Canada at the European Bank for Reconstruction and Development

2008

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

Canada

Canada at the European Bank for Reconstruction and Development

2008

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

Department of Finance Canada | Ministère des Finances Canada

Cette publication est également disponible en français.

Cat. No.: F1-29/2008E
ISBN 978-1-100-12017-1

Table of Contents

Foreword by the Minister of Finance

I am pleased to present the Department of Finance's 2008 Report on Operations Under the European Bank for Reconstruction and Development Agreement Act. This report reflects our government's strong commitment to transparency and accountability, and our desire to promote effective and efficient international financial institutions. In doing so, it 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.

Last year's report described Canada's role at the European Bank for Reconstruction and Development (EBRD) as well as actions taken by Canada to ensure priorities identified in the 2006 report were being met. In addition, the report clearly outlined Canada's policy objectives at the EBRD for the 2008–2010 period:

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.

In this year's report we describe the progress made in 2008 in reaching those goals, and the specific short- and medium-term actions being taken by Canada that are making this possible. Through this publication, the Government's intent is to provide members of Parliament and the Canadian public with a full understanding of Canada's EBRD objectives.

The 2008 report also contains a brief description of the EBRD's operations and Canada's role at the Bank, as well as an overview of turning points in 2008, such as the nomination of the Bank's new President, the Bank's response to the financial crisis, and the Bank's decision to make Turkey an EBRD recipient country.

In an increasingly challenging time for the international economy, the EBRD is taking on a more important and more demanding global role. It is my hope that this report will leave parliamentarians and all Canadians with a better understanding of Canada's contribution to this critical institution, and the many ways our country is working to ensure the EBRD fulfills its essential 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) began its operations in 1991. Its aims are to foster the transition towards open, market-oriented economies in Central and Southeastern Europe, as well as in the successor states of the former Soviet Union, 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.[1] Where countries are not committed to these principles, the Bank engages only with the private sector. To deliver on its mandate, the Bank focuses its activities on assisting its 29 countries of operations in implementing economic reforms, taking into account the particular needs of countries at different stages in the transition process.

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

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

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

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

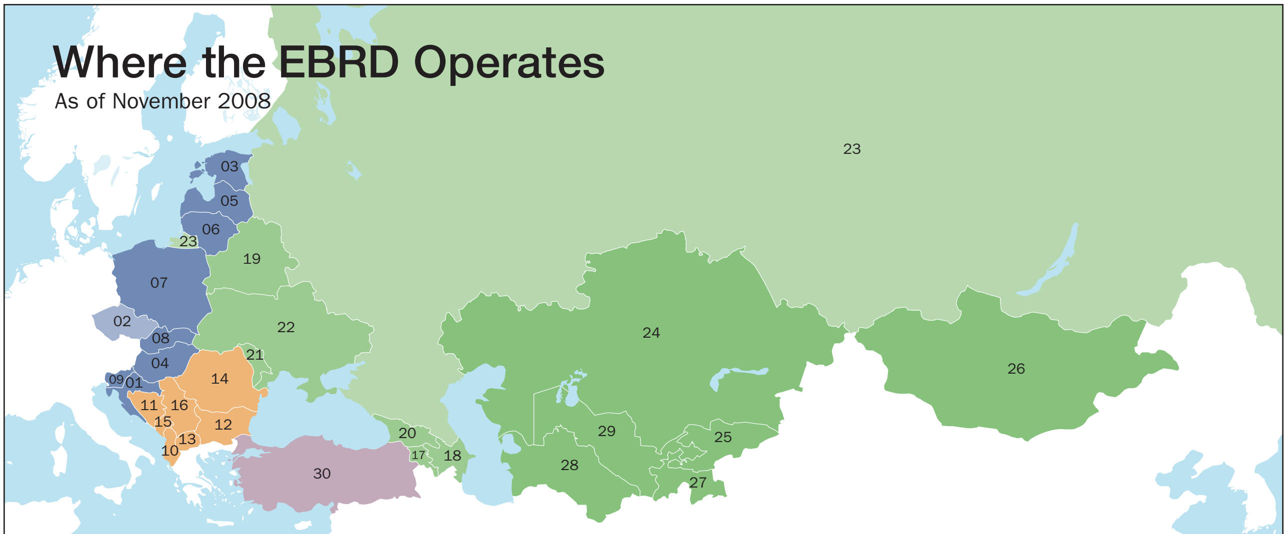
[1] Article 1, Agreement establishing the European Bank for Reconstruction and Development.

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 shareholders: 61 countries, the European Community and the European Investment Bank. There were 29[2] countries of operations last year.



Central Europe and the Baltic states	Southeastern Europe	Eastern Europe and the Caucasus	Russia	Central Asia	Turkey
01 Croatia	10 Albania	17 Armenia	23	24 Kazakhstan	30
02 Czech Republic[1]	11 Bosnia and Herzegovina	18 Azerbaijan		25 Kyrgyz Republic	
03 Estonia	12 Bulgaria	19 Belarus		26 Mongolia	
04 Hungary	13 FYR Macedonia	20 Georgia		27 Tajikistan	
05 Latvia	14 Romania	21 Moldova		28 Turkmenistan	
06 Lithuania	15 Montenegro	22 Ukraine		29 Uzbekistan	
07 Poland	16 Serbia				
08 Slovak Republic					
09 Slovenia					

