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OVERVIEW

Despite a difficult economic and political environment, in 2014 the EBRD increased its total annual investment to €8.9 billion and signed 377 projects across more than 30 emerging economies. These projects cemented the Bank's reputation as a reliable partner in times of need and produced a major contribution to the transition process, which is vital for sustainable long-term growth. Major areas of engagement alongside investment activities included support for reforms aimed at combating corruption and improving the business climate.

OPERATIONAL RESULTS

In 2014 major economic and political challenges affected the pace of transition in many countries where the EBRD works. The Bank responded to this difficult investment environment by increasing its support for transition and recovery, with total annual Bank investment (ABI)[9] for 2014 of €8.9 billion, compared with €8.5 billion the previous year. The rise in EBRD financing came despite a sharp fall in its investments in Russia following guidance from a majority of shareholders in July that for the time being they would not consider new projects in the country. Investments were made to 377 operations in 2014, compared with 392 in 2013.

The Bank continued to increase its investment levels in the southern and eastern Mediterranean (SEMED) region, signing 34 operations and investing close to €1.1 billion in 2014. This included 15 projects in Egypt, where ABI reached €593 million and business was funded through the EBRD's SEMED Investment Special Fund. In May 2014 the Bank welcomed Cyprus as a recipient country and took a stake in the Bank of Cyprus to help stabilise the country's financial sector.

[9] "Annual Bank investment" (ABI) is the volume of commitments made by the Bank during the year. This includes: (i) new commitments (less any amount cancelled or syndicated within the year); (ii) restructured commitments; and (iii) amounts issued under the Trade Finance Programme (TFP) during the year and outstanding at year-end. In EBRD Annual Reports before 2013, ABI was shown as annual business volume (ABV).

Business activity was strong in Turkey in 2014, with €1.4 billion invested and 37 transactions signed across a wide range of sectors. A third office was opened in the country, in the south-eastern city of Gaziantep, in response to demand for Bank funding outside large metropolitan areas.

The EBRD reacted to the crisis in Ukraine with new lending – as well as renewed commitments – exceeding €1.2 billion in a range of public and private sector projects after the new administration embarked on a programme of economic reform. The Ukrainian authorities also signed an Anti-Corruption Initiative, a major step forward in the bid to improve the investment climate.

Altogether, the EBRD invested in 34 countries in 2014, with investments by region as follows: Central Asia €0.8 billion, central Europe and the Baltic states €1.1 billion, Cyprus €0.1 billion, eastern Europe and the Caucasus €2.1 billion, Russia €0.6 billion, SEMED €1.1 billion, south-eastern Europe €1.7 billion and Turkey €1.4 billion.

The EBRD continued to support key economic sectors in line with its operational strategy. ABI in the financial sector reached €2.8 billion in 2014 (with SME financing a priority), in the diversified corporate sectors €2.3 billion, in the infrastructure sector €2.0 billion and in the energy sector €1.7 billion.

In 2014 the EBRD increased its efforts to prepare economies for more robust growth once the recovery is under way and to make them more resilient to future external shocks. These efforts are part of a broader strategy that also involves forging greater economic integration and addressing global challenges, such as climate change and energy security. The high transition relevance of projects signed in 2014 reflected this work, with 89 per cent of them assessed as having good, very good or excellent transition impact potential. Some 94 per cent of active EBRD projects well into implementation were assessed as generally on track to achieving envisaged transition objectives (see Transition Impact charts on page 5).

The EBRD's mandate to deliver transition and reform by working with the private sector was reflected in the private sector share of ABI, which was 72 per cent in 2014. This private sector focus was supported by the Bank's ability to offer equity investment alongside traditional debt financing, with the EBRD providing €0.9 billion of equity to 39 companies in 2014 (2013: €1.2 billion). The organisation took measures to strengthen its direct equity activities and will pursue this work in 2015.

Through the implementation of strategic initiatives the EBRD seeks to deepen the impact of its activities. These initiatives are designed to promote the sustainable use of resources, support early transition countries (ETCs), create conditions in which small and medium-sized enterprises (SMEs) can flourish and stimulate the development of local capital markets.

The EBRD's Sustainable Resource Initiative (SRI) promotes sustainable energy, climate change resilience and resource efficiency, which are important components of EBRD transition strategy in the countries where it works. As well as tackling water and materials efficiency, it supports energy efficiency, renewable energy and climate change adaptation. The EBRD invested a record €3.0 billion in 168 projects under the SRI in 2014, accounting for 34 per cent of total annual Bank investment. This is estimated to yield annual reductions of 7.3 million tonnes of CO_2 emissions.

