

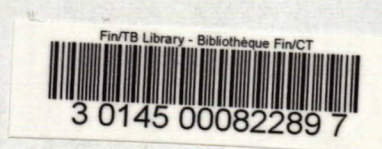


Department of Finance
Canada

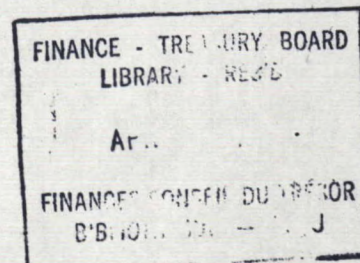
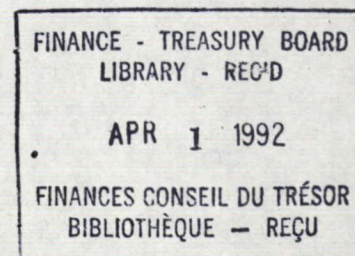
Ministère des Finances
Canada

REPORT ON OPERATIONS
UNDER
THE EUROPEAN BANK FOR RECONSTRUCTION
AND DEVELOPMENT AGREEMENT ACT
1991

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INTRODUCTORY NOTE

In conformity with Article 7 of the European Bank for Reconstruction and Development (EBRD) Agreement Act, this report reviews the operations during 1991 of the EBRD. Canadian participation in these institutions was authorized under the EBRD Agreement Act, passed by the House of Commons on January 21, 1991.

Negotiations on establishing the Bank began in Paris on January 15, 1990, and were concluded on May 29, 1990 with the signing of the Agreement establishing the Bank. On April 15, 1991, the Bank was inaugurated in London, and Mr. Jacques Attali (France) was elected by the Bank's Board of Governors as its first President.

Headquartered in London, the EBRD is the newest multilateral development bank. The EBRD is designed to further economic development and social progress among the former Communist countries of central and eastern Europe.¹ As stated in its Articles of Agreement, the main purpose of the EBRD is to foster the transition towards open market-oriented economies and to promote private and entrepreneurial initiative in the central and eastern European countries committed to and applying the principles of multiparty democracy, pluralism and market economics.

The EBRD functions as a development bank, much in the same way that the World Bank and other regional development banks serve their respective borrowing regions. However, the EBRD is distinctive in three areas from these banks. The **first** characteristic is the Bank's overriding focus on the private sector. Its Charter stipulates that not less than 60 per cent of its financing will be directed either to: private sector enterprises; or to state-owned enterprises implementing a programme to achieve private ownership and control. **Secondly**, the Bank's mandate gives it a particular concern for the promotion of democratic institutions and human rights in its countries of operations. Finally, a **third** characteristic to the EBRD is its commitment to environmental protection and restoration.

1. References to central and eastern Europe in this report also include countries of the former USSR.

The Bank provides loans, equity investment and debt guarantees. The activities of the EBRD are divided into ordinary and special operations, depending on the source of funding. Ordinary operations are those financed from the ordinary capital resources of the Bank which comprise the Bank's subscribed capital, its borrowings, income from ordinary loans and investments. Special operations are those financed from Special Funds, which are funds accepted by the Bank for inclusion in a Special Fund, e.g. technical assistance. On June 25, 1991, the EBRD Board of Directors approved its first loan. On September 25, 1991, the Bank issued its first bond of ECU 500 million ².

Detailed information on the policies and operations of the EBRD can be found in the forthcoming EBRD Annual Report, due to be released in mid-April.

2. Figures in this Report are expressed in terms of European Currency Units (ECUs), the unit of account for all EBRD transactions. The ECU is a composite currency, consisting of the fixed amounts of the currencies of the twelve member states of the European Economic Community (EEC). In 1991, the value of the ECU varied between US\$1.1200 and US\$1.4180, and averaged US\$1.2400.

The European Bank for Reconstruction and Development (EBRD)

The idea of a European development bank was first promoted by President Mitterand of France in December 1989, to pledge support for the transition toward market economies and pluralist democracies in eastern Europe.