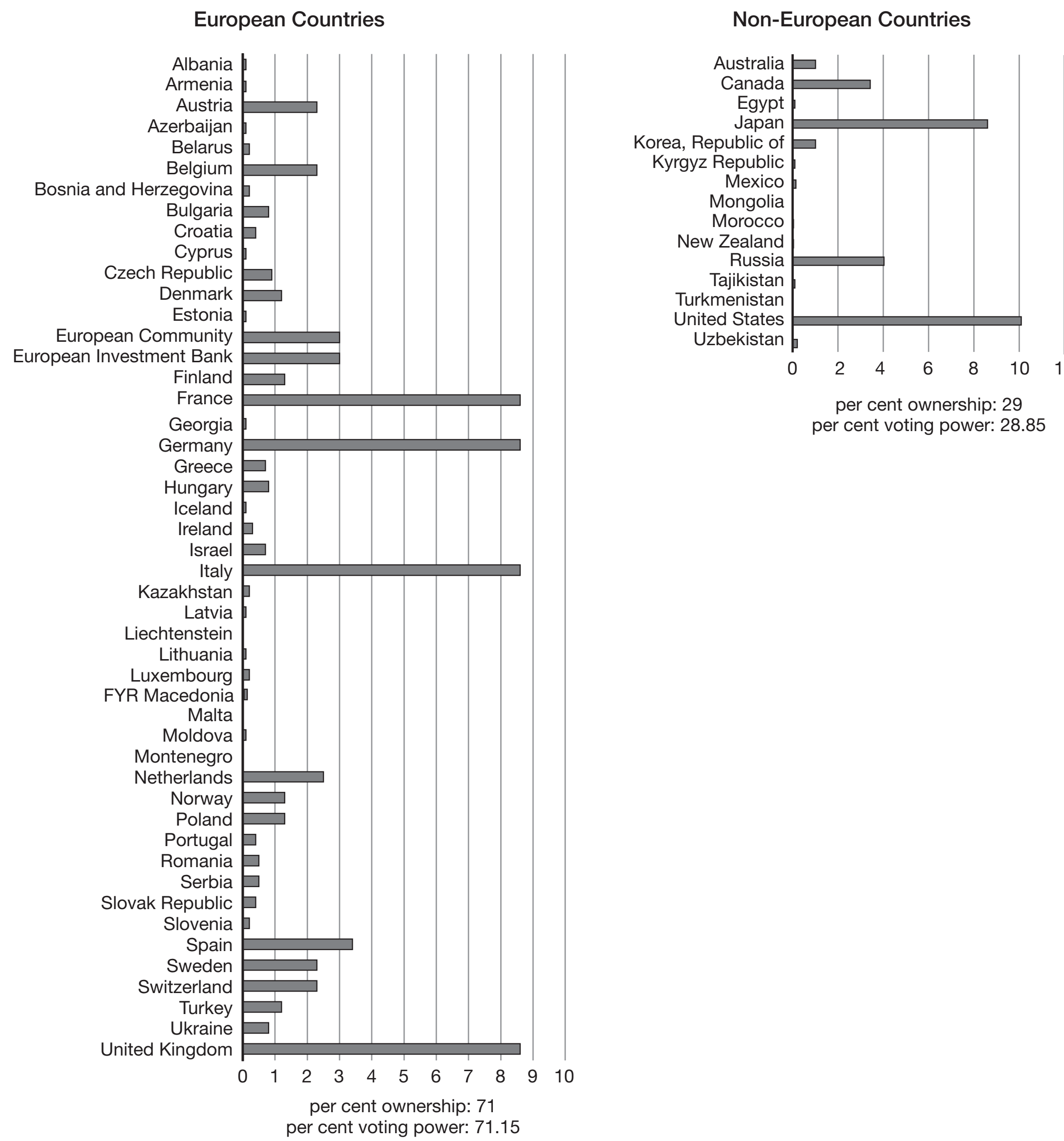
[1] As of the end of 2007, the EBRD no longer makes investments in the Czech Republic.

[2] Turkey became a country of operations in October 2008.

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, 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, the Audit Committee, the Budget and Administrative Affairs Committee, and the Financial and Operations Policies Committee. This division of labour is consistent with good corporate governance practices and provides an appropriate system of checks, balances and incentives. In addition, the structure ensures a more effective discussion by the Board, once initiatives are ready for approval.

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

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

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

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

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 generally 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, and particularly in the current environment, where the syndications market is closed to most of the Bank's clients, the Bank provides a larger share of the project costs. In rare cases, such as when a project is in corporate recovery, the Bank may become the largest shareholder in order to turn the company around and sell it.

EBRD investments range from €5 million to €250 million.[3] 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.

[3] This amounts to C$7.8 million to C$390 million, based on the 2008 average exchange rate.

Funding of EBRD Activities

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

Policy Dialogue

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

Technical 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 it assists legal and regulatory reform, institution building, company management and training. Technical assistance is important to the Bank as it allows thorough preparations for investments, more effective investments in general, and investment opportunities in higher-risk environments in particular.

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

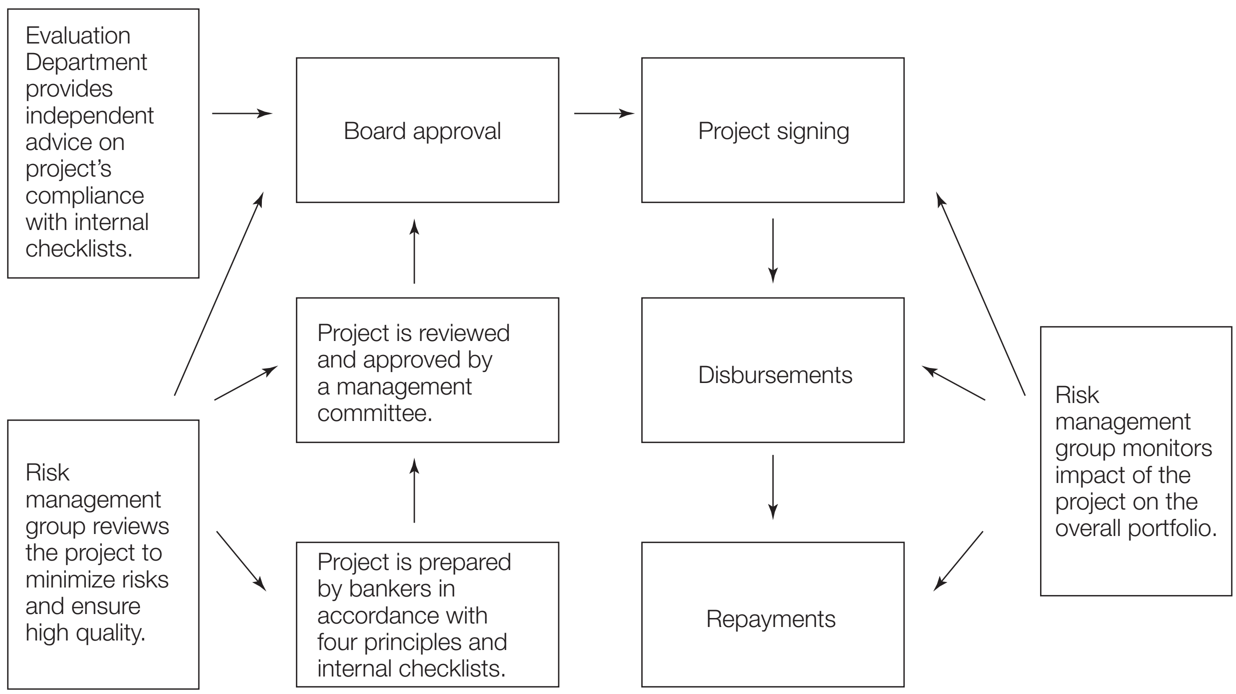
Project Cycle

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 resident representative on the EBRD Board of Directors is Mr. André Juneau. The constituency also 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 2008, there were 21 Canadian professionals on the staff of the EBRD, representing 2.7 per cent of total professional positions, just under Canada's 3.4 per cent share of the institution's capital. Canadians fill the following senior positions: Deputy Chief Compliance Officer; Director for Czech Republic, Hungary, Slovak Republic and Slovenia; and Director of the Early Transition Countries Initiative.

