



Report on

Operations Under

the European Bank

for Reconstruction

and Development

Agreement Act

1999



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INTRODUCTION

The European Bank for Reconstruction and Development (referred to in this document as the EBRD or the Bank) was established in 1991. Its aim is to foster the transition towards open, market-oriented economies in Central and Eastern Europe, as well as in the successor states of the Soviet Union, and to promote private and entrepreneurial initiative in countries in this region that are committed to the fundamental principles of multi-party democracy, pluralism and a market economy (see Annex 4 for a list of the EBRD's 26 countries of operation).

The EBRD functions as a development bank, much in the same way that the World Bank and other regional development banks operate. The EBRD, however, is distinctive in three areas. First, its overriding focus is on the private sector and support for the transition from central planning to stable market economies. Its 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. Second, the EBRD's mandate gives it a particular focus on the promotion of democratic institutions and human rights in its countries of operation. Finally, the EBRD is explicitly committed under its Articles of Agreement to ensuring the environmental sustainability of all its projects.

The Bank seeks to help its 26 countries of operation to implement structural and sectoral economic reforms, taking into account the particular needs of countries at different stages in the transition process. In particular, its private sector activities focus mainly on enterprise restructuring, including the strengthening of financial institutions, and the development of infrastructure needed to support the private sector. The EBRD has 60 members: 58 countries, the European Union (EU) and the European Investment Bank (see Annex 4 for a list of the members).

Canada is the eighth largest shareholder (tied with Spain) and following the other Group of Seven (G-7) countries and the Russian Federation. Our formal participation is authorized under the European Bank for Reconstruction and Development Agreement Act, which was promulgated in February 1991. Article 7 of the Act states that:

The Minister [of Finance] shall cause to be laid before each House of Parliament by March 31 of each year, or if that House is not then sitting, on any of the thirty days next thereafter that it is sitting, a report of operations for the previous calendar year, containing a general summary of all actions taken under the authority of this Act, including their sustainable development aspects within the meaning of Article 2 of the Agreement, and their human rights aspects.

This report responds to this requirement and reviews the activities and operations of the Bank for the year 1999.

BENEFITS OF MEMBERSHIP

As a major trading nation, Canada has a stake in global peace and stability. The successful integration of Central and Eastern Europe and the former Soviet Union into the world economy and global institutions will help to promote peace and stability. The EBRD, by fostering continued economic reform in the region, is contributing to the region's integration into the world economy.

EBRD membership provides a number of specific benefits:

- The Minister of Finance is a Governor of the Bank and elects an Executive Director to its 23-member Board of Directors. This representation allows Canada to have high-level influence on decisions taken by the EBRD on investments in the region and policies to move forward regional development.
- The EBRD provides trade opportunities for the Canadian private sector and allows a diversification of international markets for Canadian business.

ROLE AND MANDATE OF THE EBRD

The EBRD:

- fosters the transition of former centrally planned economies of Central and Eastern Europe and the Commonwealth of Independent States towards market-oriented economies;
- promotes private entrepreneurial initiative (targets at least 60 per cent of its resources to private sector projects with the balance in support of commercially viable state sector projects that promote private sector development);
- operates only in countries committed to applying the principles of multi-party democracy, pluralism and market economics;
- promotes environmentally sound and sustainable development; and
- operates on a self-financing basis.

The EBRD's operations to advance the transition to a market economy are guided by three principles: maximizing transition impact, additionality and sound banking. Financing is provided for projects that expand and improve markets, help build the institutions necessary for underpinning the market economy, and demonstrate and promote market-oriented skills and sound business practices. EBRD financing must also be additional to other sources of financing, and not displace them, further ensuring the Bank contributes to the transition process. Finally, Bank projects must be sound from a banking perspective, thus demonstrating to private investors that the region offers sound returns. Adherence to the sound banking principle also helps ensure the financial viability of the EBRD and hence its attractiveness as a co-investment partner for the private sector.

In promoting economic transition in its countries of operation, the Bank acts as a catalyst for increased flows of financing to the private sector. The capital requirements of these countries cannot be fully met by official multilateral and bilateral sources of financing, and many foreign private investors remain hesitant to invest in the region. By providing an umbrella under which wider funding for private sector investment can be assembled, the EBRD plays a catalytic role in mobilizing capital. In 1999, for every euro the EBRD invested, it mobilized an additional 2.2 euro from the private sector and multilateral and bilateral agencies.¹

Indeed, the projects of the Bank serve a dual purpose. They are intended not only to directly support the transition from a command to a market economy in countries of operation, but also to create a demonstration effect to attract foreign and domestic investors. Like the World Bank Group's International Finance Corporation, the Bank is required to operate on a strictly commercial basis and to attract companies to invest in countries through financially viable projects, not through subsidies.

¹ On January 1, 1999, the euro replaced the ECU as a market-determined currency in the euro-zone's 11 member countries participating in the Economic and Monetary Union. On December 31, 1999, one euro purchased 1.4556 Canadian dollars.

KEY DEVELOPMENTS IN 1999

The year 1999 was a challenging one for the EBRD not only in Russia itself, but throughout the Commonwealth of Independent States (CIS),² as well as in some Central and Eastern European countries with strong economic links to Russia. The impact of the Russian financial crisis, which erupted in August 1998, continued to dampen investor confidence and business activity into 1999. Investor confidence suffered an additional shock in March 1999 with NATO military intervention in Kosovo.³ The economies of southeastern Europe were affected to varying degrees by disruptions in trade routes and by the movement of large numbers of refugees caused by the Kosovo crisis. The EBRD estimates the Kosovo crisis reduced 1999 real gross domestic product (GDP) growth by about one percentage point in the six affected neighbouring countries – Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Former Yugoslav Republic (FYR) of Macedonia and Romania.

Nonetheless, by mid-1999, economic performance showed signs of improvement throughout the EBRD's countries of operation. Rising commodity prices, particularly oil prices, eased balance of payments pressures in Russia and contributed to growth in commodity-exporting CIS countries, while the end of military action in Kosovo improved prospects in southeastern Europe. However, deep-rooted structural problems remain in many of the transition economies, notably in Russia and elsewhere in the CIS, and in southeastern Europe. The absence of significant progress in structural reforms, as evidenced by state tolerance of tax arrears, the culture of non-payment, and lack of effective bankruptcy legislation, leaves these economies more vulnerable to future internal or external shocks. In many countries, the investment climate remains uninviting as powerful vested interests foster a culture of corruption and regulation that stifles competition.

The economic developments of the last year only reinforce the conclusions drawn from a decade of transition. Countries (principally in Central and Eastern Europe) that have been most committed to reform and have moved the furthest in creating strong state and corporate institutions proved best able to weather the financial turbulence of 1998. They continued to make good progress through 1999. The following table ranks transition countries according to a number of indicators.

² The CIS includes Russia and the other successor states of the Soviet Union.

³ Kosovo is a province of the Federal Republic of Yugoslavia (FRY). FRY, and by extension Kosovo, is not a member of the Bank.

