Environmental standards, legal and regulatory frameworks, good governance, anti-corruption measures, policy dialogue and public engagement in projects – these are essential components in the transition from centrally planned to open market-based economies.
DEMOCRATIC REFORM

The EBRD supports progress in democratic reform in its countries of operations, in keeping with its Article 1 mandate, which states that the Bank’s purpose is to foster transition in countries committed to and applying the principles of multi-party democracy, pluralism and market economics. Most countries in the transition region have adopted the basic tenets of democratic rule and have enshrined these in written constitutions and other recognisably democratic institutions, although developing the substance and effective implementation of democratic principles is still a work in progress.

The global financial crisis has had a severe impact on the EBRD region, testing not only the transition countries’ commitment to markets but also to democratic institutions. The effects of the crisis are still being felt in many countries across the transition region, and the impact on democratic reform has varied.

For many countries in central and south-eastern Europe, the commitment to core democratic values and institutions has become embedded in an overlapping set of domestic legislation, international conventions and obligations stemming from membership in regional and international organisations, first and foremost in Euro-Atlantic institutions. Although there has been no major reversal of reforms and domestic political stability has been maintained in all countries, social tensions mounted in the course of 2010 as governments endeavoured, with various degrees of commitment, to implement austerity measures. A shift towards more populist and nationalist policy solutions was evident in some countries, notably Hungary, while voters in Latvia, Poland and the Slovak Republic showed confidence in reform-minded parties and platforms.

In the Western Balkans, commitments related to the EU approximation process continue to serve as strong external anchors for democratic reform. However, concerns related to public governance, administrative capacity, judicial reform, media independence and freedom, and the fight against corruption remain throughout south-eastern Europe.

In the course of 2010 one country – Montenegro – formally obtained the status of an EU candidate country. The European Commission also started the preparation of its “Opinion” regarding Serbia’s membership application. Sitting pro-reform governments are relatively strong in the Western Balkans, and they continue to enjoy significant popular support. Inter-ethnic tensions persist in some countries, in particular Bosnia and Herzegovina, where they are complicated by the ongoing search for the optimal internal organisation of the country.

The strength of democratic institutions varies significantly across countries in the Commonwealth of Independent States (CIS) and Mongolia, where some countries made modest progress in strengthening democracy in 2010, while others experienced some backsliding. In Ukraine, the free and fair presidential election of early 2010, a step towards democratic consolidation, was partially offset by a ruling of the Constitutional Court to reverse constitutional amendments introduced in 2004 and new restrictions on the media – both of which have the potential to weaken the checks and balances in Ukraine’s political system. In Belarus the campaign environment for the December 2010 presidential election was more competitive and open than in the past, but the conduct of the election itself was heavily criticised by international monitors, and the mass arrests of demonstrators and disproportionate use of force against leading opposition figures, political activists and independent journalists is a significant setback for the development of democratic governance in Belarus. In Moldova parliamentary elections in November 2010 were deemed the most democratic and competitive in a decade. However, the continuing impasse on the indirect election of the president has undermined the authorities’ capacity for effective decision-making and stalled institutional reforms. In Russia despite reforms of the police and internal security services intended to strengthen the rule of law initiated by President Dmitry Medvedev, this has yet to result in any substantive improvements in democratic accountability. Violent assaults on journalists and civil society activists, as well as attacks on ethnic minorities, continue to mar the social environment, and corruption remains a major challenge.
In the Caucasus and Central Asia, the Kyrgyz Republic and Mongolia have each developed parliamentary forms of government, providing more democratic accountability, though in the former case this is at a very early stage and stable democratic governance is far from assured. Elsewhere in the region, political systems are characterised by strong presidencies, weak parliaments and judiciaries that are prone to corruption. Democratic development in this region is hampered by the absence of strong political parties, under-developed civil society networks, lack of independent media and poor human rights conditions. In Uzbekistan the Bank remains concerned about the lack of progress in building democratic and market institutions.

In countries where there are significant concerns regarding the application of Article 1 principles, the Bank has adopted a “calibrated strategic approach”, allowing it to adjust its operational scope in a measured and incremental way depending on political and economic conditions. For example, in Belarus and Turkmenistan, the Bank monitors a set of political and economic benchmarks and actively engages with the authorities in high-level policy dialogue to promote market-based and democratic reform.

**ECONOMIC REFORM**

A commitment to economic reform is an essential component of the transition from centrally planned to open, market-based economies. The EBRD monitors economic progress in all the countries in which it invests and each year publishes its analysis in the Transition Report. This assessment identifies the areas most in need of reform and can act as the basis for the EBRD’s dialogue with governments.

For the first time, the Transition Report published in 2010 presented a new set of sectoral transition scores for 16 different sectors in each country, on the same 1 to 4+ scale as that used for the traditional transition indicators. The ranking of countries under the new system is similar to that obtained under the old one, with the highest scores typically in central Europe and the Baltic states, followed by Turkey, and the lowest scores uniformly in Central Asia. However, the analysis shows that significant challenges remain in all countries, especially in the areas of sustainable energy, transport, and parts of the financial sector.