Project Cycle



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:

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

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

Canada and the EBRD

Benefits of Membership

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

Canada shares with the Bank the overriding objective of developing a strong private sector in its countries of operations, by mobilizing financing for projects with a high transition impact and by providing advice and technical assistance to businesses and governments. Through its participation in the EBRD's Board of Directors, Canada has been able to press for greater attention to governance issues in the Bank's operations. Moreover, Canada has been able to help shape the environmental and social safeguards that govern the EBRD's lending. The Bank also provides Canada with a vehicle to reach transition countries that are not normally part of our bilateral development assistance programs. For example, the Canadian International Development Agency (CIDA) gave less than $100,000 to countries like Albania, Uzbekistan and the Kyrgyz Republic and nothing to Turkmenistan, so in these cases the EBRD provides Canada with a way of impacting development/transition goals.

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 otherwise had. For example, consulting services is an area where Canada has a comparative advantage and where Canadians have been successful in winning EBRD-financed contracts. Canada was the 11th largest source country for the Bank's technical cooperation activities (up from 15th in 2007) as Canadian consultants were awarded €2,179,587 under 71 contracts in 2008.

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 Foreign Affairs and International Trade Canada and 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 2008, 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	4,669,288
2008	2,914,880	3,107,304
2009	1,457,440	1,556,952[2]

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

2 2008 average exchange rate used as an estimate.

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-Donor 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. Since 2004, Canada has contributed C$1.7 million to this untied fund.

Western Balkans Multi-Donor Fund—The Western Balkans Multi-Donor Fund was established in 2006. This fund is active in Albania, Bosnia and Herzegovina, Macedonia, and Serbia and Montenegro (including Kosovo). It focuses on technical support to prepare and implement investments that are important for economic growth, regional cooperation and integration with the European Union (EU). Priority areas are energy, transport, the environment, private sector development and institution building. At present the fund has 15 donor countries. It has been an extremely useful fund for mobilizing and leveraging CIDA funds with those of other donors to increase donor impact in the region.

Canadian Technical Cooperation Fund—The main purpose of this fund is to provide financing to hire consultants for EBRD projects across a wide range of sectors and EBRD countries of operations. Canada has transferred C$21 million to the EBRD for technical cooperation since 1992. Canada's contribution was renewed in 2006. It will continue until 2010 and include technical cooperation in Armenia, Georgia, Russia and Ukraine. The sectors of focus include: environment, private sector development and municipal governance.

Chernobyl Shelter Fund (CSF)—The main purpose of this fund launched in 1995 is to secure the sarcophagus around the destroyed Unit IV nuclear reactor in Ukraine. The CSF finances the implementation of the Shelter Implementation Plan, which includes the construction of a permanent confinement facility, enhanced radiation monitoring, and general improvements to nuclear and worker safety. The total estimated cost of this project is estimated to be between US$1.1 billion and US$1.2 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. Current resources are expected to cover work until 2010. However, new pledges are expected to be required during 2009 to cover a financial shortfall of approximately US$130 million between 2010 and the project's proposed completion date. Canada's Global Partnership Program contributed an additional C$8 million to the CSF in 2006.

Nuclear Safety Account (NSA)—This facility was established in 1993 to help address nuclear safety issues in Central and Eastern Europe. Specifically, the NSA finances the decommissioning of old Soviet-style reactors including those at Chernobyl, where donors are funding the construction of an interim spent nuclear fuel storage facility and a liquid radwaste treatment facility. Canada has contributed C$19.5 million to the total fund of US$280 million. Although work was initially slowed by difficulties with the companies awarded the construction contracts, both facilities are now progressing. In 2008, the EBRD announced that the NSA would face a financial shortfall of approximately US$170 million to finish these projects. Due to this shortfall, donors (including the Group of Eight, Ukraine and Russia) made additional pledges to the NSA in 2008–09.

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.

Northern Dimension Environmental Partnership (NDEP)—The NDEP was created in 2001 to fund the safe and secure management of the spent nuclear reactor fuel and other radioactive wastes generated by the dismantling of Russia's Northern submarine fleet. The NDEP's focus on infrastructure is critically important as it fundamentally helps improve the dismantlement process by securing spent nuclear fuel and radioactive material at various sites and increasing storage capacity. By the end of 2006, the NDEP had secured investments of more than US$1.5 billion for environmental projects. In 2003–04, Canada joined over 10 other donors by contributing C$32 million to the NDEP. Canada's Global Partnership Program is responsible for monitoring the NDEP. While progress has been satisfactory, Canada is not considering an additional contribution.

Canada at the EBRD: What Happened in 2008

Nomination of a New President

In 2008, Mr. Jean Lemierre stepped down as the President of the EBRD. After being elected by the Board of Governors on May 19, 2008, Mr. Thomas Mirow, formerly State Secretary at the German Federal Finance Ministry, replaced Mr. Lemierre on July 3, 2008.

The Financial Crisis and the EBRD's Operational Response

Credit constraints, falling asset values and consumer retrenchment have triggered the broadest economic recession in the countries of the Organisation for Economic Co-operation and Development in more than half a century. The situation has set the stage for a second wave of crisis transmission, this time through "real channels." Commodity prices have declined sharply and trade volumes are falling rapidly, significantly affecting the EBRD's countries of operations.

While the origin of the crisis was external to the region, the financial crisis has rapidly spread though the EBRD's countries of operations. Balance sheet adjustments (deleveraging) and a reassessment of risks by global financial institutions led to sharp drops in net capital inflows in the region, creating huge balance of payment funding gaps. As a result, a number of countries in the region have received loans from the International Monetary Fund (IMF), including substantial amounts for Hungary and Ukraine.

The impact of the crisis on the region is still unfolding. The impact varies from one country to another depending on pre-existing vulnerabilities, level of integration with the EU and core economic activities. Commodity-exporting countries are suffering the impact of a decline in both the volume and price of commodities, while countries with weak, undercapitalized banking systems are subject to intense pressure on their financial sectors. Countries with higher levels of industrialization are significantly affected by real sector transmission. Less developed countries may not be as vulnerable to financial or real sector transmission given their limited market integration, but are often heavily reliant on workers' remittances, which are expected to decline as a result of the downturn in construction and other industries in Russia and Western Europe.

Despite the financial crisis, most countries of operations progressed towards market-oriented economies in 2008, as shown in the Bank's latest *Transition Report*. However, as the crisis deepens, the risk that progress will slow or even reverse will increase. The most immediate impact will be felt in the financial sector, where some of the achievements over the last two decades are at risk. Difficulties in the financial sector may require increased government ownership in many of the Bank's countries of operations. While this has occurred in several Western countries, the road back to private ownership may be more difficult in transition economies given deeper concerns in the region about the market model.

Increased government ownership may extend to the non-financial sector with pressure to bail out ailing firms and infrastructure projects. A crisis in the real economy is also likely to extend to trade, and ultimately may threaten some of the measures undertaken to open these economies to the rest of the world. The effects on transition are expected to increase, depending on the depth and length of the global economic downturn.

