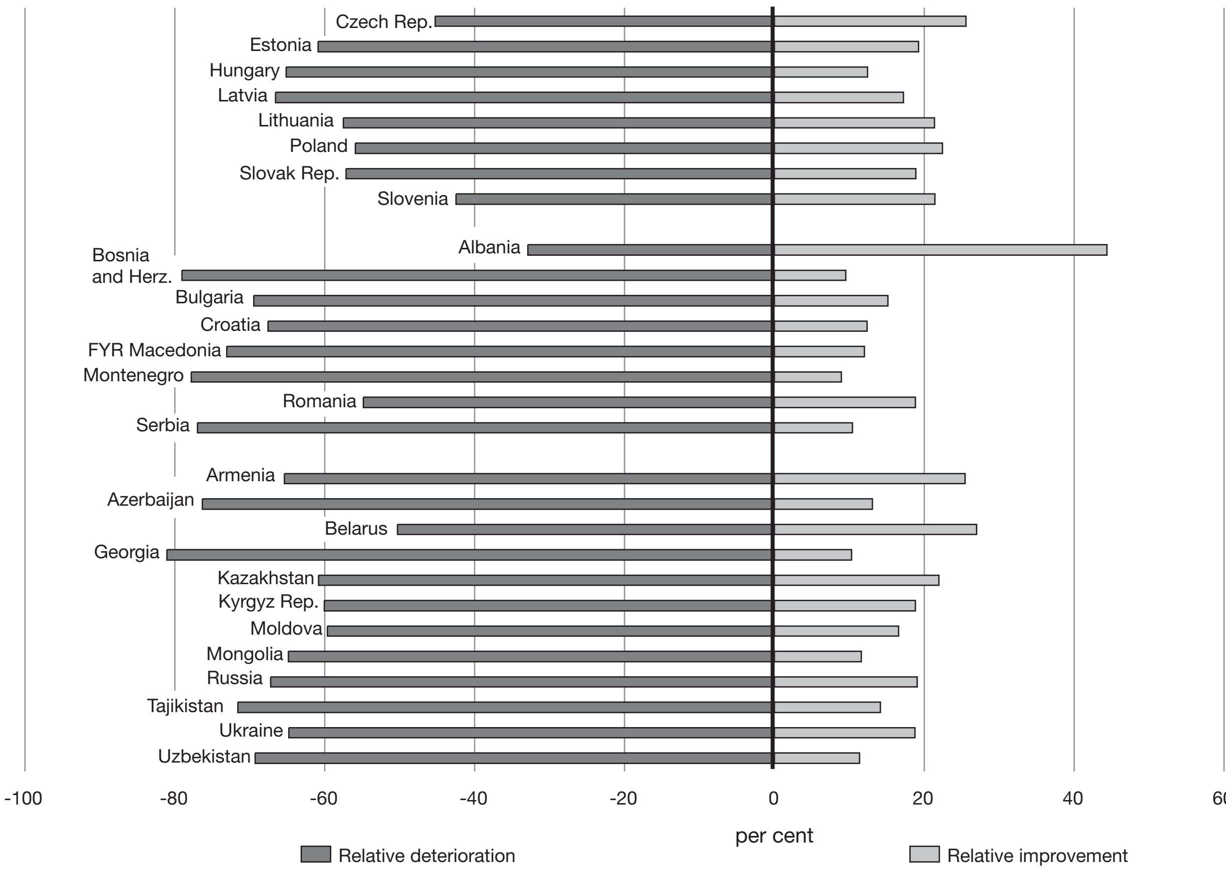


Chart 6

Views on Present Political Situation Compared With 1989

