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

2004

Canada

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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 aims are to foster the transition towards open, market-oriented economies in Central and Southeastern Europe, as well as in the successor states of the former Soviet Union,[1] and to promote private and entrepreneurial initiative in those countries that are committed to the fundamental principles of multi-party democracy, pluralism and a market economy (see Annex 3 for a list of the EBRD's 27 countries of operations).

The EBRD differs from other multilateral development banks in four ways. First, its overriding focus is 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, it has a particular focus on the promotion of democratic institutions and human rights in its countries of operations. Third, while all multilateral development banks are committed to ensuring the environmental sustainability of their projects, the EBRD is the only such institution where this commitment is explicitly written into its Articles of Agreement. Fourth, the EBRD does not provide concessional financing.

The Bank seeks to help its 27 countries of operations 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 62 members: 60 countries, the European Union (EU) and the European Investment Bank (see Annex 3 for a list of members).

Canada is the eighth largest shareholder (tied with Spain), following the other Group of Eight (G-8) countries. Canada's 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

[1] In 2004, Governors voted to make Mongolia a country of operations, recognizing its close linkage with the former Soviet economy and its long history with a centrally planned economy. This process will not be complete until all members adopt the necessary amendment to their domestic legislation governing their relations with the Bank.

> 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 2004.

Benefits of Membership

As a major trading nation, Canada has a stake in global peace and stability, which the successful integration of Central and Southeastern Europe and the former Soviet Union into the world economy and global institutions helps to promote. By fostering continued political and economic reform in the region, the EBRD is contributing to its integration into the world economy and to its stability.

The Minister of Finance is a Governor of the Bank and nominates a Director to its 23-member Board. This representation allows Canada to have high-level influence on decisions taken by the EBRD on investments in the region and on policies to move countries through the transition process. The EBRD also provides trade opportunities for the Canadian private sector, supporting a diversification of international markets for Canadian businesses.

Details on Canada's financial contributions to the EBRD are provided in Annex 1.

The EBRD

- fosters the transition of former centrally planned economies of Central and Southeastern Europe and the successor states of the former Soviet Union towards market-oriented economies;
- promotes private entrepreneurial initiative by targeting 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.

Role and Mandate of the EBRD

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 to build the institutions necessary for underpinning a 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 that 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 attractive returns. Adherence to sound banking principles also helps to 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 operations, 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 or bilateral sources of financing, and many foreign private investors remain hesitant to invest in the region, particularly the central Asian republics. 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 2004, for every euro the EBRD invested, it mobilized an additional 2.1 euros from the private sector and other multilateral and bilateral agencies.[2] Commercial co-financing mobilized by the EBRD reached a record volume of 3.5 billion euros in 2004, up 34 per cent from the previous high in 2003.

The Bank's projects serve a dual purpose. They are intended not only to directly support the transition from a command to a market economy in countries of operations, 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 through financially viable projects, not through subsidies.

[2] On December 31, 2004, one euro purchased 1.6292 Canadian dollars.

Key Economic Developments in 2004

Most of the transition economies experienced economic growth in 2004, accompanied by a rapid rise in domestic bank lending that has boosted investment and consumption. Most countries in the region continued to perform well in comparison with other emerging markets. The exception continues to be the poorer countries in the Commonwealth of Independent States (CIS),[3] where the reform process continues to lag and uncertain climates continue to discourage domestic and foreign investment.

The process of transition to market-based economies continued to advance in most of the EBRD's countries of operations. Belarus, Turkmenistan and Uzbekistan are the exception, with reform largely stalled at a very early level of transition. The results of the Bank's annual assessment of key transition indicators are summarized in the following table.

[3] The CIS includes Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, the Kyrgyz Republic, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

Progress in Transition in EBRD Countries of Operations

Countries	Population (millions, mid-2004)	Private sector share of GDP in %, mid-2004 (EBRD estimate)	Enterprises: Large-scale privatization	Enterprises: Small-scale privatization	Enterprises: Governance and enterprise restructuring	Market and trade: Price liberal-ization	Market and trade: Trade and foreign exchange system	Market and trade: Compe-tition policy	Financial institutions: Banking reform and interest rate liberalization	Financial institutions: Securities markets and non-bank financial institutions	Infra-structure: Infra-structure reform
Albania	3.2	75	2+	4	2	4+	4+	2▲	3-▲	2-	2
Armenia	3.1	75▲	3+	4▲	2+	4+	4+	2	2+	2	2+
Azerbaijan	8.3	60	2	4-	2+	4	4-	2	2+	2-	2
Belarus	9.9	25	1	2+	1	3-	2+	2	2-	2	1+
Bosnia and Herzegovina	3.8	50	2+	3	2	4	4-	1	3-▲	2-	2+
Bulgaria	7.8	75	4▲	4-	3-	4+	4+	2+	4-▲	2+	3▲
Croatia	4.4	60	3+	4+	3▲	4	4+	2+	4▲	3-	3▲
Czech Republic	10.3	80	4	4+	3+	4+	4+	3	4-	3+▲	3+
Estonia	1.4	80	4	4+	3+	4+	4+	3-	4▲	3+	3+
FYR Macedonia	2.0	65▲	3+▲	4	2+	4	4+	2	3-	2▲	2
Georgia	4.6	65	3+	4	2	4+	4+	2	3-▲	2-	2+
Hungary	10.0	80	4	4+	3+	4+	4+	3	4	4-	4-
Kazakhstan	14.4	65	3	4	2	4	3+	2	3	2+	2+
Kyrgyz Republic	4.8	75▲	4-▲▲	4	2	4+	4+	2	2+	2	2-▲
Latvia	2.3	70	4-	4+	3	4+	4+	3-	4-	3	3
Lithuania	3.5	75	4-	4+	3	4+	4+	3	3	3	3-
Moldova	4.3	50	3	3+	2-	4-	4+	2	3-▲	2	2
Poland	38.3	75	3+	4+	3+	4+	4+	3	3+	4-	3+
Romania	21.7	70▲	4-▲	4-	2	4+	4+	2+	3▲	2	3+▲
Russia	144.9	70	3+	4	2+	4	3+	2+	2	3-	3-▲
Serbia and Montenegro	8.3	50	2+	3+▲	2	4	3+	1	2+	2	2
Slovak Republic	5.4	80	4	4+	3	4+	4+	3	4-▲	3-	3-
Slovenia	2.0	65	3	4+	3	4	4+	3-	3+	3-	3
Tajikistan	6.5	50▲	2+	4-	2-	4-	3+	2-	2▲	1	1+
Turkmenistan	6.0	25	1	2	1	3-	1	1	1	1	1
Ukraine	48.4	65	3	4	2	4	3	2+	2+	2+▲	2
Uzbekistan	26.0	45	3-	3	2-	3-	2-	2-	2-	2	2-

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

Source: EBRD, 2004 *Transition Report.*

Russia

Russia's economic growth is estimated to have slowed to 7.1 per cent in 2004, down from 7.3 per cent in 2003. Economic growth continued to be driven by high oil prices, increasing oil export volumes and stronger investment, which was mainly directed to the energy sector. High taxation revenues from the oil and gas sectors led to a fifth straight budgetary surplus in 2004 and allowed the Oil Stabilization Fund to reach the equivalent of US$19 billion by year-end.

Monetary policy continued to be guided by the dual objective of reducing inflation and limiting real appreciation of the ruble. The central bank continued to intervene heavily in the foreign exchange market in 2004, allowing Russian authorities to increase their foreign exchange reserves to a record-high US$125 billion by the end of 2004. Difficulties in sterilizing this rapid reserve accumulation have, however, resulted in a surge in money growth, which in turn has contributed to higher-than-expected inflation. Year-end consumer price inflation in 2004 was 11.7 per cent, well above the initial official target of 8–10 per cent.

