



REPORT ON

OPERATIONS UNDER

THE EUROPEAN BANK

FOR RECONSTRUCTION

AND DEVELOPMENT

AGREEMENT ACT

1997

Prepared by:
International Trade and Finance Branch
March 1998



Department of Finance
Canada

Ministère des Finances
Canada

Copies of this report, published annually by the
Department of Finance, may be obtained from the:

Distribution Centre
Department of Finance
300 Laurier Avenue West
Ottawa, Ontario
K1A 0G5
Telephone: (613) 995-2855
Facsimile: (613) 996-0518

Also available on the Internet at
<http://www.fin.gc.ca/>

Cette publication est également disponible en français.



TABLE OF CONTENTS

Introduction	5
Managing Canada's Interests.....	6
Operational Priorities	8
Key Developments in 1997.....	11
Transitional Impact of the Bank's Operations	15
Political Aspects of the Bank's Mandate	20
Environmental Aspects of the Bank's Mandate	20
Challenges Ahead	22

Annexes

1. The Bank's Financial Activities	24
2. EBRD – Canadian-Sponsored Projects Approved in 1997	26
3. Doing Business with the EBRD.....	27
4. EBRD Membership.....	29



INTRODUCTION

The European Bank for Reconstruction and Development (EBRD) 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 republics of the Soviet Union, and to promote private and entrepreneurial initiative in countries which are committed to the fundamental principles of multi-party democracy, pluralism and a market economy.

The EBRD functions as a development bank, much in the same way that the World Bank and other regional development banks operate. However, the EBRD is distinctive in three areas. The first characteristic is the EBRD's overriding focus on the private sector. 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 to promoting environmental protection and restoration.

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 activities focus on private sector development, including the strengthening of financial institutions and legal systems, and the development of infrastructure needed to support the private sector. The EBRD has 60 members (58 countries, the European Community and the European Investment Bank).

Canada is the eighth largest shareholder, 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 right aspects.”

This report responds to this requirement and reviews the activities and operations of the Bank for the year 1997.

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, who succeeded John Coleman. Tom MacDonald, Minister (Economic/Commercial) in the Canadian High Commission in London, 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, the Department of Finance regularly reviews the Bank's policy papers and proposed country programs and provides advice to the Canadian Director.

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:

- voted against the basic 5.3-per-cent salary increase for all Vice Presidents and additional adjustments to the salaries of two Vice Presidents in June 1997. He opposed the proposed salary increase on the grounds that these salaries should be based on levels comparable to those of similar positions in other multilateral institutions;
- abstained on the DM 100 million loan to Krono-Wood Spolka z.o.o. because of the low transition impact of this project involving a foreign sponsor establishing a greenfield operation in Poland which is an advanced transition economy; and
- abstained on the Staff Compensation and Benefits Proposals in December 1997 since the package proposed a significant real increase in already high staff salaries and Canada is against real wage increases.

Canada has continued to advocate increased EBRD activity in Ukraine and other countries in lower or intermediate stages of transition, in line with the Bank's graduation policy. Canada has supported the development within the Bank of a "wholesale" approach to activities under which the Bank channels financing to small and medium enterprises (SMEs) through lines of credit or equity investments in local banks and other financial intermediaries in its countries of operation.

Canada has also argued that the Bank cannot relax its efforts to expand the share of its private sector operations. The Canadian Director has frequently spoken in the Board about the need to achieve a 60/40 ratio in its private/public sector activities in all countries of operation and 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 zero real growth budgets for 1997 and 1998, and the introduction of higher provisioning against sovereign risk. The Canadian Director chaired the EBRD Board's critical Financial and Operations Policies Committee until August 1997 and, as Chair, had a strong impact on the development of the EBRD's financial policies and operational priorities.

Canadian Commercial Interests at the EBRD

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.

Four Canadian-sponsored projects were approved by the EBRD Board of Directors in 1997, representing EBRD financial commitments of up to US\$197.5 million. (The aggregate size of the four projects is US\$530.9 million.) In fact, during 1997, EBRD Directors approved more financing for Canadian-sponsored projects than in the previous five years combined. A description of each of the four Canadian-sponsored projects is given in Annex 2.

A growing area of opportunity is the Bank's private sector financing operations. There are currently a substantial number of projects involving Canadian companies that are making their way through the Bank's pipeline. Most of these are in areas of traditional Canadian strength – e.g. oil and gas, power and agribusiness. Canada has also continued its strong record of success in consultancy services.

Promoting Canada's Interests

Members of the Canadian office made seven visits to Canada in 1997 to meet with business people, conduct seminars, speak at conferences and consult with government officials. The Director and Alternate Director also visited Romania, Ukraine and Russia to further Canadian interests in the region. In addition, a Director's assistant provided a briefing on Canadian commercial interests in the EBRD at a meeting in Frankfurt, Germany of Canadian trade commissioners which was organized by the Department of Foreign Affairs and International Trade.

Canadians are also well represented on EBRD staff. At the end of 1997, Canadians accounted for 3.4 per cent of the Bank's professional positions, in line with Canada's 3.4-per-cent share of the institution's capital. It is noteworthy that Canadians lead the country team for the Baltics/Belarus (this team was abolished in January 1998 and merged with the Poland team) and head the Bank's resident offices in Kiev and Minsk.