One of the most encouraging aspects of the region’s response to the crisis continues to be the near-absence of reform reversal. Even in those few cases where the process of liberalisation was reversed, steps have generally been taken to restore some of the previously introduced reforms. An example of this is Ukraine, a World Trade Organization (WTO) member, where the authorities have reversed some of the foreign exchange controls introduced during the worst stage of the crisis and have taken steps to further liberalise the foreign exchange market (although some important restrictions remain).

The level of economic reform across the region continued to vary in 2010. There was further progress in price liberalisation in Belarus and Tajikistan, two countries that in many respects are still at an early stage of transition. In the case of Belarus, the past year saw the removal of restrictions on price and trade margins for many goods and services and the substantial reduction in the list of minimum export prices. In Tajikistan there has been progressive liberalisation in the important cotton sector. Elsewhere, the EBRD’s latest survey of competition authorities in the region has revealed positive developments in Romania, where there have been continuous improvements in law enforcement, and in Serbia, where important changes have been made to competition law to harmonise it with European Union (EU) regulations and strengthen the powers of the competition commission.

In the area of infrastructure, there was progress in a number of countries in transport, especially in the railways sector, usually reflecting the introduction of new laws to strengthen institutions or a significant increase in private sector involvement and competition in the provision of services. Notable examples include Mongolia, where a formal Railway Policy was adopted, and Bosnia and Herzegovina, where public service obligations have been signed, increasing the accountability and transparency of services to railway passengers and aligning regulations to European standards.

Financial sectors across the region are still coping with the aftermath of the global financial crisis, and in certain countries some steps have been taken that have set back the course of reform. In Hungary the government’s decision to impose a temporary but substantial levy on banks and other financial institutions reflects an urgent fiscal need but is widely considered to be disproportionate compared with similar measures under consideration in other countries. This step, along with the recent decision to effectively nationalise the private pension system, may discourage the financial deepening and international financial integration that have served Hungary well during the crisis. In other countries, the regulatory environment for private pension funds is similarly in flux, which may put at risk local capital market development. Moreover, the high level of government ownership of banks poses risks of directed lending and unfair competition. A more positive development occurred in Poland with the successful introduction of a new bond trading platform, an innovation that is expected to stimulate the development of local capital markets. In addition, a number of countries have shown a willingness to work with the EBRD and other international financial institutions in developing local currency lending and local capital markets.

**LEGAL REFORM**

In 2010 the EBRD strengthened its legal policy dialogue and technical assistance activities with a view to accompanying transition countries on the road to recovery. This effort was led by the EBRD Legal Transition Programme in the Office of the General Counsel.

**New horizons**

Since 2009 the Bank has become active in public procurement law reform. In the Transition Report 2010, it published the first results of a comprehensive assessment gauging the status of public procurement legislation throughout the transition region. This assessment provides a roadmap for policy dialogue and technical assistance in that area of law, where an acute need for reforms was identified in Central Asia, the Caucasus and south-eastern Europe. An initiative was launched in Albania.
The EBRD monitors economic progress in all the countries in which it invests and each year publishes its analysis in the *Transition Report*. 
to improve public procurement legal frameworks for utilities and to strengthen recourse mechanisms. The Programme is preparing to follow with more public procurement reform assistance in Ukraine.

The EBRD judicial capacity-building actions gained momentum with the preparation of action plans for training of commercial judges in Mongolia and Tajikistan. Despite the political changes in the Kyrgyz Republic, the new training programme for candidate judges was re-activated towards the end of the year and will be implemented during 2011 in collaboration with the International Development Law Organization (IDLO). Further, the Bank has assessed the quality of commercial courts decisions in selected Central Asian countries, as well as Moldova, Russia and Ukraine, thus gathering statistical and analytical data ready to be published in early 2011. Here too, the assessment will prove a useful tool to guide EBRD technical assistance efforts in the judicial sector.

**CIS model law**

For the past 12 years the Bank has been cooperating with the Inter-Parliamentary Assembly of the Commonwealth of Independent States on the development of some key model laws in that region. In October the Assembly adopted a model company law prepared with the assistance of the EBRD. The new text is expected to inspire law-makers in the region to modernise legislation for companies.

**Cooperation with Russia**

During 2010 the EBRD Legal Transition Programme made special efforts to assist Russia with its financial legislation. Following an intense policy dialogue with the Ministry of Economic Development and other stakeholders, the Bank launched a technical cooperation project to overhaul the Russian legislation on secured transactions. A draft pledge law was prepared in the second part of the year, which will be followed in 2011 with a draft mortgage law. The Bank also helped the Ministry by preparing new standards for insolvency administrators. In September the standards were forwarded by the Ministry to the Union of Self-Regulatory Organisations of Insolvency Administrators for adoption. The Bank also organised with the Ministry and the professional association INSOL International a roundtable in Moscow to review investigatory powers of insolvency administrators, thus helping create the momentum for further legislative reforms in this area in 2011. During 2010 the Bank also provided assistance to the Russian authorities in connection with legislation on grain warehouse receipts, corporate governance, concessions, and accession to the Cape Town Convention on Security Interests over Mobile Equipment and Aircraft Protocol.