Progress in Transition in Central and Eastern Europe and the CIS¹

Countries	Population (millions, mid-1999)	Private sector share of GDP in %, mid-1999 (EBRD estimate)	Enterprises			Market and trade			Financial institutions	
			Large-scale privatization	Small-scale privatization	Governance and enterprise restructuring	Price liberalization	Trade and foreign exchange system	Competition policy	Banking reform and interest rate liberalization	Securities markets and non-bank financial institutions
Albania	3.2	75	2	4	2	3	4	2	2	2-
Armenia	3.7	60	3	3+	2	3	4	2	2+	2
Azerbaijan	7.6	45	2-	3	2	3	3+	1	2	2-
Belarus	10.2	20	1	2	1	2-	1	2	1	2
Bosnia and Herzegovina	4.3	35	2	2	2-	3	3-	1	2+	1
Bulgaria	8.2	60	3	3+	2+	3	4+	2	3-	2
Croatia	4.5	60	3	4+	3-	3	4	2	3	2+
Czech Republic	10.3	80	4	4+	3	3	4+	3	3+	3
Estonia	1.4	75	4	4+	3	3	4	3-	4-	3
FYR Macedonia	2.0	55	3	4	2	3	4	1	3	2-
Georgia	5.4	60	3+	4	2	3	4	2	2+	1
Hungary	10.1	80	4	4+	3+	3+	4+	3	4	3+
Kazakhstan	14.8	55	3	4	2	3	3	2	2+	2
Kyrgyzstan	4.8	60	3	4	2	3	4	2	2+	2
Latvia	2.4	65	3	4	3-	3	4+	3-	3	2+
Lithuania	3.7	70	3	4+	3-	3	4	2+	3	3-
Moldova	4.3	45	3	3+	2	3	4	2	2+	2
Poland	38.8	65	3+	4+	3	3+	4+	3	3+	3+
Romania	22.4	60	3-	4-	2	3	4	2	3-	2
Russian Federation	146.7	70	3+	4	2-	3-	2+	2+	2-	2-
Slovak Republic	5.4	75	4	4+	3	3	4+	3	3-	2+
Slovenia	2.0	55	3+	4+	3-	3	4+	2	3+	3
Tajikistan	6.2	30	2+	3	2-	3	3-	1	1	1
Turkmenistan	4.9	25	2-	2	2-	2	1	1	1	1
Ukraine	50.7	55	2+	3+	2	3	3	2	2	2
Uzbekistan	24.2	45	3-	3	2	2	1	2	2-	2

Source: EBRD, Transition Report – 1999.

¹ 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. Most advanced industrial economies would qualify for the 4+ rating for almost all the transition indicators.

Highlights of Macroeconomic Performance

- Real GDP is expected to show a modest increase in 1999 for the region as a whole, after declining an estimated 1.2 per cent in 1998. The stronger performance was due to the better-than-anticipated performance of the CIS, largely as a result of the recovery in world commodity prices in 1999.
- Central and Eastern Europe continued to post a substantially better inflation performance than the countries of the CIS, though the CIS performed better than expected in the wake of significant exchange rate depreciation.
- A large number of countries, particularly in the CIS, continued to run current account deficits in excess of 7 per cent of GDP, raising doubts about their ability to service future liabilities.

Russia

The 1998 financial crisis exposed the fundamental weakness of the Russian banking system.⁴ Economic activity collapsed as real incomes declined owing to accelerating inflation following the ruble devaluation, and investor and consumer confidence evaporated as the government struggled to articulate an effective recovery program for months after the onset of the crisis. However, from mid-1999 Russia experienced a surprisingly strong economic rebound, as the substitution of domestic for foreign goods following the ruble devaluation fuelled domestic production, and higher oil prices contributed to increasing government revenues and a substantially improved balance-of-payments position. The EBRD estimates real GDP grew 1.5 per cent in 1999, the highest growth rate since the beginning of transition, following a 4.5 per cent decline in 1998. The inflation rate stood at 37 per cent at the end of 1999, less than half the 1998 rate. The fiscal deficit is expected to be below the 5.1 per cent of GDP targeted in Russia's International Monetary Fund (IMF) program, agreed to in July 1999 but currently on hold. The Russian government's failure to meet IMF loan conditions has led to a suspension of disbursements.

Despite the dramatic macroeconomic adjustment in 1998 and signs of modest recovery and growth in 1999, the Russian economy remains vulnerable to external and internal shocks. The improvement in Russia's economic and fiscal performance is largely the result of positive developments

⁴ The 1998 financial crisis was precipitated by the Russian government's decision on August 17, 1998, to respond to the escalating cost of debt financing and pressure on the ruble by suspending payments on its ruble-denominated debt obligations, announcing a moratorium on foreign debt payments and effectively devaluing the ruble. Many Russian commercial banks were heavily exposed to the Russian government and had considerable unhedged foreign exchange liabilities. As a result they were severely affected by the default and devaluation, and many collapsed.

in the external environment, particularly the recent strengthening of world oil prices, rather than economic reforms and restructuring. There has been little policy action to curtail tax arrears (although higher oil prices have increased state budget revenues and, since the second quarter of 1999, federal revenues have been entirely in money, as opposed to barter, tax offsets and other money surrogates) and bankruptcy laws remain ineffective. Similarly, little has been done to strengthen Russia's financial system. Financial institutions remain under-capitalized and poorly regulated. Efforts to reform the financial sector – through the creation of a bank restructuring agency (ARCO) and enactment of laws on the insolvency of credit institutions – have been largely undermined by the lack of regulatory enforcement by the central bank. Not surprisingly, investor confidence remains low. Foreign investment in Russia (gross foreign direct investment plus portfolio investment) sank more than 30 per cent in the first nine months of 1999. Capital flight continues, at about US\$20 billion in 1999, according to the Institute of International Finance, indicating that the domestic Russian business community also has little confidence in the Russian economy.

Central and Eastern Europe

Within Central and Eastern Europe and the Baltic States (CEE) the overall economic picture is more encouraging. These economies showed considerable resilience to the Russian financial crisis. There was, however, significant variation across countries. Annual growth rates in Hungary and Poland remained strong at around 4 per cent in 1999, though down from a year ago owing to business cycle effects. In the Czech Republic growth is expected to show another year of decline, reflecting the slow response of the government to the domestic financial crisis in 1997. The recession appears to have bottomed out in the second quarter of 1999. In the Baltic States, growth slowed substantially in the first half of the year, reflecting the closer commercial ties of the countries to the Russian economy.

The stronger macroeconomic position of many countries of Central and Eastern Europe has been fostered by significant gains in competitiveness through successful enterprise restructuring and by the creation of strong market-supporting institutions (fiscal, legal, financial and social). Poland and Hungary in particular have advanced significantly in the transition process (see table on page 9) and appear well poised for long-term sustained economic growth.

Southeastern Europe

All the countries of southeastern Europe affected by the Kosovo conflict – Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia and Romania – were able to maintain macroeconomic stability and a number, including Bosnia and Herzegovina, Bulgaria and Romania, continued to push forward with long-delayed structural reforms. Growth was particularly strong

in Albania and Bosnia and Herzegovina (8 and 10 per cent respectively), reflecting their low starting points. In Romania, the recession that began in 1997 appears to have bottomed out.

Despite the progress to date, southeastern Europe faces significant challenges in the future, principally as a result of its past uneven commitment to reform rather than the crisis in Kosovo. In many countries, the privatization process is incomplete, and loss-making enterprises and banks continue to operate and accumulate tax arrears, weakening governance. Progress in establishing the legal and social institutions that underpin effective markets and set the ground for private investment has been limited to date.

Accession to the European Union

The expectation of accession to the European Union (EU) has been an important factor strengthening financial stability and underlying economic reform efforts in Central and Eastern Europe. In December 1997, the EU, at its intergovernmental Council meeting, identified 10 “accession countries” as candidates for early membership and in March 1998 began initial accession negotiations with 5 (the Czech Republic, Estonia, Hungary, Poland and Slovenia).¹ In December 1999, at the Helsinki Summit, the EU decided to initiate accession negotiations with the remaining 5 accession countries (Bulgaria, Latvia, Lithuania, Romania and the Slovak Republic), with progress through the negotiations as quickly as warranted by each country’s own efforts to prepare for accession. In addition, the Summit committed the EU to be ready to decide from the end of 2002 on the accession of candidates that fulfill all necessary criteria.