OPERATIONAL PRIORITIES

Although the Bank shares many characteristics with other multilateral development banks, it has certain unique features. One of these is the explicit link between its financing operations and civil and political rights in the countries of operation. This two-pronged mandate is enshrined in the Bank's founding charter and differentiates its purpose and character from that of other international financial institutions. The Bank's operations are guided by (a) sound banking practices, (b) the requirement that individual projects advance the transition to a market economy, (c) the principle that EBRD financing catalyzes and *does not displace* private sources of capital, and (d) the requirement that EBRD projects have a positive environmental impact.

In promoting economic transformation in its countries of operation, the Bank's main role is to act 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 in Central and Eastern Europe and regions of the former Soviet Union can be assembled, the EBRD plays a catalytic role in mobilizing capital.

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 International Finance Corporation (IFC), the Bank is required to operate on a strictly commercial basis and to attract companies to invest in unfamiliar countries through financially viable projects, not through subsidies.

Financial Highlights

- In 1997, the Bank achieved a net profit of ECU¹ 16.1 million (C\$25.3 million) after provisions, three times that of ECU 4.9 million (C\$7.7 million) a year earlier.
- The Bank almost doubled its provisions against losses to ECU 178 million (C\$279 million) in 1997, not because of a worsening portfolio, but reflecting the strong growth in commitments and disbursements, as well as the new general provisioning for sovereign exposures.
- Last year, 76 per cent of signed projects and 80 per cent of approved projects were in the private sector.
- Equity investments accounted for 19 per cent of the value of all approved projects, and the Bank used a number of new investment funds to better target small and medium-sized companies.
- After six years of operation, the Bank has approved projects worth ECU 15.6 billion (C\$24.5 billion). The Bank is fully operational in each of its 26 countries of operation.
- The Bank expects the annual level of its commitments to rise steadily from ECU 2.3 billion (C\$3.5 billion) in 1997 to more than ECU 2.7 billion (C\$4.2 billion) in 2001.
- The doubling of the Bank's capital to ECU 20 billion (C\$31.4 billion), which became effective in April, will ensure the Bank's continued strong contribution to the transition process.

¹ The ECU is the standard unit of account for the EBRD's operations. It represents a weighted basket of 11 European currencies. At the end of 1997, the exchange rate was ECU 1 = C\$1.57015.

Nevertheless, there remain many countries and sectors that continue to receive limited attention from investors. Almost 70 per cent of the US\$61 billion of foreign direct investment in EBRD clients since 1989 went to just four countries – the Czech Republic, Hungary, Poland and the Russian Federation. At one extreme, FYR Macedonia received a scant US\$65 million in foreign direct investment over this period, compared to US\$15.3 billion invested in Hungary at the other extreme. Part of the EBRD's mission is to help narrow these differences by signalling to investors those activities within its countries of operation which provide good potential for investment.

The Bank almost always acts with partners – such as banks and local and international companies – in financing a project loan and, typically, puts up no more than 35 per cent of the capital required. At the end of 1997, the EBRD had approved loans and investments totalling ECU 13.9 billion (C\$21.8 billion) which, in turn, supported projects with an overall value of ECU 25 billion (C\$39 billion). As the scale of these figures illustrate, the EBRD has now become a key financial institution in this part of the world.

Over the years, the Bank has undertaken a number of structural reforms to fulfil its mandate. It has streamlined procedures and expanded partnerships with other institutions in financial and other sectors in pursuit of its goal of strengthening the private sector in its countries of operation.

The Bank has also extended its streamlined approach to industrial sectors, by establishing “multi-project facilities” with various corporations. By initiating such “package deals”, it is able to support a broad range of projects, some of which might otherwise have been too small for the EBRD to undertake. In addition, the Bank is working actively with local and regional banks, providing them with funds and guaranteeing their loans. In turn, this increases financing for many small and medium-sized enterprises. In addition to the financing the EBRD provides to financial intermediaries for onward lending to SMEs, it is also developing a series of venture capital funds (there are now more than 10) to help address the critical needs of SMEs for more venture capital.

