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

2003

Canada

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Prepared by:
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Copies of this annual report may be obtained from the:

Distribution Centre
Department of Finance Canada
Room P-135, West Tower
300 Laurier Avenue West
Ottawa, Ontario K1A 0G5
Telephone: (613) 995-2855
Facsimile: (613) 996-0518

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Introduction

The European Bank for Reconstruction and Development (referred to in this document as the EBRD or the Bank) was established in 1991. Its aims are to foster the transition towards open, market-oriented economies in Central and Southeastern Europe, as well as in the successor states of the former Soviet Union, and to promote private and entrepreneurial initiative in those countries that are committed to the fundamental principles of multi-party democracy, pluralism and a market economy (see Annex 3 for a list of the EBRD's 27 countries of operations).

The EBRD differs from other multilateral development banks in four ways. First, its overriding focus is the private sector and support for the transition from central planning to stable market economies. Its charter stipulates that not less than 60 per cent of its financing commitments should be directed either to private sector enterprises or to state-owned enterprises implementing a program to achieve private ownership and control. Second, it has a particular focus on the promotion of democratic institutions and human rights in its countries of operations. Third, while all multilateral development banks are committed to ensuring the environmental sustainability of their projects, the EBRD is the only such institution where this commitment is explicitly written into its Articles of Agreement. Fourth, the EBRD does not provide concessional financing.

The Bank seeks to help its 27 countries of operations to implement structural and sectoral economic reforms, taking into account the particular needs of countries at different stages in the transition process. In particular, its private sector activities focus mainly on enterprise restructuring, including the strengthening of financial institutions, and the development of infrastructure needed to support the private sector. The EBRD has 62 members: 60 countries, the European Union (EU) and the European Investment Bank (see Annex 3 for a list of members).

Canada is the eighth largest shareholder (tied with Spain), following the other Group of Eight (G-8) countries. 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 2003.

Benefits of Membership

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

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

The EBRD

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

Role and Mandate of the EBRD

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

In promoting economic transition in its countries of operations, the Bank acts as a catalyst for increased flows of financing to the private sector. The capital requirements of these countries cannot be fully met by official multilateral or bilateral sources of financing, and many foreign private investors remain hesitant to invest in the region, particularly the central Asian republics. By providing an umbrella under which wider funding for private sector investment can be assembled, the EBRD plays a catalytic role in mobilizing capital. In 2003, for every euro the EBRD invested, it mobilized an additional 1.4 euros from the private sector and other multilateral and bilateral agencies.[1] Commercial co-financing mobilized by the EBRD reached a record volume of 2.6 billion euros in 2003, up 30 per cent from the previous high in 2001.

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

Key Economic Developments in 2003

Most of the transition economies experienced economic growth in 2003, showing considerable resilience in the face of sometimes difficult external conditions. Most countries in the region continued to perform well in comparison with other emerging markets. The exception continues to be the poorer countries in the Commonwealth of Independent States (CIS),[2] where the reform process continues to lag and uncertain climates continue to discourage domestic and foreign investment. The process of transition to market-based economies continued to advance in most of the EBRD's countries of operations. The results of the Bank's annual exercise in assessing key transition indicators are summarized in the table on the next page.

[1] On December 31, 2003, one euro purchased 1.6279 Canadian dollars.