There are growing concerns that Russia's oil-driven boom may be losing steam. These concerns have led Russian authorities to decrease their 2005 growth forecast to 5.8 per cent. In order to promote more sustainable growth, Russia needs to diversify its economy by implementing structural reforms aimed at increasing economic activity in the non-energy sector and at improving the overall investment climate. Russia's investment climate was clouded in 2004 by concerns of growing government interference in the economy, triggered by the Yukos affair. Concerns about the business climate contributed to net capital outflows of US$7.8 billion in 2004, quadruple 2003's outflow. Unless structural reforms enable other sectors of the economy to develop, Russia's dependence on natural resource exports will increase, and economic growth will continue to fluctuate in tandem with oil and other raw material prices.

Other CIS Countries

Other oil-exporting CIS countries continued their rapid economic growth in 2004. This strong growth largely reflected revenue from sustained high oil prices and rising fixed investment in resource-based sectors. Kazakhstan recorded the strongest economic growth among oil-exporting CIS countries in 2004, with estimated real gross domestic product (GDP) growth of 9.4 per cent, mainly due to a continuing investment boom in the oil and gas-related sectors. Azerbaijan also maintained strong growth momentum at 7.8 per cent in 2004, fuelled by the construction of the Baku-Tbilisi-Ceyhan pipeline, which will begin operations in mid-2005.

Many of the remaining CIS countries have also benefited from high non-oil commodity prices. These include Ukraine (steel), Tajikistan (aluminum), the Kyrgyz Republic (gold) and Uzbekistan (gold). High commodity prices have also had positive indirect effects on other economic sectors, such as services and construction. Despite its year-end political crisis, Ukraine is estimated to have recorded real GDP growth of 12.0 per cent in 2004, up from 9.4 per cent in 2003. Decisive action to address double-digit inflation and large increases in government spending will be crucial, however, to deal with the mounting pressures on the economy. Growth rates in Tajikistan, the Kyrgyz Republic and Uzbekistan all increased in 2004 compared to the previous year, although per capita incomes in these countries still remain very low relative to other CIS countries.

Reforms must urgently address the chronically poor investment climates and weak institutions if these countries are to enjoy stronger growth over the medium and longer term.

Central Europe[4]

In 2004, the economies of Central Europe grew by an average of 4.9 per cent, up from 3.8 per cent in 2003, driven primarily by domestic demand and increasingly by an expansion of exports.

The Baltic States continued to register strong growth in 2004, led by Latvia, which grew by 8.5 per cent for the second consecutive year. All Central Eastern European countries recorded significant real GDP growth in 2004. In particular, growth in Poland increased strongly to 5.4 per cent, up from 3.8 per cent in 2003, buoyed by exports and investment. Growth in Hungary also picked up, rising from 2.9 per cent in 2003 to 4.0 per cent in 2004.

Economic conditions across the region contributed to the improvement in government deficits from an average of 3.6 per cent of GDP in 2003 to 3.2 per cent of GDP in 2004. However, several large Central Eastern European countries have failed to bring their fiscal positions under control. Fiscal deficits as a per cent of GDP in Hungary (5.6), Poland (5.4) and the Czech Republic (3.4) have remained substantial, and further fiscal consolidation will be required. In order to meet the Maastricht criteria for monetary union (to join the euro), among other things these countries must reduce their public deficits to 3 per cent of GDP or less.

The average current account deficit in Central Europe remained at 5.8 per cent of GDP in 2004. High investment and consumption levels, fuelled by a booming credit market (particularly for consumer finance), have led to sustained demand for imports.

[4] Includes the Czech Republic, Hungary, Poland, the Slovak Republic, Slovenia and the three Baltic States (Estonia, Latvia and Lithuania).

Following a sharp drop from 6.6 per cent of GDP in 2002 to 2.4 per cent of GDP in 2003, foreign direct investment (FDI) is estimated to have increased marginally in 2004. In Hungary and Poland, FDI inflows were replaced by less stable portfolio inflows, which have increased their vulnerability to sudden reversals in capital flows. The decline in net inflows of FDI reflects the tapering off of major privatization deals as a source of FDI, and the increasing difficulty in attracting greenfield investments.

Accession to the European Union

2004 marked a milestone in the EBRD's short history, with 8 of its 27 countries of operations joining the EU on May 1 (the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia). As the transition process advanced in Central Europe, the Bank began to slowly shift its operations to the less advanced transition countries, particularly as it begins to implement the newly approved Early Transition Countries Initiative.[5] In line with its principles of transition impact, sound banking, and additionality, the EBRD also sharpened the focus of its operations in the advanced transition countries. The beneficiaries of EBRD operations in these countries are now largely small and medium-sized municipalities that cannot obtain funds elsewhere without a sovereign guarantee and small and medium-sized enterprises that require equity or longer-term commercial financing on reasonable terms. Co-financing with EU structural funds also figures in the Bank's activities in the new EU countries.

Southeastern Europe[6]

Increased political stability, although still fragile in some cases, and the prospects of EU membership for Bulgaria (for entry in 2007), Romania (for entry in 2007), and Croatia (accession negotiations to begin in April 2005) are motivating structural reform and economic growth in Southeastern Europe.

Average real GDP growth increased from 4.4 per cent in 2003 to 5 per cent in 2004. Growth in Albania and Romania has been particularly strong (6.2 and 8.0 per cent, respectively). Only FYR Macedonia (2.5 per cent) is lagging behind the region, which is partly due to persistently low per capita net FDI inflows.

[5] Advanced transition countries include Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia. The early transition countries are the Bank's seven poorest countries of operations: Armenia, Azerbaijan, Georgia, the Kyrgyz Republic, Moldova, Tajikistan and Uzbekistan. Intermediate transition countries include the balance of the EBRD's countries of operations, excluding Russia. The EBRD considers Russia to be in a category of its own.

[6] Southeastern Europe includes Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Former Yugoslav Republic of Macedonia (FYR Macedonia), Romania, and Serbia and Montenegro.

Throughout the region, rapid real GDP growth has been associated with the expansion in bank lending (domestic bank lending grew by 23 per cent in 2003), leading to higher consumption levels. Credit has expanded particularly quickly in Bulgaria and Romania. Excessive credit growth, however, can lead to vulnerabilities in the financial sector, with possible repercussions for public and corporate sector creditworthiness and exchange rate stability. This has prompted the introduction of tighter regulations on bank lending in many countries.

General government deficits averaged less than 3 per cent of GDP in 2004. Albania and Croatia were the only countries with fiscal deficits above this level. In contrast, FYR Macedonia reduced its deficit to around 1 per cent of GDP, reflecting significant fiscal consolidation.

Current account deficits remained large throughout the region, averaging 8.8 per cent of GDP. In Bulgaria, the current account deficit remained above 8 per cent due to the credit-fuelled consumption boom.

In contrast to Central Europe, net FDI into Southeastern European countries has remained at historically high levels for the second year in a row. This has mainly been generated by large privatization contracts. The increase in net FDI inflows—and the simultaneous decrease of flows into Central Europe—also partly result from European investors relocating business activities to Southeastern European countries, with the aim of taking advantage of lower unit labour costs and taxation levels than those in some Central European countries.

Canada's Cooperation With the EBRD in Southeastern Europe

In response to the Kosovo crisis in 1999, the EBRD developed the South Eastern Europe Action Plan (SEEAP), which seeks to promote investment and to assist in the economic recovery of the region. Eligible countries are Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Romania, and Serbia and Montenegro.

Under the SEEAP, EBRD investments focus on developing commercial approaches to infrastructure (such as telecommunications, airports, and municipal and environmental infrastructure), micro, small and medium-sized enterprises, and the financial sector. These investments address the transition challenges facing the region: crumbling infrastructure; a weak industrial asset base; mostly small, fragile banks; and pervasive problems of poor governance.

To date, Canada, through the Canadian International Development Agency (CIDA), has committed $18 million in support of the EBRD's SEEAP activities. The total Canadian contribution is being used for technical assistance and co-financing related to project preparation and implementation, advisory services, and capacity building. Canada's assistance is contributing to the efforts of both the EBRD and the international community in supporting the transition process and in promoting stability in the region.

