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

2001

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 Eastern Europe, as well as in the successor states of the former Soviet Union, 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 4 for a list of the EBRD's 27 countries of operation).

The EBRD differs from other regional development banks in four ways. First, its overriding focus is on the private sector and support for the transition from central planning to stable market economies. Its charter stipulates that not less than 60 per cent of its financing commitments should be directed either to private sector enterprises or to state-owned enterprises implementing a program to achieve private ownership and control. Second, the EBRD's mandate gives it a particular focus on the promotion of democratic institutions and human rights in its countries of operation. Third, the EBRD is explicitly committed under its Articles of Agreement to ensuring the environmental sustainability of all its projects. Fourth, the EBRD does not provide concessional financing.

The Bank seeks to help its 27 countries of operation to implement structural and sectoral economic reforms, taking into account the particular needs of countries at different stages in the transition process. In particular, its private sector activities focus mainly on enterprise restructuring, including the strengthening of financial institutions, and the development of infrastructure needed to support the private sector. The EBRD has 62 members: 60 countries, the European Union (EU) and the European Investment Bank (see Annex 4 for a list of members).

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

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

This report responds to this requirement and reviews the activities and operations of the Bank for the year 2001.

Benefits of Membership

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

EBRD membership provides a number of specific benefits:

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

Role and Mandate of the EBRD

The EBRD

- fosters the transition of former centrally planned economies of Central and Eastern 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.

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 operation, the Bank acts as a catalyst for increased flows of financing to the private sector. The capital requirements of these countries cannot be fully met by official multilateral and bilateral sources of financing, and many foreign private investors remain hesitant to invest in the region, particularly the eastern part. 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 2001, for every euro the EBRD invested, it mobilized an additional €2.7 from the private sector and multilateral and bilateral agencies.[1]

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

[1] On December 28, 2001, one euro purchased 1.4080 Canadian dollars.

Key Economic Developments in 2001

Real gross domestic product (GDP) grew by 4.3 per cent for the region as a whole in 2001, down from 5.5 per cent in 2000. The slowdown in economic growth reflected the overall weakening of the world economy, particularly in the EU and Russia. The Commonwealth of Independent States (CIS)[2] countries experienced the largest drop in economic growth, from 7.9 per cent in 2000 to 5.8 per cent in 2001, primarily due to the economic slowdown in Russia, which saw its growth rate drop from 8.3 per cent in 2000 to 5.2 per cent in 2001. In the transition countries of Central Europe and the Baltic States,[3] the overall rate of growth fell from 4.0 per cent in 2000 to 2.9 per cent in 2001. In Southeastern Europe[4] output increased 3.6 per cent in 2001, down slightly from 4.0 per cent in 2000.

Reform efforts in most countries were sustained in 2001, as measured by the EBRD's transition indicators (see table on page 9). Several countries in Southeastern Europe benefited from improvements in the political and economic climate and, as a result, were able to make significant progress in reforms, particularly Bosnia and Herzegovina and FR Yugoslavia. Most of the EU accession candidate countries continued to make steady progress. Russia and other CIS countries also made progress in their reform efforts, except for Turkmenistan, which regressed from the limited progress that had been made in previous years.

The following table ranks transition countries by their progress in moving to a market economy, based on a number of indicators.

[2] Includes Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

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

[4] Includes Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Former Yugoslav Republic of Macedonia (FYR Macedonia), Romania, and the Federal Republic of Yugoslavia (FR Yugoslavia), which became a member of the Bank in early 2001. Kosovo is a province of FR Yugoslavia.

Progress in Transition in EBRD Countries of Operation

Countries	Population (millions, mid-2001)	Private sector share of GDP in %, mid-2001 (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
Albania	3.4	75	2+	4	2	3	4+	2-	2+	2-
Armenia	3.8	60	3	4-	2	3	4	2	2+	2
Azerbaijan	8.1	60	2	3+	2	3	3+	2	2+	2-
Belarus	10.0	20	1	2	1	2	2	2	1	2
Bosnia and Herzegovina	4.3	40	2+	3-	2-	3	3	1	2+	1
Bulgaria	8.1	70	4-	4-	2+	3	4+	2+	3	2
Croatia	4.6	60	3	4+	3-	3	4+	2+	3+	2+
Czech Republic	10.3	80	4	4+	3+	3	4+	3	4-	3
Estonia	1.4	75	4	4+	3+	3	4+	3-	4-	3
FR Yugoslavia	8.6	40	1	3	1	3	3	1	1	1
FYR Macedonia	2.0	60	3	4	2+	3	4	2	3	2-
Georgia	5.4	60	3+	4	2	3+	4+	2	2+	2-
Hungary	10.0	80	4	4+	3+	3+	4+	3	4	4-
Kazakhstan	14.9	60	3	4	2	3	3+	2	3-	2+
Kyrgyzstan	4.7	60	3	4	2	3	4	2	2+	2
Latvia	2.4	65	3	4+	3-	3	4+	2+	3+	2+
Lithuania	3.7	70	3+	4+	3-	3	4+	3	3	3
Moldova	4.3	50	3	3+	2	3+	4+	2	2+	2
Poland	38.7	75	3+	4+	3+	3+	4+	3	3+	4-
Romania	22.3	65	3+	4-	2	3+	4	2+	3-	2
Russia	145.4	70	3+	4	2+	3	3-	2+	2-	2-
Slovak Republic	5.4	80	4	4+	3	3	4+	3	3+	2+
Slovenia	2.0	65	3	4+	3-	3+	4+	3-	3+	3-
Tajikistan	6.2	45	2+	4-	2-	3	3+	2-	1	1
Turkmenistan	5.4	25	1	2	1	2	1	1	1	1
Ukraine	49.3	60	3	3+	2	3	3	2+	2	2
Uzbekistan	25.0	45	3-	3	2-	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.