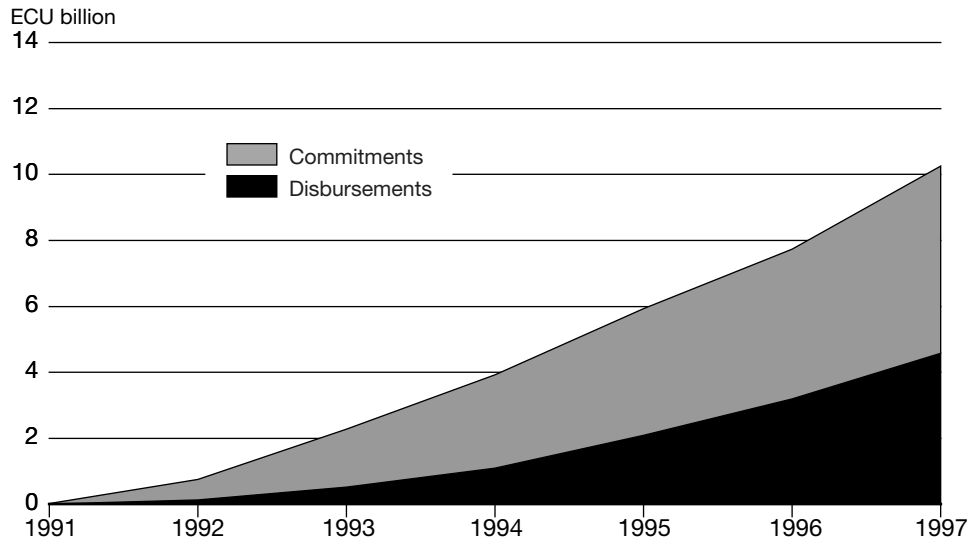
KEY DEVELOPMENTS IN 1997

In 1997, the Bank continued to focus on developing more projects in more countries. It broadened its private sector emphasis and sharply increased its loan and equity investment portfolio. Its target of ECU 2.2 billion (C\$3.5 billion) in new commitments was exceeded as commitments reached ECU 2.3 billion (C\$3.6 billion) for 108 new projects. The cumulative value of signed projects at the end of 1997 stood at ECU 10.3 billion (C\$16.1 billion) with cumulative disbursements reaching ECU 4.6 billion (C\$7.2 billion).

In the past year, the Bank continued to step up its geographic diversification, shifting the focus from the reform-minded states of Central Europe towards more challenging countries in Eastern Europe and the former Soviet Union. Commitments in five countries – the Czech Republic, Hungary, Poland, Romania and Slovakia – accounted for 25 per cent of the EBRD's signed commitments for loans and equity investments in 1997, compared to 50 per cent at the end of 1994.

At the end of 1997, the Bank had approved and signed projects in all its 26 countries of operation; in addition, it had signed 36 regional projects.

EBRD Operational Indicators



A country's financial sector is critical to the future development of its broader private sector and, as such, is a key focus for Bank activities. The Bank is developing equity stakes in a number of financial institutions in its countries of operation with a view to improving the quality of their financial services and the degree of competition within their financial sectors. In 1997, the Bank signed 52 agreements to finance financial sector activities valued at ECU 477 million (C\$749 million). The Bank also committed a further ECU 855 million (C\$1.3 billion) to the transport, telecommunications and energy sectors.

The international banking community sees the Bank as an attractive partner. To date, more than 115 international banks have participated in EBRD programs supporting private sector projects. The EBRD also organized more than 300 technical co-operation projects in 1997 worth ECU 103 million (C\$162 million), which facilitated investment and lending operations by providing much-needed financing for project preparation and implementation.

Increase in the Bank's Capital Stock

The doubling of the Bank's capital to ECU 20 billion (C\$31 billion), which was approved by Governors at the 1996 annual meeting in Sofia, became effective in April 1997. At the end of 1997, about 85 per cent of the capital increase had been subscribed. The increase in capital, which marked an historic moment for the EBRD, is expected to provide sufficient resources to respond to growing demands in the Bank's countries of operation without further infusions of capital.

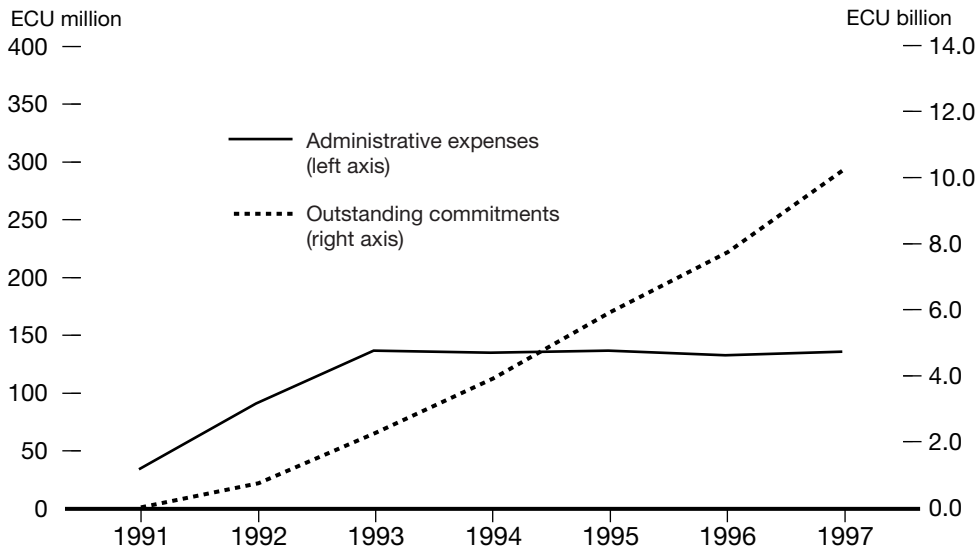
Canada deposited its instrument of subscription in November 1996 and subscribed to 34,000 additional shares – i.e. 3.4 per cent of the total. This will require a total paid-in capital investment of US\$97.2 million (C\$139 million) to be paid over the 1998-2005 period. This capital represents a government asset and, as such, has no impact on the deficit.