Given the urgency perceived by western economies, the EBRD was created within five months. The first discussions were held in Paris on January 15, 1990 and were attended by 36 nations. On May 29, 1990, 40 nations and two European institutions (i.e. the European Economic Community - EEC - and the European Investment Bank - EIB) reached final agreement on the Bank's charter, its initial size, and the distribution of power among shareholders. At the end of 1991, there were 42 shareholders of the Bank. (During 1991, Albania completed membership requirements.) On April 15, 1991, the Bank was inaugurated in London, and Mr. Jacques Attali (France) was elected by the Bank's Board of Governors as its first President.

Economic Developments in Central and Eastern Europe

The countries of central and eastern Europe, including the newly-independent states of the former-Soviet Union, differ widely in terms of natural resources and level of human capital. However, they all share one common characteristic: growth has been inhibited by a system of economic organization that discouraged individual incentive and inventiveness. The transition to an incentive-oriented system requires considerable effort and assistance to ensure that reform occurs as quickly and smoothly as possible. The international financial and economic institutions, including the EBRD, have assisted reform efforts throughout the region by providing much-needed technical advice on the workings of market economies.

Although market-based reforms have been endorsed in all countries in the region, the pace of reform has been uneven. Poland, Hungary, Czechoslovakia, Bulgaria, and Romania are further along the road to reform which can be attributed to the fact that the degree of social consensus on the need for reform is strongest in these countries. This has enabled these governments to introduce the most-comprehensive economic reforms

including IMF-supported economic programmes to reduce imbalances and enhance the effectiveness of structural reforms. The programmes combine tight macroeconomic policies with wage controls to control inflation. Czechoslovakia and Poland have also fixed their exchange rates to help fight inflation.

The monetary and fiscal restraint inherent in these programmes have already generated benefits in terms of closing the most-pronounced macroeconomic imbalances. Restraint has contributed to a severe contraction of output in the region, however, and unemployment has increased significantly. Output stagnated in 1989 and contracted in 1990. Real GDP is expected to fall by a further 10 per cent in 1991, implying a cumulative drop of 17 per cent since 1989. Most international economic observers expect the contraction in output to be reversed in 1992. The IMF, for example, projects a moderate increase in output in 1992, largely as a consequence of increased private sector activity. This projection is contingent, however, on the maintenance of the necessary systemic reforms and the adherence to tight macroeconomic policies so that inflation is controlled and external imbalances contained.

The situation in the former USSR is more difficult. The authorities in the newly-recognized successor states to the USSR, have generally affirmed their belief that only market-based reforms can reverse the problem of secular economic decline. There is, however, an urgent need to provide these authorities with responsible policy advice. IMF membership, which Canada supports, would give these countries two important benefits: first, it would give them access to the expertise of the Fund staff in the design and implementation of economic policies; and second, it would make Fund financial resources available to assist in the transition process. Fund advice is particularly important for these countries given the enormous problems that confront the authorities.

The most pressing problem is a severe contraction of economic activity: some estimate that the level of economic activity declined by as much as 20 per cent during 1991. The outlook for this year is for a further output decline unless corrective action is taken. In the view of most observers, the cause of this economic collapse can be traced to earlier reform efforts, which weakened the forces of the central planning system, but did not foster the development of market forces. As a consequence, there was no system governing the allocation of resources.

The Russian government implemented a broad programme of economic reform in early 1992 in an attempt to reverse the economic decline. The initial phase of Russian economic reforms consists of:

- the liberalization of most prices, and a three- to five-fold increase in prices of goods kept under administrative control;
- trade and exchange rate reforms, including the introduction of a dual exchange rate system; and
- decrees calling for the privatization of state enterprises, shops, and agricultural land have also been issued.

Prices have increased significantly as a consequence of the liberalization, and there has been a predictable public backlash against the reforms. The ultimate success of the reforms depends crucially on the ability of the Russian government to stabilize the internal and external value of the rouble. This is contingent on the resolve of the government to restrain money creation and to impose fiscal discipline.