In 2000, CIDA committed a total of $12 million to Phase I of the CIDA-EBRD Cooperation Fund for Southeastern Europe (CFSEE), of which $2 million was designated for the Balkan Region Special Fund (BRSF) to support post-conflict reconstruction efforts in the Balkan region. The total amount ($12 million) has been earmarked against 36 projects approved by CIDA—26 against the BRSF and 10 against the CIDA-EBRD CFSEE Program.

In March 2003, CFSEE Phase II, valued at $6 million, was launched. Phase II builds upon the results of Phase I and adheres to a more focused programming approach in line with CIDA's Strategy for the Balkans Region. In Phase II, Canadian funding is targeted to countries that CIDA identified as priority countries—Bosnia and Herzegovina, and Serbia and Montenegro. Projects with a regional focus are also supported under Phase II and these may include other countries in the Balkans.

2004 *Transition Report*

The *Transition Report* is an annual publication of the EBRD that charts the progress of transition from a centrally planned to a market economy in each of the Bank's 27 countries of operations. The *Transition Report* is recognized as the leading publication analyzing the progress of transition in the former Soviet bloc. Infrastructure, and the private sector's role in its provision, was chosen as the special theme of the 2004 report in recognition of the shift in thinking about infrastructure. Apart from the EBRD, international financial institutions (IFIs) had reduced their involvement in core infrastructure services on the assumption that, with proper regulation, the private sector could finance and operate these services. However, the expected private financing did not materialize. Contributing factors were the global economic slowdown (2000–2003) and the coinciding crises in the international telecommunications and electricity markets that led to a scaling back of private sector investment in emerging markets. Thus, realizing that good infrastructure is essential for economic development and poverty alleviation and that the private sector will not do it alone, infrastructure is back on the IFIs' agendas.

In the transition economies, the infrastructure challenges are maintaining and upgrading service networks and developing rules and regulations that encourage efficient, cost-effective, environmentally sustainable and affordable services. The 2004 *Transition Report* assesses the potential contribution the private sector can make to infrastructure, and suggests past expectations were too high. The changing nature of private sector participation, with the private sector increasingly providing management skills rather than capital investment, will make the arrangements less risky for both the government and private sector partners. It suggests that strengthening regulatory institutions and removing political constraints can improve the success of private sector participation. Tariff reform is a particularly challenging area, and the report suggests that innovations, including "lifeline" tariffs that allow a certain level of services to be provided free of charge, offer a way to address equity concerns while improving the overall efficiency of services.

2004 Financial Results

In 2004, the EBRD realized another strong financial performance with profits after provisions of €297.7 million, below last year's figure of €378.2 million but significantly higher than previous years. The EBRD continued to see a reduction in its impaired assets (non-performing loans) in 2004. At December 31, 2004, the EBRD had €86 million in impaired loans, compared with €125.2 million at the end of 2003. The EBRD's general administrative expenses in 2004 were £138.1 million, compared to £132.8 million in 2003.

Financial Highlights

- The Bank recorded €4.1 billion of new operations in 2004, an increase of €400 million from 2003. Of this amount, 47 per cent was approved for early and intermediate transition economies in the former Soviet Union and Southeastern Europe. Another 23 per cent went to the advanced transition countries of Central Europe and 30 per cent to Russia.
- As the institution reports its financial results in euros, the depreciation of the US dollar in 2004 reduced the euro value of EBRD operations, given that many of its operations (and especially those in CIS countries) are transacted in US dollars.
- Profits after provisions were €297.7 million, down from €378.2 million in 2003 but significantly higher than in past years.
- Total provisions on banking assets were €1.1 billion at the end of 2004, the same as at the end of December 2003.
- Gross disbursements, at €3.4 billion, were up strongly (60 per cent) from 2003.
- The Bank mobilized €2.1 in additional financing for every euro that it invested in 2004, compared to €1.4 in 2003.
- The private sector share of annual business volume was 86 per cent, up from the 79 per cent reported in 2003 and the highest share to date.
- Administrative expenses were £138.1 million, continuing a 10-year trend of no real increases in approved budgets. Indeed, actual administrative expenses in 2004 were once again somewhat below the approved budget for the year.
- Reserves[7] at the end of 2004 were €1,786 million, up sharply from €989.6 million at the end of 2003, primarily reflecting net profits for the year and an increase in the fair value of the Bank's listed share investments.

[7] Reserves are Bank capital set aside to cover unexpected losses.

The EBRD approved 129 projects in 2004, up from 119 the previous year. These commitments totalled €4.1 billion, up from €3.7 billion in 2003, surpassing the €3.5-billion to €3.9-billion target range of the Bank's medium-term operational strategy. Net cumulative commitments by the end of 2004 amounted to €15.4 billion, breaking the €15-billion threshold for the first time. The level of disbursements, at €3.4 billion, was over 60 per cent above the €2.1 billion recorded in 2003. Net disbursements were particularly high in the early and intermediate transition countries, and slightly negative in the advanced transition countries (due to strong reflows from these countries). Guarantees decreased by 24 per cent to €180 million at the end of 2004.

Even as the Bank increases its emphasis on the early transition countries—where the investment climate is particularly risky—it continues to follow sound banking principles, as the overall financial performance for 2004 indicates.

Institutional Developments

Early Transition Countries Initiative

In early 2004, the Bank launched a new initiative for the seven early transition countries (ETCs). With the accession of eight of the Bank's borrowing members to the EU, it has become increasingly necessary for the Bank to shift its focus to its less advanced borrowing members. The new initiative aims to stimulate market activity in these countries by using a streamlined approach to financing more and smaller projects, mobilizing more investment, and encouraging ongoing economic reform. Governors agreed that the Bank should accept higher risk in the projects it finances for the ETCs, while still respecting the principles of sound banking. The Bank has established a Multi-Donor Trust Fund to help support this new initiative. This fund will coordinate grants, financed by bilateral donors, to catalyze investment in these countries by paying for technical cooperation, advice on regulatory and governance improvements, and co-financing for investments with widespread economic and social impact.

Reflecting the Bank's comparative advantages, the ETC strategy will emphasize private sector development, particularly in micro, small and medium-sized enterprises. The Bank is currently developing or refining several financing instruments dedicated to the funding of local entrepreneurs and enterprises. The initiative also promotes financing of smaller government infrastructure investments appropriate to local consumers' ability to pay for improvements in these services (e.g. water, heating).

Excluding oil and gas extraction and pipeline projects, the Kumtor restructuring and the Azerbaijan Silk Road project (major investments not directly affected by the new strategy), business volume increased from €84 million in 2003 to €93 million in 2004, encouraged by the ETC Initiative.

Private Sector Development

Fostering the development of strong private sectors in its countries of operations is an essential element of the EBRD's strategy for promoting the transition to a market economy. A strong small and medium-sized enterprise (SME) sector is one means of developing a "constituency for reform" in the transition economies that can act as a counterweight to powerful vested interests that benefit from weak state governance. The Bank's Articles require it to commit at least 60 per cent of its portfolio to private sector activities, both globally and in individual countries. The global portfolio ratio was first satisfied in 1994 and has grown to a record high of 86 per cent in 2004.

A core part of the EBRD's work with the private sector is its support of micro, small and medium-sized enterprises (MSMEs), which are important engines for job creation and growth, and therefore poverty reduction. The Bank's strategy for the MSME sector is founded on three pillars: financing, improving the investment climate through policy dialogue, and developing business support networks for MSMEs. The strategy explicitly recognizes that the poor investment climate, and not just limited access to financing, is a major impediment to the development of the sector. The strategy emphasizes the need to identify and promote the removal of the main obstacles to MSME growth, as well as to encourage the development of strong business associations. In 2004, the Board began to examine the Bank's MSME policy with a view to renewing it in 2005, to reflect lessons learned and the changing external environment.

In 2004, the Bank established, with the EU, a €60-million program under their joint SME finance facility specifically to bridge a gap in finance in rural areas of the EU accession countries. The new "Rural Sub-Window" will help address the inability of many agricultural businesses and rural enterprises to obtain adequate short- or long-term finance by extending loans and strengthening the capacity of local financial intermediaries.