Administrative Efficiency and Cost-Effectiveness

In 1997, the Bank's administrative spending was frozen in real terms for a fourth straight year. This was achieved through strict budgetary control, increased cost recovery and cost-saving measures, such as the continued subletting of several floors of the headquarters building.

The Bank's efforts at productivity enhancement have been commendable. In 1997, productivity continued to increase as both commitments and projects under implementation rose sharply while other costs remained flat.

Productivity Gains



Zero-Base Budgeting Initiative

In March 1997, management launched a zero-base budgeting (ZBB) initiative which reviewed the Bank's work processes and procedures in order to identify ways of further increasing productivity and enhancing revenue to help offset the increase in costs that is anticipated as the Bank's portfolio continues to grow.

The ZBB is a commitment to greater efficiency in the future. The review made a number of recommendations, which are expected to direct more resources to priority areas such as project monitoring by streamlining activities in departments. The ZBB initiative has contributed to both reducing the preparation time and number of bureaucratic steps to approve a project.

Changes in Presidency

In June, Jacques de Larosière announced that, for personal reasons, he would not seek re-election upon completion of his four-year term ending in September 1997. However, at the request of Philippe Maystadt, Minister of Finance of Belgium and Chairman of the Bank's Board of Governors, he agreed to stay on until January 1998 to ensure an orderly succession.

Mr. de Larosière has made an outstanding contribution to the EBRD. Under his stewardship, the Bank's international standing has been fully restored. In addition, the Bank has actively increased its lending and investment activities in the private sector and broadened the geographical spread of its operations in the less advanced countries of the region.

As of end of February, no successor has been proposed by the European shareholders who hold the majority of votes. Until a new President is elected, Charles Frank, who succeeded to Ron Freeman as First Vice President (Banking), will be the Acting President.

Changes to the Provisioning Policy

The Bank's risk management policies are intended to ensure that adequate levels of provisions and reserves are maintained relative to the potential losses in the Bank's portfolio of loans, equity investments and guarantees. In 1997, the Bank made considerable progress in this area as it doubled its loss provisions.

The decision to revise its provisioning policy brought the Bank into line with practices in other multilateral development banks as it introduced a uniform general provision of 3 per cent against outstanding sovereign risk exposures.

The implementation alone of the new provisioning against sovereign risk resulted in an increase in provisions of more than ECU 50 million. In addition, the Bank has made considerable progress towards its reserve target of 10 per cent for disbursed loans and 25 per cent for disbursed equity investments. A challenge for the institution is to achieve, as quickly as possible, these reserve levels while at the same time expanding its operations in higher-risk transition economies. Canada has continued to encourage the Bank to pursue these objectives aggressively.

Information on Procurement Data

In its 1996 Annual Report, for the first time, the Bank released information on procurement activities related to its public sector operations. The Canadian government welcomed this development after having consistently urged Bank management to improve its information on procurement.

Canada will continue to press for similar information on the Bank's private sector projects. Canada will also encourage Canadian companies to bid on EBRD projects and provide strong support through its Director's office to Canadian suppliers and consultants.

TRANSITIONAL IMPACT OF THE BANK'S OPERATIONS

In November, the Bank issued its fourth Transition Report reviewing the process of transition in each of its countries of operation. The Report's key summary statistics are provided in Table 1. The Report argues that a new phase of transition has begun in the countries of Eastern Europe, the Baltics and the Commonwealth of Independent States (CIS). After strong progress in liberalizing markets, privatizing state enterprises and stabilizing prices, the challenge ahead is to create the institutions, policies and practices that generate high, sustained growth in market economies.

The Report shows that those countries that have reformed more vigorously have recovered from recession more rapidly and attracted greater private capital inflows. To launch themselves on a path of rapid sustained growth, these economies now need to enhance the effectiveness of institutions that support the market and reduce their legacies of bureaucratic interference and corruption which undermine investment and competition.

The Report also observes that the region as a whole is expected to grow in 1997 for the first time since the beginning of transition, although growth rates will vary significantly by country. While the return of growth has brought with it rising confidence and capital inflows, it has also resulted in rapidly deteriorating external balances. The sustainability of current accounts is a matter that will need to receive increasing attention from policymakers.

The Report focuses particular attention on enterprise performance and long-term growth. It examines which measures are needed to sustain and accelerate growth, and the long-term prospects of countries in the region. The Report's key message is that governments should establish policies, institutions and practices that allow competition to develop and market-oriented enterprises to flourish.

The Report identifies reasons for optimism and for pessimism in the long-term growth prospects in the region. Genuine restructuring has the potential to generate large productivity gains that could fuel rapid growth, particularly in view of the highly skilled workforces in the region. The main reason for pessimism lies in the weakness of the institutions, policies and practices which are required to underpin a well-functioning market economy.

Highlights of Macroeconomic Performance

The region as a whole experienced its first year of real gross domestic product (GDP) growth, with a projected increase of 1.7 per cent in 1997, as recent declines in Russia finally came to an end. Total GDP for the region is now estimated to be about US\$1 trillion. Real growth in 1998 is projected to accelerate to 3.5 per cent. Inflation has continued to fall in most countries, but developments this year highlight the fragility of the macroeconomic position in many countries. In most CIS countries, fiscal revenue performance continues to deteriorate.