Source: EBRD, 2001 *Transition Report*.

Russia

Russia's macroeconomic fundamentals remain strong, and it is making progress on key structural reforms. Real GDP growth reached 5.2 per cent in 2001, while the federal budget posted a surplus for the second year in a row. Economic growth was supported by robust growth in business fixed investment and consumer spending. The current account surplus is large at 11.2 per cent of GDP, which allowed the central bank to boost its international reserves by US$8.6 billion during the year to US$36.5 billion.

The key risks to Russia's economic outlook in 2002 are its vulnerability to changes in international energy prices and the risk of rising inflation. A deep, sustained fall in energy prices would adversely affect its fiscal and external accounts. While inflation is on a downward trend, at 18.6 per cent (year-over-year) in December, it remains well above that of advanced transition countries. The central bank's expansionary monetary policy framework has led to continued growth in the money supply, which could put upward pressure on inflation.

Russia appears very able to address the large "hump" in its external obligations in 2003 due in part to its proactive liability management, which includes substantial buybacks of sovereign bonds and early repayments of International Monetary Fund debt. Over the last year Russia has implemented structural reforms related to fiscal matters, banking and corporate governance. A number of other important reforms are starting to be addressed, including pension and judicial reforms. Russia has also expressed a desire to become a member of the World Trade Organization (WTO) before the next trade ministerial conference in 2003, but it must first adjust foreign trade legislation to meet WTO standards.

Despite important progress on structural reform, serious weaknesses remain in the overall environment for business, competition and investment in Russia. The low number of small private businesses, persistent capital flight and rather low investment outside of the oil and gas sectors underscore this reality. Although they have showed signs of improvement since the 1998 financial crisis, Russian commercial banks generally remain weak, poorly capitalized, and without reliable sources of profit.

Other CIS Countries

The other CIS countries also experienced slower economic growth in 2001. Lower oil production and falling oil prices contributed to this weakening economic performance for the oil-producing countries, such as Kazakhstan and Azerbaijan. Ukraine was the exception, with real GDP growth reaching about 9 per cent due to strong exports (especially to Russia), continued external competitiveness resulting from the substantial depreciation of its currency in 1998-99, and increased capacity utilization.

Inflation in the region continued to fall, except in Belarus, Tajikistan and Uzbekistan, where delays in implementing reforms led to continued inflationary pressures. Inflation in Ukraine fell to about 12 per cent from 26 per cent in 2000, largely as a result of a good grain harvest, which led to lower food prices.

Despite the implementation of fiscal reforms in many of the CIS countries, the public finances of several countries, particularly Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan, remain weak, primarily due to the interest burden resulting from large and unsustainable public debt levels.

The CIS countries continue to face significant challenges in terms of their central-planning legacy, the extent of structural distortions and the limited capacity of state institutions. In addition, they continue to lag considerably behind Central Europe and the Baltic States in implementing structural reforms (see table on page 9). Nonetheless, difficult structural reforms have begun in a number of countries, notably Armenia, Azerbaijan, Georgia and Ukraine. Turkmenistan was the one country in the region that fell back, regressing from the little progress it had made to date in implementing reforms. It remains to be seen, however, whether further reforms will be undertaken in countries such as Belarus, Uzbekistan and Turkmenistan, where there is little political commitment to market-oriented reforms.

Central Europe and the Baltic States

Real GDP growth in Central Europe and the Baltic States slowed in the latter half of 2001, as exports to the EU fell as a result of the economic slowdown in the EU. However, in some countries, such as the Czech Republic and Hungary, the drop in exports was partially offset by strong domestic demand. Current account deficits were high, at over 6 per cent of GDP, in the majority of countries in Central Europe, leading to substantial external financing requirements. Most of these countries, however, have been able to attract large inflows of foreign direct investment and other external funding, which have offset the current account deficits.

The improvement in economic performance in many countries of Central Europe and the Baltic States over the last few years has been fostered by significant gains in competitiveness due to successful enterprise restructuring and by the creation of market-supporting institutions (fiscal, legal, financial and social). Poland and Hungary, in particular, have advanced significantly in the transition process and appear well poised for long-term sustained economic growth. There are downside risks, however, for a number of countries, with the ability of monetary and fiscal policies to respond to an economic slowdown limited by inflationary pressures (in Hungary, in particular) and rising government deficits (for example, in Hungary and Poland).

Accession to the European Union

Expected accession to the EU has been an important factor underlying economic and political reform efforts in Central and Eastern Europe. Accession negotiations are currently underway with 12 countries: Bulgaria, Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, the Slovak Republic and Slovenia. At least 3 countries (the Czech Republic, Hungary and Slovenia) are expected to have completed their negotiations within the next two years.

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

The EU has also offered the prospect of eventual EU membership for the countries of Southeastern Europe through the Stabilisation and Association Process. Under this process, the EU has started to negotiate Stabilisation and Association Agreements with democratic, reform-minded countries in the region. The Agreements offer the prospect of better trade access, increased assistance for education and institution building, co-operation in the areas of justice and home affairs, formal political relations with the EU and, one day, membership in the EU. It is hoped that the prospect of EU membership will spur reform efforts in Southeastern Europe as it has done in Central Europe and the Baltic States. Thus far the EU has entered into or completed negotiations to establish agreements with FYR Macedonia, Albania, Croatia, Bosnia and Herzegovina, and FR Yugoslavia.

Southeastern Europe

After three years of recession real GDP growth increased in Southeastern Europe in 2000. This growth continued in 2001, primarily due to strong domestic and export demand in the first half of the year. Export demand from the EU fell in the latter part of the year and will likely have a negative impact on growth in 2002. While inflation in the region has been falling, it remains high, especially in FR Yugoslavia and Romania. Current account deficits also remain high. Unlike in Central Europe and the Baltic States, these deficits have been financed primarily by official sources of financing rather than foreign direct investment.