In 2004, the EBRD continued its strong focus on supporting credit lines for SMEs through financial intermediaries in its countries of operations. Since the Bank's first small business program was established in 1994, more than 800,000 loans worth more than €4.0 billion have been disbursed to small and micro businesses. In 2004, the EBRD disbursed 329,000 loans for small and micro enterprises, totalling roughly €1.5 billion.

Activities in the Financial Sector

Financial Sector Policy—The EBRD's financial sector policy takes a country-specific approach to financial sector development, focusing on the need to promote confidence and competition in an independent financial system. The EBRD seeks to strengthen confidence in the sector primarily by helping to improve local institutions' governance and business practices. It also tries to improve financial supervision and regulation, although its activities here are constrained by its investor role in the sector and potential concerns about conflict of interest. Nonetheless, as a reputable foreign investor in the sector, the EBRD offers important insights on supervisory and regulatory requirements, which it shares with other international financial institutions operating in the region and with governments. To address competition and independence, EBRD investments attempt to increase the diversity of institutions and services available (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 2004, the EBRD committed €1.5 billion in financing to financial sector operations, representing 36 per cent of the EBRD's business volume in 2004.

Banking Sector Activities—In 2004, the EBRD signed new loans valued at €858.9 million to the banking sector, and signed equity transactions worth €197.3 million. 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 appropriate environmental reviews and procedures. Participation in bank privatizations is a key factor behind equity investments in early and intermediate transition countries.

Non-Bank Financial Institutions—During 2004, the EBRD continued its support of the non-bank financial sector. New commitments of €72 million were made under the EBRD's micro and small enterprise program. The EBRD is one of the largest financial investors in this sector, with investments in local asset management and mutual fund companies becoming increasingly important as voluntary pension sectors in the Bank's countries of operations develop. By the end of 2004, the Bank had investments in the non-bank financial sector in most of the countries in the region, where necessary institutional and regulatory regimes had been or were in the process of being introduced. The EBRD also committed €174 million to insurance companies, leasing companies and specialist mortgage lending institutions in 2004, mainly in advanced transition countries.

Environment

Under its establishing Articles, the EBRD is explicitly committed to ensuring the environmental sustainability of all its projects. By investing in projects that reduce waste and pollution, the EBRD plays an important role in improving environmental standards in borrowing countries. EBRD projects have focused on upgrading municipal wastewater plants and improving energy efficiency by upgrading power generation and distribution systems. The EBRD is also assisting borrowing countries to comply with EU environmental standards. It also works with commercial financial institutions in borrowing countries to increase the profile of environmental issues in their lending policies.

In 2003, the Bank adopted a new Environmental Policy, which covers occupational health and safety issues as well as core labour standards, and expanded its public consultation process and information disclosure with respect to project environmental impact assessments. In November 2004, the

EBRD published its first annual *Environmental Report*, covering the Bank's 2003 operations. The report emphasizes the role of public consultations in ensuring a project's sustainability, and highlighted the extensive public consultations the Bank undertook in the Caucasus and in London before signing the Baku-Tbilisi-Ceyhan pipeline project. It also discusses the EBRD's contributions to reducing the emissions of greenhouse gases, including the work undertaken with the Dutch government to establish one of Europe's first carbon trading funds. Created in October 2003, the Carbon Credit Fund will invest in climate-friendly projects that reduce greenhouse gas emissions from Central Europe to Russia and Ukraine. The report also notes that the EBRD is in discussion with other countries about the establishment of similar funds.

Apart from the initiatives to specifically redress environmental weaknesses, many EBRD projects include environmental targets—for example, to reduce atmospheric emissions and industrial wastewater discharges and promote waste recovery, recycling and clean technologies. The EBRD contributes to international initiatives such as the "Environment for Europe" process, including the Environmental Action Plan for Central and Eastern Europe, the Danube River Basin Strategic Action Plan, the Helsinki Commission and the Global Environment Facility, for which it is an executing agency.

In 2004, the EBRD did not approve any projects for support under the Northern Dimension Environmental Partnership (NDEP), although the pipeline for 2005 is strong. The NDEP[8] provides donor funding to address severe environmental problems in northwest Russia, particularly in the areas of nuclear waste, water and wastewater treatment, and energy efficiency. Within the framework of its mandate, the EBRD supports relevant multilateral and regional agreements on the environment and sustainable development, including the Framework Convention on Climate Change and the measures agreed to in the Kyoto Protocol. Canada became an official contributor to the NDEP Support Fund at the end of 2003 and has committed €20 million to the "nuclear window." This contribution made Canada the NDEP's sole non-European contributor. Canada's contribution counts towards its commitment to the G-8 Global Partnership program. To deal with nuclear waste, the NDEP provides full funding within an international cooperation framework designed to address the complex challenges of cleaning up the legacy of the former Soviet navy's Northern Fleet. In 2004, on the nuclear side, the Assembly approved in principle eight priority measures, for which the EBRD is expected to develop financing proposals early in 2005.

[8] NDEP members include Russia, the EBRD, the EU, the Nordic Investment Bank, Canada, Denmark, Finland, France, Germany, the Netherlands, Norway, Sweden and the UK.

The EBRD applies environmental due diligence to all its investment and technical cooperation operations. Project sponsors are required by the Bank to undertake environmental impact assessments, analyses and audits that address potential environmental, health and safety, and socio-economic impacts of projects. Environmental impact assessments and analyses are conducted when potential impacts are significant. Environmental audits are performed post-approval. In some cases, both an audit and an assessment/analysis are performed. The EBRD also requires local financial intermediaries, through which it channels funds to micro, small and medium-sized enterprises, to adopt appropriate environmental policies and procedures.

Municipal and Environmental Infrastructure

EBRD investments in this sector focus on upgrading local facilities, such as municipal wastewater treatment plants, and on raising the service levels of municipal and local utility companies. Reducing costs and increasing the reliability of municipal services can stimulate the development of commercial and industrial enterprises. At the same time, greater access to clean water and sanitation services improves public health and increases public confidence in the transition process and ongoing reform efforts.

Over the last few years, the EBRD has increasingly relied on municipal, as opposed to national, guarantees in this sector, providing local governments with important new financial opportunities and responsibilities. The EBRD's operations policy for municipal and environmental infrastructure emphasizes private sector involvement, the development of appropriate regulatory structures, and improvements in energy efficiency.

As discussed above, the EBRD dedicated part of its 2004 *Transition Report* to a discussion of the challenges and emerging trends in infrastructure services. In 2004, the EBRD provided financing of more than €216 million to projects designed to improve municipal infrastructure and promote energy efficiency.

Energy Sector Investments

Most of the EBRD's countries of operations suffer from severe economic and environmental problems caused by polluting energy systems and inefficient energy pricing. Under its Energy Operations Policy, the Bank promotes energy efficiency through its operations. One of the policy's key objectives is to improve environmental performance, including meeting climate change objectives and supporting renewable forms of energy. The Bank began consultations in 2004 on a new energy policy to update and consolidate its existing Energy Operations and Natural Resources Operations Policies.

The EBRD and Nuclear Safety

Through the Nuclear Safety Account (NSA), 15 donors, including Canada and other Group of Seven (G-7) countries, have continued to work closely with the EBRD to improve nuclear safety in countries of Central and Southeastern Europe and in the former Soviet Union. The NSA is used primarily for making essential safety improvements to older-generation, Soviet-built reactors and to help Ukraine cope with the aftermath of Chernobyl. Total contributions to the NSA are approximately €280 million.

The Bank has continued to administer the Chernobyl Shelter Fund for securing the sarcophagus around the Unit IV reactor in Ukraine (which was destroyed by nuclear accident). The G-7 nations, the EU and other countries have pledged US$716 million (of the original estimate of US$768 million), of which Canada has pledged US$33 million. In 2003, the conceptual design for the new shelter was completed and the overall cost estimated at approximately US$1.1 billion. The construction work on the stabilization of the sarcophagus started in 2004, and the proposals for the detailed design and construction of the new shelter are under evaluation with the contract award planned for the first half of 2005. The project is expected to be completed by the end of 2008, but requires up to US$300 million in additional funds. The G-7/EU are currently discussing financing for up to US$200 million of the shortfall.