External deficits have risen sharply in most countries as growth is increasingly driven by the recovery in household consumption and enterprise investment demand. Almost half the countries of the region have current account deficits in excess of 7 per cent of GDP.

A growing supply of foreign, mostly private, capital inflows has financed part of the expansion in domestic demand. While capital inflows reflect growing confidence, they can pose risks of excessive exchange rate appreciation and macroeconomic volatility. Domestic financial systems intermediate much of the capital inflow and it is essential that they be strengthened and closely regulated and supervised.

In several countries, the combination of wage increases and real exchange rate appreciation exceeded productivity growth for the first time in 1996, pointing to a potential loss of competitiveness in international markets. Continued enterprise restructuring and the efficient provision of services, such as infrastructure, will be crucial to maintaining competitiveness in the future.

Private Sector Development in the Russian Federation

At the beginning of 1997, the private sector accounted for about 70 per cent of GDP, 60 per cent of employment and almost 75 per cent of investments. The main source of the expansion of the private sector remains the privatization process and the contraction of the state sector. The number of wholly state-owned enterprises was reduced to 88,000 from 205,000 in 1992. Since mid-1997, private sector activity has been reinvigorated by the adoption of a new law on privatization.

The creation of new enterprises continues to lag behind the pace seen in the Central European countries. Moreover, new businesses are operating in the informal economy. Private sector development remains particularly problematic in the agricultural sector as the Duma continues to stall legislation, which would enable the sale of agricultural land.

Foreign participation in privatization and subsequent share transactions continue to be restricted. In the most important strategic enterprises, mostly in the energy sectors, foreigners are allowed a maximum 15 per cent of company shares. Special restrictions also apply to the financial sector and the Duma intends to further tighten restrictions in a wide range of sectors by amending the Law on Foreign Investment. At the beginning of 1997, foreigners owned less than 2 per cent of Russia's medium-sized and large enterprises.

Table 1

Progress in Transition in Central and Eastern Europe and the Former Soviet Union

Countries	Population mid-1995 (million)	Private sector share of GDP (mid-1997) (%)	Enterprises		Governance & restructuring	Markets and Trade		Competition policy	Financial Institutions	
			Large-scale privatization	Small-scale privatization		Price liberalization	Trade and foreign exchange system		Banking reform & interest rate liberalization	Securities markets & non-bank financial institutions
Albania	3.2	75	2	4	2	3	4	2	2	2 -
Armenia	3.7	55	3	3	2	3	4	2	2 +	1
Azerbaijan	7.5	40	2	3	2	3	2 +	1	2	1
Belarus	10.4	20	1	2	1	3	1	2	1	2
Bulgaria	8.4	50	3	3	2 +	3	4	2	3 -	2
Croatia	4.8	55	3	4 +	3 -	3	4	2	3 -	2 +
Czech Republic	10.3	75	4	4 +	3	3	4 +	3	3	3
Estonia	1.5	70	4	4 +	3	3	4	3 -	3 +	3
FYR Macedonia	2.1	50	3	4	2	3	4	1	3	1
Georgia	5.4	55	3 +	4	2	3	4	2	2 +	1
Hungary	10.3	75	4	4 +	3	3 +	4 +	3	4	3 +
Kazakhstan	16.8	55	3	3 +	2	3	4	2	2 +	2
Kyrgyzstan	4.5	60	3	4	2	3	4	2	3 -	2
Latvia	2.5	60	3	4	3 -	3	4	3 -	3	2 +
Lithuania	3.7	70	3	4	3 -	3	4	2 +	3	2 +
Moldova	4.4	45	3	3	2	3	4	2	2	2
Poland	38.5	65	3 +	4 +	3	3	4 +	3	3	3 +
Romania	22.7	60	3 -	3	2	3	4	2	3 -	2
Russian Federation	148.4	70	3 +	4	2	3	4	2 +	2 +	3
Slovak Republic	5.3	75	4	4 +	3 -	3	4	3	3 -	2 +
Slovenia	2.0	50	3 +	4 +	3 -	3	4 +	2	3	3
Tajikistan	5.8	20	2	2	1	3 -	2	1	1	1
Turkmenistan	4.4	25	2	2	2 -	2	1	1	1	1
Ukraine	51.9	50	2 +	3 +	2	3	3	2	2	2
Uzbekistan	22.4	45	3 -	3	2	3 -	2 -	2	2 -	2

Source: Transition Report (EBRD, November 1997).

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.