Domestic political changes in several of the countries of Southeastern Europe led to accelerated reform efforts. In both FR Yugoslavia and Albania, improvements in political stability helped to attract new investment and donor financing. FYR Macedonia, on the other hand, was the only country in the region to experience negative growth in 2001, due to continued ethnic conflict and slow progress in implementing reforms.

Canada's Co-operation 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, FR Yugoslavia, FYR Macedonia and Romania.

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

In support of the SEEAP, the Canadian International Development Agency (CIDA) established a C$6-million Cooperation Fund for Southeastern Europe, which is tied to the use of Canadian companies and consultants. In addition, CIDA made an untied contribution of C$2 million to the Balkan Region Special Fund to support priority investment projects in the region.

Canada's assistance has contributed to the efforts of both the EBRD and the international community in supporting the transition process and promoting stability in the region. CIDA's funding has been used for technical assistance and co-financing related to project preparation and implementation, advisory services and capacity building. During 2001 six projects were supported under both funds for a total of C$6.7 million. Three of these projects targeted the transport sector, with the other three focused on municipal infrastructure and capacity building.

2001 *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 operation. Each year the report has a special theme. In 2001 it examined the role of energy in the transition process.

The report notes that the transition economies, like advanced economies, are highly dependent on fossil fuels as sources of energy. At the same time, Russia, Azerbaijan, Kazakhstan, Turkmenistan and Uzbekistan have substantial reserves of oil and gas that could be used to supply the region's demand for energy. Russia is the only country in the region with a well-developed oil and gas sector, however. While the other countries have the potential to become important international suppliers of oil and gas, to be able to fully develop their oil and gas reserves, they need significant investment, much of which will have to come from external sources.

Foreign investment will only be attracted to the region, however, if the countries can offer a stable investment climate and competitive tax arrangements. This requires improved corporate governance and financial transparency on the part of domestic producers, improved state governance, and a shift in the role of the state in the energy sector from that of owner to that of regulator, including over environmental issues. Governments also need to foster competitive market access and improve their management of resource rents in order to ensure longer-term sustainable development of this sector and of their overall economies. In general, however, the energy-producing countries have tended to make less progress on market liberalization and reform than other transition countries, as income from the oil and gas sectors has reduced the fiscal necessity to implement reforms.

The transition economies are also inefficient in their use of energy compared to more advanced countries. While energy efficiency has improved in Central Europe and the Baltic States and in Southeastern Europe, all transition countries lag significantly behind Organisation for Economic Co-operation and Development countries in this area. Slow progress in energy sector reform and inappropriate energy tariff policies have been the main factors delaying improvements in energy efficiency. As a result, energy consumption per capita is higher than in Western European countries, pollution levels remain high, and more environmentally sustainable technologies have not yet been widely introduced.

The report concludes that energy tariff reform is key to improving energy efficiency but cautions that, in order to be politically and socially acceptable, targeted support for poor households to help them pay for increased energy prices will be needed.

Capital Resources Review

The Bank's Articles of Agreement mandate a review of the Bank's capital resources every five years. In 2001 the Board of Governors approved the second review of the EBRD's capital resources. The review focused on ensuring that the Bank's portfolio as a whole reflects the transition objectives and operational priorities of the Bank. In addition, emphasis was placed on balancing the Bank's portfolio across countries, products and risk categories. The review also placed emphasis on accelerating the pace of portfolio growth, both to increase the transition impact of the Bank's activities and to increase the rate of growth of its earnings so as to allow the Bank to cover, on a sustainable basis, its administrative costs and expected losses.

The review noted that between 1995 and 2000, the Bank's portfolio more than doubled, rising from €5.7 billion at the end of 1995 to €12.2 billion at the end of 2000, making the Bank a major investor in the region. It was able to do this despite the Russian financial crisis in 1998, which affected a number of the Bank's countries of operation.

The review noted that over the five years, the Bank's activities had shifted from advanced to early and intermediate transition countries, although activities in the advanced transition countries remain significant.[5] The sector composition of the portfolio has remained broadly stable over the five-year period, with the proportion of shares of the corporate, financial institution and infrastructure sectors remaining around 40:30:30. The private sector share of annual business volume increased from 73 to 78 per cent over the period.

The review confirmed that the doubling of the EBRD's capital to €20 billion following the 1996 capital resources review had been necessary, as by 1998 capital utilization exceeded the original €10 billion capital limit. The review also concluded that the capital increase in 1996 gave the Bank sufficient capital to support its projected medium-term portfolio expansion.

2001 Financial Results

The continued profitability of the EBRD in 2001 reflects high net interest income, significant recoveries from projects that had experienced difficulties, strong treasury results and continued budgetary discipline. The Bank has been able to continue to rebuild its reserves (shareholder capital set aside to cover unanticipated events) by releasing provisioning taken in the aftermath of the Russian financial crisis.

In addition, the level of disbursements grew substantially from 2000. Ultimately, an objective of the Bank is to generate sufficient income to cover its operating costs. In order to achieve this, the Bank's earning asset base must grow, which requires an increasing portfolio of investments.

The increasing access of the advanced transition countries to private capital and financial markets and the continued poor investment climate in many early and intermediate transition countries create a challenge for the Bank. The Bank needs to balance the requirement to apply sound banking principles with the need to provide transition assistance to countries where the investment climate is risky. The financial results for 2001 suggest that, so far, the Bank has managed to achieve this balance. The challenge over the coming year will be to maintain this balance in an environment of slower economic growth.

The EBRD's general administrative expenses in 2001 were within budget and comparable to those for 2000, reflecting continuing budgetary discipline, effective cost controls and a proactive cost-recovery program.