Reflecting shareholder support for a Bank response to the crisis throughout the region, the upper end of the business volume range for 2009 was raised by 20 per cent to €7 billion. However, given the limited financial resources of the Bank, the Bank's response is based on its project and regional expertise rather than lending volume. The Board of Directors approved the Bank's operational response to the crisis on December 10, 2008. In developing its response, the Bank aimed to:

- Respect its core operating principles of transition impact, sound banking and additionality.
- Address crisis needs across the region, including in Central Europe and the Baltics.
- Preserve, in particular, its focus on the early transition countries and the Western Balkans.
- Make effective use of its capital in order to enable a flexible response.
- Clearly and forcefully communicate both its capacity and willingness to respond to the crisis.

The Bank has taken steps to ensure it is up to date on the development of the crisis and is able to draw operationally relevant conclusions. Key areas in which monitoring and analysis have been stepped up include country risk updates; assessments of crisis channels, sector-specific vulnerabilities and sector demand shifts; financing conditions; political and economic policy implications; and medium-term implications for transition and transition impact assessment.

Following its assessment of which areas of the crisis it can adequately address, the Bank developed response packages for the financial and corporate sectors. The financial response package is based on a systematic review of existing clients aimed at establishing their liquidity, funding and capital adequacy situation, and needs. Such information allows the Bank to determine what steps need to be taken to enable banks to continue financing key client groups. EBRD financing in the form of equity, quasi-equity or debt will be combined with institutional support in crucial areas such as risk management.

The enterprise response package is based on a systematic review of the needs of clients in selected vulnerable sectors, including the car and automotive supply industry, the food and retail industry, property, metals, and construction materials. Early evidence suggests that working capital constraints, short-term debt refinancing and balance sheet strength are likely to become key risk factors in the real sector.

In addition to the response packages, the Bank has stepped up its policy dialogue with a focus on the financial sector in close cooperation with the IMF. More broadly, crisis-specific policy dialogue in all crisis countries is likely to include intensive consultations with central banks and other relevant agencies, with emphasis on diagnostics and the design of private sector–led consolidation processes and essential regulatory changes (e.g. bank insolvency, corporate governance in banks).

In short, the Bank's crisis response is targeted at protecting the Bank's portfolio, generating a timely and relevant set of response projects and supporting targeted policy dialogue. In addition, the response is designed to ensure flexibililty and consistency across the Bank's crisis-driven activities. Given the significant uncertainties surrounding the crisis, the Bank will undertake a mid-year review of the implementation of its 2009 Business Plan with a particular focus on its crisis response components.

Turkey Becoming a Recipient Country

Turkey has been a member of the Bank since the Bank started operations in 1991. In April 2008, the Turkish government officially requested to become a country of operations of the EBRD. At the Bank's annual meeting in May 2008, the Board of Governors directed the Board of Directors to undertake a strategic review of the implications of granting recipient country status to Turkey. The review covered several topics including the EBRD's objectives in Turkey, transition challenges and a transition impact assessment, activities of other international institutions in Turkey, and the linkages between the Bank's operations in Turkey and the implementation of the third Capital Resources Review (CRR3).[4]

In light of the strategic review, the Bank's Board of Governors agreed to Turkey becoming an EBRD country of operations, which Canada supported. The EBRD anticipates investing approximately €500 million in projects in Turkey by the end of 2010. The Bank will support the development of Turkey's private sector and will focus on financing small and medium-sized companies that may come under pressure due to the current financial crisis and global economic slowdown.

[4] The CRR3 lays out the Bank's strategic direction for 2006 to 2010.

Chart 2

EBRD Annual Investments and Gross Disbursements

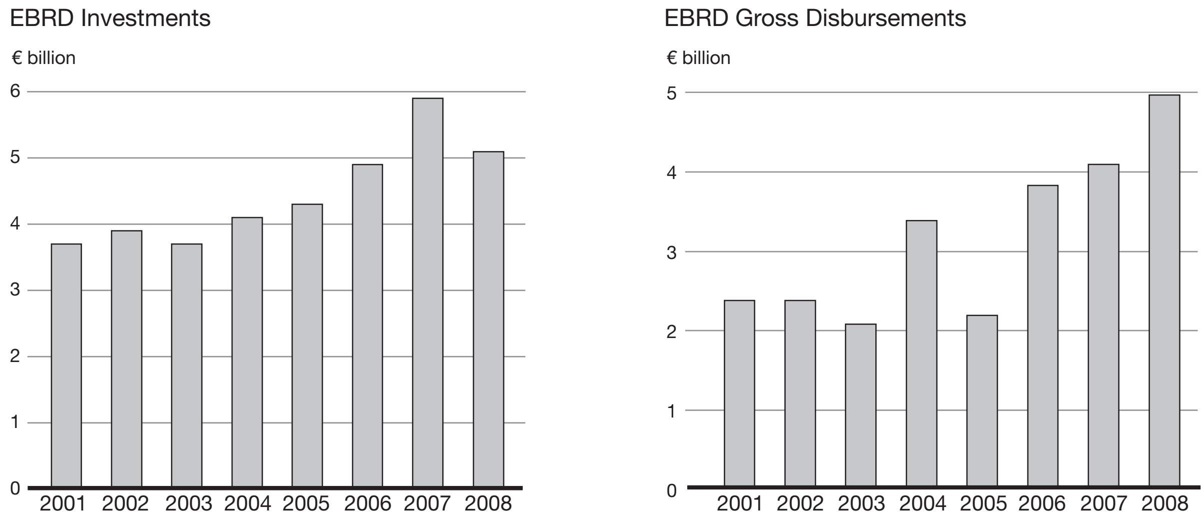


Table 2

Financial Results

	2008	2007	2006	2005	2004
Number of projects	302	353	301	276	265
			(€ million)		
EBRD financing	5,100	5,583	4,936	4,277	4,133
Resources mobilized	8,390	8,617	8,915	6,211	8,799
Total project value	13,490	14,200	13,851	10,488	12,932
Operating income	-981	1,611	2,667	1,543.9	658.6
Expenses and depreciation	-250	-251	-225	-218.9	-189.8
Operating profit before provisions	-1,231	1,353	2,442	1,325.0	468.8
Provision for impairment of loans and guarantees	-232	201	-53	200.6	-67.2
Net profit for the year	-826	1,884	2,389	1,525.6	401.6
Reserves and retained earnings	6,552	8,676	6,974	4,656.1	1,686.0
Provisions for impairment of loans and guarantees (cumulative)	227	124	341	351.6	539.5
Total reserves and provisions	6,600	8,800	7,315	5,007.7	2,225.5

Canada's Voting Record in 2008

Canada and other shareholders typically raise concerns and questions about specific Bank operations before they get to the Board. 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 2008 (with the exception of the Turkmenistan strategy update), as well as the vast majority of the 155 projects approved by the Board. There were 5 exceptions, which reflected 3 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 where it is possible that an investor might have access to private sector funding on reasonable terms. The Canadian Director voted against one project on these grounds.