The EBRD, European Commission and World Bank have signed a memorandum of understanding setting out the basic principles for collaboration in supporting projects that will assist all accession countries in meeting the requirements of EU. In particular, all 10 accession countries face specific requirements for investment in infrastructure to meet the requirements of the EU’s *Acquis Communautaire*, or inventory of laws and standards. The EBRD will actively support projects where its mandate and EU accession requirements overlap.

¹ The 10 accession countries are Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia. The EU has negotiated accession partnerships with all 10 countries.

The Non-Russian CIS

The effects of the 1998 Russian financial crisis continued to be felt throughout the non-Russian CIS region in 1999. In general, these economies were most affected by the financial crisis because they share many of the key problems of the Russian economy (such as a weak financial sector) and because of their close links to the Russian economy. In the first half of 1999, growth rates slowed considerably in most non-Russian CIS countries while recovery was delayed in others. However, only Ukraine and Moldova saw output decline. As Russia recovered and world commodity prices began to move higher in the second half of the year, growth in the non-Russian CIS strengthened. In particular, all the central Asian republics are estimated to have recorded growth in 1999 for the first time since the beginning of the transition process.

Ukraine was one of the countries most affected by the Russian financial crisis. As a result, real GDP is expected to have declined further in 1999, leaving Ukraine as the only country in the CIS not to experience economic growth in the 1990s. Progress on implementing reforms in 1999 was further delayed in the lead-up to the presidential elections in November. These delays led the IMF to put its program for Ukraine on hold. Since his re-election, President Kuchma has appointed Viktor Yushchenko – the reform-minded and highly respected former Governor of Ukraine’s central bank – as Prime Minister, raising hopes that long-delayed reforms will be implemented. The fractious pro-reform elements in parliament formed a united front early in 2000, which could make implementing reform efforts easier for the government, provided the coalition holds together.

Like Russia, the non-Russian CIS countries face significant challenges in terms of their communist legacy and the extent of structural distortions and the limited capacity of state institutions. CIS countries continue to lag considerably behind CEE countries in implementing structural reforms (see table on page 9). Nonetheless, difficult structural reforms have begun in a number of countries, notably Azerbaijan and Georgia, and they have now experienced a few years of growth. In 1999, Georgia, Armenia and Moldova strengthened structural reform efforts. In other countries, notably Belarus, Turkmenistan and Uzbekistan, there were reform reversals.

1999 FINANCIAL PICTURE

Financial Highlights

- The Bank posted a profit of 42.7 million euro (C\$62.2 million) in 1999 following a significant loss of 261.2 million euro (C\$468.3 million) in 1998, when it provisioned heavily against potential losses from the Russian crisis.¹
- In 1999, provisioning charges totalled 160.9 million euro, down substantially from the record 553.1 million euro (C\$992.4 million) in 1998.
- Operating income was 376.4 million euro, down from 450.5 million euro in 1998, primarily due to lower levels of dividend income, net fee and commission income, lower profits from the sale of share investments (although well above budget) as well as lower interest income due to non-performing loans.
- Despite the difficult operating environment, the Bank signed new commitments of 2.2 billion euro (C\$3.2 billion) in 1999, just below the record of 2.4 billion euro in 1998 and virtually in line with the 1999 business plan. This provided funding to 88 projects.
- The share of new commitments going to Russia declined significantly in 1999, to 217 million euro (10 per cent of total) from 546 million euro in 1998 and a peak of 761 million euro in 1997, reflecting the weak investment climate in Russia. Nonetheless, Russia's share of the Bank's total disbursed portfolio remained substantial at 23.3 per cent at the end of 1999, though down from a peak of over 25 per cent in the third quarter of 1998. Early and intermediate transition countries² accounted for 48 per cent of new commitments and advanced transition countries 42 per cent in 1999.
- The Bank mobilized 2.2 euro in additional financing for every euro that it invested in 1999, down significantly from an exceptionally high ratio of 3.5 in 1998, as investor interest in the region waned. The average mobilization ratio since operations began in 1991 is 2.5.
- Equity investments represented 31 per cent of new commitments as the EBRD participated in a number of bank privatizations.
- Administrative expenses were well within budget, with zero nominal growth recorded in 1999.

¹ Provisions are subtracted from operating income along with other expenses. For private sector projects, the bulk of the EBRD portfolio, provisioning follows a risk-based approach. Management continually reviews the portfolio to ensure that the current value of loans and investments reflects management's best estimate of the recoverability of Bank assets.

² Advanced transition countries include Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia. The early and intermediate transition countries include the balance of the EBRD's countries of operation, excluding Russia: Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, FYR Macedonia, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Romania, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

The return to profitability at the EBRD in 1999 is encouraging. Strong portfolio monitoring, significant efforts to restructure problem investments, as well as a careful review of the committed but undisbursed portfolio helped put the EBRD back in the black. Nonetheless, the financial position of the Bank remains vulnerable. The loss in 1998 eliminated the Bank's reserves and surpluses (shareholder capital and retained earnings set aside to protect the Bank from unanticipated losses). Only by generating net income after provisions will the EBRD be able to rebuild its reserves and surpluses and increase its capital base and future risk-bearing capacity. This is especially important as shareholders provided a capital increase in 1996 on the understanding that there would be no further need for capital replenishments.

The impact of the 1998 Russian financial crisis on the EBRD's portfolio has likely been fully felt. Impaired assets, non-accruing loans and impaired equity peaked in the third quarter of 1999. At the end of 1999, they stood at 795 million euro, or about 11 per cent of the disbursed portfolio, up substantially from 519 million euro, or 7.6 per cent of the disbursed portfolio at the end of 1998, and under 4 per cent of the disbursed portfolio at the end of 1997, underlining the significant impact the crisis has had on the Bank's assets. Progress was made throughout 1999 in resolving a large number of problem loan investments in Russia, although the Bank did not reach the point where it was ready to lower outstanding provisions.

The EBRD wrote off six investments totalling 8.9 million euro over the course of 1999, including three in Russia and one each in Ukraine, Estonia and Hungary. The Bank made the decision to write off the investments only after exhausting all reasonable avenues to recover outstanding amounts. Two of the Russian exposures were to the Russia Small Business Fund⁵ borrowers that were already in difficulty prior to the outbreak of the crisis. All the write-offs were at least partly provisioned.

Administrative Efficiency and Cost-Effectiveness

The EBRD's general administrative expenses in 1999 expressed in pounds sterling were well within budget and comparable to those for 1998, reflecting continuing budgetary discipline and cost controls. As a result of the strengthening of sterling against the euro during the year, the Bank's general administrative expenses, when expressed in euro, were 172.8 million euro (C\$251.5 million), or 8.9 per cent above the 1998 level of last year.

The Bank's efforts at productivity enhancement have been commendable. In 1999, productivity continued to increase as both commitments and projects under implementation rose while costs (in £) remained flat. This achievement is

⁵ In 1995, the G-7 committed US\$150 million to the US\$300 million Russia Small Business Fund. The G-7 contribution was split between an investment fund, which assumed a "first loss" position, and a technical assistance fund. Canada's contribution was for both funds.

particularly impressive, given the increased resource demands stemming from the need for greater portfolio monitoring and asset restructuring due to the credit deterioration in many of the Bank's countries of operation.

MEDIUM-TERM OPERATIONAL PRIORITIES REVISED

In early 1999, largely in reaction to the Russian financial crisis, the EBRD developed revised operational priorities for the medium term that were outlined in the paper *Moving Transition Forward*. Governors endorsed the paper at the annual general meeting in April 1999 in London. The new priorities outlined in the paper are the result of a fundamental review of Bank operations and an assessment of the lessons learned from 10 years of experience working with countries in transition, as well as from the Russian crisis.