Even before the events of September 11, the slowdown in economic growth in the US and the EU was expected to have a negative impact on the economic growth of the transition countries. The increased uncertainty of world

[5] Advanced transition countries include Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia. Early and intermediate transition countries include the balance of the EBRD's countries of operation, excluding Russia: Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, FR Yugoslavia, FYR Macedonia, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Romania, Tajikistan, Turkmenistan, Ukraine and Uzbekistan. Russia is considered to be in a category of its own by the EBRD.

economic growth presents new challenges to the Bank in the next year as it looks to increase the size of its portfolio through sound investments. Nonetheless, the medium-term prospects for the region remain good. The EU accession process will continue to attract private investment to Central Europe and the Baltic States, while the restoration of some political stability and economic reform in FR Yugoslavia should improve the prospects for Southeastern Europe. In Russia progress in implementing economic reforms has improved its prospects, although the process is far from complete.

Financial Highlights

- Profits after provisions increased to €157.2 million (C$221 million), up from €152.8 million in 2000.[1]
- Provision charges totalled €137.6 million (C$194 million) in 2001, below the €174.3 million in 2000, due to successful asset recovery, particularly in Russia.
- Operating income was €501.5 million (C$705 million), down slightly from €519.2 million in 2000.
- Gross disbursements rose by 67 per cent to €2.4 billion (C$3.4 billion) in 2001 from €1.5 billion in 2000.
- Annual business volume in 2001 reached €3.7 billion for 102 operations, a 37-per-cent increase from 2000. Of this amount, 44 per cent went to advanced transition countries, 33 per cent to early and intermediate transition countries, and 23 per cent to Russia. The annual business volume in the early and intermediate transition countries increased by 14 per cent from 2000, to €1.2 billion from €1.1 billion. In Russia annual business volume increased by 42 per cent to €822 million from €579 million.
- The Bank mobilized €2.7 in additional financing for every euro that it invested in 2001, up significantly from €1.9 in 2000.
- The private sector share of annual business volume was 76 per cent, down slightly from 78 per cent in 2000.
- Administrative expenses, denominated in pounds sterling (the currency in which most of the Bank's expenses accrue), were just below budget at £138.5 million.
- Reserves[2] at the end of 2001 were €488.7 million (C$688 million).

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

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

Institutional Developments

Private Sector Development

A key part of the EBRD's work with the private sector is its support of micro, small and medium-sized enterprises (SMEs), which are potentially important engines for job creation and growth, and therefore poverty reduction, in the region. Canada is a strong proponent of the private sector work of the Bank, recognizing that a strong private sector is key for the successful transition to a market economy. Canada views a strong SME sector as one means for 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 strategy for the SME sector is founded on three pillars: financing, improving the investment climate through policy dialogue, and developing business support networks for SMEs. 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 SME growth, as well as to encourage the development of strong business associations.

About 76 per cent of the EBRD's annual business volume in 2001 was in the private sector, down slightly from about 78 per cent in 2000. In 2001 the EBRD increased the number of credit lines for SMEs to financial intermediaries and expanded its various small business programs. New commitments for SME financing rose to nearly €700 million. In the EU accession countries, the EU/EBRD SME Finance Facility provided €223 million in SME financing to 17 banks, which made, on average, sub-loans of €24,000. The microlending programs disbursed over €650 million through more than 70,000 micro and small loans.

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 2001 the EBRD committed financing to 33 financial sector operations, bringing total EBRD exposure to the financial sector region-wide to €5.9 billion. Financial sector operations represent about 30 per cent of the EBRD's portfolio.

Banking Sector Activities – In 2001 the EBRD signed new loans valued at €591 million to the banking sector and took €184 million in new equity positions in local banks. 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 2001 the EBRD also stepped up its activities in the non-bank financial sector, especially in the EU accession countries, predominantly by taking minority equity stakes in insurance companies and asset management/mutual fund companies, and by expanding its support for leasing activities. A total of seven new transactions were signed in the non-bank financial sector during the year, with new commitments of €93 million. 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 operation develop. By the end of 2001 the Bank had investments in the non-bank financial sector in nearly all the countries in the region, where necessary institutional and regulatory regimes had been or were in the process of being introduced.

Environment

Support for the environment remained a key priority in 2001, reflecting the Bank's mandate to ensure sustainable long-term development in its countries of operation. The Bank fulfills its environmental mandate principally through its projects. In 2001 the Bank provided financing of over €240 million in support of environmental projects, mainly in the areas of municipal infrastructure (water and waste management) and energy efficiency. Other projects also had environmental components, such as reduction in emissions and recycling. In addition, to help address some of the environmental challenges of northern Europe, the EBRD launched the Northern Dimension Environmental Partnership, which focuses on projects aimed at cleaning up the environment in the region, including the Baltic States and northwest Russia.

The EBRD also 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, and the

Helsinki Commission and the Global Environment Facility, for which it became an executing agency in 1999. 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.

The EBRD applies environmental due diligence to all its investment and technical co-operation 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 when a project relates to an existing operation. In some cases both an audit and assessment/analysis are required. 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. In 2001 the EBRD provided financing to 15 environmental projects worth more than €240 million and conducted 56 environmental analyses, 4 environmental impact assessments and 28 environmental audits on projects approved by the Board of Directors.

The EBRD has an Environmental Advisory Council (ENVAC), which provides advice to the Bank on issues related to the EBRD's environmental mandate. ENVAC is composed of environmental experts from both the public and private sector. In 2001 it discussed environmental and social issues associated with oil and gas projects, biodiversity issues and health and safety issues associated with the EBRD's operations.

The EBRD also has an environmental training program, financed primarily by the EU's Phare and Tacis programs. In 2001 environmental training was provided to 22 financial institutions in 14 countries to help them better understand their exposure to environmental risk and the business opportunities that exist in areas such as financing energy efficiency improvements.