The ETC Initiative, which increases financing and strengthens the business climate in the EBRD's less economically advanced countries of investment, marked its 10th anniversary in 2014. Close to one-third of the Bank's transactions in that year were undertaken in the ETCs, with investment of more than €1.1 billion. Since most firms in these countries are locally owned, and considered to be SMEs by international standards, 87 per cent of operations had a value of less than €10 million, with an average investment size of under €3 million.

Working to create the conditions in which SMEs can flourish is firmly anchored in the EBRD's transition mandate and its business model. This commitment was re-emphasised in 2014 with the creation of the SME Finance and Development group within the EBRD's Banking department to implement the Small Business Initiative, which aims to streamline and strengthen the support that the EBRD provides to SMEs. (For more information, see page 24). In 2014, in addition to investments of €1.2 billion in 87 financial intermediaries for on-lending to SMEs, the Bank made direct investments in 39 SMEs.

The EBRD's Local Currency and Capital Markets (LC2) Development Initiative aims to establish viable local currency financing and to encourage the development of efficient and self-sustaining local capital markets, thereby mitigating key vulnerabilities in the EBRD region. Banks in most EBRD recipient countries continue to face significant challenges, making local capital market development more important than ever. In 2014, the Bank signed 81 local currency loan and bond transactions – 24 per cent of the total number of debt transactions by the EBRD during the year.

The Bank's portfolio of investment operations (including undisbursed commitments) increased from €37.8 billion in 2013 to €38.7 billion by the end of 2014, with finance provided through new investment operations exceeding reflows from existing investment operations and cancellations of unused amounts.

Gross disbursements reached €6.5 billion in 2014, up from €5.9 billion in 2013, with loan repayments of €4.7 billion and equity divestments of €1.2 billion resulting in operating assets of €27.2 billion at end 2014, up from €26.4 billion at end 2013.

In accordance with aspects of its mandate, which cover the mobilisation of domestic and foreign capital for clients, the EBRD maintained a strong record of raising debt and grant co-financing from a variety of sources, despite difficult economic and geopolitical circumstances.

The Bank's projects included additional non-EBRD finance of around €13.9 billion in 2014 (2013: €13.5 billion), with the EBRD directly mobilising €1.2 billion of investment from co-financiers – principally through €865 million of syndicated loans using the Bank's A/B loan structure (2013: €759 million) in 22 transactions. These spanned numerous sectors and brought finance to borrowers in Albania, Azerbaijan, Croatia, Georgia, Kazakhstan, Poland, Romania, Turkey and Ukraine.

In addition, the EBRD raised €312 million for 37 projects from bilateral or other lenders, either through parallel loans or through its Special Funds structures. EBRD activities remained strongly supported by donor funding, including the Special Funds programme and technical and investment cooperation funds. These broad-based results reflect an ongoing commitment to countries in the EBRD region as they build and strengthen open-market economies.

> “The portfolio of investment operations increased from €37.8 billion in 2013 to €38.7 billion by the end of 2014.

FINANCIAL RESULTS

In 2014 the EBRD recorded a net realised profit of €0.9 billion before provisions, unrealised losses on share investments and other unrealised amounts (2013: €1.2 billion profit). The main contributor to realised profit is the Bank's strong net interest income.

Including provisions and unrealised amounts, the Bank recorded a net loss of €0.6 billion for 2014 (2013: €1.0 billion net profit). This loss was primarily due to a decline in the value of its equity investment portfolio, with the weakening of the Russian rouble having a notable effect, together with increased provisions raised on the Bank's loan book which was affected by the economic deterioration in Ukraine.

The ratio of non-performing loans increased to 5.6 per cent at year-end (2013: 3.3 per cent) and the average credit rating of the loan portfolio overall equated to B+. While the Bank is now operating in an environment of more difficult political and economic conditions in some countries, it will maintain its high standards of project selection and enhance the monitoring of its portfolio.

The value of assets under the EBRD's Treasury management at 31 December 2014 was €22.5 billion compared with €20.1 billion at the close of 2013, the increase primarily explained by the revaluation of assets denominated in the US dollar due to the appreciation of the latter against the euro. Before hedge accounting adjustments and the impact of currency basis swap spreads, the operating profit of Treasury was €137 million compared with €147 million in 2013. Treasury uses currency swaps to fund its banking loan operations, mainly the Russian rouble-denominated portfolio. These swaps are held to maturity and therefore the unrealised losses caused by volatility in currency basis swap spreads reverse over time. After allowing for the impact of hedge accounting and currency basis swap spreads, Treasury returned a profit of €46.0 million (2013: €221 million).

The EBRD continues to enjoy a triple-A rating, reaffirmed by all three major rating agencies in 2014. The Bank raised €5.2 billion of long-term funding in 2014 under its annual borrowing programme, with an average maturity of 4.2 years. The bonds were issued in 14 currencies, with US dollar issuance accounting for 54 per cent of the total.