This review identified the creation of a sound institutional and policy environment to encourage investment and private sector development as the key challenge for the next decade. Thus, the main thrust of the revised operational priorities is ensuring that Bank projects contribute to strengthening the institutions that underpin a market economy. To achieve this objective, the Bank has identified six areas of focus:

- developing sound financial sectors linked to the needs of enterprises and households;
- providing leadership for the development of 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 to equity investment to improve corporate governance; and
- engaging governments in policy dialogue to strengthen institutions and improve the investment climate.

The medium-term priorities underline that opportunities for investment depend on the institutional and policy environment that governments create. Therefore, the level and nature of the Bank's activities in a given country will be strongly influenced by the country's commitment to reform.

To foster a better investment climate and the development of strong institutions, the Bank will work closely and co-operatively with other international financial institutions to exploit synergies. In countries where progress on reform is slow, the Bank will cluster projects in reform-minded regions, at the municipal level, and in specific sectors, including the financial sector, in an effort to advance reform. The Bank hopes that through this strategy it will help create a critical mass of individual and business support for a "bottom-up" impetus for reform.

The paper *Moving Transition Forward* also reaffirms that, in order to fulfill its mandate, the Bank must be financially viable. Therefore, the Bank will adopt a strategic approach to portfolio management to ensure an appropriate balance of risks across countries, regions and products. A thorough risk analysis began in 1999 and will be completed in 2000. To ensure implementation, the paper also called for an enhanced role for Resident Offices.

CANADIAN PRIORITIES IN 1999

Private Sector Development

Canada has been a strong supporter of the private sector work of the Bank, recognizing that a strong private sector is key for the successful transition to a market economy. About 75 per cent of new commitments in 1999 were private sector operations, compared to about 80 per cent in 1998.

The Private Sector Focus of the Bank

The EBRD Agreement requires that the Bank achieve at least a 60/40 ratio (the so-called “portfolio ratio”) in its private/public sector activities, both globally and in individual countries.

The global portfolio ratio was first satisfied in 1994. By 1999, nearly 70 per cent of the Bank’s cumulative outstanding commitments were for private sector activities. Progress in reaching the individual country ratios, however, was mixed. At the end of 1999, the ratio was attained in only 10 of the Bank’s 26 countries of operation, with two new countries, Lithuania and Turkmenistan, joining the list during the year.

The deadline for meeting the portfolio ratio requirement in individual countries of operation (i.e., five years after the approval of the Bank’s first operation in that country) elapsed in 1999 for all but one country. The shortfall in meeting the ratio has been most evident in lower transition economies, where privatization has developed relatively slowly and where the Bank has often been active in developing public infrastructure critical to the development of a strong private sector. Many lower and intermediate transition economies still have relatively small and immature private sectors.

In 1999, most countries made progress towards meeting the ratio with the exception of Albania and Azerbaijan, where large public sector projects were signed. The Bank continues to pursue strategies in each country to reach at least a 60 per cent private sector ratio.

An increasingly important part of the EBRD's work with the private sector is its support of micro, small and medium-sized enterprises. In recognition of the potential for these enterprises to create jobs and growth, the EBRD developed in 1999 an SME sector strategy. The strategy has three pillars: finance, investment climate, and small and medium-sized enterprise (SME) support networks. The strategy explicitly recognizes that the poor investment climate – and not just limited access to financing – faced by many SMEs is an important impediment to the development of the sector. Therefore, the strategy calls on the EBRD to work to identify and promote the removal of the main obstacles to SME growth, as well as to encourage the development of strong business associations. The SME sector is seen as an important “constituency for reform” in the transition economies that can act as a counterweight to powerful vested interests that benefit from weak state governance.

In the past, much of the Bank's support for SMEs was provided via credit lines to local financial intermediaries that would on-lend to the small enterprise sector. The Russian crisis underlined, however, the need to review this approach in countries where financial regulation and supervision are weak and where concerns about systemic risks remain high. As a result, during 1999 the EBRD worked closely with the EU, bilateral institutions and the International Finance Corporation to establish a number of micro-enterprise banks in the region, including in Russia, Ukraine and Kosovo. The new micro-credit institutions are modelled on earlier successful efforts in Bosnia and Herzegovina. By the end of 1999, the Russian Small Business Credit Bank (in which the EBRD made a US\$6-million equity investment and provided a US\$30-million loan for on-lending to Russian businesses in 1999) had granted 1,250 new micro and small loans worth almost US\$20 million with arrears (30 days past due) of just 0.2 per cent of the portfolio. The new micro-credit institutions in Ukraine and Kosovo have yet to undertake operations. Efforts are under way to establish a micro-finance bank in Albania.

The EBRD continued to extend credit lines to local banks to on-lend to micro, small and medium-sized enterprises in 1999. Notably, the EBRD committed 75 million euro and the EU 50 million euro to an SME finance facility for the 10 EU accession countries to encourage local banks and private equity funds to expand SME operations. The Russian Small Business Fund Program continued to operate in 1999, albeit at a scaled-down level due to the insolvency of a large number of participating banks in the wake of the Russian financial crisis. The Kazakhstan Small Business Program grew steadily in 1999 and by year end had disbursed over 3,200 loans for a total of over US\$25 million with arrears (more than 30 days) of just 1.6 per cent. The Ukraine micro-credit program started showing good results in the second half of 1999, ending the year with 774 loans disbursed worth US\$10.6 million and arrears of 2.4 per cent.

The Russia Small Business Fund

Established by the EBRD as a pilot project in 1993, following a request by the G-7, the Russia Small Business Fund (RSBF) was financed jointly by the EBRD, the G-7, the EU and Switzerland for the promotion of small- and micro-enterprise lending in Russia. At its inception, the Fund was valued at US\$300 million. The Fund operates by lending to local banks that then on-lend to local SMEs. The RSBF also has a technical assistance facility whereby partner Russian commercial banks receive assistance from western experts. Canada, through the Canadian International Development Agency (CIDA), contributed US\$8.1 million (C\$11.3 million) to the program, including US\$2 million in 1998.

In 1999, the effects of the Russian financial crisis on the Russian banking sector constrained many of the banks participating in the RSBF. Despite the problems of these banks, the micro, small and medium-sized business loan portfolio continued to perform relatively well, however. To preserve the important work of the RSBF in supporting SME development, the EBRD developed, in conjunction with foreign strategic investors a new bank, the Russian Small Business Credit Bank (KMB). During the course of 1999, the relatively healthy RSBF loan portfolio of insolvent Russian banks was transferred to the KMB. The strong shareholder base of the KMB, and its commitment to transparency and strong corporate governance, make it a model for local financial institutions in the region. The EBRD also continued to work in 1999 with partner banks in the RSBF that had co-operated with it through the crisis and that were potentially solvent.

Despite the difficult operating environment in 1999, the RSBF granted a total of 7,299 micro, small and medium-sized enterprise loans worth US\$60 million, bringing the overall total since the program's inception in 1994 to almost 31,000 loans with a value of over US\$380 million. Arrears (more than 30 days)¹ stood at 4.7 per cent. The RSBF model has been replicated by the EBRD in Moldova, Bosnia and Herzegovina, Kazakhstan and Ukraine.

¹ This includes arrears only for banks that are active under the program.

In 1999, the EBRD also extended its equity support to small and medium-sized enterprises through investments in private equity funds.⁶ These funds are the most significant source of equity finance for SMEs in the region. By the end of 1999, the EBRD had committed 947 million euro to 60 private equity funds. The EBRD has also invested in 28 post-privatization equity funds, 25 venture equity funds and 21 large equity funds. The post-privatization funds make significant use of technical assistance provided by bilateral donors to assist companies in the privatization and immediate post-privatization periods.