The EBRD has also established Corporate Environmental Awards to promote high standards of environmental practice in the Bank's countries of operation. The awards provide recognition to companies that reduce environmental damage through innovative products, services or systems or through implementation of clean production techniques or recycling programs. In 2001 two companies received the award: Pliva, a pharmaceutical company in Croatia, and Polar Lights Company, an oil production company in Russia.

In 2001 the EBRD completed an independent evaluation of 39 of its projects that had strong environmental components and looked at other environmental aspects of the Bank. The evaluation concluded that the Bank has done well in its environmental performance and has been able to improve the overall environmental performance of its projects, especially in the municipal and environmental infrastructure, natural resources, and industry and manufacturing sectors. It has made less progress in improving environmental performance in the energy and transport sectors.

The evaluation also concluded that the EBRD has been able to help companies comply with many of the relevant domestic and EU or World Bank environmental regulations and guidelines and to meet the objectives of the EBRD's Environmental Action Plans. Nonetheless, there is still room for improvement. The Bank could do more through technical co-operation, working with non-governmental organizations (NGOs), and providing more support to environmental and energy service companies.

Municipal and Environmental Infrastructure

EBRD investments in this sector focus on upgrading local facilities, such as municipal waste-water 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 sovereign, 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.

In 2001 the EBRD committed €188 million to nine municipal and environmental infrastructure projects.

Energy Sector Investments

Most of the EBRD's countries of operation suffer from severe economic and environmental problems caused by polluting energy systems and inefficient energy pricing. In 2000 the EBRD reviewed and updated its Energy Operations Policy, which sets out how the Bank intends to promote energy efficiency through its operations. One of the revised policy's key objectives is to improve environmental performance, including meeting climate change objectives and supporting renewable forms of energy. In addition, the 2001 *Transition Report* focused on the energy sector and its role in transition.

In 2001 the Bank committed €364 million to projects in the energy sector, bringing cumulative commitments in this sector to over €1.8 billion. The Bank commissioned a consultant to develop an efficient way of measuring greenhouse gas emissions as part of the Bank's environmental assessment of potential projects.

The EBRD and Nuclear Safety

Canada and other G-7 countries have been working closely with the EBRD to improve nuclear safety in countries of Central and Eastern Europe and in the former Soviet Union. To facilitate this work, Canada has contributed to the Nuclear Safety Account (NSA), which the EBRD administers on behalf of the G-7 countries and other contributors. The NSA is used primarily for making essential safety improvements to older-generation, Soviet-built reactors and to help Ukraine cope with the aftermath of Chernobyl. As of December 31, 2001, pledges to the NSA totalled €261 million (C$367.5 million). Canada has contributed C$19.5 million.

On behalf of the G-7, the Bank has agreed to administer the US$768-million Chernobyl Shelter Fund for securing the sarcophagus around the destroyed – by nuclear accident – Unit IV reactor in Ukraine. The G-7 nations, the EU and other countries have pledged US$716 million, of which Canada has pledged a contribution of US$33 million.

In 2000 three International Decommissioning Support Funds were created 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). The €500 million in grant funds will assist these countries with the early phase of decommissioning as well as with restructuring, upgrading and modernizing the energy production, transmission and distribution sectors, and improving energy efficiency more generally.

In December 2000 the EBRD approved in principle a US$215-million loan to Ukraine’s nuclear operator for the completion of and safety upgrades to the Khmelnitsky Unit 2 and Rovno Unit 4 (K2R4) nuclear power plants. Canada supported this project at the EBRD Board. It considered that this project would contribute to a substantial improvement in nuclear safety and to energy sector reform in Ukraine. In addition, EBRD financing would ensure that K2R4 would be completed to Western safety standards, as it was conditional on assurances that nuclear safety standards in Ukraine would be further improved and properly maintained.

EBRD financing was conditional on the permanent closure of the older Chernobyl 3 reactor, which occurred on December 15, 2000, as well as several other financing conditions. By November 2001 Ukraine had met all the required conditions and the loan was scheduled to go before the EBRD Board for final approval on November 29, 2001. On November 28 Ukraine unexpectedly indicated that it wanted a last-minute renegotiation of some of the loan conditions, specifically the level at which electricity prices were to be set and the total cost of the project. As a result, no decision was taken and any loan agreement now requires a full review of all terms and conditions. Detailed technical discussions are taking place between the EBRD and Ukraine to determine whether a new agreement can be negotiated.

Addressing Corruption and Poor Governance

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

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 and pluralism. These principles, effectively implemented, contribute to transparency in government policy making and act as a check on corruption. Canada fully supports this approach.

In 2001 two countries were found to be weak in meeting their obligations under Article 1: Turkmenistan and Belarus. In both cases an Interim Strategy was approved that limited the Bank's involvement in the countries to the private sector until political reforms were forthcoming and the governments demonstrated a greater commitment to economic reform. In the case of Belarus, when the Interim Strategy was approved in April 2001, EBRD President Jean Lemierre wrote a letter to Belarus President Alyaksandr Lukashenko expressing his strong concern regarding Belarus' lack of commitment to Article 1. This letter was posted on the EBRD's Web site. It was agreed that the Interim Strategy would be reviewed after the September presidential elections. This review is currently underway.

The EBRD seeks to improve governance and transparency largely through the projects it undertakes. Equity investments have been an important tool in this regard. The Bank's participation on the 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 counterparts are examined to ensure they meet the highest standards of business practice. The Bank now routinely seeks the services of forensic accountants and specialized firms to perform integrity checks on potential investee companies and their management and shareholders. For those doing business with the EBRD, the EBRD's public procurement rules underline the standards of ethics and conduct required during the procurement and execution of EBRD-financed projects.

The Bank's work in the area of legal transition also plays an important role in addressing issues of corruption and poor governance. Under its Legal Transition Programme, the Bank has worked to improve the legal environment in its countries of operation 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's Insolvency Initiative, which seeks to develop international principles of bankruptcy, and the Financial Stability Forum's efforts to co-ordinate 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*.