Purpose and Functions of the EBRD

The primary purpose of the EBRD is to foster the transition towards democracy and open market-oriented economies, and to promote private and entrepreneurial initiative in the countries of central and eastern Europe. The Bank's mandate gives it a particular concern for the promotion of democratic institutions and human rights in its countries of operations.

Its function is to lend and invest exclusively for projects and investment programmes in its countries of operations. The Bank is a unique combination of merchant bank and development bank. Its Charter stipulates that not less than 60 per cent of its financing will be directed either to private sector enterprises or to state-owned enterprises implementing a programme to achieve private ownership and control. However, there is a grace period of two years, i.e. until April 15, 1993, for the Bank to comply with this 60 per cent limit. The purpose of the grace period is to permit the Bank to support at the outset public sector infrastructure projects designed to assist private sector development.

There are two operations departments at the EBRD: Merchant Banking; and Development Banking. The Merchant Banking group is responsible for the financing of private or "privatizable" enterprises in the competitive sector. The Development Banking section focusses on physical and financial public infrastructure projects.

Environmental Concerns

The Bank is directed by its Agreement to promote, in the full range of its activities, environmentally sound and sustainable development. This is the first time that an international financial institution has been given, in its founding charter, a clear and proactive mandate on environmental protection and restoration. Each Bank project is screened at an early stage by environmental staff to determine the level of environmental information required.

Human Rights Issues

The Bank monitors progress toward multiparty democracy in each of its countries of operations to ensure that they adhere to the Bank's mandate and seek to encourage civil and political rights (e.g. right to life and physical integrity, freedom from arbitrary arrest and detention, freedom of thought, expression and association, right to participate in politics and respect for election results, freedom of religion and from discrimination, right to form and join trade unions and to strike) as well as economic rights such as right to private property, which are essential to the full development of multiparty democracy and pluralism. If a country of operations implements policies inconsistent with the Bank's mandate, the Bank may postpone, restrict or suspend some or all of its operations. For instance, because of the worsening civil conflict since the independence declarations of the republics of Slovenia and Croatia in June 1991, the EBRD Board of Directors decided to restrict Bank activities to transactions with those parties in Yugoslavia contributing to the resolution of the conflict by peaceful means and procedures.

EBRD RESOURCES

The activities of the Bank are divided into ordinary operations and special operations, depending on the source of funding:

(i) Ordinary Capital Resources

The authorized capital of the Bank is ECU 10 billion (approximately US\$13 billion), divided into 1 million shares. The authorized capital is comprised of paid-in shares and callable capital in the proportion of three to seven. The callable capital of ECU 6.9 billion is subject to call only if it is required to meet the Bank's liabilities.

Of the EBRD's authorized capital, ECU 3.0 billion or 30 per cent is to be paid by shareholders in hard currency in equal annual installments over five years, half in promissory notes and half in cash. At the end of 1991, out of the ECU 9.85 billion subscribed capital of the Bank, ECU 591.2 million had already been paid-in. The remaining ECU 2.36 billion will be paid within the next four years.

(ii) Borrowings

On June 18, 1991, Standard & Poor's, an international bond rating agency, assigned a AAA long-term and A-1+ short-term ratings to the EBRD debt issues, reflecting the Bank's high capital ratio. Moody's rating is also AAA. On September 4, 1991, the Board of Directors authorized a global borrowing programme equivalent to ECU 800 million until December 31, 1992. Subsequent to Directors' authorization, the Bank successfully launched its first long-term borrowing of ECU 500 million.

(iii) Technical Assistance and Cooperation Funds

Cooperation Funds are grants from bilateral donors provided for technical assistance activities, administered by the Bank, for the preparation, financing and implementation of projects. As of December 31, 1991, the Bank had entered into eleven bilateral agreements for an aggregate amount of approximately ECU 68 million. At the end of 1991, Canada had not concluded its negotiations with the Bank on an intended contribution of C\$1 million to the Bank's Technical Cooperation Fund.