  1. An EBRD loan to Globus, a Russian hypermarket development 400 kilometres outside Moscow. The project came to the Board before the EBRD's region of operations was affected by the financial crisis. At that time, it was clear the sponsor and the borrower would be able to raise funds from commercial institutions.

- **Lack of transition impact**. Helping to move a country closer to a full market economy ("transition impact") is another of the EBRD's core operating principles. As per Article 2 of the Agreement establishing the European Bank for Reconstruction and Development, 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.

  2. An EBRD loan to Belgazprombank for on-lending to micro and small enterprises. Belgazprombank is partly owned by Gazprom and the state ownership was considered not to be improving transition.

  3. An EBRD equity investment to ARX Private Equity Fund providing equity capital in the mid-market of Central and Southeastern Europe. The project came to the Board prior to the financial crisis. Given the fund manager's positive reputation in the market, it appeared there would be no difficulty raising funds. As well, no new products were being proposed.

  4. An EBRD facility called EU/EBRD Accession Compliance Facility to help small and medium-sized enterprises comply with EU standards in areas of environmental protection, health and safety, and product quality and safety. The Canadian Director suggested it would be better for the European Investment Bank to provide this loan. In addition, the incentive payments involved distorted the project market and were not perceived favourably.

- **Inconsistency with Canada's policy on steel**. In keeping with Canada's 2001 assessment of the global steel supply, Canada does not support steel projects at multilateral development banks that contribute to excess global capacity, The Canadian Director voted against one project on these grounds:

  5. An EBRD loan to Geo Steel, a steel company in Georgia, to construct and operate a steel mini-mill.

Canadian Policy Priorities for 2008–2010

To promote greater transparency and accountability, the Government identified three standing priorities for the 2008–2010 period in the 2007 annual report:

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.

The following section describes progress that was made in 2008 and specific actions taken by Canada to support those priorities.

The financial crisis and its impacts on the Bank's countries of operations as well as the Bank's resources and mandate will have a great influence over the actions taken by Canada at the EBRD in 2009. Canada's priority for 2009 will be to ensure that the Bank provides an adequate response to the crisis. A key part of this work will be done within the Group of Twenty (G20). In November 2008, the leaders of the G20 nations met in Washington, DC, to discuss the financial crisis. Following the summit, G20 members created a working group on the World Bank and other multilateral development banks (MDBs). This working group's mandate is to ensure that the World Bank and MDBs have sufficient resources and instruments to respond to the financial crisis, as well as to provide momentum for further governance and effectiveness reforms. Canada is actively participating in the working group.

The response to the crisis will also be important in the context of the discussions on the Bank's finances as part of the fourth Capital Resources Review (CRR4) in 2009. The outcome of this review will be very important for the future of the EBRD and Canada's involvement in the Bank. In considering Canada's position, we will take into account our three standing priorities for the Bank. Specific actions regarding the CRR4 are listed for each priority.

Assessment of Progress on the 2008 Priorities and Planned Actions Going Forward

Canada made strong efforts to focus on the priorities set out in the 2007 Report. The summary chart provides a colour-coded assessment of the EBRD's progress against Canada's priorities (not Canada's efforts to achieve the priorities). Full reporting on actions, results and remaining challenges are also provided after the summary chart.

Colour code: Little progress | Some progress | Good progress

1. Governance and Accountability

Priority	Short-Term Action (2008)	Medium-Term Action (2009–2010)
1.1 Greater Transparency in the Appointment Process of the EBRD President	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 international filnancial institutions.	Encourage the Bank to consider officially incorporating a new transparent, open and merit-based process into the EBRD by-laws.
1.2 Sustainable Finances Encourage the Bank to maintain a sufficient administrative budget in support of the EBRD's mandate and maintain a sustainable capital base.	Advocate for a reformed budget process and 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.	Advocate for a gearing ratio interpretation change to make more effective use of the Bank's capital.

2. Institutional Effectiveness

Priority	Short-Term Action (2008)	Medium-Term Action (2009–2010)
2.1 Article 1 Promote economic and democratic reform.	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). 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.	

2. Institutional Effectiveness *(cont'd)*

Priority	Short-Term Action (2008)	Medium-Term Action (2009–2010)
2.2 Strong Transition Impact	Encourage the Bank to continue its analysis of indicators to ensure a better assessment of its transition impact.	Encourage the Bank to remain disciplined and selective in the use of its capital in support of activities that are consistent with its mandate.

3. Environmental Sustainability and Gender Equality

Priority	Short-Term Action (2008)	Medium-Term Action (2009–2010)
Promote sustainable best practices with respect to the EBRD's investments.	Advocate for a timely adoption of the Bank's Environmental and Social Policy, with a target date of the summer of 2008. In collaboration with other donors, work with the Bank to develop products and policies to help address gender inequality in the region, with the objective of improving the economic situation of women.	Work with donors and Bank staff to ensure the implementation of the Gender Action Plan and provide assistance to develop projects and policies. Encourage the Bank to examine its internal practices and policies with respect to gender equality. Monitor the Environment and Sustainability Department on the effective implementation of the new Environmental and Social Policy, the creation of Good Practice notes for clients and internal training for Bank staff on the implications of the new policy.

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. Canada supports 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.

Priority 1.1: Greater Transparency in the Appointment Process of the EBRD President

Little progress

While important progress was made in 2006 and 2007, with the Bank significantly broadening its public disclosure policy and holding public consultations on a country strategy for the first time, Canada continued to press the Bank to adopt the very highest standard of internal governance.

Action in 2009: Further encourage the Bank to broaden its public disclosure.

In 2008, the selection of the new EBRD President was completed outside an open and merit-based selection process, without the involvement of all the Bank's Governors. Despite this setback, Canada continued to underline that it favours a transparent, open and merit-based process for the selection of the heads of international institutions at the Bank's 2008 annual meeting. This puts Canada in a better position to push for change in the future.

Priority 1.2: Sustainable Finances

Some progress

In 2006 and 2007, the Bank's results exceeded the projections of the CRR3 strategy and framework, which set out the strategic direction of the Bank for the 2006–2010 period. During these two years, strong growth in the EBRD's portfolio increased pressure on the Bank's capital adequacy and risk ratios.

In 2008, Canada advocated for a decision on the 2007 net income allocation which would ensure discipline and selective use of the Bank's capital in support of activities that are consistent with the EBRD's mandate. In particular, the Canadian Director, along with like-minded Directors, pressed the Bank to develop the Strategic Operations Framework, which provides more transparency to the net income allocation decision and capital adequacy needs.