UKRAINE CRISIS RESPONSE

In response to adverse macroeconomic and geopolitical conditions for Ukraine, the EBRD stepped up its investments in the country by committing over €1 billion to public and private sector projects, reinforced by technical assistance and extensive policy dialogue.

Significant investments were made in Ukraine's gas transport, road, municipal and agribusiness infrastructure, and in agribusiness production. The Bank also increased the availability of its trade finance to support financial institutions as they facilitate international trade. In addition, it launched a specialised facility for existing clients to address their needs for liquidity and working capital, helping them to overcome difficulties caused by the financial crisis and the reduced availability of external funding.

Governors of the EBRD approved additional Bank contributions for the completion of the New Safe Confinement on the site of the 1986 nuclear accident at Chernobyl (see Chapter 2). EBRD shareholders established the EBRD-Ukraine Stabilisation and Sustainable Growth Multi-Donor Account (MDA), which will support the country's efforts to reform its economy, improve the business climate and return to a path of sustainable growth.

In the use of EBRD funding there will be a strong emphasis on improving the investment climate and combating corruption, stabilising the banking sector, increasing energy security, enhancing the competitiveness of the private sector and upgrading municipal infrastructure. The Bank played a pivotal role in driving anti-corruption efforts in Ukraine, in particular by devising an appropriate structure and effective legal foundation for the Business Ombudsman Institution. The institution will be financially supported by the EBRD-Ukraine MDA.

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PROJECTS BENEFITED FROM €312 MILLION RAISED FROM BILATERAL AND OTHER LENDERS

THE EBRD DIRECTLY MOBILISED

€1.2 billion

OF INVESTMENT FROM CO-FINANCIERS

General administrative expenses for 2014 were €355 million (2013: €345 million). Sterling general administrative expenses for 2014 totalled £300 million (2013: £295 million).

Overall, the Bank's reserves decreased to €7.9 billion at the end of 2014 (2013: €8.7 billion), reflecting both the net loss for the year and net income allocations.

The geopolitical uncertainty in the EBRD region is likely to continue contributing to volatility in the Bank's earnings.

Full details and financial statements are provided in the EBRD's *Financial Report* 2014 (see www.ebrd.com).

DONOR-FUNDED ACTIVITIES

Donors play a major part in the transition process. They provide financing – for example, through technical assistance, investment grants, concessional financing, risk-sharing facilities and incentive payments – and promote policy dialogue that helps to prepare the way for Bank-funded projects, foster reform and improve the investment climate. Grants from donor countries, the European Union (EU), multilateral donor funds and the EBRD Shareholder Special Fund, among others, act as catalysts for Bank investments and support key strategic initiatives across almost all EBRD activities. Total donor funding in 2014 amounted to €340.6 million.

Donors are active throughout the EBRD region, with a particular focus on those areas that face the biggest challenges: the early transition countries, the Western Balkans and the SEMED region. Among the priorities for donors in 2014 were: tackling climate change and boosting resource efficiency and energy security; supporting small firms; building a stable financial sector and promoting the development of local capital markets; accelerating transition in infrastructure; fostering the region's contribution to global food security; encouraging legal reform; and championing gender and social inclusion in Bank-funded projects.

Technical cooperation (TC) projects feature in the Bank's overall scorecard. Their outcomes are tracked in the TC results framework, which was created in 2013 to monitor the results of the Bank's efforts and to improve the flow of information to donors and other stakeholders. In 2014 the EBRD continued work on reforming the management of its grant resources. More information is available in the *Donor Report* 2014 (see dr-ebrd.com).

POLICY DIALOGUE AND INITIATIVES

To achieve the highest impact through its projects, the Bank has developed policy initiatives addressing key transition challenges in the countries in which it invests. With strong support from donors, these initiatives link investments, policy dialogue, TC, and knowledge and capacity-building in sectors of strategic importance.

The four strategic initiatives reflected in the EBRD's corporate scorecard are the Sustainable Resource Initiative (SRI), the Early Transition Countries (ETC) Initiative, the Local Currency and Capital Markets (LC2) Development Initiative and the Small Business Initiative (SBI) (see "Operational Results" on page 7).

CASE STUDY
JORDAN TAPS INTO VAST SOLAR POWER POTENTIAL

Jordan's renewable energy sector received a major boost in 2014, with four investments by the EBRD in solar power plants worth a total of US$ 75 million (€62 million equivalent).

The four plants will together deliver 60 megawatts of much-needed generating capacity from a clean, reliable domestic resource, thereby reducing the country's dependence on expensive imported hydrocarbons. Jordan, which has a rapidly growing demand for power, imports 97 per cent of the energy it consumes.