Three International Decommissioning Support Funds created in 2000 are operational. They were put in place to assist with the decommissioning of potentially unsafe nuclear reactors in Lithuania (Ignalina Units 1 and 2), the Slovak Republic (Bohunice VI Units 1 and 2) and Bulgaria (Kozluduy Units 1–4).

Discussions between the EBRD and the government of Ukraine on financing for the completion of the Khmelnitsky Unit 2 and Rovno Unit 4 (K2R4) nuclear reactors were concluded in 2004, and EBRD financing of US$42 million was approved in July. Since Ukraine had already completed the K2R4 reactors on its own, the EBRD project's scope is narrower than initially planned and helps finance the post–start-up component of the safety modernization program that will bring the reactors up to international safety standards.

In 2004, the Bank approved a total of US$170 million for two Caspian gas projects: the development of the Shah Deniz gas field and the South Caucasus Gas Pipeline. The pipeline will be built along the route of the Baku-Tbilisi-Ceyhan oil pipeline, a major project developed in cooperation with the World Bank Group and for which the Bank approved financing in 2003. This new EBRD loan is expected to foster improved business and environmental standards at the local partner level and underpin initiatives to ensure transparency and monitoring of project revenues that are so important in the economic development of Azerbaijan, one of the poorest countries in the EBRD's region of operations. The two projects will mean increased, dependable access to gas as a source of energy for Azerbaijan and Georgia, and diversification of supply in the Caucasus.

Addressing Corruption and Poor Governance

The transition countries, like most emerging economies, face significant challenges in improving transparency and governance. As required by its statutes (Article 1 of the Agreement Establishing the European Bank for Reconstruction and Development), the Bank reviews on an annual basis each country's progress towards multi-party democracy, pluralism and a market economy. These principles—which Canada fully supports and encourages—contribute to transparency in public policy making and act as a check on corruption.

From this standpoint, the domestic policies of Belarus, Turkmenistan and Uzbekistan continue to raise concerns as they are difficult to reconcile with the political and economic conditions set out in Article 1 of the Bank's Articles of Agreement. The Bank's country strategies for Belarus and Turkmenistan were renewed in 2004 and, in recognition of these concerns, link the level and nature of the Bank's involvement to the extent of improvement in the political and economic situation. Given the lack of reform progress, these countries continue to be excluded from direct EBRD investments in the state sector. The 2003 strategy for Uzbekistan, reflecting serious concerns, set out seven political and economic benchmarks for reform and scheduled a progress review for the spring of 2004. After monitoring developments over the year, in April 2004, the Bank concluded that very limited progress had been made and decided to restrict its activities to private sector operations and those public sector projects that either finance cross-border activities or clearly benefit the Uzbek people. As part of the regular country strategy updates, the strategy for Uzbekistan will be updated in the summer of 2005.

To a large degree, the EBRD seeks to enhance good governance and transparency in its countries of operations through the projects it undertakes. Equity investments have been an important tool in this regard. The Bank's participation on the boards 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 more broadly in the region. In addition, all Bank business partners are examined to ensure they meet the highest standards of business practice. The Bank routinely seeks the services of forensic accountants and specialized firms to perform integrity checks on companies in which it might invest and on their management and shareholders. For those doing business with the EBRD, the EBRD's procurement policies and rules set 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 supports these goals. Under its Legal Transition Programme, the Bank has worked to improve the legal environment in its countries of operations by advancing legal reform in six areas: bankruptcy, company law/corporate governance, concessions, financial market regulation, secured transactions and telecommunications. In addition, the Bank has participated in international standard-setting efforts, including the World Bank Insolvency Initiative, which seeks to develop international principles of bankruptcy, and the Financial Stability Forum's efforts to coordinate the development and implementation of international financial standards. The Bank also initiated a project with the Russian Federal Commission for the Securities Market to develop a Corporate Governance Code and helped the CIS Inter-Parliamentary Assembly draft a model securities law. To promote transparency the EBRD publishes an annual survey of the extensiveness and effectiveness of various commercial laws in the region in its legal journal, *Law in Transition*. In 2004, the EBRD introduced a new tool, known as a country law assessment, that evaluates core commercial laws using international standards as a benchmark and assesses how laws actually work in practice, drawing on the views of local lawyers working in private practice.

Enhancing Institutional Transparency, Accountability and Governance

The EBRD's Public Information Policy is based on the presumption that information about Bank activities should be made public in the absence of a compelling reason for confidentiality. The following documents are available to the public, with commercially sensitive information deleted as required: draft sectoral policies (for public comment); final sectoral policies; Board-approved country strategies following consultation with the country concerned; summaries of medium- and long-term operational strategies; executive summaries of environmental impact assessments for public and private sector projects; and reports on public sector projects (on a request basis). The Bank's policy requires management to report annually to the Board on the implementation of the Public Information Policy. These findings are made available on the Bank's Web site.

The Bank's Public Information Policy was reviewed and revised in 2003 to enhance transparency and to expand communications with stakeholders. In July 2004, the Bank launched its Independent Recourse Mechanism (IRM), a set of procedures providing for independent review of complaints about Bank-financed projects. The IRM has the mandate to resolve complaints concerning Bank compliance with its own policies. This is in addition to the Manager of Outreach/NGO Relations, who serves as a point of contact between the Bank and the NGO (non-governmental organization) community. The IRM gives local groups, who may be directly and adversely affected by Bank activities, a means of addressing grievances to the Bank—and evaluates whether the Bank has acted in line with its own policies. It includes a problem-solving function to encourage or restore dialogue between parties in an effort to resolve the underlying issues giving rise to a complaint.

To be accountable to its shareholders and its stakeholders, the EBRD evaluates its projects, usually within two years after full disbursement, to assess the extent to which the projects have met their objectives. In 2004, 88 per cent of the Bank's approved projects received a transition impact potential rating of "Good" or "Excellent." From 2005 onwards, the expected transition impact rating—that is, transition potential adjusted by risk—will be part of the Bank's institutional scorecard.

As part of the international effort to combat the financing of terrorist activities, the Bank adheres to internationally coordinated controls on the illegal use of funds. This includes extensive checks on the integrity of potential clients and monitoring levels of corruption in countries of operations.

Canada has encouraged these policy initiatives. In all international financial institutions (IFIs) in which it is a member, Canada has been at the forefront of efforts to enhance transparency and accountability.

Encouraging Partnerships

The EBRD is required by its founding agreement to involve outside sources of financing in its operations. The Bank plays a key role in attracting co-financiers that might not otherwise be willing to invest in the region. Co-financing has the benefit of increasing a country's access to international capital markets, promoting foreign direct investment and allowing appropriate risk sharing. The EBRD's main co-financing partners are commercial banks, government agencies, export credit agencies and other IFIs. In 2004, the EBRD worked in partnership with commercial banks and other private lenders to achieve a dramatic increase in total co-financing volume, achieving a record commercial co-financing amount of €3.5 billion.

The EBRD also works with donor countries to provide financing for institution building and technical cooperation. Such funding has played a significant role in promoting transition. In 2004, total donor funding received was €82 million and is increasingly used for supporting enhancements to the investment climate in the region. Canada was the sixth largest donor in 2004, with €2.4 million of Canadian technical cooperation funding used for EBRD commitments (projects identified and initiated). Where possible, the EBRD also works with other IFIs in order to extend the impact of the Bank's financing and to benefit from complementarities with the other institutions. In 2004, the EBRD worked with other IFIs on projects involving €682 million in co-financing. Key partners for the EBRD included the International Finance Corporation and the European Investment Bank. Total co-financing from all partners was €5.4 billion in 2004.