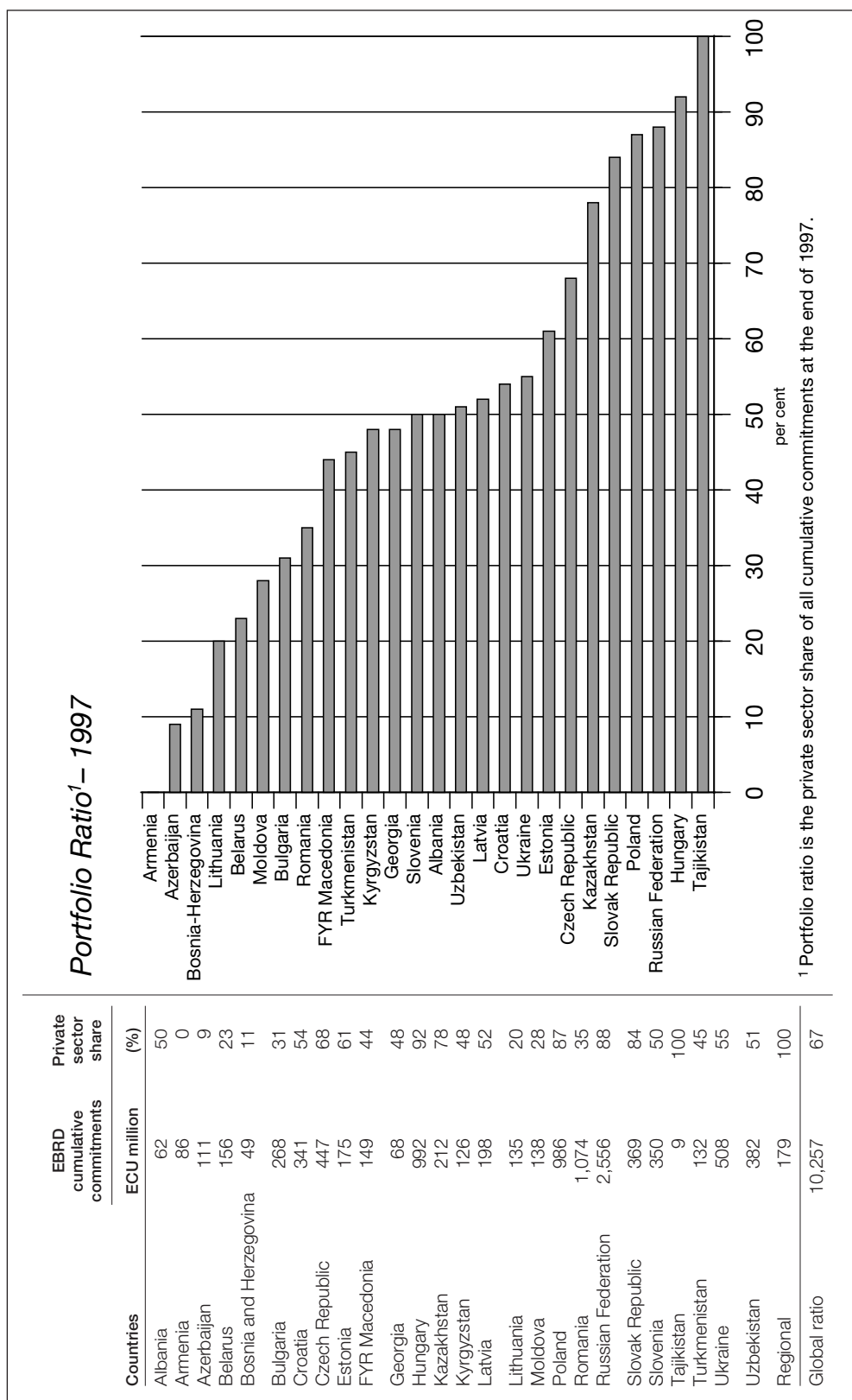
The Private Sector Focus of the Bank

The EBRD Agreement requires that the Bank achieve 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 broadly satisfied in 1997 with 67 per cent of the Bank's total commitments linked to private sector activities. Progress in reaching the individual country ratios was mixed. At the end of 1997, these were attained in only eight of the Bank's 26 countries of operation. Armenia is noteworthy in that it has had no private sector commitments to date.

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) is nearing in a number of countries. The shortfall 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.

Nevertheless, the portfolio ratio has also been problematic in a number of high transition economies where the private sector is dominated by companies which are often too small to be the focus of direct EBRD operations. In some cases, the Bank is reaching out to SMEs through a wholesale approach involving support for local financial intermediaries which then on-lend to companies too small to be considered for direct EBRD operations. The Bank's challenge remains to expand and broaden its support for private sector operations.



POLITICAL ASPECTS OF THE BANK'S MANDATE

The Bank's Articles of Agreement link the successful transition of member countries to market-oriented economies with progress toward democracy and the rule of law. This is a key part of the Bank's mandate.

The Bank takes its political mandate seriously. For each country of operation, the Bank examines the political situation, relying on a team of counsellors who specialize in political analysis. These individuals work very closely with the Council of Europe, the Organization for Security and Co-operation in Europe (OSCE) and the United Nations to reach their political assessments. During their examination of the Bank's "country strategies", the Board of Directors discusses appropriate follow-up activities in light of these evaluations. In certain cases, the Board has considered progress inadequate and has asked the President to formally convey its concerns to the national authorities.

Democracy has strengthened in many countries of operation as the second and third rounds of elections were completed, not only at the national level, but also at the local level. Changes of government have taken place without civil disruption. It is noteworthy that, in line with recent progress in Bosnia and Herzegovina, the Bank has been able to increase its operational activities and help contribute to the peace implementation process.