Helping to develop sustainable energy resources and increase energy security are key objectives of the EBRD's strategy in Jordan, a country with huge potential for solar power generation.

CASE STUDY
SAFE DRINKING WATER FOR RURAL MOROCCANS

Nearly half a million people living in rural communities and medium-sized cities of Morocco will enjoy improved access to safe drinking water thanks to a water-supply investment programme supported by the EBRD. A €65 million sovereign-backed loan extended by the Bank to the Office National de l'Electricité et de l'Eau Potable (ONEE) will finance the provision of EU-quality drinking water to approximately 260 towns and rural communities in the Azilal, Ben Guerir and Ouarzazate regions. The loan is backed by €4.6 million in TC funds from Austria, the SEMED Multi-Donor Account and EBRD shareholders through the SEMED cooperation funds account.

As well as contributing to better health, the project features an important economic inclusion component as it will facilitate access to drinking water for people in economically less-advanced parts of Morocco. Women and girls in rural villages will benefit in particular as they are typically tasked with water collection, often from distant supply points. Thanks to the improved system of drinking-water delivery, they will have more time to engage in economically productive activities or education.

KNOWLEDGE ECONOMY AND INNOVATION

In order to compete successfully on the world stage, the EBRD region needs to harness the power of technology and embrace innovation in all areas of economic activity. This is particularly important in the countries where the Bank invests, as many of them have a legacy of energy waste, labour-intensive production processes and over-reliance on natural resources.

In 2014 the Board approved the Knowledge Economy Initiative, which brings a more strategic focus to the EBRD's successful support for innovation and technological dynamism. Under the Initiative, the Bank uses investments and related activities to foster appropriate innovation policies, the development of information systems and infrastructure (such as broadband), technological upgrades for industry, and financing for small, innovative technology companies, for example through the Bank's Venture Capital Investment Programme. This approach takes into account the different levels of technological development in the region, helping each country develop its own knowledge economy.

Among the notable investment projects that supported the knowledge economy in 2014 were financing worth €50 million to research the development of energy-efficient smart TV sets by Turkish electronics producer Vestel Elektronik (see case study on page 22), and a €20 million loan to Bulgarian company Bulsatcom to expand its mobile and fibre-optic broadband networks. The EBRD also engaged in extensive policy dialogue and provided technical assistance to help improve the region's innovation policies, including telecoms regulation, and create ecosystems that allow venture capital and private equity firms to grow.

Through these activities, the EBRD helps businesses to improve their productivity and contribute to sustainable economic growth.

A range of other initiatives support Bank efforts to deepen the transition process. Launched in 2014, the Investment Climate and Governance Initiative (ICGI) reaches beyond projects to encourage broader systemic change. ICGI programmes are developed in countries showing strong demand for EBRD engagement, demonstrable political will to improve governance and the investment climate, and a clear role for the Bank to add value to reform of the business climate. ICGI programmes were developed for Albania, Moldova and Serbia. The Bank also signed an Anti-Corruption Initiative with the new government of Ukraine, focused on establishing an independent Business Ombudsman Institution.

The EBRD also engaged in extensive high-level policy dialogue to support the launch of its Infrastructure Project Preparation Facility, which aims to improve the efficiency and replicability of infrastructure projects. The Facility will help strengthen local capacity to close the infrastructure gap that exists in many countries where the EBRD works.

The Strategic Gender Initiative (SGI) sets out how the Bank promotes women's socio-economic empowerment, equality of opportunity and participation in the labour market through its activities. The SGI recognises that equal opportunities for men and women contribute to the efficient use of all resources and are an essential aspect of a modern, well-functioning economy. Since 2013, the EBRD has formally taken the promotion of economic inclusion – the opening-up of economic opportunities to previously underserved social groups – into account when assessing the potential transition impact of investments. The Bank's work on economic inclusion focuses on women, young adults and people from economically less-developed regions.

In response to the increased pressure on food supply resulting from climate change and the growing global population, the EBRD has developed a Private Sector for Food Security Initiative. This focuses on unlocking the vast agricultural potential of the countries in which the Bank invests, overcoming constraints on market supply, improving the efficiency of production and distribution and promoting food quality and animal welfare. In this area, the Bank works closely with partners, including the Food and Agriculture Organization (FAO) of the United Nations.

The EBRD pays special attention to the Western Balkans in order to promote stability, regional integration and economic development. A highlight of 2014 was the hosting of a gathering at which all seven prime ministers of the Western Balkans (Albania, Bosnia and Herzegovina, FYR Macedonia, Kosovo, Montenegro and Serbia) and Croatia discussed economic cooperation and investment opportunities in the region.

Other areas of strategic focus for the EBRD include the knowledge economy, a key role with partners in the Vienna Initiative and Joint IFI Action Plan and the Legal Transition Programme. (For more information on these areas of work, see the box to the left, and the "Policy Dialogue and Initiatives" section, page 32).