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

Progress in Transition in EBRD Countries of Operations

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	Infra-structure: Infra-structure reform
Albania	3.4	75	2+	4	2	4-	4+	2-	2+	2-	2
Armenia	3.0	70	3+	4-	2+	4+	4+	2	2+	2	2+
Azerbaijan	8.1	60	2	4-	2+	4	4-	2	2+	2-	2-
Belarus	10.0	25	1	2+	1	3-	2+	2	2-	2	1+
Bosnia and Herzegovina	4.3	50	2+	3	2	4	4-	1	2+	2-	2+
Bulgaria	8.1	75	4-	4-	3-	4+	4+	2+	3+	2+	3-
Croatia	4.6	60	3+	4+	3-	4	4+	2+	4-	3-	3-
Czech Republic	10.3	80	4	4+	3+	4+	4+	3	4-	3	3
Estonia	1.4	80	4	4+	3+	4	4+	3-	4-	3+	3+
FYR Macedonia	2.0	60	3	4	2+	4	4+	2	3	2-	2
Georgia	5.4	65	3+	4	2	4+	4+	2	2+	2-	2+
Hungary	10.0	80	4	4+	3+	4+	4+	3	4	4-	4-
Kazakhstan	14.9	65	3	4	2	4	3+	2	3	2+	2+
Kyrgyzstan	4.7	65	3	4	2	4+	4+	2	2+	2	1+
Latvia	2.4	70	3+	4+	3	4+	4+	3-	4-	3	3-
Lithuania	3.7	75	4-	4+	3	4+	4+	3	3	3	3-
Moldova	4.3	50	3	3+	2-	4-	4+	2	2+	2	2
Poland	38.7	75	3+	4+	3+	4+	4+	3	3+	4-	3+
Romania	22.3	65	3+	4-	2	4+	4	2+	3-	2	3
Russia	145.4	70	3+	4	2+	4	3+	2+	2	3-	2+
Serbia and Montenegro	8.6	45	2+	3	2	4	3+	1	2+	2	2
Slovak Republic	5.4	80	4	4+	3	4+	4+	3	3+	3-	2+
Slovenia	2.0	65	3	4+	3	4	4+	3-	3+	3-	3
Tajikistan	6.2	50	2+	4-	2-	4-	3+	2-	2-	1	1+
Turkmenistan	5.4	25	1	2	1	3-	1	1	1	1	1
Ukraine	49.3	65	3	4	2	4	3	2+	2+	2	2
Uzbekistan	25.0	45	3-	3	2-	3-	2-	2-	2-	2	2-

Note: The classification of transition indicators uses a scale from 1 to 4, where 1 implies little or no progress with reform and 4 implies a market economy. A rating of 4+ indicates the country has achieved standards and performance typical of advanced industrial economies.

Source: EBRD, 2003 *Transition Report*.

Russia

Russia's economic growth is estimated to have increased by 7.3 per cent in 2003, up from 4.7 per cent in 2002. This stronger growth is largely the result of higher oil prices and an increase in oil production. Buoyant exports have kept the government budget in surplus (1.7 per cent of gross domestic product [GDP] in 2003), despite fiscal slippage in the midst of the election cycle (parliamentary elections were held in December 2003 and presidential elections are scheduled for March 2004). The ruble appreciated by over 9 per cent against the US dollar in 2003, despite active intervention by the central bank. Foreign exchange reserves increased by US$30 billion over the year, reaching a historic high of US$77.8 billion in December (or the equivalent of 18.3 per cent of GDP). The large accumulation of foreign reserves, however, hampered efforts to reduce inflation within the 10–12 per cent target range for 2003.

Economic growth since the 1998 financial crisis has been mainly driven by temporary factors such as the gain in competitiveness from the post-crisis real depreciation of the ruble and the upturn in oil prices. The benefits of these factors, however, are beginning to dissipate.

In order to promote more sustainable growth, Russia would need to diversify its economy by implementing reforms aimed at attracting investment in the non-energy sector and at improving the investment climate more generally. Substantial progress was made in implementing structural reforms in 2001 and 2002, but further progress slowed during the 2003–04 election cycle. Nonetheless, considerable progress has been achieved recently in improving productivity and strengthening corporate governance, and this has put the economy on a stronger footing. The main challenge ahead is to ensure that key structural reforms in the banking and corporate sectors are implemented.

Other CIS Countries

Other oil-exporting CIS countries also recorded rapid economic growth in 2003. This strong growth largely reflected oil windfalls and rising fixed investment in resource-based sectors. Kazakhstan recorded the strongest economic growth in the CIS in 2003, with real GDP estimated to have expanded by 9.2 per cent, down only marginally from the 9.5-per-cent rate in 2002. Azerbaijan's economy also maintained strong growth momentum, mainly due to a continuing investment boom in the oil and gas-related sectors. This resource-driven expansion, however, has only had a limited impact on the efforts on increasing employment and reducing poverty. As is the case in Russia, these countries face the challenge of diversifying their economic base away from the natural resource sector and managing the complications that can arise from large and volatile foreign exchange inflows.

Among the remaining CIS countries, which are less well endowed with natural resources, Ukraine is estimated to have recorded real GDP growth of 9.3 per cent in 2003, up substantially from the 4.8-per-cent level recorded in 2002. This stronger growth is largely the result of more favourable world market conditions for the country's principal exports—steel and chemicals. More favourable economic conditions in 2003 provided the government with some room to reduce public debt and to increase foreign exchange reserves.

The poorest CIS countries (Armenia, Georgia, Moldova, Kyrgyzstan, Tajikistan and Uzbekistan) have achieved only modest economic growth over the past few years, with Armenia showing the best progress in the transition process. Per capita income still remains very low in all of these countries relative to other CIS countries. Poverty is widespread and these countries are increasingly reliant on concessional loan and grant financing from multilateral and bilateral donors. Reforms must urgently address the chronically poor investment climates and weak institutions if these countries are to enjoy stronger growth over the medium and longer term.