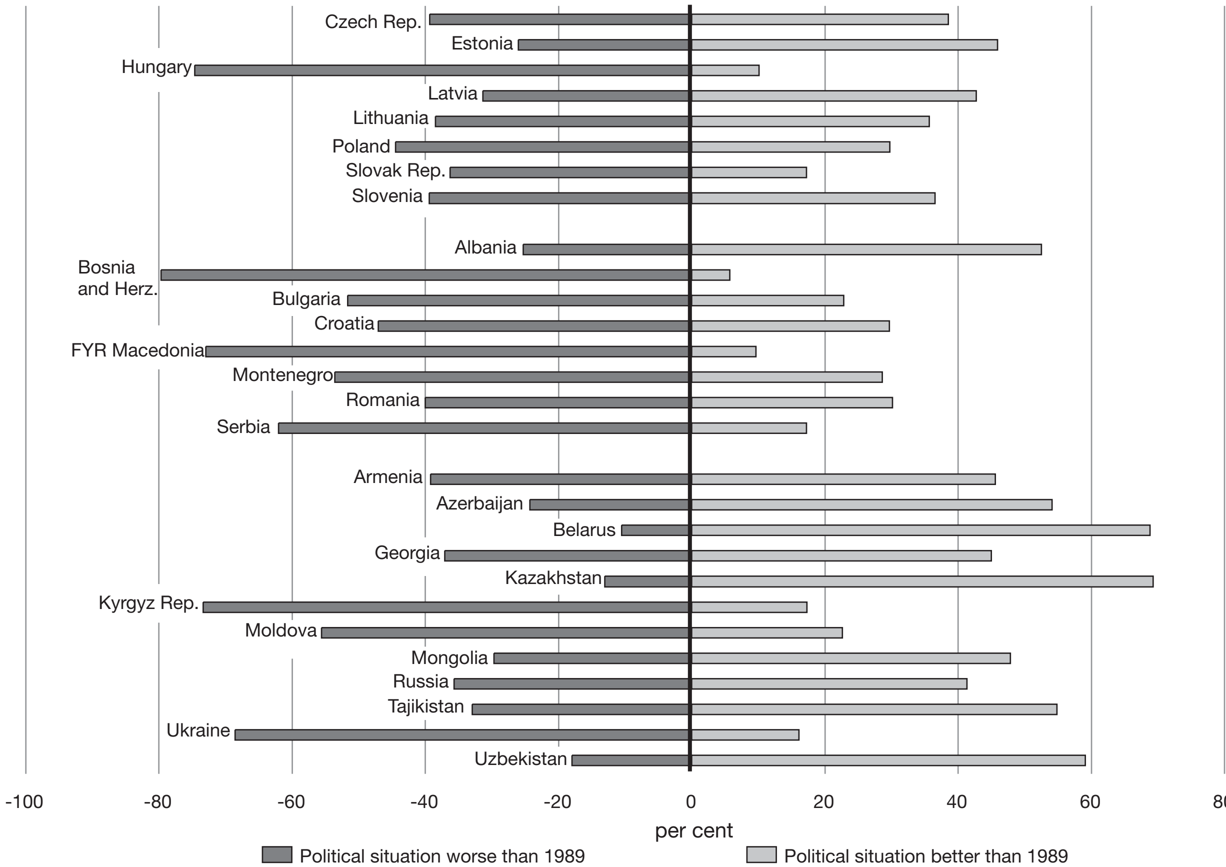


Chart 7

Views on Present Economic Situation