The Bank currently has sufficient capital and reserves to implement the crisis response it has developed for 2009, which includes an increase in its lending volume of 20 per cent to €7 billion. However, as the crisis unfolds, current lending headroom may prove to be insufficient for the Bank to continue to fulfill its mandate in the crisis context. As such, discussions on a change in the EBRD's gearing ratio will take place in 2009. A change in the interpretation of the gearing ratio would allow for a more efficient use of capital.

The ongoing financial crisis will also put pressures on the Bank's administrative budget. The Bank's plan for a 20-per-cent increase in lending activity for 2009 will present new demands on the EBRD's resources. The Bank has already increased its monitoring and analysis activities with the goal of providing more timely and relevant assistance to the region. The intensity and costs of monitoring activities could also rise as project risks increase. The Bank's administrative resources are limited and must be employed where they can most effectively advance the institution's mandate. Going forward, Canada will seek to ensure that the EBRD's overall administrative expenses are in line with those of other multilateral development banks.

Action in 2009: Ensure that the Bank has sufficient lending headroom to fulfill its long-term mandate while maintaining a reasonable risk level.

Action in 2009–2010: Ensure that good financial governance and effective use of the Bank's capital are at the centre of the CRR4 discussions. Advocate for setting priorities to ensure the Bank's resources are used in the most efficient and effective manner.

2. Institutional Effectiveness

Priority 2.1: Article 1

Little progress

The EBRD has an explicit political mandate, set out in Article 1 of the Agreement establishing the European Bank for Reconstruction and Development, which is to foster transition in countries that are committed to and applying the principles of multi-party democracy and pluralism. The EBRD's analysis shows that the establishment of strong, democratic institutions is a key transition success factor. 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. It has a strong interest in ensuring that nascent democratic regimes have access to the financing and advice needed for a sustainable transition to a market-oriented economy. In Board discussions in 2008, Canada took a strong stand in favour of continued limitation of the EBRD's activities in Turkmenistan, where the commitment to core democratic principles had remained particularly weak.

An update to the Turkmenistan country strategy was approved by the Board in May 2008. The Board agreed to allow the Bank to provide credit lines to state-owned banks for on-lending to small and medium-sized enterprises. Canada abstained on this decision as it was Canada's view that this credit provision would not promote market liberalization or a lessening of control by an undemocratic government that continues to operate under a central planning model.

Action in 2009: Actively participate in Board discussions on country strategies. If the analysis indicates countries are not moving towards multi-party democracy, Canada will continue to support limited scope of Bank activities.

Priority 2.2: Strong Transition Impact

Good progress

By helping to build the right conditions to attract private sector financing, the EBRD played an important role in the transition process leading to the accession of several of its borrowers to the EU in 2004 (EU8)[5] and 2007.[6] In December 2007, a significant milestone was achieved when the Czech Republic graduated from the EBRD. In November 2008, the Governors voted in favour of Turkey's request to become a country of operations at the EBRD. Canada supported the change in Turkey's membership status from "member" country to "country of operations."

As part of the Bank's CRR3, its business model for 2006–2010, Governors from the EU8 countries committed to graduate from EBRD operations by 2010. As such, in 2008 Canada encouraged the Bank to review its indicators of transition impact to better take into account the characteristics of early transition economies. The Office of the Chief Economist (OCE) is currently reviewing the transition indicators to better reflect the specificities of these economies.

Canada is very concerned that the financial crisis may reverse the progress made on transition. In its operational response to the crisis, the Board of Directors agreed to address the needs throughout the region, without questioning graduation. The OCE is reviewing the meaning of transition given the severe impact of the financial crisis on countries with high transition scores. Once the Bank is able to better understand the impact of the crisis on transition, it may be necessary to reassess the suitability of the Bank ceasing to do new business in the remaining seven countries of the EU8 by 2010, as set out in its CRR3. While these countries are well advanced in transition and benefit from EU membership, to cease doing new business may jeopardize the Bank's previous efforts to foster transition towards market economies in these countries.

Over the course of the next year, the Bank will attempt to determine how much progress its remaining countries of operations have made in the transition to market-oriented economies.

Action in 2009: With the proposed lending increase in 2009, encourage the Bank to remain disciplined and selective in the use of its capital in support of activities that are consistent with its mandate.

Action in 2009–2010: As part of the CRR4, advocate for the analysis of the demands the EBRD faces in light of economic and political developments in the region and their impact on transition in countries of operations.

5 The Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia.

6 Bulgaria and Romania.

New Priority

Cooperation With Other International Financial Institutions

The financial crisis has increased the need for close cooperation between international financial institutions (IFIs) in order to provide a rapid and coherent response incorporating effective policy advice and financing. The Bank has limited resources, but it has built up deep local knowledge through its presence in the region and credibility with key stakeholders, governments and market players. As such, the Bank and other IFIs, particularly the International Finance Corporation (IFC), have an important role to play in developing innovative ways to mitigate the impact of the financial crisis on the private sector.

Action in 2009: Encourage the Bank to increase its collaboration with other IFIs, in particular with the IFC, to support private sector adjustments to the new circumstances resulting from the financial crisis.

Action in 2009–2010: Encourage the Bank to untie all donor funds, which will increase the effectiveness of technical cooperation and IFI collaboration and increase commercial opportunities.

3. Environmental Sustainability and Gender Equality

Good progress

Environmental and social issues are increasingly regarded as fundamentally interconnected with long-term economic and political sustainability, as well as quality of life. 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 and Social Policy was approved by the Board in May 2008 and implemented in November 2008. The review took place throughout 2007–08. 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.

In 2008, EBRD President Thomas Mirow joined nearly 100 other leaders across the world in accepting the MDG3 (Millennium Development Goal) Gender Equality Torch from the Government of Denmark. The MDG3 Torch Initiative campaign commits political leaders, private sector representatives, international organizations, influential non-governmental organizations and prominent individuals to accelerate progress in achieving the MDGs.

By accepting a torch, President Mirow committed to implement a Gender Action Plan in the Bank's countries of operations, to promote greater opportunities for women—increasing the economic participation of women in the private sector, including in decision-making roles, through EBRD projects, staff and clients—and to mitigate gender inequalities in the region.

EBRD environmental and social priorities include:

- 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.
- Working in partnership with other institutions to address regional and global environmental issues.

As a result of representation by Canada and like-minded donors, the EBRD made a commitment to incorporate gender equality in its operations. The EBRD's Gender Working Group, which includes numerous Directors from different departments, developed a Gender Action Plan. Canada was instrumental in having €1 million earmarked for gender equality projects under the Shareholder Fund, which will assist the Gender Working Group to carry out its tasks. €270,000 has already been committed to the hiring of two gender specialists.

Action in 2009–2010: Work with donors and Bank staff to ensure the implementation of the Gender Action Plan and provide assistance to develop projects and policies.