Enhancing Institutional Transparency, Accountability and Governance

Public Information Policy – In 2000 the EBRD modernized its Public Information Policy to broaden significantly the scope of information that the Bank makes available to the public. The 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 now made 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 policy requires management to report annually to the Board on the implementation of the Public Information Policy, which was done in July 2001. These findings are made available on the Bank's Web site.

Canada welcomes this policy as a marked improvement over the previous public access and disclosure of information policy. In all international financial institutions (IFIs) in which it is a member, Canada has been at the forefront of efforts to improve transparency and accountability.

Shipping Operations and Property Policies – New policies were approved in 2001 for operations in the shipping sector and in the property sector. In line with the Public Information Policy, drafts of both policies were posted for 45 days on the EBRD's Web site and public comments were taken into account when the policies were finalized.

Manager of Outreach/NGO Relations – The Manager of Outreach/NGO Relations serves as a point of contact between the Bank and the NGO community, as well as other stakeholders and interested person. This position was created and staffed in 2001.

Chief Compliance Officer – The Chief Compliance Officer is responsible for promoting good governance within the Bank and ensuring that all employees respect the highest standards of business integrity. The Chief Compliance Officer has developed a training program for EBRD nominees to boards of directors of those enterprises in which the Bank has invested to ensure the nominees are fully aware of their responsibilities and possible actions that could breach the Bank's integrity. The Chief Compliance Officer also provides guidance to EBRD management and staff on appropriate behaviour and helps to develop Bank policies and procedures regarding misconduct.

Encouraging Partnerships

The EBRD is required by its founding agreement to involve outside sources of financing in its operations. By virtue of its guarantees to a project, the Bank can play 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 2001 the EBRD worked with 62 commercial banks from 21 countries on 33 projects, for a total co-financing of nearly €2 billion.

The EBRD also works with donor countries to provide financing for institution building and technical co-operation. Such funding has played a significant role in promoting transition.

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 2001 the EBRD worked with other IFIs on 18 projects involving €489 million in co-financing. Key partners for the EBRD included the World Bank, the Asian Development Bank, the European Investment Bank and the International Finance Corporation.

Canada has encouraged greater co-operation and co-ordination among multilateral development banks and is pleased with the efforts of the EBRD to work more closely with its sister institutions, where possible.

Changes in Senior Management

The Bank appointed a new First Vice President of Banking in 2001, Noreen Doyle, who assumed her responsibilities in September 2001. Prior to this appointment, Ms. Doyle was the EBRD's Deputy Vice President, Finance. Steven Kaempfer was reappointed Vice President, Finance. Ayesa Shah was appointed the new Treasurer in early 2002. Dorina Calorianu was appointed the first Manager of Outreach/NGO Relations.

New Members

The Bank expanded its membership to include FR Yugoslavia in January 2001.

Canadian Priorities in 2001

Canada is a strong supporter of the Bank's medium-term operational priorities, which are premised on: (1) the central importance of creating and strengthening those institutions – administrative, behavioural and financial – that ensure markets work well and (2) the key role that small businesses can play in creating dynamic, competitive and more equitable economies. These are key challenges facing all the countries in transition, particularly those in the CIS and Southeastern Europe. Canada supports the Bank's focus on:

- developing sound financial sectors linked to the needs of enterprises and households;
- providing leadership for the development of microlending 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 issue of accession to the EU by some of the EBRD's countries of operation and the role, if any, the EBRD might continue to play in those countries are key questions that will need to be addressed over the next two to three years. Indeed, one measure of the Bank's success could be considered to be the number of countries that make the successful transition to a market economy and no longer need its financing.

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 supports this requirement and believes it is appropriate for the Bank to limit its participation to the private sector in those countries not living up to their Article 1 commitments.

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 co-operatively with other IFIs and donors in the region. Canada strongly supports this approach. Co-ordination 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 Paul Martin, Minister of Finance, is the Canadian Governor and Mr. Gaëtan Lavertu, 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 4 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 was Patrice Muller until September 1, 2001. Mr. Muller was succeeded by Scott Clark. The Minister (Economic/Commercial) at the Canadian High Commission in London, 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 Finance and Economic Analysis Division of the Department of Finance. In consultation with the Department of Foreign Affairs and International Trade and 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 a member of the Financial and Operations Policies Committee, which reviews financial policies, including the Bank's borrowing policy, general policies relating to operations, and procedures and reporting requirements. Until the change in Director, the Canadian Director was also a member of the Budget and Administrative Affairs Committee, which considers general budgetary policy, proposals and procedures, as well as personnel, administrative and organization matters, including administrative matters relating to Directors and their staff.

Positions Taken in 2001 – 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.

To ensure EBRD operations remain additional and contribute to the transition process, Canada continued to advocate increased Bank efforts to find sound projects in those countries in the early and intermediate stages of transition that respect the principles of multi-party democracy and are making efforts at reform. In our view, only by focusing on quality will the Bank contribute to advancing transition in these countries. In the advanced transition countries, Canada has underlined the need for Bank financing to be additional, as the Bank's Articles of Agreement state that it should not displace financing available from the private sector on reasonable terms. Therefore we have urged the Bank to be innovative by seeking out niche activities and developing new financial products in the advanced transition countries where private sector financial and capital markets are increasingly active.

Canada has also been a strong proponent of greater EBRD transparency and shareholder accountability, believing that the Bank should be a model of behaviour for the region; thus it supported the revision of the Public Information Policy. Canada has also strongly supported measures to strengthen internal governance at the Bank to ensure that all staff function at the highest standards of business integrity, as well as efforts to strengthen the budget process.