MEASURING RESULTS

As part of institution-wide modernisation efforts, the EBRD has been reviewing how it measures the transition impact of its work. The Bank focuses on results at the investment and technical co-operation (TC) project level as well as at country and institutional levels.

In September 2014, the Board approved the design of a country strategy results framework which includes clear and measurable objectives for each country, based on an analysis of challenges, opportunities and risks. The framework reflects the Bank's specific transition mandate and business model and helps guide the EBRD's activities in each of the countries where it invests.

At the institutional level, the EBRD has revised its corporate scorecard. This provides a framework for aligning the organisation to the strategy set out by the Bank's shareholders.

> "In 2014 the EBRD increased efforts to prepare economies for more robust growth and to make them more resilient to external shocks.

> "Since the Bank began working in the SEMED countries in 2012 it has invested over €1.7 billion in the region.

The expanded scorecard tracks the performance of the Early Transition Countries, Sustainable Resource, Local Currency and Capital Markets, and Small Business initiatives. The scorecard sets targets for the transition impact objectives of investments at their approval stage; measures how successful their implementation has been against these objectives; and tracks the number of projects signed, the amount of investment provided or mobilised by the EBRD and the proportion of successfully completed technical cooperation assignments.

At the project level, the Bank measures the results of investments and TC projects. Work on improving the results framework for investment projects is ongoing. The EBRD has already developed a TC results framework that specifies the results expected and enhances the flow of information to donors and other stakeholders.

SOUTHERN AND EASTERN MEDITERRANEAN REGION

In 2014 the EBRD invested €1.07 billion and signed 34 projects in the SEMED region, bringing the total the Bank has invested in this region since it began operating there in 2012 to €1.76 billion and the total number of projects to 58. This strong financial engagement, supported since 2012 by some 130 donor-funded TC projects, demonstrates the EBRD's commitment to economic growth and private sector development in Egypt, Jordan, Morocco and Tunisia following the historic events across the Middle East and North Africa in 2011.

Important areas of focus for the Bank's work in SEMED countries include assisting financial institutions, developing infrastructure, supporting SMEs and other private businesses, and promoting the sustainable use of energy, water and other resources. Through investments complemented by TC projects and extensive policy dialogue, the EBRD helps to address the pressing economic issues facing SEMED countries – such as high levels of unemployment among women and young adults – and contributes to a stable political future for the region.

The Bank opened permanent offices in Egypt, Jordan and Tunisia – one was scheduled to open in Morocco in the first quarter of 2015. Jordan, Morocco and Tunisia are EBRD recipient countries while Egypt continues to have potential recipient country status. The Bank invests in Egypt through the EBRD SEMED Special Investment Fund.

Landmark transactions in 2014 included: major modernisation investments in Egypt's power and rail sectors; solar power deals in Jordan that will help the country reduce its dependence on expensive energy imports; support for the expansion of drinking water services for rural communities in Morocco; property and tourism projects with important economic inclusion elements in Egypt and Morocco; and credit lines in all four countries to facilitate access to finance for SMEs, particularly those led by women.

The EBRD supported the development of local currency lending and capital markets in SEMED, including through participation in a bond issue by Moroccan agribusiness group Zalagh Holding and currency swap agreements in Egypt and Tunisia. The Bank's Trade Facilitation Programme remains an important means of establishing banking relationships in the region. The programme signed eight agreements with banks in SEMED for a total value of €205 million in 2014. These agreements help local companies obtain the trade finance they need to import and export goods and expand.

A wide range of donor-funded activities were carried out in the region, many of which aimed to facilitate project preparation and implementation and build institutional capacity. The donor-funded Small Business Support programme increased its activities across SEMED, providing approximately 250 small and medium-sized firms with business advice in 2014 to help them grow. The programme formally launched in Jordan, Morocco and Tunisia in 2014, having previously launched in Egypt. TC funds for the region are provided from the SEMED Multi-Donor Account and by EBRD shareholders through the SEMED cooperation funds account.

Coordination with other IFIs active in SEMED remained an important feature of Bank engagement in the region. In 2014 the EBRD hosted the secretariat of the IFI Coordination Platform for the Arab Transition Countries under the Deauville Partnership.

TRANSITION PROGRESS IN THE EBRD REGION: DEMOCRATIC AND MARKET REFORMS

In accordance with its Article 1 mandate, the EBRD monitors democratic reform in the region in which it invests. The Article states that the Bank's purpose is to foster transition to open markets in countries committed to and applying the principles of multi-party democracy, pluralism and market economics. While transition countries that have joined the European Union (EU) or have attained candidate status have mostly reached a high level of democratic consolidation, there have been setbacks in some countries where populism is on the rise, and achievements in democratic reform in the rest of the EBRD region remain uneven.