Action in 2009–2010: Encourage the Bank to examine its internal practices and policies with respect to gender equality.

Action in 2009–2010: Monitor the Environment and Sustainability Department on the effective implementation of the new Environmental and Social Policy, the creation of Good Practice notes for clients, and internal training for Bank staff on the implications of the new policy.

Annex 1—2008 Governor's Speech

Statement by Ted Menzies, Temporary Alternate Governor for Canada, at the EBRD Annual Meeting Kiev, Ukraine, on Monday, May 19, 2008

It is a pleasure to address you here in Kiev, a beautiful city steeped in culture and tradition. I want to express my appreciation to the Government of Ukraine and to the City of Kiev for graciously hosting the 17th Annual Meeting of the EBRD.

Let me begin by thanking President Jean Lemierre for eight years of extraordinary leadership. His determination and vision have provided a solid foundation for the ongoing relevance of the institution, as well as its strong financial success. He is also a great friend of Canada and we will be pleased to see him again in June.

This year's meeting takes place in an environment of global uncertainty because of the current turmoil in financial markets and soaring food prices. The latter threatens to reverse many of the gains we have made in promoting prosperity in this and other regions over the last decade.

Fortunately, the EBRD has reported very strong results again this year both in its financial performance and, more importantly, in its transition impact. The decision on net income in 2007 provides the basis for an allocation Canada is pleased to support. The package ensures that the Bank's capital will be used effectively and in line with its mandate. The Shareholder Fund will allow the Bank to be more active in countries and sectors where it is additional and the projects generate higher transition impact. And, we are pleased to be making a one-time contribution to the completion of the confinement of the Chernobyl site.

Another resolution before us concerns the process for considering the request by Turkey to become a country of operations. Canada welcomes the consensus approach of the resolution, and we look forward to a recommendation from the Board of Directors.

This past year also saw the first graduation of a country of operations, the Czech Republic. We congratulate them and we look forward to seeing more countries graduate over the next two years.

Let me turn to the issues Canada believes the Bank should focus on:

First, transition impact, of course, is fundamental.

We all agree that many challenges remain in the Bank's countries of operations. As the demand for its support remains strong, the Bank can be selective and continue to apply rigorously its three pillars of additionality, sound banking, and transition impact. We believe that good governance and integrity are core determinants of transition impact. With a waning commitment to democratic reforms in some parts of the region, the EBRD should increasingly focus on projects where it can effect a bottom-up change by identifying clients with a potential to be industry trend-setters in business and environmental conduct.

We support the various steps taken towards a renewed effort in the Early Transition Countries. The risks are high but the potential rewards, not only in financial terms, justify the risks. Canada strongly supports the Bank's efforts in policy dialogue and institutional reform to build the foundations for a strong market economy in these countries.

The Bank's new Environment and Social Policy will further enhance our transition impact in the region. The process of public consultation demonstrates the Bank's commitment to engage with stakeholders. Canada sees the inclusion of gender equality in this new policy as setting best practice for project finance and hopes that this inclusion demonstrates the bank's overall commitment to incorporating gender equality across the Bank.

Second, the new strategic framework is critical.

As I mentioned, Canada is pleased with this year's progress for reviewing the allocation of net income and the adoption of a strategic operational framework, including the creation of a strategic reserve. Its adoption will ensure the sustainability of the Bank's business model over the medium-term.

Third, the Bank should set a good governance example.

The Bank, appropriately, requires high standards of governance from its partners. It can set a first-class example in all aspects of its own governance, from compliance to risk management, from Board decision-making to the role of Governors. Today, we will elect a new president of the EBRD and we congratulate him in advance. However, Canada favours a transparent, open and merit-based process for the selection of the heads of international institutions.

In addition to the priorities I have just outlined, three emerging policy matters deserve to be mentioned. First, the current turmoil in financial markets raises issues about appropriate regulatory structures. At their Spring Meeting, G7 Finance Ministers committed to reviewing their national regulatory frameworks in order to promote greater stability. We would encourage national authorities in the Bank's countries of operation to do the same.

Secondly, food price increases are an opportunity to reduce barriers to promote competition in the food sector. In particular, there is a huge opportunity to increase food production in Ukraine, Russia and Kazakhstan.

Finally, the EBRD has emerged as a leader on climate change issues by successfully engaging in mitigation projects and developing the Sustainable Energy Initiative. The experience the Bank has gained will be invaluable as the international community looks for ways to deal with the effects of climate change.

In concluding, having briefly outlined Canada's priorities, I want again to welcome Thomas Mirow. Canada looks forward to working with him.

He will be pleased to hear that Canada is committed to working with the EBRD to ensure the continued economic growth of the region. In the current uncertain environment, where there is a possibility of a backlash against the very ideals that led to the EBRD's creation, we must work together to preserve and build on our collective accomplishments. A strong, credible and effective EBRD will play a critical role in facilitating the international cooperation needed to achieve that goal.

I wish to thank the Board of Directors, President Jean Lemierre, and the staff of the Bank for a year of considerable accomplishments.

Annex 2—Summary of the *Transition Report*

The *Transition Report* is an annual publication of the EBRD that charts the progress of transition towards a market economy in each of the Bank's countries of operations. The 2008 report presents the main economic and reform developments in those countries from 2007 to mid-2008. The special theme of the 2008 *Transition Report* is growth. Using various data sources, the report looks at the role of competition policy, education and export structure in shaping countries' long-term growth performance, and examines the experience and potential role of industrial policy in the region.

Macroeconomic Overview and Reform Progress

With real gross domestic product (GDP) growing by 7.5 per cent on average in 2007, the transition countries experienced their strongest economic growth since transition began in 1991. While in the first half of 2008 growth continued to be strong, signs of a slowdown became clear in the third quarter as the financial turmoil hit several countries with full force in October 2008. With output in the world's most advanced regions expected to remain flat or even fall in the second half of 2008 and in 2009, the EBRD expects GDP growth in the region to fall to 6.3 per cent in 2008 and to 3.5 per cent in 2009.[7]

In 2007, inflation became a threat to macroeconomic stability and sustainable growth, reversing the trend of previous years. Significant commodity price increases since mid-2007, capacity constraints in the labour market and inadequate fiscal policy explain the sharp rise in inflation. Although commodity prices have sharply declined recently, core inflation will be more challenging to reduce. While capacity constraints should ease as growth slows, labour market tightness may remain a challenge in the medium term as demographic factors and emigration weigh on labour supply in the region.

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. Notwithstanding the context of macroeconomic challenges outlined above, the EBRD reports progress in the reform process. As shown in the table below, the Bank reports 22 transition score upgrades in 14 countries and no downgrades in 2008. The higher number of upgrades compared to 2007 suggests that there was no slackening in the pace of transition in 2008. However, while there was no serious backtracking on reform in any transition country, there have been worrying instances of the state taking a more intrusive role in key sectors of the economy, notably in Russia.