Canadian Staff at the EBRD – Canadians are well represented on EBRD staff. At the end of 2001 there were 24 Canadian professionals on the staff of the EBRD, representing about 4 per cent of total professional positions, which slightly exceeds Canada's 3.4-per-cent share of the institution's capital. It is noteworthy that a Canadian heads the Baltic Team and another Canadian is Director of Communications.

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 as determined by consultations with their constituencies. The Canadian Director abstained or voted against the following policies and projects in 2001:

- He abstained on a subordinated loan of between €12.4 million and €24.9 million to Lukas Bank (Poland) because of concerns about low additionality of the Bank's resources.
- He voted against a US$25-million loan to ISTIL, a Ukrainian steel mill. Canada has always expressed the opinion that oversupply in the sector should be addressed in a comprehensive, multilateral manner.

Canadian Commercial Interests

The EBRD offers a number of investment opportunities for Canadian businesses and financial institutions. A key task of the Canadian Office is 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 Department of Foreign Affairs and International Trade and Industry Canada, the office also identifies EBRD procurement opportunities and, with CIDA, promotes Canadian technical co-operation activities and official co-financing with the EBRD.

In 2001 the EBRD's Board of Directors approved EBRD participation in two Canadian-sponsored transactions. The aggregate size of these two projects is €169.4 million (C$238.5 million), of which EBRD financial commitments are €62.3 million (C$87.7 million). A description of the transactions is given in Annex 2. Additionally, in 2001 a Canadian bank acted as a lead arranger of a major EBRD syndicated loan in Central Europe, which was the first time a Canadian financial institution participated in the EBRD's syndicated loan program since the Russian financial crisis of 1998. Details of this transaction are also included in Annex 2.

With respect to official co-financing and technical co-operation, in 2001 the EBRD committed €3.7 million (C$5.2 million) from the CIDA-EBRD Cooperation Fund for Southeastern Europe to co-finance Bank transactions in the railway sector in Bosnia and Herzegovina and FR Yugoslavia. Procurement of goods and services under this arrangement commenced in the second half of 2001 and is limited to Canadian firms. In addition, Canadian consultants were awarded €345,816 (C$486,909) in EBRD technical co-operation and TurnAround Management assignments in 2001 to assist the Bank with energy efficiency in Poland and telecommunications regulatory reform, airport modernization and shipbuilding restructuring in Russia.

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 co-operation 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 five visits to Canada in 2001 to meet with business people, conduct seminars, speak at conferences and consult with government officials. This included the Canadian Director meeting with Canadian businesses and financial institutions in Toronto. In addition, the Assistants to the Director promoted the EBRD to the Canadian business community through meetings with: representatives of the mining industry at the Annual Meeting of the Prospectors and Developers Association of Canada in Toronto in March; representatives of the Canadian oil and gas industry in Calgary; and a large number of Canadian firms in Montréal and Toronto from a wide range of sectors, as part of a stronger EBRD marketing initiative in Canada. One of the Director's Assistants also took part in presentations of the EBRD 2001 *Transition Report* to business people and academics in Toronto and to government authorities in Ottawa in November.

The Canadian Office met with approximately 140 Canadians during 2001, including business people, representatives of financial intermediaries, government representatives (from all three levels of government), NGOs, consultants and academics.

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

- the Canadian Director working with the Canadian missions in Moscow and St. Petersburg in preparation for the Team Canada visit to Russia in 2002;
- the participation of the Canadian Director's Assistant in a commercial mission to Hungary, organized by the World Trade Centre in Montréal and led by the Mayor of Montréal, which focused on municipal and environmental infrastructure; and
- attendance of the Director's Assistant at the inaugural Canada-Poland Gas and Energy Forum in Warsaw, which was organized by Export Development Canada and the Canadian Embassy in Warsaw.

Challenges Ahead

In assisting its countries of operation over the second decade of transition, the EBRD will face significant challenges in expanding and managing its portfolio. In the advanced transition countries, which are increasingly able to obtain private sector financing, the Bank will have to develop new products and activities in order to remain additional. In the early and intermediate transition economies and Russia, the challenge will be to find quality projects in a high-risk environment that is characterized by a lack of market-supporting institutions. Over the coming decade the Bank will have to work in close partnership with other international financial institutions to address these challenges. Expanded co-operation with these institutions 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 the region to move forward with politically difficult but essential reforms, particularly the restructuring or closure of large enterprises.

Good governance continues to play a critical role in the future success of the region. Good corporate governance is one key aspect of this role. The state also has a strong role to play in supporting an enabling investment climate by promoting sound institutions, administering tax collection and improving legal and regulatory frameworks. It must ensure not only that appropriate legislation is developed, but also that it is properly implemented and enforced.

The first decade of transition has provided clear lessons for the future. Countries that have achieved more rapid and comprehensive reforms – particularly in liberalizing markets and trade, respecting government budget constraints and fostering the private sector by removing obstacles to the entry and exit of enterprises – have laid solid foundations for sustaining progress in reform. 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 appropriate macroeconomic policies, are laying the foundation for sustained rapid growth and increased access to international capital markets.

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.

Contacting the Office of the Director for Canada

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

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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:

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Annex 1

The Bank's Financial Activities

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

Ordinary Capital Resources

At the end of 2001 the total authorized capital of the Bank was €20 billion (C$28 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 2001 Canada made its fourth 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 instalments of US$12,145,331.25 (40 per cent in cash and 60 per cent in non-interest-bearing demand notes encashed over five years). Under the initial capital, 30 per cent was paid-in over five years (split evenly between cash and notes encashed over a three-year period) and 70 per cent was callable. Canada completed payments for the initial capital in April 1997. The table on the next page details Canadian payments to the Bank in US dollars.