Compared With 1989

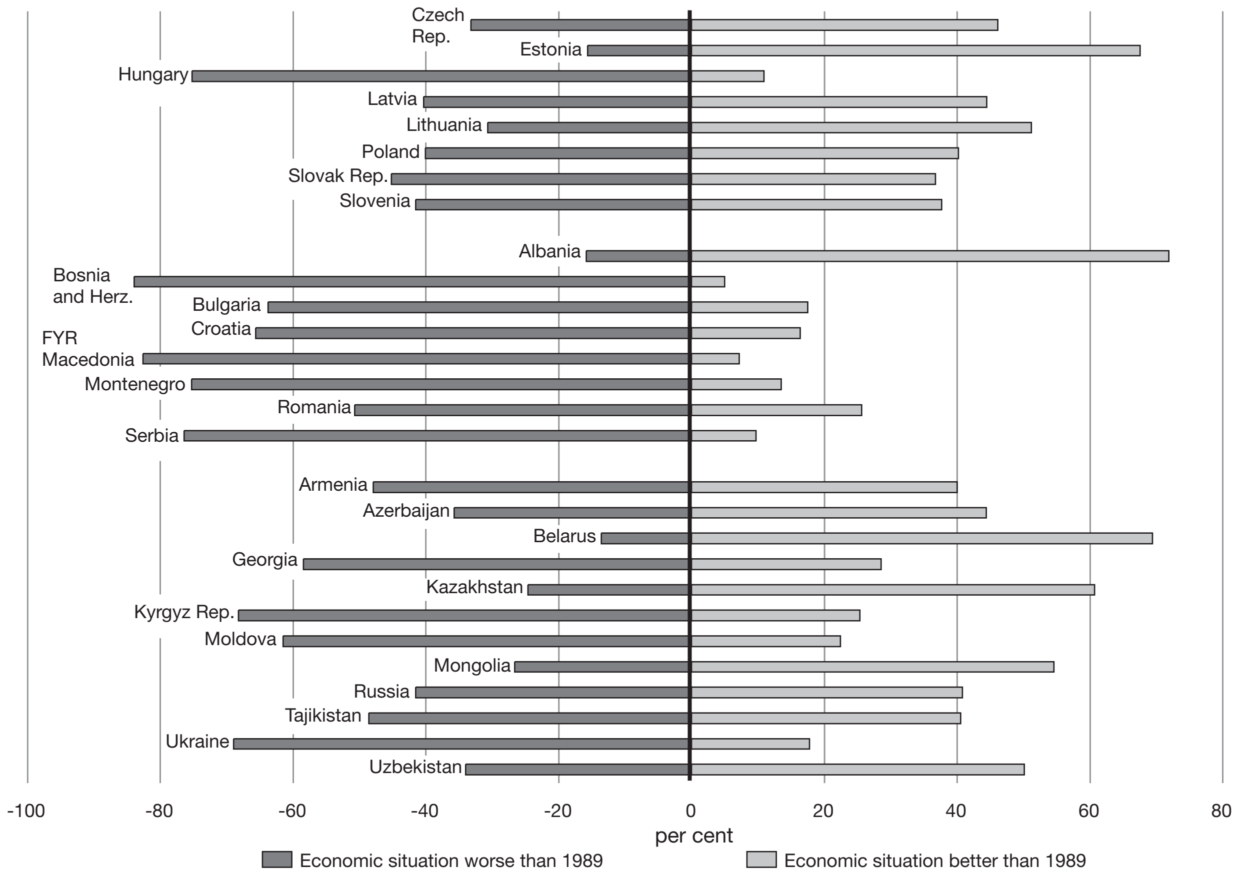


Chart 8
Support for Democracy Versus