Canada has encouraged this cooperation and coordination among multilateral development banks and is pleased with the efforts of the EBRD to work more closely with its sister institutions.

Human Resources

At end of December 2004, the EBRD had regular staff of 965 at its headquarters, unchanged from 2003. Locally hired staff in the Bank's Resident Offices totalled 237, up from 229 in 2003. There are approximately twice as many male professional staff as female professional staff.

Canadian Priorities in 2004

Canada is a strong supporter of the Bank's medium-term operational priorities, which are premised on: the central importance of creating and strengthening those institutions that ensure markets work well; the key role that small businesses can play in creating dynamic, competitive and more equitable economies; and the relevance to the transition process of the Bank's mandate to support countries committed to and applying the principles of multi-party democracy and pluralism.

To achieve these priorities going forward, Canada continues to support the Bank's focus on:

- promoting transparency and accountability in public sector management;
- developing sound financial sectors linked to the needs of enterprises and households;
- providing leadership for the development of micro lending and SMEs;
- developing market-based and commercially oriented infrastructure;
- demonstrating, through selected examples, effective approaches to restructuring viable large enterprises;
- taking an active approach in its equity investments to improve corporate governance;
- engaging governments in policy dialogue to strengthen institutions and improve the investment climate;
- taking a regional approach where appropriate; and
- promoting sustainable development and environmental due diligence.

The EBRD is the only multilateral financial institution that has an explicit requirement that its members be committed to and apply principles of multi-party democracy and pluralism. Canada fully supports this requirement and believes it is appropriate for the Bank to limit its participation in those countries where commitment to the principles embodied in Article 1 is very weak.

Promoting a multilateral rules-based trading system is also a key Canadian priority, and many of the Bank's activities work to support the integration of the transition countries into the world trading system.

The EBRD is committed to working closely and cooperatively with other IFIs and donors in the region. Canada strongly supports this approach. Coordination with other IFIs and donors is an important determinant of the EBRD's effectiveness in promoting the transition to a market economy. Further, the role of other IFIs in addressing poverty directly can complement the EBRD's work in the region.

Managing Canada's Interests

Role of Governors—The highest authority in the Bank is the Board of Governors. A Governor and an Alternate Governor represent each member country. The Honourable Ralph Goodale, Minister of Finance, is the Canadian Governor and Mr. Peter Harder, Deputy Minister of Foreign Affairs, is the Alternate Governor.

Role of the Board of Directors—The Board of Directors, which is responsible for the general operations of the Bank, 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 Mr. Scott Clark. The Minister (Economic/Commercial) at the Canadian High Commission in London, Mr. David Plunkett, is the non-resident Alternate Director and represents Canada in the absence of the Canadian Director.

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

Functions of the Canadian Director—In addition to participating in regular Board meetings, the Canadian Director is currently a member of the Board of Directors' Budget and Administrative Affairs Committee, which monitors efficiency, cost control and budgetary prudence, oversees the Bank's human resources policies (including those relating to governance and ethics), and ensures that the Bank's resources are directed towards its priorities. The Canadian Director was an active member of the Audit Committee in 2004, until the Board Committees' memberships were renewed. The Canadian Director continues to participate actively in Audit Committee meetings as well as those of the Financial and Operations Policies Committee.

Positions Taken in 2004—The Canadian Director has frequently spoken to the Board on the importance of the Bank's charter requirement that member countries be committed to market reform and multi-party democracy. In 2004, Canada's Director spoke on the need to address issues related to the disregard for human rights and democratic principles, and actively supported the decision to restrict the Bank's operations in Uzbekistan. Canada's Director also spoke strongly on the need to rigorously apply the additionality test for projects in EU-accession countries and stressed the importance of the Bank's goal of shifting operations to the south and east to early and intermediate transition economies.

To ensure EBRD operations are additional (i.e. the Bank's Articles stipulate that the EBRD should not displace financing available from the private sector on reasonable terms) and contribute to the transition process, Canada continued to advocate increased Bank efforts to find sound projects in countries that are in the early and intermediate stages of transition, that respect the principles of multi-party democracy, and are making efforts at reform. Only by focusing on quality projects will the Bank contribute to advancing transition in these countries. In the advanced transition countries, Canada has insisted on the need for Bank financing to be additional. Therefore Canada has urged the Bank to be increasingly focused and strategic in the advanced transition countries, where private sector financial and capital markets are increasingly active. The Canadian Director abstained from supporting several projects in 2004, due to a lack of additionality.

Canada has also been a strong proponent of greater EBRD transparency, accountability to shareholders and improved internal governance, believing that the Bank should be a model of behaviour for the region.

Canadian Staff at the EBRD—Canadians are well represented on EBRD staff. At the end of 2004, there were 25 Canadian professionals on the staff of the EBRD, representing 3.9 per cent of total professional positions, in line with Canada's 3.4-per-cent share of the institution's capital. It is noteworthy that Canadians fill the following positions: Director of Communications, Director of the Procurement Department and Director of the Early Transition Countries Initiative.

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. Directors may, however, abstain or vote against projects in consultation with their constituencies. The Canadian Director abstained or voted against the following policies and projects in 2004:

- On the grounds of a lack of additionality: a €15-million loan to PKP Energetyka, an electricity supplier in Poland; a €350-million loan to Slovenske Elektrarne, the Slovak Republic's state-owned electricity generation utility; a €50-million regional facility in favour of Wienerberger AG, a brick and pipe manufacturer; an equity investment of €11.2 million to Uniqua Biztositó, an insurance company in Hungary; and a US$90-million loan to the Russian Standard Bank, the country's pioneer consumer finance institution.
- A €20-million loan in favour of Celsa Huta Ostrowiec, a steel producer in Poland, and a US$35-million loan to ISTIL, a private steel mill in Ukraine, because of concerns about the global overcapacity in the steel industry.
- An €8-million equity investment in International Moscow Bank (IMB), over concerns about an apparent conflict of interest between the Russian central bank's role as both a regulator and shareholder of IMB.

Canadian Commercial Interests

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

To achieve these objectives, the Canadian Office provides EBRD market information and intelligence to Canadian firms and advises Canadian project sponsors on EBRD financing options. In addition, the office develops commercial co-financing opportunities with Export Development Canada and other Canadian financial institutions. Together with the Departments of Foreign Affairs, International Trade and Industry, the office also identifies EBRD procurement opportunities and, with CIDA, promotes Canadian technical cooperation activities and official co-financing with the EBRD.

In 2004, there was one new investment in the region with Canadian sponsor involvement. The EBRD provided a US$10-million loan to Chelopech Mining EAD for environmental remediation, refurbishment and modernization and expansion of the Chelopech mine and processing plant in Bulgaria. Chelopech Mining EAD is 100 per cent owned by Dundee Precious Metals Inc., a public company traded on the Toronto Stock Exchange. In addition, the Board approved EBRD support for Project Vltava through participation of up to €50 million in a bond issue by Cesky Mobil, the third largest mobile phone operator in the Czech Republic. The bond issue will be up to €450 million and will allow Cesky Mobil to upgrade its network to 3G technology. The project was sponsored by a Canadian company, Telesystem International Wireless.

In 2004, 16 contracts that totalled €2.2 million were awarded to Canadian consultants for project preparation, project implementation, and investment climate reform support in the transportation, financial institutions, environment, natural resources, and legal reform sectors. The majority of these assignments were funded through Canadian technical cooperation (TC) funds.