Countries in the Western Balkans region continued with democratic reforms, supported by the process of EU approximation. Montenegro made further progress in EU accession negotiations, while Serbia formally opened them in January. Albania was granted the status of EU candidate country in June, and in July Kosovo initialled the Stabilisation and Association Agreement with the EU. This positive process is further supported by inter-ethnic reconciliation and intensified regional cooperation, notably through enhanced dialogue in

CASE STUDY
STABILISING THE FINANCIAL SECTOR IN CYPRUS

The EBRD participated in the successful €1 billion capital-raising by the Bank of Cyprus, to help stabilise the largest financial institution in its newest country of investment. The EBRD holds a 5 per cent stake in the bank, which is implementing a comprehensive restructuring programme in line with a €10 billion international support package aimed at helping the island emerge from a deep financial crisis. Due to its size, the stabilisation of the Bank of Cyprus is critical for the full recovery of the Cypriot economy and financial sector. A key focus for the EBRD in its role as a shareholder will be to ensure that the bank adheres to the best international standards of corporate governance.

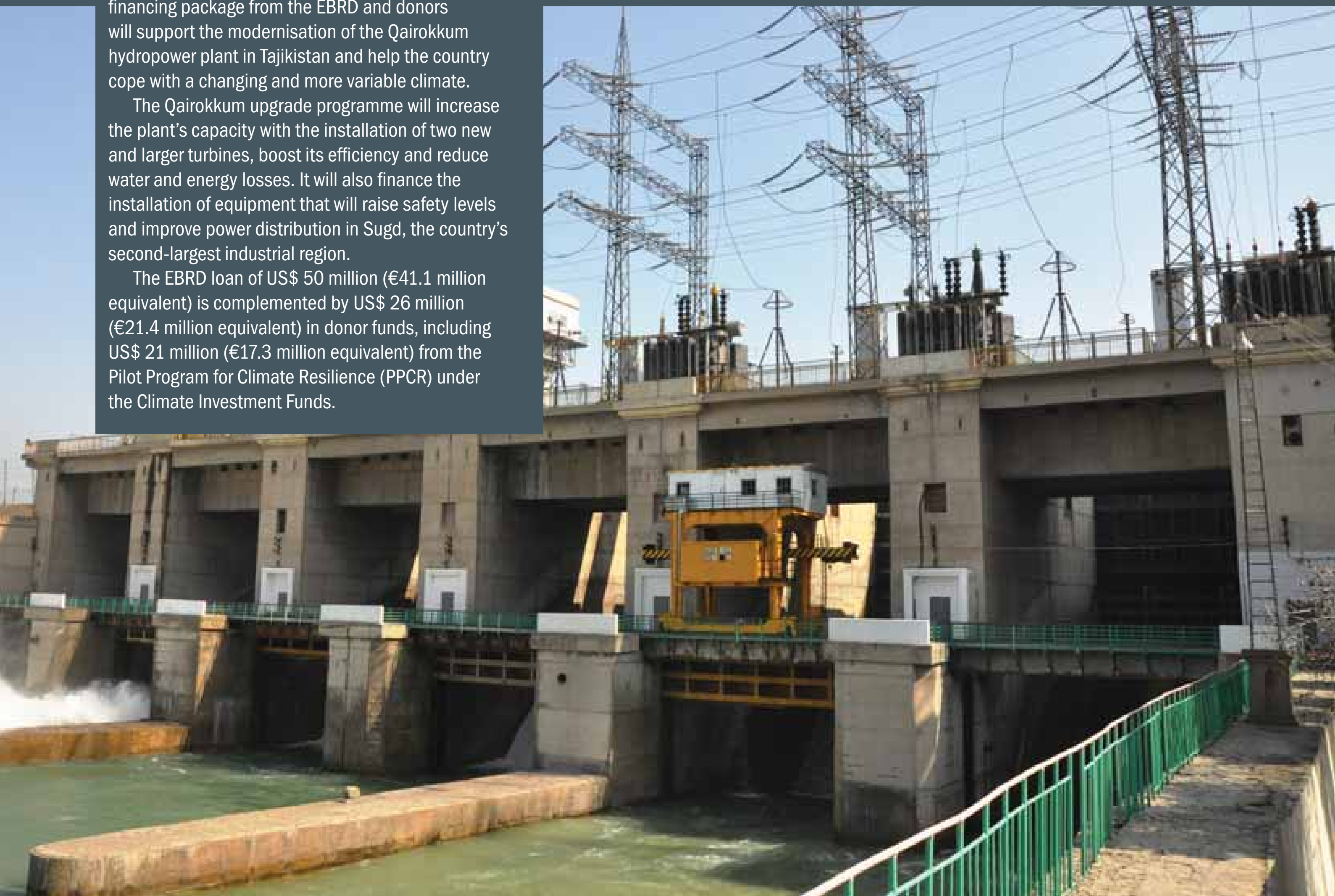
CASE STUDY
TAJIK HYDROPOWER PLANT MEETS CLIMATE CHALLENGE

Tajikistan experiences chronic electricity shortages during the winter months as demand exceeds supply. These outages are exacerbated by climate change; hydropower plants depend on river basins fed by glacial meltwater and snowmelt, which are vulnerable to the effects of a warming climate.