Authoritarianism

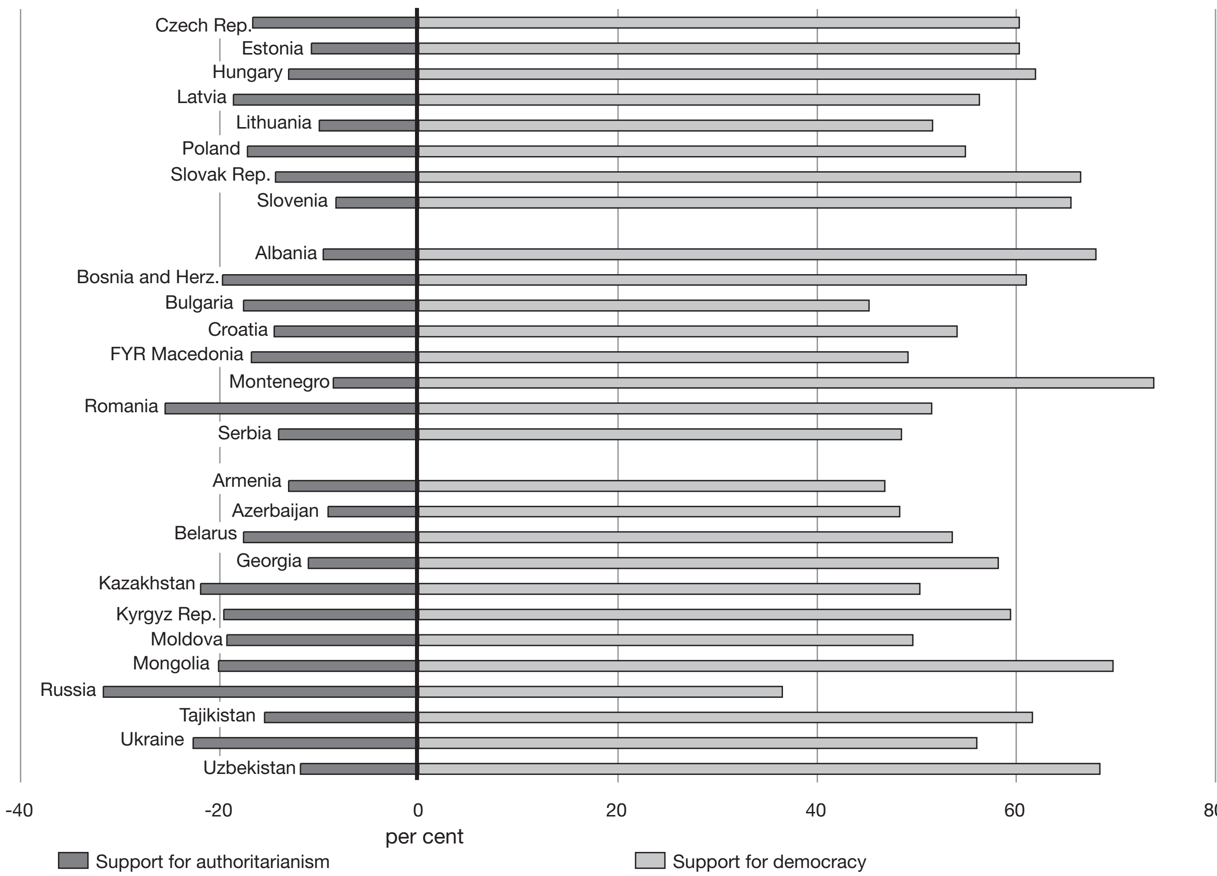
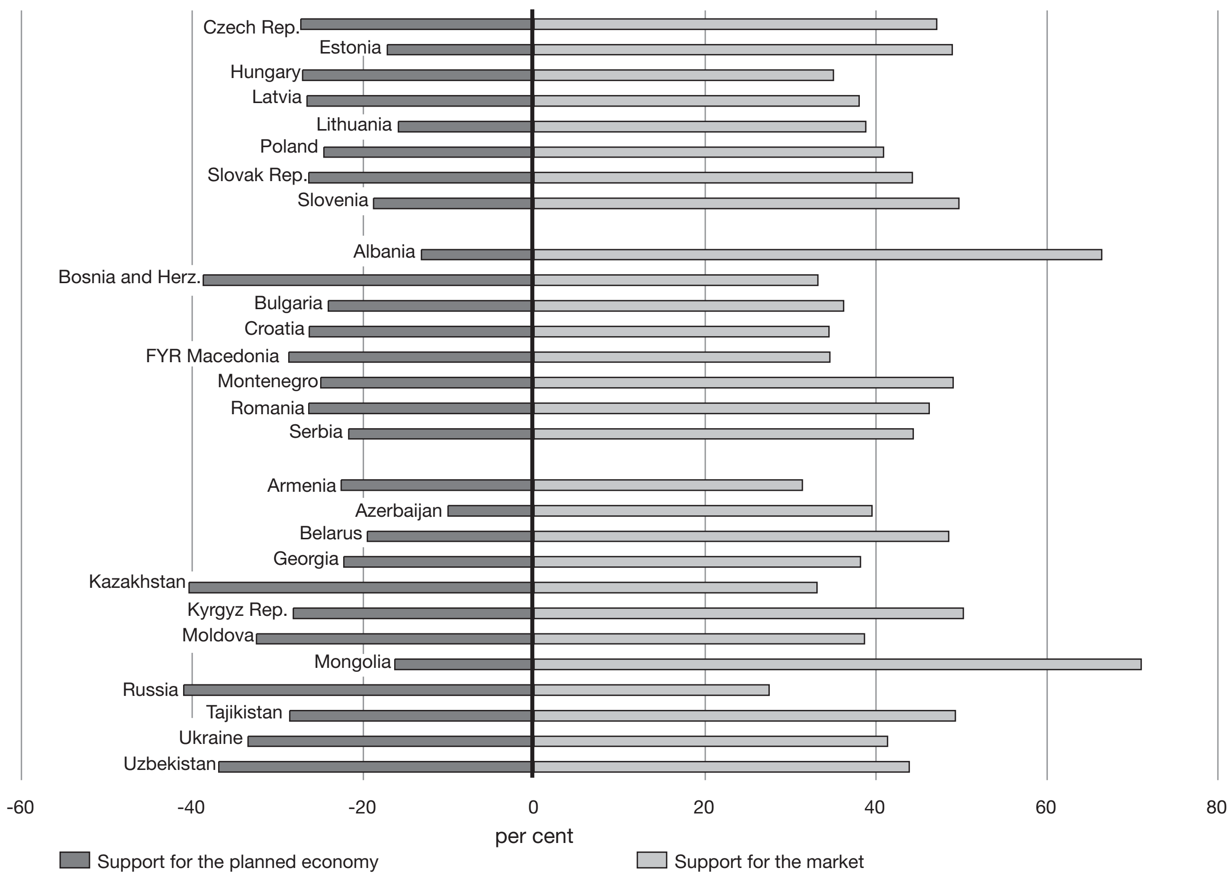