⁶ These are sponsored by private institutions and fund managers.

Together these equity funds have invested in over 500 companies throughout the region and have contributed to mobilizing total financing of 3.5 billion euro (C\$5.1 billion) for companies in the region, as well as 270 million euro of technical assistance contributed by donors.

A Private Sector Development Initiative for Southeastern Europe

For the countries of southeastern Europe, the EU, working with the G-8 and the international financial institutions (IFIs), including the EBRD, launched the Stability Pact for South East Europe in 1999. The stability pact was inaugurated at the Heads of Government Summit in Sarajevo in July 1999. The pact's objective is the progressive integration of southeastern Europe into EU structures – with the eventual prospect of EU membership – as a way of promoting regional co-operation, security and development. Reflecting its comparative advantage relative to other IFIs in promoting private sector trade and investment, the Bank was given the leading role in developing a regional private sector approach.

The EBRD established the South Eastern Europe Action Plan (SEEAP) in 1999 in an effort to promote investment and assist in the economic recovery of the region. The SEEAP covers the EBRD's countries of operation in the region – Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia and Romania – as well as Kosovo. Under the SEEAP, the EBRD will focus its support to the region on private sector investment, including corporations, SMEs and micro enterprises; commercial approaches to infrastructure (such as telecommunications, airport and municipal finance); and the financial sector. This focus is supported by the Stability Pact for South East Europe, which is an umbrella initiative under which multilateral and bilateral assistance to the region is being co-ordinated.

In 1999, the EBRD signed projects totalling 300 million euro in member countries in southeastern Europe. Of this amount, 95 million euro was for projects directed at the three members most affected by the Kosovo crisis: Albania, FYR Macedonia and Bosnia and Herzegovina. Given the low level of income of these countries, as well as their balance of payments problems, the EBRD drew on concessional co-financing to support some of these projects. CIDA explored establishing a technical support facility with the EBRD during 1999, and is likely to reach agreement with the Bank on this in 2000.

In 1999, the EBRD also undertook a number of activities in Kosovo, including working with other institutions to extend the operations of the micro-credit bank in Bosnia and Herzegovina to Kosovo, and to extend an existing equity fund operating in Albania to Kosovo. Unlike operations in member countries, the EBRD's activities in Kosovo cannot be funded from ordinary capital resources. The EBRD's Articles of Agreement limit such funding to Bank members. Therefore, Bank operations in Kosovo are financed by co-operation funds provided by donor governments or bilateral agencies.

Activities in the Financial Sector

In 1999, the EBRD updated its financial sector policy in light of recent developments and experience. A key element of the updated policy is its focus on country-specific approaches to financial sector development. The need to promote confidence and competition in an independent financial system are key themes of this policy. Confidence ensures that businesses and individuals utilize financial institutions. Competition and independence ensure that financial institutions respond to these demands. The EBRD will seek to build confidence in the sector primarily through investments that strengthen local institutions' governance and business practices. The EBRD's ability to shape the regulatory and supervisory environment, which is the building block for confidence, is limited by its investor role in the sector and potential concerns about conflict of interest. Nonetheless, the EBRD took the lead in 1999 in drafting a joint EBRD-IMF-World Bank paper on restructuring the Russian banking sector. To address competition and independence, EBRD investments in the sector will seek to increase the diversity of institutions and services, particularly to the private sector and SMEs, facilitate foreign direct investment, and strengthen the commercial orientation of state-owned financial institutions, particularly in preparation for privatization.

In 1999, the EBRD signed 33 financial sector operations, bringing total EBRD exposure to the financial sector region-wide to 4.2 billion euro (C\$6.1 billion). By the end of 1999, the EBRD had signed loans valued at 2.275 billion euro to the banking sector, taken 726 million euro in equity positions in local banks, placed 216 million euro of equity in two micro-credit institutions and signed 83 million euro worth of operations with non-bank financial institutions. In most cases where the EBRD holds an equity stake in a local financial institution, it is represented on the supervisory board of the institution, where it promotes management accountability, good corporate governance, sound banking practices and proper environmental reviews and procedures. In 1999, the EBRD made equity investments in financial institutions in Ukraine, Armenia and Tajikistan. Participation in bank privatizations was a key factor behind equity investments in a number of advanced transition countries as well as in FYR Macedonia and Croatia.

During 1999 the EBRD also stepped up its activities in the non-bank financial sector, predominantly by taking minority equity stakes in insurance companies and pension fund management companies. A total of 10 new transactions were signed during the year with new commitments of 65.6 million euro (C\$95.5 million). The EBRD is one of the largest financial investors in this sector, which also includes leasing, consumer finance, mortgage institutions, local asset management and mutual funds. By the end of 1999, the Bank had participated in nearly all the countries in the region where necessary institutional and regulatory regimes had been or were in the process of being introduced.

Environment

Support for the environment remained a key priority in 1999, reflecting the Bank's mandate to ensure sustainable long-term development in member countries. The Bank is directed by its statutes to "promote in the full range of its activities environmentally sound and sustainable development." The EBRD applies environmental due diligence to all its investment and technical co-operation operations.

Countries at more advanced stages of transition, especially those seeking accession to the EU, are now channeling more resources into investments to improve environmental conditions. In addition, increased attention is being given to improving the provision of essential municipal services, such as district heating, water supply and urban transport, as the availability and quality of these services are critical to underpinning economic development.

A key achievement for the EBRD in 1999 was the creation of the Energy Efficiency and Joint Implementation Fund. The fund will make equity investments in companies involved in providing energy efficient goods or services, or companies requiring a capital infusion to realize energy savings. The EBRD invested 20 million euro in the fund, and private sector investors provided a further 41 million euro.

In 1999, 14 environmental projects were signed with a total EBRD commitment of 196 million euro (C\$285.3 million). Fifty-three environmental analyses, including one environmental impact assessment and 23 environmental audits, were conducted on projects approved by the Board of Directors in 1999. Project sponsors, as required by the Bank, undertake environmental impact assessments, analyses and audits that address potential environmental, health and safety and socio-economic impacts of a project. Environmental impact assessments and environmental analyses are conducted when potential impacts are significant. In the latter case, impacts can be readily identified, assessed and mitigated; in the former, they cannot. Environmental audits are performed when a project relates to an existing operation. The audit identifies past and present concerns, potential environmental risks and liabilities. In some cases both an audit and assessment/analysis are required.

Municipal and Environmental Infrastructure Policy

The adequate provision of basic public infrastructure and services is essential for the economic transition process. Poor quality and under-supply of municipal services, together with energy inefficiencies, have often limited productivity. The EBRD is pioneering operations in this area. In 1999, the EBRD became the first international financial institution to provide financing to municipal water and sewerage companies without a full financial guarantee from the municipality. The EBRD's operations policy for municipal and environmental infrastructure emphasizes private sector involvement as well as the development of appropriate regulatory structures and energy efficiency.

Despite the impact of the Russian financial crisis, which in many countries severely constrained the financial capacity of regional and municipal authorities, EBRD commitments remained at the same level as the previous year. By the end of 1999, the EBRD had committed a total of 572 million euro (C\$832 million) to municipal infrastructure and services projects in about 125 municipalities in 15 countries.

The EBRD and Nuclear Safety

Canada and other G-7 countries have been working closely with the EBRD to improve nuclear safety in CEE countries and the former Soviet Union. To facilitate this work, Canada has contributed to the Nuclear Safety Account (NSA), which the EBRD administers on behalf of the G-7 countries and other contributors. The NSA is used primarily for making essential safety improvements to older-generation, Soviet-built reactors as part of a comprehensive program for their early decommissioning. As of December 31, 1999, pledges to the NSA totalled 289 million euro (C\$420.7 million). Canada has contributed C\$19.5 million. In April 1999, the Board of Directors of the EBRD approved the extension of the NSA for another three years.