**Local Currency Initiative**

At the Bank’s Annual Meeting in 2010 an initiative to promote local capital markets and local currency operations in transition countries was launched. The EBRD Legal Transition Programme is in charge of regulatory aspects of the initiative. Towards the end of the year, it introduced a regulatory diagnostic of selected countries and gathered an advisory panel of recognised specialists to provide additional input in its findings. First results and recommendations on how to boost local capital markets in those countries will be published at the EBRD’s Annual Meeting in May 2011.
Infrastructure regulation and natural resources

The Bank has put in place a regulatory training programme for telecommunications officials in the CIS. The first round of training was completed in Georgia, and more sessions are under way in Armenia and Azerbaijan. Preparations were made to roll out the initiative to Belarus, Turkmenistan and Ukraine in 2011. Energy efficiency is increasingly on the Legal Transition Programme’s radar, with first reform activities in Moldova in connection with regulations applying to residential buildings. In an attempt to assist in the fight against corruption in the mining sector, the Bank has helped Mongolia to align itself with the Extractive Industries Transparency Initiative (EITI) and has taken steps to do the same in the Kyrgyz Republic.

ENVIRONMENTAL AND SOCIAL REFORM

The Bank’s Environmental and Social Policy and Performance Requirements ensure that Bank-financed projects are socially and environmentally sustainable; that they respect the rights of affected workers and communities; and that they are designed and undertaken in compliance with regulatory requirements and good international practice. This is implemented by fully integrating environmental and social issues into the Bank’s project cycle, from planning to financing and implementation. The EBRD’s policies, procedures and Performance Requirements in this regard are consistent with the Equator Principles, the financial sector’s internationally recognised benchmark for management of environmental and social issues in project financing.

The EBRD’s Environmental and Social Policy came into force in November 2008, and the Bank completed a smooth and effective transition to the new policy in 2009 through the delivery of training and guidelines to staff, clients and consultants. The Bank therefore began 2010 with a firmly anchored Policy – and the objective of deepening its investment in human capital with regard to Policy implementation and sustainability objectives.

Internally, the Bank has integrated sustainability into the curriculum of its Banking Academy programme, a compulsory course for all new Banking staff. Other internal capacity-building actions in 2010 included the formation of a Health and Safety Steering Group to further strengthen the Bank’s management of health and safety risks in investments, and the recruitment of a new occupational health and safety specialist to work on project due diligence and monitoring. The Bank has continued to make more tools, guidance and systems available across the organisation and externally. This includes an eManual and online training course to help the Bank’s financial sector clients to implement the Environmental and Social Policy in their own lending and investment operations.

Other resources introduced in 2010 include new tools for the implementation of the Bank’s Gender Action Plan, for example by integrating gender issues into public consultation on new projects in ways that help to optimise project design from a gender equality perspective. The Bank also provided gender equality guidelines and training to those men and women nominated by the EBRD to serve on the boards of companies where the EBRD is a shareholder. Some parts of the Bank’s region continue to have capacity weaknesses in the use and enforcement of environmental and social standards. To address this, the Bank provides a range of capacity-building programmes for local partners. Examples in 2010 include support from the Bank’s European Western Balkans Joint Fund to deliver training to local and regional authorities on managing the resettlement of people affected by different types of projects.

Best practice is also promoted through the EBRD’s Energy Efficiency and Sustainability Awards, which publicly recognise the achievements of Bank clients who demonstrate excellence in business areas such as environmental and social performance.

An important area of work for the Bank in 2010 – and a topic of ongoing activity for 2011 – is climate change adaptation and resilience. This refers to the assessment and management of both short- and long-term risks that climate change issues may pose to Bank-financed projects, particularly in relation to critical infrastructure. In 2010 the Bank completed a series of case studies on selected EBRD investments ranging from copper mining in Bulgaria to flood defence schemes in Russia. This information was then used by the Bank to develop guidance on new approaches for integrating climate change adaptation into technical due diligence and the application of the Bank’s Environmental and Social Policy, and for using climate models as inputs to project development. The Bank then piloted these approaches in a number of new projects under development during the year, including investments in water supply systems, hydropower, port infrastructure and industrial water use efficiency. The results and lessons of pilot projects launched in 2010 will be used by the Bank in 2011 to further refine its approach to climate change adaptation in a manner that is consistent with the EBRD’s transition mandate, project-focused approach and private-sector focus.

For a complete overview of the Bank’s environmental activities, see the Bank’s Sustainability Report 2010 or go to: www.ebrd.com/sustainabilityreport