Central Europe

The economies of Central Europe[3] again showed considerable resilience in 2003, despite weakness in much of the global economy and poor growth in the EU. The economies of the Central European and Baltic countries are anticipated to have increased by an average of 2.5 per cent in 2003. The Baltic States continued to register the strongest growth, with GDP growth in Latvia reaching 7.2 per cent. A long-overdue resurgence in the Polish economy, where growth is estimated to be up by 3.7 per cent, is also boosting the average growth rate in the region. Poland's stronger economic growth can be attributed mainly to a significant easing of fiscal and monetary policy.

Large fiscal and current account imbalances have characterized Poland, Hungary, and the Czech and Slovak republics for the past few years, and foreign direct investment is beginning to decline. Consolidated general government deficits in these countries have exceeded 4 per cent of GDP over the past two years. In addition, much of the recent fiscal expansion has resulted from discretionary spending. Fiscal problems have had an impact on the exchange rate of the Hungarian forint, which fell to a historic low in December 2003. The Hungarian finance minister was forced to resign in January 2004, when the 2003 fiscal deficit was reported. The deficit, at 5.6 per cent of GDP, was higher than forecast.

Once the eight accession countries join the EU in May 2004, however, addressing these fiscal problems will need to be a high priority. Under the EU's Stability and Growth Pact, these countries will have to reduce their deficits to the Pact's 3-per-cent deficit/GDP maximum. At the same time, however, many of these countries will face pressures to fund various programs to raise internal standards to EU levels.

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

Accession to the European Union

Accession to the EU has been an important factor underlying economic and political reform efforts in Central Europe. At the Copenhagen Summit in December 2002, the EU reached agreement on a timetable for final accession for the first wave of candidate countries. The Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia will become full members of the EU in May 2004. At the same time, a roadmap was articulated for the accession of Bulgaria and Romania, which is expected in 2007.

The EBRD, European Commission and World Bank have signed a memorandum of understanding (MOU) 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 imminent accession of the first wave of candidate countries has raised important issues concerning the operationalization of the interagency MOU and its interaction with the graduation policies of the World Bank and EBRD.

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 agreements with democratic, reform-minded countries in the region. These offer the prospect of better trade access, increased assistance for education and institution building, cooperation 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.

Southeastern Europe

Recent political and economic stability, fostered by increasing cooperation among Southeastern European countries and closer ties between them and the EU, has helped the region increase economic growth rates over the past few years.[4] In 2003, GDP in the region increased by an estimated 3.9 per cent, down slightly from the 4.5-per-cent level achieved in 2002. Within the region, growth in Albania has been strongest, with GDP estimated to have grown by 6 per cent in 2003. Growth in the two EU accession candidates (for entry in 2007), Bulgaria and Romania, is estimated to have achieved 4.5 per cent and 4.9 per cent respectively in 2003. FYR Macedonia experienced a substantial increase in growth in 2003, following a contraction in GDP that coincided with a flare-up in inter-ethnic conflict in 2001. Although economic performance is improving in the region, GDP per capita still lags considerably behind the countries of Central Europe. Even in a relatively advanced country such as Bulgaria, which has been spared the ethnic tensions evident elsewhere in the region, GDP per capita remains less than one-third that of the Czech Republic or Hungary.

Southeastern European countries are continuing the difficult process of fiscal adjustment. Fiscal deficits, though still high in some countries in the region, have decreased substantially, with the average for the region estimated to have been 2.9 per cent of GDP in 2003. As in Central Europe, large fiscal deficits tend to be accompanied by large and persistent current account deficits, averaging 8.6 per cent of GDP for Southeastern Europe as a whole in 2003. The risks associated with these twin deficits are exacerbated by the region's large infrastructure expenditure requirements, falling aid flows and an onerous debt burden.

The region has only had very limited success in financing its high investment requirements through private capital flows. Except for Romania and Bulgaria, most capital inflows to the region have been in the form of official aid, which is now beginning to decline. Southeastern European countries will need to attract higher private flows in order to compensate for falling aid.

[4] Southeastern Europe includes Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Former Yugoslav Republic of Macedonia (FYR Macedonia), Romania, and Serbia and Montenegro, which became a member of the Bank in early 2001. Kosovo is a province of Serbia.