On behalf of the G-7, the Bank has agreed to administer the US\$768-million Chernobyl Shelter Fund for securing the sarcophagus around the destroyed – by nuclear accident – Unit IV reactor in Ukraine. The G-7 nations and the EU have pledged US\$391 million, of which Canada has pledged a contribution of US\$20 million. Following the statement of the June 1999 Summit in Cologne, the G-7 countries took the lead in organizing a second pledging conference to take place around May 2000. This initiative will ensure timely and efficient completion of the project.

Canada also supports the use of the EBRD's own resources to finance the upgrading of Soviet-designed nuclear power plants to Western safety standards. The EBRD applies strict conditions to this support. The completion of these plants must be a commercially viable and "least-cost" solution to the country's future electricity requirements; the completed plants must comply fully with Western nuclear safety standards; and any resulting increase in nuclear power in upgraded facilities must be offset by the closure of other unsafe nuclear plants.

Addressing Corruption and Poor Governance

The transition countries, like most emerging economies, face significant challenges in improving transparency and governance. The EBRD's mandate assigns it an important role in addressing governance issues by permitting it to operate only in countries committed to applying the principles of multi-party democracy and pluralism. These principles, when effectively implemented,

contribute to transparency in government policy making, act as a check on corruption and ensure an effective state. To underline their importance, the Bank has curtailed financing of public sector projects in countries where the government's commitment to the principles of multi-party democracy is weak, such as in Belarus. Canada fully supports this approach. Canada also continues to monitor closely developments in the Russian military campaign in Chechnya. The bulk of the EBRD portfolio in Russia is in the private sector, and no public sector projects have come to the Board of Directors for approval since the military campaign began in October 1999.

The EBRD seeks to improve governance and transparency largely through the projects it undertakes. Equity investments have been an important tool in this regard. The Bank's participation on the Board of Directors of companies in which it invests has been instrumental in improving the transparency of their accounting and business practices and their respect for minority shareholder rights. It is hoped that the success of these companies will demonstrate the importance of applying similar practices in the region. In addition, all Bank counterparts are examined to ensure they meet the highest standards of business practice. The EBRD's public procurement rules underline, for all doing business with the EBRD, the standards of ethics and conduct required during the procurement and execution of EBRD-financed projects.

The Bank's work in the area of legal transition also plays an important role in addressing issues of corruption and poor governance in its countries of operation. As such, the EBRD's participation in international standard-setting efforts was expanded in 1999. The EBRD worked closely with the World Bank on its Insolvency Initiative to develop international principles of bankruptcy. The EBRD is also a member of the Global Corporate Governance Forum of the Organisation for Economic Co-operation and Development (OECD). To promote transparency, the EBRD each year publishes a survey of the extensiveness and effectiveness of various commercial laws in the region in its legal journal, *Law in Transition*.

The medium-term priorities assign importance to addressing issues of corruption and governance, as these are key factors influencing the investment climate in the Bank's countries of operation. Key efforts in this regard include strengthening the policy dialogue with governments by achieving joint agreement on necessary improvements. Important high-level venues for this dialogue are the Foreign Investment Advisory Councils, which exist in Russia, Ukraine and Kazakhstan. They bring together government ministers, political leaders from the Bank's countries of operation, representatives of the international business community and high-ranking EBRD officials twice yearly to discuss how to improve the investment climate in the countries.

INSTITUTIONAL DEVELOPMENTS

Organizational Changes

In the summer of 1999, the EBRD implemented a number of organizational changes to sharpen the focus of the Bank's structure and management and to facilitate implementation of the medium-term priorities. Key among the changes was a reorganization of the Banking Department into six business groups: three country groups (Central Europe; Russia and Central Asia; and Southern and Eastern Europe and the Caucasus) and three sector groups (Financial Institutions; Infrastructure; and Industry and Commerce). A special unit responsible for the investment climate as it relates to SMEs and SME support networks was also created to report directly to the Vice-President of Banking. The decision was also taken to strengthen resident offices to improve portfolio monitoring and the efficiency and effectiveness of Bank projects. Strengthening resident offices will be done by shifting some banking staff, including country-team directors, from headquarters in London to countries of operation.

In 1999, the EBRD created the position of Chief Compliance Officer, responsible for promoting good governance and ensuring that the highest standards of integrity are applied in all Bank activities. New guidelines for the selection, training and supervision of EBRD nominees to boards of directors of enterprises in which the Bank has invested were adopted in 1999 to ensure the highest governance outcomes.

In the autumn of 1999, Nicholas Stern, the Chief Economist and Special Counselor to the President, resigned. As Chief Economist and Special Counselor, he helped define the Bank's strategic role in the region and explored economic issues related to transition. Early in 2000, EBRD President Horst Köhler appointed Professor Willem H. Buiter as the Bank's new Chief Economist. Prof. Buiter has written extensively on macroeconomic policy and holds a position at Cambridge University. He is also a member of the Bank of England's Monetary Policy Committee.

Introduction of the Euro

The EBRD changed its reporting currency from ECU to euro on January 1, 1999, when the euro replaced the currencies of each of the 11 participating countries for accounting purposes. The main impact for the Bank was the modification of its processing and accounting systems. Since these systems were successfully modified prior to the changeover, there was no adverse impact on either the Bank or its clients on January 1, 1999.

Year 2000 Compliance

The EBRD's business was uninterrupted over the millennium date change. This was achieved by ensuring that all information technology systems in the EBRD were Y2K compliant by March 1999, by identifying potential high-risk clients and working with them through 1999 to reduce risks, and by including Y2K resolutions in all standard loan agreements for several years prior to 2000.

MANAGING CANADA'S INTERESTS

The highest authority in the Bank is the Board of Governors. Member countries are represented by a Governor and an Alternate Governor. The Honourable Paul Martin, Minister of Finance, is the Canadian Governor and Donald Campbell, Deputy Minister of Foreign Affairs, is the Alternate Governor.

The Board of Directors is responsible for the general operations of the Bank. The Board is composed of 23 members, of which four are non-European members. Canada is the third largest non-European shareholder, after the United States and Japan, and by virtue of its share has the right to elect its own Director. Canada also represents Morocco at the Bank. The Canadian Director is Patrice Muller. The Minister (Economic/Commercial) at the Canadian High Commission in London, Tom MacDonald, is the non-resident Alternate Director who represents Canada in the absence of the Canadian Director.

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

To ensure the EBRD remains additional and contributes to the transition process, Canada continued to advocate EBRD activity in Ukraine and other countries in lower or intermediate stages of transition respecting the principles of multi-party democracy and making efforts at reform, provided the increased risks could be accommodated in the portfolio. Canada has supported the development within the Bank of a "wholesale" approach to activities, under which the Bank channels financing to SMEs through lines of credit or equity investments in local banks and other financial intermediaries in its countries of operation. In light of the Russian crisis, Canada has encouraged the EBRD to pay greater attention to systemic risks in the financial sector and to improve co-ordination with other institutions, particularly the World Bank, in addressing issues of regulation and supervision.

Canada's Voting Record

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 without a formal vote. Nevertheless, the Canadian Director abstained on:

- a guarantee for a telecommunications project in Poland because Canada could not support the concept of the EBRD providing a guarantee that would benefit another multilateral financial institution (the European Investment Bank), especially given that both institutions are primarily owned by the same shareholders.