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

Canadian Payments to the EBRD

Year	Notes	Cash	Encashment of notes	Total cash outlay
		(in US dollars)		
1991	11,903,502	11,903,502	11,903,502	23,807,004
1992	11,903,502	11,903,502	3,967,834	15,871,336
1993	11,903,502	11,903,502	7,935,668	19,839,170
1994	11,903,502	11,903,502	11,903,502	23,807,004
1995	11,903,502	11,903,502	11,903,502	23,807,004
1996	–	–	7,935,668	7,935,668
1997	–	–	3,967,834	3,967,834
1998	7,287,198	4,858,132	1,457,440	6,315,572
1999	7,287,198	4,858,132	2,914,879	7,773,011
2000	7,287,198	4,858,132	4,372,319	9,230,451
2001	7,287,198	4,858,132	5,829,759	10,687,891
Total	88,666,302	78,950,038	74,091,907	153,041,945

Market Borrowings

At the end of 2001 total outstanding debt was €11.5 billion (C$16.2 billion) with an average maturity of 9.4 years at an average cost of funds of LIBOR (London Inter-Bank Offered Rate) minus 30 basis points. Funds have been swapped into floating-rate instruments, primarily in US dollars, euros and Deutsche Marks.

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:

The Canadian Technical Cooperation Fund – The main purpose of this fund is to provide financing to hire Canadian consultants for EBRD projects. Canada has contributed C$12.65 million since the fund was established in 1992.

Chernobyl Shelter Fund – The main purpose of this fund is to secure the sarcophagus around the destroyed Unit IV nuclear reactor in Ukraine. The total estimated cost of this eight-year project is US$768 million, of which US$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 operation until the plants can be closed. The NSA complements other bilateral and multilateral nuclear safety technical assistance and functions in parallel with multilateral efforts to achieve broader energy sector reform in the region. Canada has contributed C$19.5 million to the total fund of €261 million (C$367.5 million).

Russia Small Business Fund (RSBF) – The purpose of this fund is to establish a facility for small business finance and microlending 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) – In support of the EBRD's South Eastern Europe Action Plan, CIDA has contributed C$8 million for technical co-operation and co-financing activities in Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Romania and FR Yugoslavia (Kosovo, Montenegro and Serbia). Of this amount, C$6 million has been made available to the EBRD through the CFSEE for technical co-operation and co-financing tied to Canadian consultants and suppliers. The remaining C$2 million has been provided to the EBRD for untied co-financing of critical investment projects under the Bank's Balkan Region Special Fund.

TurnAround Management 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 1999 Canada made its first contribution of C$550,000 to this program, to be used to hire Canadian advisors.

Ukraine Micro Finance Bank (MFB) – In 2000 CIDA entered into a contribution agreement with the EBRD to provide C$1.25 million over two years for the provision of technical assistance related to the development of the MFB. The MFB will 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 will also serve 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 2003 CIDA will provide C$3 million for technical assistance services by qualified Canadian organizations to Ukrainian commercial banks receiving loans under the EBRD's Ukraine Micro, Small and Medium-Sized Enterprises Line of Credit II for on-lending to micro, small and medium-sized enterprises. The technical assistance will include risk- and loan-evaluation training.

Annex 2

EBRD – Canadian-Sponsored Project Activity in 2001

Date of Board approval	Canadian company	Project country	Project name	Type of financing	Sector	EBRD commitment (€ millions)	Total project cost (€ millions)
February 2001	Capcom (subsidiary of Caisse de dépôt et placement du Québec)	Regional	TIME Capital Communications Fund	Equity	Tele-communications, informatics and media	53.4	160.2
November 2001	High River Gold Mines Ltd.	Russia	Buryatzoloto Power Line	Corporate loan	Natural resources	8.9	9.2
Total						62.3	169.4

EBRD – Canadian Commercial Co-Financing in 2001

Date of Board approval	Canadian co-financier	Project country	Project name	Type of financing	Sector	EBRD commitment (€ millions)	Total project cost (€ millions)
July 2001	Canadian Imperial Bank of Commerce (acting as a lead arranger)	Hungary	Vivendi Telecom Hungary	Syndicated debt	Tele-communications, informatics and media	100.0	350.0

Annex 3

Doing Business With the EBRD

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

Canadian Project Sponsors: Canadian companies interested in potentially sponsoring a project with the EBRD are requested to direct initial inquiries either to Project Inquiries in London (tel: +44 20 7338 6282 or +44 20 7338 6252; fax: +44 20 7338 6102) or to the Bank's resident office in the country of operation. Summaries of EBRD private sector operations can be obtained on the Bank's 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 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 Data on Consultants (DACON) registration system. Although it is not required for consultants to register with DACON to be eligible for EBRD assignments, it is nonetheless advisable as it is a useful marketing tool. Requests for DACON registration packages should be sent directly to:

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

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

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

ANNEX 4

EBRD MEMBERSHIP AS AT DECEMBER 31, 2001

	Share of the Bank's capital		Share of the Bank's capital
	(%)		(%)
European Members		**Countries of Operation**	
Austria	2.28	Albania	0.10
Belgium	2.28	Armenia	0.05
Cyprus	0.10	Azerbaijan	0.10
Denmark	1.20	Belarus	0.20
Finland	1.25	Bosnia and Herzegovina	0.17
France	8.52	Bulgaria	0.79
Germany	8.52	Croatia	0.36
Greece	0.65	Czech Republic	0.85
Iceland	0.10	Estonia	0.10
Ireland	0.30	FR Yugoslavia	0.47
Israel	0.65	FYR Macedonia	0.07
Italy	8.52	Georgia	0.10
Liechtenstein	0.02	Hungary	0.79
Luxembourg	0.20	Kazakhstan	0.23
Malta	0.01	Kyrgyzstan	0.10
Netherlands	2.48	Latvia	0.10
Norway	1.25	Lithuania	0.10
Portugal	0.42	Moldova	0.10
Spain	3.40	Poland	1.28
Sweden	2.28	Romania	0.48
Switzerland	2.28	Russia	4.00
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
		Uzbekistan	0.21
Non-European Members			
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		