Loans and Equity Investments

Between the inauguration of the Bank in April 1991 and the end of the year, the Board of Directors approved fourteen projects for investment in the Bank's countries of operations. The total amount committed in loans and equity investments was ECU 427.5 million (approximately US\$570 million), i.e. 11 loans amounting to ECU 393.7 million and 3 equity investments totalling ECU 33.8 million. Some projects were geared towards improving infrastructure such as in the field of telecommunications and energy. There were three equity financings for direct investments in private enterprises. Attached is a table detailing the financing approved in 1991.

Due to the fact that most of the loans were approved in the latter part of the year, only three loans have been signed. Since no disbursements had been made, there were no outstanding loans at the end of 1991.

In addition to ordinary resources, the Bank approved, in 1991, total commitments of ECU 8.5. million funded from bilateral cooperation funds for activities in the environment related operations, financial sector, and the field of privatization.

Canada and the EBRD

Canadian Representation on EBRD Executive Boards

Mr. Don Mazankowski, Deputy Prime Minister and Minister of Finance, is the Canadian Governor and Mr. Reid Morden, the Under Secretary of State for External Affairs, is the Alternate Governor. Mr. Don McCutchan is the Canadian Director and Mr. Robert Mackenzie is the Alternate Director. Mr. McCutchan also serves as Director for Morocco.

Funds Subscribed and Committed

Canada's share of EBRD capital is ECU 340 million or 3.45 percent of the Bank's subscribed capital. Canada paid-in ECU 20.4 million in 1991 and will pay-in the remaining ECU 81.6 million over the next four years, leaving ECU 238 million subject to call.

Canadian Goods and Services for Projects Financed by the EBRD

No disbursements were made on loans or equity financings approved by the Bank in 1991. Therefore, it is not possible to report on Canada's performance with respect to its share of EBRD disbursements. This is also true for Canada's share of international contracts financed by the EBRD, because no such contracts had been awarded due to the fact that only three loans had been signed in the latter part of the year.

Canadian Personnel

There were 8 Canadian nationals on the staff of the EBRD at the end of 1991; all 8 were in professional positions. In addition, 1 Canadian is employed, on contract, as a consultant. Canadians accounted for about 4.4 per cent of the Bank's professional staff in 1991.

EBRD - LOAN APPROVALS IN 1991
(Million)

DATE OF APPROVAL	COUNTRY	PROJECT	AMOUNT OF FINANCING	EQUIVALENT IN ECU *
June 25	Poland	Bank of Poznan (WBK) (heat supply project)	US\$ 50.00	37.29
Sep. 24	Hungary	Petofi Nyomba Rt. (packaging co.)	DM 10.00	4.91
Sep. 24	Regional	NMB/EBRD Central Europe Agency Line	US\$ 40.00	29.83
Nov. 26	Poland	Polska Telefonii Komorkowa (cellular phones)	US\$ 60.00	44.75
Nov. 26	Poland	LODOM (cold storage facility)	US\$ 2.20	1.64
Nov. 26	USSR	Enhanced Digital Network (EDN)	US\$ 6.50	4.85
Nov. 26	USSR	Parker Siberia (drilling rigs)	US\$ 12.45	9.28
Dec. 18	Romania	Rom Telecom (expansion of telephone networks)	ECU 142.00	142.00
Dec. 18	Hungary	Hungarian Telecommunications Company	DM 185.00	90.89
Dec. 18	Romania	GEC Alsthom-IMGB (power generation equipment)	ECU 23.00	23.00
Dec. 18	Poland	IBG Food Processing	DM 10.70	5.26
			TOTAL	393.69

EBRD - EQUITY INVESTMENTS APPROVED IN 1991
(Million)

DATE OF APPROVAL	COUNTRY	EQUITY INVESTMENTS	AMOUNT OF FINANCING	EQUIVALENT IN ECU *
Sep. 24	CSFR	Czechoslovakia Investment Corporation Inc.	US\$ 10.00	7.46
Dec. 18	CSFR	Investment in Cokoladovny (food manufacturer)	CKr 975.00	24.10
Dec. 18	Hungary	Investment in Microsystem Rt (computer co.)	US\$ 3.00	2.24
			TOTAL	33.79

* Exchange rates as of December 31, 1991.