Canada has approved €1.5 million over five years for the EBRD's TurnAround Management Programme, to be used to hire retired and semi-retired Canadians to work as advisors to SMEs in EBRD countries of operations. In 2004, five assignments worth €446,500 were initiated to assist companies in Georgia, Tajikistan, Russia, and Serbia and Montenegro. Under Canada's Phase V EBRD Trust Fund, five new TC assignments were approved by CIDA totalling €1.1 million: two in the Kyrgyz Republic and one each in Russia, Ukraine and Moldova. These assignments were initiated to assist with reforms in the road sector, the aviation industry, standards setting, the deposit insurance industry, pension privatization, and telecommunications. In Southeastern Europe, Canada approved 13 TC assignments under the Canada South East Europe Fund totalling €2.7 million—including five in Serbia and Montenegro, two regional, and one each in Bosnia and Herzegovina, Bulgaria, Albania, Croatia, FYR Macedonia and Romania. The assignments covered legal reform, transportation, municipal and environmental infrastructure, and financial institutions, including SME credit training. In 2004, Canada also approved a new untied C$2-million fund in the Caucasus and Central Asia that will focus on projects in Baku-Tbilisi-Ceyhan, Tajikistan and Georgia. This new fund supports the Bank's Early Transition Countries Initiative.

Since January 1, 2004, Canada no longer funds technical cooperation assignments in the Central European countries that acceded to the EU in 2004.

In 2005, CIDA and the EBRD will continue to work to align their technical cooperation activities more closely with CIDA programming priorities.

On the commercial co-financing side, Cordiant Capital of Montréal (formerly known as International Finance Pension Trust), has co-financed 15 transactions with the EBRD since 2002, ranking as the EBRD's 10th largest co-financing partner. In 2004, Cordiant participated in 9 EBRD transactions, including a very innovative involvement with a microbank in Ukraine, and the development of its first euro fund.

Looking forward, the EBRD hopes to increase the number of high-quality Canadian project sponsors with whom it invests to better align its official co-financing and technical cooperation needs with Canadian interests in the region, and to strengthen its partnership with Export Development Canada and other Canadian commercial co-financiers.

Promoting Canada's Interests

Members of the Canadian Office made a number of visits to Canada and the EBRD's countries of operations in 2004 to meet with business people, conduct seminars, speak at conferences and consult with government officials. A highlight for the year was the June investor outreach visit to Toronto and Montréal, where the Canadian Director and the EBRD President met with representatives of the Canadian business and investment communities to explain the role of the EBRD and showcase opportunities for Canadian companies.

The following events in 2004 supported by the Canadian Director's office also promoted Canada's interests:

- The EBRD Private Public Partnership Specialist on the Municipal and Environmental Industries Team participated in GLOBE 2004 in Vancouver on April 1, including an Export Development Canada (EDC) roundtable.
- Canadian government officials and business representatives attended the EBRD Annual Meeting in London, England, on April 18–19.
- The Business Advisor for the Canadian Director's office participated in CIDA/Canadian Manufacturers and Exporters sponsored International Development Days in Calgary, April 21–23—including presentations and one-on-one meetings. The Business Advisor met with approximately 30 individuals and companies expressing interest in the region.
- The EBRD's Deputy Head of the Bulgaria office participated in the EDC/Foreign Affairs Bulgarian Business Opportunities Event, held in Montréal on April 29.
- In June, EBRD President Jean Lemierre, Canadian Director Scott Clark, and Business Advisor Sandy Ferguson made an investment promotion visit to Canada. President Lemierre was the keynote speaker at the Conférence de Montréal. The group also had meetings with private sector firms interested in investment in the region in both Montréal and Toronto. This event received excellent media coverage in both the French- and English-language national papers.
- The Business Advisor participated in the Montréal World Trade Centre and partners outreach "Doing Business with Multilateral Development Banks," Sept.14–17 in Montréal, Toronto and Fredericton.
- An EBRD representative for the Trade Facilitation Programme participated in the Ontario Exports Financing seminar on October 14.
- The EBRD's Director of Policy Studies from the Chief Economist's Office and Advisor travelled in December to Ottawa to present to business, academics and government officials key findings of the Bank's 2004 *Transition Report* on developments in the business and economic environments of the Bank's countries of operations.

Members of the Canadian Director's Office in London met with approximately 95 Canadians in 2004, including business people, representatives of financial intermediaries, parliamentarians, representatives from all levels of government, non-governmental organization representatives, consultants and academics.

Challenges Ahead

There were some spectacular developments in the region in 2004, including the accession of eight EBRD countries of operations to the EU in May and the election in Ukraine at year-end. These events are key transition successes.The success of EU accession suggests that the transition to democracy and market economies is all but complete in the new EU countries. In particular, these countries are increasingly able to obtain private sector financing. In the short term, this means that the Bank's activities must increasingly be focused on those areas that represent real additionality and have sufficient transition impact to warrant the use of Bank resources. In the medium term, the transition successes in the EU accession countries—as well as those in the EU candidatures of Romania, Bulgaria and Croatia—elevate the question of the EBRD's Graduation Policy and the future of the Bank itself. These fundamental questions will form the backdrop of the work being done in 2005 for the next Capital Resources Review, which Bank Governors will consider in 2006.

In Russia, high oil prices continue to support high GDP growth, but this also underscores the economy's vulnerability to fluctuations in oil prices and, similar to other resource-rich CIS countries, delays necessary reforms. Priority needs to be given to promoting investment in a wide range of sectors, including the financial sector, and encouraging improved investment climates. In the early transition countries, and to a lesser extent the intermediate transition ones, the challenge continues to be to find quality projects in a high-risk environment that is characterized by a lack of market-supporting institutions. The Bank's new Early Transition Countries Initiative provides a platform for increasing both the effectiveness and the volume of its activities in these countries. The Bank must continue to work in close partnership with other international financial institutions. Expanded cooperation will also be necessary to develop high-transition impact projects with explicit social and poverty alleviation benefits in order to strengthen the willingness of governments in some of the least advanced transition economies to move forward with politically difficult but essential reforms, particularly the restructuring or closure of large state-owned enterprises.

The transition experience of the Bank provides clear lessons for the future. Commitment to market-oriented economic and democratic political reforms along with sound fiscal policies are a prerequisite for sustained economic growth and access to international capital markets, which provide the foundation for further transition successes. Although the relationship between reform and growth is complex, and other factors allow some countries to delay reform while continuing to grow, transition is deepest in those countries that have made progress on economic and democratic reforms. In these economies, market-supporting institutions have tended to develop. These institutional frameworks—predictable fiscal and regulatory environments, secure property rights, an impartial judiciary and sound financial supervision and regulation—combined with commitment to democratic principles, have transformed their citizens' opportunities.

In contrast, in some countries in the Bank's region of operation, particularly those further east, progress in putting in place the institutions that underpin a market economy has been limited, and the process of liberalization and privatization is far from complete. As a result, economic growth remains vulnerable to external and internal shocks. In addition, the significant increase in poverty and inequality since the start of transition has eroded support for necessary reforms in many countries. Overcoming resistance to reform will be a challenge; it will require creating new employment opportunities and social fallback options for those displaced by structural change, and breaking the hold of powerful vested interests over the reform process.

Good governance will continue to play a critical role in the future success of the region and, in this regard, the EBRD will need to find ways to conduct its business to promote its Article 1 commitment to the principles of multi-party democracy and pluralism. In particular, the Bank will continue to monitor the progress of Belarus, Turkmenistan and Uzbekistan. The Bank's financing in Belarus and Turkemenistan is strictly limited to the private sector. As for Uzbekistan, the Board of Directors will revisit its country strategy in the summer of 2005, and will be looking for evidence of progress towards the EBRD's political and economic benchmarks. Given the lack of progress in Uzbekistan since April 2004, the new strategy will likely reflect the existing approach. Canada will continue its vigorous support for Bank efforts to address issues related to the rule of law, human rights and democratic principles.

Good corporate governance will also figure prominently in the period ahead, and the EBRD will need to continue to promote sound institutions, more efficient tax collection and improved legal and regulatory frameworks. It must ensure not only that appropriate legislation is developed, but also that it is properly implemented and enforced.