A US$ 76 million (€62.5 million equivalent) financing package from the EBRD and donors will support the modernisation of the Qairokkum hydropower plant in Tajikistan and help the country cope with a changing and more variable climate.

The Qairokkum upgrade programme will increase the plant's capacity with the installation of two new and larger turbines, boost its efficiency and reduce water and energy losses. It will also finance the installation of equipment that will raise safety levels and improve power distribution in Sugd, the country's second-largest industrial region.

The EBRD loan of US$ 50 million (€41.1 million equivalent) is complemented by US$ 26 million (€21.4 million equivalent) in donor funds, including US$ 21 million (€17.3 million equivalent) from the Pilot Program for Climate Resilience (PPCR) under the Climate Investment Funds.



the format of the "Western Balkans Six" launched in the course of 2014. The EBRD contributed to this process by organising a historic summit of regional leaders at its London headquarters in February 2014. Despite these developments, the quality of political dialogue within the countries remains uneven. This was highlighted by the opposition boycotting parliament for prolonged periods in Albania and in FYR Macedonia, and by the failure to convene parliament in Kosovo for six months after the general elections in June. International organisations and NGOs expressed concerns regarding press freedom in most countries of the region.

The ruling Justice and Development Party (AKP) won a convincing victory in Turkish local elections, and the former Prime Minister Recep Tayyip Erdoğan won the first direct presidential elections. However, questions have arisen regarding the strength of checks and balances in the system.

The countries of eastern Europe and the Caucasus were affected by a rise in geopolitical tensions in 2014, which was associated with democratic advances in some countries and a deepening of their ties to the EU. In Ukraine, the Maidan protests calling for more democratic accountability, a stronger rule of law and fight against corruption culminated in the transfer of power to an interim government followed by free and fair presidential and parliamentary elections. Ukraine signed an Association Agreement with the EU and an accompanying Deep and Comprehensive Free Trade Area (DCFTA) agreement in June. However, intense fighting with separatists in eastern Ukraine leading to the loss of control of some territories placed the newly elected authorities under extreme pressure. Georgia and Moldova, continued to make progress on the path to democratic reform; both countries signed EU Association Agreements and accompanying DCFTAs in June. In Georgia, however, selective justice remains an issue affecting democratic transition, while in Moldova, enforcing the rule of law and fighting corruption, particularly in the judiciary, remain major challenges.

Political trends in Russia and other parts of Europe, the Caucasus and Central Asia in 2014 were partly shaped by the crisis in Ukraine, the annexation of Crimea and the associated rise in geopolitical tensions. The imposition of Western political and economic sanctions against Russia contributed to Russia's economic downturn, while domestic support for the country's policies and leadership remained robust. Independent NGOs and opposition groups in Russia continued to face pressure. Russia reinforced its efforts to advance integration with Armenia, Belarus and Kazakhstan under the Eurasian Economic Union (EEU), which comes into force in January 2015. Others in the region, including Kyrgyz Republic, may also join the EEU.

Democratic progress in several countries of Central Asia and the Caucasus remained slow and uneven in 2014. The major challenges were highly centralised decision-making mechanisms, weak checks and balances in the political system, widespread corruption and reported human rights violations. In Azerbaijan, prominent international organisations expressed concerns regarding freedom of the media and restrictions on the activities of independent civil society organisations. Two countries with a parliamentary form of government – the Kyrgyz Republic and Mongolia – made further progress in democracy-building, but the process was not linear and many challenges remain. The Bank remains seriously concerned about the lack of progress toward multi-party democracy and pluralism in Belarus

CASE STUDY

MAJOR BOOST FOR WOMEN IN BUSINESS

In 2014 the EBRD launched an innovative Women in Business programme that brings together financing and advisory services to help women manage and grow their own small and medium-sized enterprises (SMEs).

In the Bank's region, SMEs led by women tend to be relatively small and to focus on economic activities with low added value. Reasons for this include legal and cultural barriers to accessing capital, restricted opportunities for acquiring business management skills, and the frequent need to reconcile business and family responsibilities. At the same time, credit supply is restricted as many financial institutions have limited understanding of women-led SMEs as a market segment.