The Bank has not yet faced a situation where the Board has decided to suspend operations in a member country on political grounds. However, in one case, the Bank has put in place an operational strategy that has resulted in a scaling back of operations in response to a weakening of a government's commitment to market reform and multi-party democracy. Under this strategy, the Bank will no longer fund public sector projects and will limit its activities only to those private sector projects that could be insulated from interventionist government policies until such time as there is positive movement on political reform.

ENVIRONMENTAL ASPECTS OF THE BANK'S MANDATE

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.

Environmental due diligence requirements vary depending on the nature and location of the project, the potential environmental liabilities or risks associated with past, current or future operations, worker health and safety considerations, and other issues. Investigations are normally undertaken early in the operation cycle in order to allow time to identify environmental concerns, plan mitigation and enhancement measures, and obtain agreement

on actions to be taken prior to Board approval. Environmental conditions, relating to mitigation and enhancement measures and project monitoring, are incorporated into loan agreements.

In 1997, six environmental projects were signed with a total EBRD commitment of more than ECU 180 million (C\$280 million). More than 60 environmental analyses, including three environmental impact assessments and 35 environmental audits, were conducted on projects approved by the Board of Directors in 1997. In some cases, analyses and audits were both required.

Countries at more advanced stages of transition, especially those seeking accession to the European Union, are now channelling 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.

The EBRD and Nuclear Safety

Canada and other G-7 countries have been working closely with the EBRD to improve nuclear safety in Central and Eastern European countries and the former Soviet Union. To facilitate this work, Canada has generously 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.

On the Group of Seven's behalf, the Bank has agreed to administer the US\$760 million Chernobyl Shelter Fund (CSF) for securing the sarcophagus around the destroyed (by nuclear accident) Unit VI reactor in Ukraine. The G-7 nations have committed US\$300 million, of which Canada will contribute US\$20 million.

Canada also supports the use of the EBRD's own resources to finance the completion of Soviet-designed nuclear power plants up to Western safety standards. The EBRD applies strict conditions to this support. The completion of these plants must be part of a "least cost" solution to the country's future electricity requirements; the completed plants must fully comply 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.

The Bank is at the forefront of innovation with adapted instruments which, it is hoped, will continue to expand in the future. The Bank has established two special teams which are engaged proactively in the environment: the Municipal and Environmental Infrastructure Team, and the Energy Efficiency Team. The Energy Efficiency Team, for example, has developed commercial mechanisms for implementing energy-saving projects, thus eliminating the need for sovereign credits. Among the most important of these are the energy service companies (ESCOs), which combine technical and financial resources to provide a complete energy efficiency service to their clients. The ESCOs make energy-saving investments in their clients' premises and are repaid from the realized energy savings.

CHALLENGES AHEAD

Over the last four years, the Bank has made considerable progress under the strong leadership of President de Larosière. It is hoped that his successor will continue his excellent work. Given the risky environment in which the Bank must operate, it will need to pay particular attention to protecting its financial viability. Keeping a tight rein on the budget is indispensable. In addition, the Bank should continue to strive to increase productivity, and to reduce overhead costs in order to concentrate resources on key functions. It will also be important to keep and foster its corporate spirit, and to keep the organizational structure as light and flat as possible and not encumber it with unnecessary layers of hierarchy.

Looking ahead, the Bank's success is also dependent on its flexibility and sense of innovation. With a market that is certain to change, the Bank must remain ahead of events and provide the best new products to meet the needs of its clients. It will also be important for the Bank to elaborate and develop its environmental mandate.

Finally, the Bank must continue to contribute to the development of democratic societies, stronger institutions and more transparent governance structures which are essential characteristics of the type of society we all wish to build.

The Bank has now emerged as an important force promoting transition in Central and Eastern Europe and the countries of the former Soviet Union. In the coming years, the demand for its expertise and resources can be expected to continue to increase. In meeting this demand, the EBRD will need to ensure that its operations continue to satisfy the principles of sound banking, ensure that its resources do not substitute for other available financing (i.e. "additional") and continue to support the process of transition. One area of particular attention will be the process of accession by certain of the Bank's countries of operation to the European Union. Accession would be a firm demonstration that transition has been accomplished and support for accession is an operational priority of the Bank. However, the EBRD can only

be involved in projects that support accession to the extent that such support is based firmly on its operating principles of additionality, transition impact and sound banking practices.

The turbulence in international capital markets at the end of 1997 has had a strong impact on the ability of many governments and corporate entities in the Bank's countries of operation to raise financing on a commercial basis. Recent events have demonstrated clearly that increased access to commercial financing for many of the EBRD's countries of operation is not a linear development and that the EBRD's additionality will vary according to the market perception of country risk.

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 2EH
United Kingdom

Patrice Muller, Director	Tel: 44-171-338-6457
Tom MacDonald, Alternate Director ¹	Tel: 44-171-338-6507
Stephen Millar, Director's Assistant ²	Tel: 44-171-338-6458
John Kur, Director's Assistant ³	Tel: 44-171-338-6509
Diana Price, Executive Secretary	Tel: 44-171-338-6507
	Fax: 44-171-338-6062
	Internet address: PriceD@ebrd.com

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., Annual Report, Transition Report), country strategies and assorted fact sheets.