Finally, good governance within the EBRD itself is also important. Since the EBRD, as a multilateral institution, is not regulated, the Bank must ensure that it adopts and maintains the highest industry standards. To this end, in 2004, the Bank started work on a formal Certification of Internal Controls procedure with the aim of establishing the system by the start of 2005. The formal certification of financial controls will ensure the presence and effectiveness of internal controls, helping to identify and minimize risks. The procedure known as COSO, which was developed in the United States in recent years, is being widely adopted by corporate America, especially in the wake of the Sarbanes-Oxley legislation. COSO is also used by the World Bank. In addition, in 2004, the Board reviewed and renewed the terms of reference for the Bank's Audit Committee. Reviews of the Terms of Reference of the other two Board committees also began in 2004, as did review of the EBRD's Code of Conduct, to ensure they are all in line with best practices; these reviews will be completed in 2005.

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[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 (such as *Financing With the EBRD*), special reports (such as the *Annual Report* and *Transition Report*), country strategies and assorted fact sheets.

Information can also be obtained on the Bank's 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, the EBRD does not operate a concessional or "soft" loan window.

Ordinary Capital Resources

At the end of 2004, the total authorized capital of the Bank was €20 billion. Canada has subscribed to 3.4 per cent—or €680 million (C$958 million)—of the Bank's authorized capital. Canadian contributions to the Bank's capital are made in US dollars (at a pre-determined euro/US$ exchange rate).

In 2004, Canada made its seventh purchase of shares under the first capital increase (which came into effect on April 3, 1997, and doubled the initial €10-billion capital base). Under the first capital increase, 77.5 per cent of Canada's 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 are being made in eight equal annual installments (40 per cent in cash and 60 per cent in non-interest-bearing demand notes encashed over five years). The following table 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 represent an asset. Nonetheless, Canada's paid-in contributions to the Bank do increase the Government's financing 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	7,287,199	4,858,132	1,457,439	6,315,572
1999	7,287,199	4,858,132	2,914,878	7,773,010
2000	7,287,199	4,858,132	4,372,317	9,230,449
2001	7,287,199	4,858,132	5,829,759	10,687,891
2002	7,287,199	4,858,132	7,287,198	12,145,331
2003	7,287,199	4,858,132	7,287,199	12,145,331
2004	7,287,199	4,858,132	7,287,199	12,145,331
Total	110,527,903	93,524,434	95,953,503	189,477,937

Market Borrowings

At the end of 2004, total EBRD borrowings stood at €12.2 billion with an average remaining life of 8.3 years at an average cost of funds of LIBOR (London Inter-Bank Offered Rate) minus 34 basis points. Funds have been swapped into floating-rate instruments, primarily in US dollars and euros.

Standard & Poor's has assigned the Bank an AAA long-term and A1+ short-term credit rating. Moody's Investors Service has similarly rated the EBRD long-term bonds AAA.

Special Funds

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

Canadian Technical Cooperation Fund—The main purpose of this fund is to provide financing to hire Canadian consultants for EBRD projects across a wide range of sectors and EBRD countries of operation. Canada has contributed C$12.65 million since the fund was established in 1992 and is currently completing Canada Phase V.

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

Nuclear Safety Account (NSA)—This facility was established in 1993 to help finance the closure of the Chernobyl nuclear power plant and to improve safety conditions at nuclear power plants in countries of operations until the plants can be closed. The NSA complements other bilateral and multilateral 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 €280 million. Canada's contribution has been completely disbursed.

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. The RSBF was established in 1993 as a pilot project and became permanent in 1995. Canada has contributed C$11.3 million towards the US$300-million fund.

CIDA-EBRD Cooperation Fund for Southeastern Europe (CFSEE)—By 2002, Canada had contributed C$10 million in support of the EBRD's South Eastern Europe Action Plan, to be used for technical cooperation and co-financing activities. These funds, tied to Canadian consultants, were used in Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Romania, and Serbia and Montenegro. In 2003, an additional C$6 million was added to the CFSEE, which focuses on CIDA priority sectors and countries of focus.

CIDA-EBRD Balkan Region Special Fund (BRSF)—In addition to the CFSEE, Canada has contributed C$2 million to the Balkan Region Special Fund to support post-conflict reconstruction efforts in the Balkan region.

TurnAround Management (TAM) Programme—The TurnAround Management Programme was established in 1993 to match senior industrial advisors from market-driven economies with chief executives of selected firms in the region. The objective is to provide industrial management know-how and develop business skills so that these companies can become competitive and profitable. In 2003, Canada signed a new agreement with the TAM Programme to provide C$2.5 million over five years to be used to hire Canadians to work as advisors. This brought Canada's total contribution to the TAM Programme to C$3.05 million.

Ukraine Micro Finance Bank (MFB)—In 2000, Canada entered into a contribution agreement with the EBRD to provide C$1.25 million for the provision of technical assistance related to the development of the MFB. Over three years, Canada has assisted the MFB to develop a branch network throughout Ukraine, with special attention being paid to Slavutych, the community where many former employees of the Chernobyl nuclear power plant reside. As a greenfield operation specializing in financial services for the micro and small enterprise sector, the MFB is also serving as a demonstration bank for the Ukrainian commercial banking sector to show the commercial viability of micro and small enterprise lending.

Technical Assistance in Support of the Ukraine Micro, Small and Medium-Sized Enterprises Line of Credit II—Between 1999 and 2004, Canada provided 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 has included risk- and loan-evaluation training.

Northern Dimension Environmental Partnership (NDEP)—NDEP provides donor funding to address severe environmental problems in northwest Russia, particularly in the areas of nuclear waste, water and wastewater treatment, and energy efficiency. Within the framework of its mandate, the EBRD supports relevant multilateral and regional agreements on the environment and sustainable development, including the Framework Convention on Climate Change and the measures agreed to in the Kyoto Protocol. Canada became an official contributor to the NDEP Support Fund at the end of 2003 and has committed €20 million. This made Canada the NDEP's sole non-European contributor. Canada earmarked its contribution for the facility's "nuclear window," which counts towards Canada's commitment to the G-8 Global Partnership program. To deal with nuclear waste, the NDEP provides full funding within an international cooperation framework designed to address the complex challenges of cleaning up the legacy of the former Soviet navy's Northern Fleet. In this regard, the NDEP completed a Strategic Master Plan in 2004 that has been adopted by all contributors as the basis for projects in the nuclear window.

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

Annex 2
Doing Business With the EBRD

For general information, please refer to www.infoexport.gc.ca/ifinet or contact the Bank's Communications Department in London (tel: +44 20 7338 6096; fax: +44 20 7448 6690).

Further inquiries should be directed to the Office of the Director for Canada, Advisor for Business Development and Investor Relations,
Ms. Sandy Ferguson (tel: +44 20 7338 6509; e-mail: fergusos@ebrd.com).

Canadian Project Sponsors: Canadian companies interested in potentially sponsoring a project with the EBRD are requested to direct initial inquiries either to the Office of the Director for Canada, to the 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 Web site at 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 cooperation notifications and invitations for expressions of interest for consultancy services pertaining to both public and private sector projects. The EBRD is currently working on an e-Procurement initiative expected to be launched in 2005. This initiative will involve the selection of consultants through a Web-based process.

Current procurement information can be found at
http://www.ebrd.com/oppor/procure/index.htm

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 permanent positions and summer jobs should be sent to:

Paolo Gallo, Director for Human Resources
Human Resources Management Department
European Bank for Reconstruction and Development
One Exchange Square
London, EC2A 2JN
United Kingdom

Annex 3
EBRD Membership as at December 31, 2004

	Share of the Bank's capital		Share of the Bank's capital
	(%)		(%)
European Members		**Countries of Operations**	
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	Kyrgyz Republic	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	Russia	4.00
Switzerland	2.28	Serbia and Montenegro	0.47
Turkey	1.15	Slovak Republic	0.43
United Kingdom	8.52	Slovenia	0.21
European Union	3.00	Tajikistan	0.10
European Investment Bank	3.00	Turkmenistan	0.01
		Ukraine	0.80
Non-European Members		Uzbekistan	0.21
Australia	0.50		
Canada	**3.40**		
Egypt	0.10		
Japan	8.52		
Korea, Republic of	1.00		
Mexico	0.15		
Mongolia	0.01		
Morocco	0.05		
New Zealand	0.05		
United States	10.00		