The Women in Business programme helps address these issues by providing dedicated credit lines for women entrepreneurs and by offering tailored advice and training to increase their know-how and networking opportunities. In addition, the programme advises partner financial institutions on how to reach more potential borrowers among women entrepreneurs through improved marketing and product development and by introducing a risk-mitigation scheme.

2014 saw Women in Business credit lines signed in Bosnia and Herzegovina, Egypt and Turkey and the programme is being developed across a wider range of countries. It benefits from the generous support of donors.

INNOVATION IN TRANSITION

Why do certain firms in the region innovate and grow while others become stuck in terms of their development? Drawing on unique data, the EBRD's *Transition Report 2014* reveals that innovative firms in the Bank's region continue to suffer disproportionately from constraints imposed by the business environment, such as pervasive corruption, shortages of skilled labour, excessive customs and trade regulations or lack of access to finance. While governments cannot directly make firms improve their performance, they can ensure that economies are open to trade and investment. They can also help companies learn about more efficient ways of doing business, enable workers to acquire the right skills, and promote competition which puts pressure on laggard firms to improve.

The Report argues that, as firms transform themselves, innovation policies should also be reshaped: there is no one-size-fits-all innovation policy. At the initial stages, policy-makers should focus more on improving the country's capacity to absorb technologies that have been developed elsewhere. As firms gradually close the gap to the global technological frontier, the focus of policies needs to shift to nurturing creativity and providing highly specialised human capital.

The overall message of the *Transition Report 2014* is a hopeful one: regardless of a country's progress in transition or its level of economic development, individual businesses can make a difference. As firms move along their transition path, so will the countries in which they operate.

The *Transition Report* is produced by the EBRD's Office of the Chief Economist (OCE), which evaluates macroeconomic developments in the region, produces data and analysis and contributes to the development of the Bank's country and sector strategies. OCE also assesses the transition impact of projects and manages an economic research programme, disseminating the output through publications such as the *Transition Report* and the Regional Economic Prospects series. For more information on the work of OCE in 2014, see www.ebrd.com.

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Individual firms can make a difference to the economic development of countries, according to the *Transition Report 2014*.

and Turkmenistan. It therefore continued to employ a calibrated strategic approach to operations, matching the scope of its activities to progress against well-defined political and economic benchmarks.

Turbulence in the Middle East in 2014 affected political conditions and reforms in the SEMED region. Militant jihadism and the rise of the Islamic State in Iraq and Syria (ISIS) put significant pressure on Jordan, which now hosts over 750,000 refugees. Egypt adopted a new constitution in January and held presidential elections in May, which were major milestones on the country's democratic roadmap. However, questions regarding the inclusiveness of political processes remain. Tunisia completed its cycle of free, fair, and inclusive parliamentary and presidential elections. In doing so, the country's political parties demonstrated their commitment to genuine consensual democracy.

During 2014, the political and economic situation in many countries continued to provide a challenging environment for market reforms. The crisis in Ukraine and the rise in geopolitical tensions had damaging implications for regional confidence and growth. Indeed, the region's annual growth in 2014 was significantly lower than in the previous year, reaching just 1.6 per cent. Against this backdrop, market reforms struggled to gain traction and reversals were observed in several cases.

The EBRD's annual assessment of transition progress and remaining challenges for 16 sectors in all countries where the Bank invests once again revealed the size of “transition gaps” still facing the region. (An extensive discussion of the methodology and scores is available in the *Transition Report 2014*.) For the first time, assessment of progress in reform by sector contained more downgrades than upgrades. The downgrades were mainly concentrated in the financial sector where a number of additional structural challenges have been revealed, even though the assessment of institutional reforms remained largely unchanged. Downgrades in non-financial sectors were concentrated in EU countries. In several cases, disproportionate government interference across different sectors had a negative effect on market function.

Positive developments were observed in the infrastructure sector, which saw the successful introduction of commercially based mechanisms to ensure the efficiency of services, notably in Moldova and the Slovak Republic. In addition, small improvements in access to finance for SMEs led to upgrades in related financial-sector indicators. Reform advances remained scarce in the energy sector, and there was another downgrade in Hungary (for the third year in a row) owing to a deterioration in market-supporting institutions in this sector.

Two countries were upgraded in one of the EBRD's traditional country-level indicators – competition policy. Croatia was upgraded from 3 to 3+ in light of its accession to the EU and important amendments to the country's Competition Act that entered into force in mid-2013. In Montenegro, the establishment of a fully independent competition authority and increased prosecution of cartels led to an upgrade of the competition policy indicator from 2 to 2+. On the negative side, the region's largest economy, Russia, was downgraded on trade liberalisation as a result of trade restrictions introduced in 2014. ●