Chart 9
Support for the Market Versus Planned Economy



Annex 3—CIDA Programming in EBRD Countries of Operations

In order to increase the effectiveness of its programming, CIDA is focusing its efforts on a limited number of countries in the region. Efforts in the region are therefore concentrated in Ukraine, which is the main country of operation. CIDA also has active bilateral programming in the Balkans (Bosnia and Herzegovina, Serbia, and Montenegro), Tajikistan and Russia, as well as regional programming in the South Caucasus (Armenia, Azerbaijan and Georgia). The timeline for disengaging from the Balkans is 2010. The highlights of CIDA's programming in EBRD countries of operations can be found below.

Ukraine—Since 1991, Canada has provided C$342 million in development assistance to Ukraine. CIDA's Ukraine Program focuses on democratic governance, with particular emphasis on accountable public institutions and the rule of law, as well as private sector development and the enabling environment for business. The 2008–2012 Country Development Programming Framework for Ukraine is currently in the advanced stages of development.

Russia—As a G8 member, a nuclear power, a key partner in the fight against terrorism and Canada's largest northern neighbour, Russia is of great strategic importance. To date, Canadian technical cooperation programming expenditures in Russia total over C$350 million. Current CIDA programming in Russia is focused on delivering results related to governance and economic well-being. It covers four areas: increasing public sector competence, building an enabling environment for a market economy, building an engaged civil society, and supporting sustainable regional economic development in the Russian north. CIDA's Russia Program is preparing a new programming strategy that will manage a smaller but strategically focused program that targets democratic governance. CIDA will continue to emphasize a whole-of-government approach to the Canada-Russia relationship.

Balkans—The international community's strong commitment to peace, stability and cooperation in the Balkans has started to show concrete results. A fragile peace has emerged, and the political discourse is increasingly focused on the future and closely bound with the institutions and prosperity of Europe and EU accession. Since 1990, CIDA has disbursed over C$540 million in funding to the Balkans for approximately 800 projects. The program is focusing its efforts in countries that are key to regional stability: Bosnia and Herzegovina, Serbia (including Kosovo) and Montenegro. CIDA's Balkans Program has shifted from post-conflict technical assistance to institutional capacity building, and is directed at initiatives that contribute to public sector reform and enhance social capital in the areas of rule of law, health and education. Gender, youth, environment and refugees are all cross-cutting issues. CIDA is planning to disengage from the Balkans by 2010.

South Caucasus—CIDA has been present in the South Caucasus (SC) region since 1992, lending its support to initiatives aimed at improving governance structures and institutional capacity, strengthening civil society, promoting peace and security, and enhancing respect for human rights and democracy. To date, CIDA has disbursed over C$60 million in assistance to the SC. The majority of funding has been allocated through responsive programming, with remaining funds provided via humanitarian assistance grants and the Canada Fund. Georgia has received C$33 million, which represents the majority of CIDA'S assistance.

Tajikistan—CIDA's main area of assistance is agrarian reform, as well as the governance and strengthening of private sector development. The initiatives support:

- The development of a comprehensive regulatory system and related procedures in support of the country's agrarian reform (e.g. debt resolution, farm restructuring and land rights).
- The resolution of excessive government centralization and lack of cooperation and understanding between local authorities and communities (e.g. partnership between local governments and civil groups to manage the communities' development).
- Building the capacity of the State Land Committees and community organizations to monitor land reform progress.
- Advancing women's access to land, and assuring their participation in their communities' decision making.
- The reorganization of agricultural enterprises to a market economy, including improved farmer access and utilization of strengthened market information systems.
- The access of farmers to micro-credit and technical assistance.

Europe Regional Program (ERP)—The ERP works with selected multilateral and bilateral institutional partners that are addressing issues of regional and trans-boundary interests in the region. The ERP collaborates with the EBRD and the Organization for Security and Co-operation in Europe in the areas of governance, private sector development and environment, with gender equality as a cross-cutting theme. The ERP helps co-ordinate and facilitate program activities undertaken by geographic programs, and collaborates closely with other government departments to ensure policy coherence and a whole-of-government approach.