Canada has continued to underline the importance of the project-centered, private sector focus of the EBRD. It has also argued that the Bank cannot relax its efforts to expand the share of its private sector operations. The last 10 years of transition experience have, however, underlined the importance of the state and its institutions in private sector development. Therefore, Canada fully supports the medium-term priorities emphasis on improving the investment climate. The Canadian Director has frequently spoken in the Board on the importance of the Bank's charter requirement that member countries be committed to market reform and multi-party democracy.

With respect to its own contributions to the EBRD, Canada continued to play a leading role in the adoption of a zero nominal growth budget for 1999 and 2000. Canada has been a strong proponent of greater EBRD transparency, believing that the Bank should be a model of behaviour for the region. Therefore, Canada has pushed hard for the EBRD to increase the transparency of its operations and policies. In 1999, the Bank began a review of its Public Disclosure of Information Policy. It also began to publish on its Web site draft sectoral policies.

The Canadian Director is a member of the Financial and Operations Policies Committee, which reviews financial policies, including the Bank's borrowing policy, general policies relating to operations, and procedures and reporting requirements.

CANADIAN COMMERCIAL INTERESTS

The EBRD offers a wide variety of opportunities for Canadian businesses. One of the tasks of the Canadian office is to make Canadian business people aware of investment opportunities, explain how the Bank's contracting works and ensure that all contracts are awarded in a transparent and fair manner.

To achieve these objectives, the Canadian office provides market information and intelligence to Canadian firms, advises Canadian project sponsors on EBRD financing options, develops commercial co-financing opportunities with the Export Development Corporation and Canadian financial institutions, identifies and sources EBRD procurement opportunities with DFAIT and Industry Canada, and promotes Canadian technical co-operation activities and official co-financing between the EBRD and CIDA.

In 1999, three Canadian-sponsored projects were signed representing EBRD financial commitments of US\$46.5 million. (The aggregate size of the three projects is US\$312 million.) A description of each of the Canadian-sponsored projects is given in Annex 2. In 1999, Canadian consultants also won five EBRD technical co-operation assignments totalling approximately 654,000 euro. The largest of these assignments was a 394,000 euro project to assist the EBRD with due diligence in the Russian alluvial gold mining sector, which led to 130 million euro in EBRD pre-production financing.

Canadians are also well represented on EBRD staff. At the end of 1999, Canadians accounted for 4.8 per cent of the Bank's professional positions, above Canada's 3.4-per-cent share of the institution's capital. It is noteworthy that a Canadian heads the Baltic Team and another Canadian is the deputy head of the Bank's resident office in Kazakhstan.

Promoting Canada's Interests

Members of the Canadian office made seven visits to Canada in 1999 to meet with business people, conduct seminars, speak at conferences and consult with government officials. This included the Canadian Director accompanying EBRD President Köhler in March to meet members of the Canadian government, notably Prime Minister Jean Chrétien, as well as members of the Canadian business community.

Canada's commercial interests in the region were also promoted by:

- participation of the Canadian Director and Alternate Director in the Team Canada mission to Ukraine and Poland;
- travel by the Canadian Director to Romania and the Slovak Republic as part of signing ceremonies for EBRD-Canada sponsored projects; and
- promotion by the Canadian Director's assistant of the Canadian office and the EBRD as instruments for advancing Canadian commercial interests to a telecommunications trade mission from Canada travelling in Russia.

CHALLENGES AHEAD

Most of the countries of the region have made significant progress in economic and political transition since the early 1990s. Throughout this process the EBRD has, both directly and through the demonstration effects of its projects, helped to advance the transition process. The Bank has been important in catalyzing private sector investment in the region and has been a strong force in promoting entrepreneurship, particularly through its support for SMEs.

The Russian crisis has highlighted the challenges for the future of the transition process. It has underlined the importance of an effective institutional framework for a well-functioning market economy. It has shown that those countries with strong institutions and good regulatory frameworks should be in a good position to continue to make progress in the transition process in the coming year. Those with weak underlying fundamentals, however, will remain extremely vulnerable to external shocks.

Good governance will continue to play a critical role in these countries. Good corporate governance is one aspect of this role. The state, however, also has a strong role to play in supporting an enabling investment climate, by promoting sound institutions, administering tax collection and improving legal and regulatory frameworks. It must also ensure that appropriate new legislation is not only developed, but is properly implemented and enforced.

In assisting its member countries in 2000, the EBRD in turn will face the challenge of managing its portfolio in an increasingly uncertain and risky environment. The Bank will need to pay increased attention to balancing its portfolio across countries, products and risk categories. The EBRD's medium-term strategy for 2001-04 will be critical in ensuring the Bank has sufficient flexibility to meet new challenges in the coming years and in providing strong direction to the Bank in fulfilling its mandate.

A clear lesson from the crisis is that transition in the region is a complex and difficult process that will take longer than many initially expected. The primary responsibility for shaping a response to the challenges of transition lies with the countries themselves. The international financial institutions, however, particularly the EBRD, have an important supporting role to play.

Contacting the Office of the Director for Canada

The Canadian Director's office at the EBRD may be reached at:

Office of the Director for Canada and Morocco
European Bank for Reconstruction and Development
One Exchange Square, Room 8.15
London, EC2A 2JN
United Kingdom

Mr. Patrice Muller, Director	Tel: 44-20-7338-6457
Mr. Tom MacDonald, Alternate Director ¹	Tel: 44-20-7338-6507
Ms. Josée Berthiaume, Director's Assistant ²	Tel: 44-20-7338-6458
Mr. John Kur, Director's Assistant ³	Tel: 44-20-7338-6509
Mrs. Alicja Kujawa, Executive Secretary	Tel: 44-20-7338-6507
	Fax: 44-20-7338-6062
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¹ Resident at the Canadian High Commission in London.

² Responsible for policy matters.

³ Responsible for business development and investor liaison.

For More Information on the EBRD

The Bank releases considerable information on its various activities. Bank publications include information guides (e.g., *Financing With the EBRD*), special reports (e.g., *The Annual Report, Transition Report*), country strategies and assorted fact sheets.

Information can also be obtained on the Bank's Web site:

<http://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
(Fax: 44-20-7338-7544)

ANNEX 1

THE BANK'S FINANCIAL ACTIVITIES

The Bank's financial activities are divided into ordinary and special operations, depending on the source of funds. Ordinary operations are financed from the ordinary capital resources of the Bank, which comprise subscribed capital, market borrowings and income from loans and investments. Special operations are those financed by "Special Funds" for specially designated purposes that are typically outside the Bank's regular activities. Unlike other regional development banks, however, the EBRD does not operate a concessional or "soft" loan window.

Ordinary Capital Resources

At the end of 1999, the total authorized capital of the Bank was 20 billion euro (about C\$35 billion). Canada has subscribed to 3.4 per cent – or 680 million euro (about C\$1.2 billion) – of the Bank's authorized capital. Canadian contributions to the Bank's capital are made in US dollars (at a pre-determined euro/US\$ exchange rate).

In 1999, Canada made its second purchase of shares under the first capital increase (which came into effect April 3, 1997, and doubled the initial 10-billion-euro capital base). Under the first capital increase, 77.5 per cent of our share is "callable," meaning that the Bank can request these resources in the unlikely event that it requires them to meet its financial obligations to bondholders; the balance, or 22.5 per cent, is "paid-in." Payments will be made in eight equal annual installments of US\$12,145,331.25 (40 per cent in cash and 60 per cent in non-interest-bearing demand notes encashed over five years). Under the initial capital, 30 per cent was paid-in over five years (split evenly between cash and notes encashed over a three-year period) and 70 per cent callable. Canada completed payments for the initial capital in April 1997. The table below details Canadian payments to the Bank in US dollars.