Requests for information can be addressed to:

Publications Desk
European Bank for Reconstruction and Development
One Exchange Square, London, EC2A 2EH, United Kingdom
(Fax: 44-171-338-7544)

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 those 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 1997, the total authorized capital of the Bank was ECU 20 billion (about Cdn\$31.4 billion). Canada has subscribed to 3.4 per cent – or ECU 680 million (about Cdn\$1.1 billion) – of the Bank's authorized capital. Canadian contributions to the initial capital of ECU 10 billion have been made in U.S. dollars as shown in the table below. Under the initial capital subscription, 30 per cent of ECU 10 billion represented paid-in capital provided in equal annual instalments over five years, half in cash and half in promissory notes. While this represents a non-budgetary expenditure, it does increase the government's borrowing requirements. The remaining 70 per cent of authorized capital is "callable" – i.e. subject to call in the unlikely event that it is required to meet the Bank's financial obligations to bondholders. At the end of 1997, Canada had made the following payments in U.S. dollars:

Year	Notes	Cash	Encashment of notes	Total cash outlay
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
Total	59,517,510	59,517,510	59,517,510	119,034,520

The capital increase of ECU 10 billion became effective on April 3, 1997. Canada's paid-in capital payments will be made in eight equal instalments of US\$12,145,331.25 starting in April 1998.

Market Borrowings

At the end of 1997, cumulative borrowings by the Bank totalled ECU 7.4 billion (Cdn\$11.6 billion) with an average maturity period of 5.5 years at an average cost of funds of LIBOR minus 47 basis points. Funds have been swapped into floating rate instruments, primarily in U.S. dollars, ECU and deutschemarks.

Standard & Poor's has assigned the Bank a AAA long-term and A-1+ short-term credit rating. Moody's 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 Cdn\$7.4 million since it was established in 1992.

Nuclear Safety Account – This facility was established to help finance the closure of the Chernobyl nuclear power plant and to improve safety conditions at nuclear power plants in countries of operation. The NSA functions in parallel with multilateral efforts to achieve broader energy sector reform in the region. Canada has contributed Cdn\$19.5 million to the total fund of Cdn\$438 million. The NSA was established in 1993.

Chernobyl Shelter Fund – The main purpose of this US\$760 million fund is to secure the sarcophagus around the destroyed Unit VI nuclear reactor in Ukraine. 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 financing and micro-lending in various regions of Russia. Canada has contributed US\$6 million toward the US\$300 million fund. The RSBF was established in 1993.

ANNEX 2

EBRD – Canadian-Sponsored Projects Approved in 1997

Approval date	Canadian company	Project country	Project name	Type of financing	Total EBRD commitment (ECU million)
July	Telesystem International Wireless Corporation (TIWC)	Romania	MobiFon GSM	Senior debt ¹ and quasi-equity	Up to 128.00
November	Consumers Packaging, Inc. (CPI)	Belarus	Elizovo Glass	Senior debt and quasi-equity	Up to 8.45
December	Consumers Packaging, Inc. (CPI)	Ukraine	AD-Zarya Glass	Equity	Up to 11.11
December	Saskatchewan Wheat Pool SWP (SWP) Strait Crossing Inc. and Dessaport International	Poland	Europort Gdansk Grain Terminal	Senior debt	Up to 29.00
Total					Up to 176.56

¹ EDC provided a parallel loan of US\$25 million, and CIBC Wood Gundy acted as a co-arranger of the syndicated loan with a participation of US\$10 million.

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: 44-171-338-6096; fax: 44-171-448-6690).

Canadian Project Sponsors: Canadian companies interested in potentially sponsoring a project with EBRD are requested to direct initial inquiries either to **Project Inquiries** (tel: 44-171-338-6282 or 44-171-338-6252; fax: 44-171-338-6102) in London 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: In its monthly newsletter, *Procurement Opportunities*, 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 and co-financing notices and contract awards information are also published in the newsletter. *Procurement Opportunities* can be accessed on the Bank's Internet site (as addressed above), and a hard copy subscription can be obtained for £85 from:

EBRD Subscription Department (*Procurement Opportunities*)
82-84 Peckham Rye
London, SE15 4HB
United Kingdom
Tel: 44-171-639-0333
Fax: 44-171-358-9568

Canadian Consultants: The EBRD's *Procurement Opportunities* newsletter 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, D.C. 20433, U.S.A.

Individual Canadians: The EBRD maintains a recruitment section on its Internet 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:

Ernst Mahel, Senior Recruitment Advisor
Personnel Department
European Bank for Reconstruction and Development
One Exchange Square
London, EC2A 2EH
United Kingdom

ANNEX 4**EBRD Membership – As at December 31, 1997**

	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	0.05
Denmark	1.20	Belarus	0.20
Finland	1.25	Bosnia and Herzegovina	0.08
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	4.26	Hungary	0.79
Liechtenstein	0.02	Kazakhstan	0.12
Luxembourg	0.20	Kyrgyzstan	0.05
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	1.70	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	0.05
European Community	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	0.05		
Japan	8.52		
Korea	1.00		
Mexico	0.15		
Morocco	0.05		
New Zealand	0.05		
United States	10.00		