The regional variation in upgrades is similar to previous years, with significant advances in Southeastern Europe and, to a lesser extent, in the Commonwealth of Independent States and Mongolia. Little discernible progress was made in Central Eastern Europe and the Baltic States, which can be explained by the so-called "reform fatigue" that set in after EU accession in 2004. In all cases, market-deepening reforms (e.g. privatization of larger enterprises and strengthening of financial institutions) and market-sustaining reforms (e.g. governance of enterprises, development of institutions to protect and promote competition) are still needed.

7 As of the end of October 2008.

Table 3

Progress in Transition in EBRD Countries of Operations

Countries	Population (millions, mid-2008)	Private sector share of GDP in %, mid-2008 (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: Overall 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+↑	3-↑
Azerbaijan	8.4	75	2	4-	2	4	4	2	2+	2-	2
Belarus	9.7	30↑	2-↑	2+	2-↑	3-	2+	2	2	2	1+
Bosnia and Herzegovina	3.8	60	3	3	2	4	4↑	2	3↑	2-	2+
Bulgaria	7.6	75	4	4	3-	4	4+	3↑	4	3	3
Croatia	4.4	70	3+	4+	3	4	4+	3-	4	3	3
Estonia	1.3	80	4	4+	4-	4+	4+	4-	4	4-	3+
FYR Macedonia	2.0	70↑	3+	4	3-	4+	4+	2+	3↑	2+	2+
Georgia	4.5	75	4	4	2+	4+	4+	2	3-	2-	2+
Hungary	10	80	4	4+	4-	4+	4+	3+	4	4	4-
Kazakhstan	15.7	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	4↑	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	75	3+	4+	4-	4+	4+	3+	4-	4-	3+
Romania	21.7	70	4-	4-	3-	4+	4+	3-	3+	3↑	3+
Russia	142.2	65	3	4	2+	4	3+	2+	3-	3	3-
Serbia	9.9[1]	60↑	3-	4-	2+	4	4-↑	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	6.8	55	2+	4	2-	4-	3+	2-	2+	1	1+
Turkmenistan	6.7	25	1	2+↑	1	3-	2↑↑	1	1	1	1
Ukraine	46.6	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.

[1] Including Kosovo.

Source: EBRD, *Transition Report 2008: Growth in Transition*.

Report Focus: "Growth in Transition"

While growth has been strong and largely sustained since the early 1990s, improving and sustaining growth potential over the longer term remains a major challenge for the transition region. Selective government intervention can substantially increase long-term growth prospects of the transition countries and help them catch up with the technological frontier.

The report argues that competition and the quality of education are two areas where policy can be particularly effective. It underlines the necessity for transition countries to ensure competition by continuing to remove entry and trade barriers for domestic and foreign firms by strengthening/ establishing transparent and effective competition agencies. It also emphasizes the importance for the transition countries to collectively invest more in the quality of all levels of education in order to improve the quality of skills available to the economy.

Experience suggests that countries that are successful exporters tend to grow faster that those that are not. As well, the composition of the export basket can have important implications for a country's future growth opportunities. The report considers two dimensions of structural transformation to export baskets that can foster growth: growing in existing sectors and moving to new sectors. The suitability of growing in existing sectors largely depends on how much scope there is to upgrade quality within the existing export basket and whether the basket is sophisticated enough relative to GDP per capita to sustain growth. On the other hand, moving from existing products to new products requires that the existing capabilities be easy to redeploy to alternative production. It is likely appropriate for countries in that situation to use industrial policies focusing on providing the sector-specific public goods that emerging activities require.

In light of this analysis, the role for industrial policies in stimulating growth was examined. Any industrial policy must have at least one of the two following broad aims: 1) improve the efficiency of individual firms and sectors, which usually involves restructuring and investments, and 2) achieve structural change using policies that favour more dynamic and productive activities generally, irrespective of the sector or industry in question. Policies can either be horizontal (i.e. providing the framework in which firms and industries operate and where market mechanisms ultimately determine survival and prosperity) or vertical (i.e. targeted at specific firms, industries or sectors).

The report underlines that horizontal policies to support investments and innovation are important tools in the policy armoury. It concludes that in transition countries where market failures and other constraints are significant, there can be justification for also using targeted or vertical policies. Targeted policies drawing on public resources can be helpful in promoting the growth of new activities by improving credit and infrastructure in particular. However, the difference between success and failure with this type of intervention comes down to the detailed design of the policy and its effective implementation. As such, vertical, or targeted, industrial policies are likely to be far more problematic the weaker the country's institutional environment.

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. The timeline for disengaging from the Balkans and the South Caucasus (Armenia, Azerbaijan and Georgia) is 2010. The highlights of CIDA's programming in EBRD countries of operations can be found below.

Ukraine—Since 1991, Canada has provided C$367 million in technical assistance to Ukraine. The goal of CIDA's bilateral Ukraine Program is to strengthen democracy and further Ukraine's integration into the global economy while improving economic opportunities for its citizens. Current programming builds on past efforts and focuses on democratic governance and private sector development. The latter will focus on two sub-sectors: creating an enabling environment and promoting entrepreneurship in order to increase the competitiveness of Ukrainian small and medium-sized enterprises, especially agricultural producers, in domestic and international markets.

Russia—To date, Canadian technical cooperation programming expenditures in Russia total over C$360 million. Current CIDA programming in Russia is mostly focused on governance, in support of public administration reforms, rule of law and civil society.

Balkans—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 and Serbia. 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 cross-cutting issues being addressed by these investments. CIDA is planning to disengage from the Balkans by 2010.

South Caucasus—CIDA has been present in the South Caucasus 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 region. The majority of funding has been allocated through responsive programming, with remaining funds provided via humanitarian assistance grants and the Canada Fund for Local Initiatives. Georgia has received C$33 million, which represents the majority of CIDA'S assistance. CIDA is planning to disengage from the South Caucasus by 2011.

Tajikistan—Canada has had a presence in Tajikistan since 1994, working with its partners to reduce instability through poverty alleviation, particularly in rural areas. Tajikistan's openness to cooperation with aid partners also allows Canada to contribute to regional security in Central Asia. The Tajikistan Country Strategy focuses on governance and private sector development within the broader realm of agrarian reform. CIDA's assistance program for Tajikistan focuses on agrarian reform in rural areas, where the majority of the population lives. CIDA's approach is to foster local ownership and leadership. At present, Canadian support targets democratization and public sector capacity building in rural agrarian reform as well as the promotion of rural entrepreneurship and access to markets for rural producers.

Europe Regional Program (ERP)—The ERP works with selected multilateral and bilateral institutional partners that are addressing issues of regional and trans-boundary interests. 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. The uncommitted balance of the $8-million EBRD-CIDA Canada Fund is slightly over $2 million and is due to close March 1, 2010.