Canada's contributions to the Bank's capital are non-budgetary expenditures because our shares in the Bank are considered an asset. Nonetheless, Canada's contributions to the Bank do increase the Government's borrowing requirements.

Canadian Payments to the EBRD

Year	Notes	Cash	Encashment of notes	Total cash outlay
(in US dollars)				
1991	11,903,502	11,903,502	11,903,502	23,807,004
1992	11,903,502	11,903,502	3,967,834	15,871,336
1993	11,903,502	11,903,502	7,935,668	19,839,170
1994	11,903,502	11,903,502	11,903,502	23,807,004
1995	11,903,502	11,903,502	11,903,502	23,807,004
1996	–	–	7,935,668	7,935,668
1997	–	–	3,967,334	3,967,334
1998	7,287,198	4,858,132	1,457,439	6,315,572
1999	7,287,198	4,858,132	2,914,878	7,773,010
Total	74,091,906	69,233,774	63,889,327	133,123,102

Market Borrowings

At the end of 1999, cumulative borrowings by the Bank totalled 12.6 billion euro (C\$18.3 billion) with an average maturity of 8.1 years at an average cost of funds of LIBOR (London Inter-Bank Offered Rate) minus 35 basis points. Funds have been swapped into floating-rate instruments, primarily in US dollars, euro and Deutsche Marks.

Standard & Poor's has assigned the Bank an AAA long-term and A-1+ short-term credit rating. Moody's Investors Service has similarly rated the EBRD long-term bonds triple-A.

Special Operations

The EBRD administers a number of bilateral and multilateral concessional funds. Canada has contributed to the following special funds:

The Canada Technical Co-operation Fund – The main purpose of this fund is to provide financing to hire Canadian consultants for EBRD projects. Canada has contributed C\$7.66 million since the fund was established in 1992.

Nuclear Safety Account (NSA) – This facility was established in 1993 to help finance the closure of the Chernobyl nuclear power plant and to improve safety conditions at nuclear power plants in countries of operation until the plants can be closed. The NSA complements other bilateral and multilateral nuclear safety technical assistance and functions in parallel with multilateral efforts to achieve broader energy sector reform in the region. Canada has contributed C\$19.5 million to the total fund of 289 million euro (C\$420.7 million).

Chernobyl Shelter Fund – The main purpose of this fund is to secure the sarcophagus around the destroyed Unit IV nuclear reactor in Ukraine. The total estimated cost of this eight-year project is US\$768 million, of which US\$391 million has been pledged so far. Canada has pledged a contribution of US\$20 million to be paid over six years starting in 1998.

Russia Small Business Fund (RSBF) – The purpose of this fund is to establish a facility for small business finance and micro-lending in various regions of Russia. Canada has contributed US\$8.1 million towards the US\$300-million fund, including a new contribution of US\$2 million in 1998 for investments in northern Russia in response to the success of the fund. The RSBF was established in 1993 as a pilot project and became permanent in 1995.

Technical assistance in support of the Ukraine Micro, Small and Medium-Sized Enterprises Line of Credit II – CIDA will provide C\$3 million for technical assistance services by qualified Canadian organizations to Ukrainian commercial banks receiving loans under the EBRD's Ukraine Micro, Small and Medium-Sized Enterprises Line of Credit II for on-lending to micro, small and medium-sized enterprises. The technical assistance will include risk- and loan-evaluation training. The EBRD Board of Directors approved the credit line in May 1998. Activities to be undertaken as part of this facility were on hold in 1998 and 1999 pending ratification of the facility by the Ukrainian Rada. This occurred early in 2000, and activities, including the procurement of Canadian services, can now commence.

ANNEX 2**EBRD – CANADIAN-SPONSORED PROJECT ACTIVITY IN 1999**

Date of signing	Canadian company	Project country	Project name	Type of financing	Sector	EBRD commitment (millions of euro)	Total project cost (millions of euro)
January 1999	Telesystem International Wireless Corporation	Romania	MobilFon GSM Phase II Financing	Debt	Tele-communications	9.882	153.170
August 1999	TrizecHahn	Slovak Republic	Polus Centre	Debt	Property development	23.0	68.9
December 1999	TrizecHahn	Regional	Trigranit Group	Equity	Property development	13.6	88.0
Total (euro)						46.5	310.1

ANNEX 3

DOING BUSINESS WITH THE EBRD

General inquiries about working with the EBRD should be directed to the Office of the Director for Canada or to the Bank's **Communications Department** in London (tel: 44-20-7338-6096; fax: 44-20-7448-6690).

Canadian Project Sponsors: Canadian companies interested in potentially sponsoring a project with the EBRD are requested to direct initial inquiries either to **Project Inquiries** in London (tel: 44-20-7338-6282 or 44-20-7338-6252; fax: 44-20-7338-6102) or to the Bank's resident office in the country of operation. Summaries of EBRD private sector operations can be obtained on the Bank's Internet site: <http://www.ebrd.com/>.

Canadian Suppliers of Goods and Works: The EBRD makes available information on all stages of public sector project development, from the point a project has been identified by the Bank through to its approval. Procurement opportunities and co-financing notices, as well as contract awards information, can be accessed on the Bank's Web site free of charge (see address above).

Canadian Consultants: The EBRD's Web site contains technical co-operation notifications and invitations for expressions of interest for consultancy services pertaining to both public and private sector projects. The EBRD also makes use of the World Bank's electronic DACON (Data on Consultants) registration system. Although it is not required for consultants to register with DACON to be eligible for EBRD assignments, it is nonetheless advisable as a useful marketing tool. Requests for DACON registration packages should be sent directly to:

DACON Information Centre
World Bank
1818 H Street
Washington, DC 20433 USA

Individual Canadians: The EBRD maintains a recruitment section on its Web site which provides information on specific employment competitions at the Bank as they become available. In general, applications for employment for both permanent positions and summer jobs should be sent to:

Franco Furno, Director of Personnel
Personnel Department
European Bank for Reconstruction and Development
One Exchange Square
London, EC2A 2JN
United Kingdom

ANNEX 4

EBRD MEMBERSHIP – AS AT DECEMBER 31, 1999

	Share of the Bank's capital		Share of the Bank's capital
	(%)		(%)
European Members		Countries of Operation	
Austria	2.28	Albania	0.10
Belgium	2.28	Armenia	0.05
Cyprus	0.10	Azerbaijan	0.10
Denmark	1.20	Belarus	0.20
Finland	1.25	Bosnia and Herzegovina	0.17
France	8.52	Bulgaria	0.79
Germany	8.52	Croatia	0.36
Greece	0.65	Czech Republic	0.85
Iceland	0.10	Estonia	0.10
Ireland	0.30	FYR Macedonia	0.07
Israel	0.65	Georgia	0.10
Italy	8.52	Hungary	0.79
Liechtenstein	0.02	Kazakhstan	0.23
Luxembourg	0.20	Kyrgyzstan	0.10
Malta	0.01	Latvia	0.10
Netherlands	2.48	Lithuania	0.10
Norway	1.25	Moldova	0.10
Portugal	0.42	Poland	1.28
Spain	3.40	Romania	0.48
Sweden	2.28	Russian Federation	4.00
Switzerland	2.28	Slovak Republic	0.43
Turkey	1.15	Slovenia	0.21
United Kingdom	8.52	Tajikistan	0.10
European Union	3.00	Turkmenistan	0.01
European Investment Bank	3.00	Ukraine	0.80
		Uzbekistan	0.21
Non-European Members			
Australia	0.50		
Canada	3.40		
Egypt	0.10		
Japan	8.52		
Korea	1.00		
Mexico	0.15		
Morocco	0.05		
New Zealand	0.05		
United States	10.00		