Canada's Cooperation With the EBRD in Southeastern Europe

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

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

In 2000, Canada contributed $2 million to the Balkan Region Special Fund (BRSF) to support post-conflict reconstruction efforts in the Balkan region. In that same year, Canada created the Cooperation Fund for Southeastern Europe (CFSEE) in support of the SEEAP. As part of the first phase of this fund, the Canadian International Development Agency (CIDA) contributed $10 million. Between 2000 and 2002, $6.3 million of this fund was used to support six projects. In 2003, the remaining $3.7 million of the fund was used to support three new projects. These nine projects in total have targeted the transport sector, municipal infrastructure, local enterprise and capacity building.

In March 2003, CIDA launched a second $6-million phase of the CFSEE project, to build upon the results of Phase 1. This second phase will run until March 2005 and will adhere to the more focused programming approach outlined in CIDA's Strategy for the Balkan region. Funds will target countries CIDA has identified as priority countries—Bosnia and Herzegovina and Serbia and Montenegro—and will concentrate on priority sectors (financial institutions and municipal, environmental and regional infrastructure).

Canada's total contribution of $18 million to the CFSEE and BRSF is being used for technical assistance and co-financing related to project preparation and implementation, advisory services and capacity building. Our assistance has contributed to the efforts of both the EBRD and the international community in supporting the transition process and in promoting stability in the region.

2003 *Transition Report*

The *Transition Report* is an annual publication of the EBRD that charts the progress of transition from a centrally planned to a market economy in each of the Bank's 27 countries of operations. Given that eight EBRD countries of operations are on the threshold of EU membership, regional integration was chosen as the special theme of the 2003 report. The report notes that the process of the integration of transition countries into the world economy has not been uniform, with more rapid progress in the countries of Central Europe. The accession of most of these economies to the EU will have a significant impact on the structure of regional trade as well as on migration patterns—both legal and illegal. The countries of Southeastern Europe and the former Soviet Union are much less integrated into the world economy, and Central European accession raises a danger of further marginalization of some of these countries.

The 2003 *Transition Report* outlines three means of dealing with the problem of limited international integration of Southeastern European and former Soviet countries. First is the need to improve market access to EU markets. Second is the need for these countries to press ahead with institutional and structural reforms. The *Transition Report* recommends that greater EU market access should be granted in parallel with such reforms. Finally, the report suggests that there should be closer regional cooperation to complement the process of international integration. The report points to the EU's Stabilisation and Association Process with the countries of Southeastern Europe. In the case of the former Soviet countries, where trade is limited by obstructive domestic and regional trade policies as well as distance from other markets, more attention is needed to improving regional cooperation on trade and transit issues.

2003 Financial Results

2003 marked another strong year for EBRD financial performance. The institution earned a profit after provisions of €378.2 million. This compares very favourably with the €108.1 million figure recorded in 2002. The EBRD continued to see a reduction in its impaired assets (non-performing loans) in 2003. At December 31, 2003, the EBRD had 19 impaired loans totalling €125.2 million, compared with 23 such loans in 2002 totalling €204.5 million at the end of the year. The EBRD's general administrative expenses in 2003 were £132.8 million, compared to £142.0 million at the end of 2002. This performance reflected continuing budgetary discipline, effective cost controls, a proactive cost-recovery program and a renegotiation of its Headquarters building rental contract.

The EBRD approved 119 projects in 2003, up from 102 the previous year. These commitments totalled €3.7 billion, down slightly from €3.9 billion in 2002, but within the €3.5-billion to €3.9-billion target range of the Bank's medium-term operational strategy. Net cumulative commitments by the end of 2003 amounted to €22.7 billion. The level of disbursements, at €2.1 billion, was slightly lower than the €2.4 billion recorded in 2002. While the EBRD reports operations in euros, many of its commitments and disbursements are made in US dollars. Therefore, the depreciation of the US dollar lowered the euro value of its operations in 2003. In addition to disbursements, EBRD guarantees increased by 31 per cent to €342 million at the end of 2003.

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 continue to be a challenge for the Bank.[5] The Bank needs to continue to balance the requirement to follow sound banking principles with the need to provide transition assistance to countries where the investment climate is risky. The financial results for 2003 suggest that, so far, the Bank continues to achieve this balance.

Financial Highlights

- The Bank recorded €3.7 billion of new operations in 2003, a decrease of €200 million from 2002. Of this amount, 39 per cent was approved for early and intermediate transition economies in the former Soviet Union and Southeastern Europe. The remaining 61 per cent was roughly equally divided between Russia and the advanced transition economies of Central Europe and the Baltic States.
- While the institution reports its financial results in euros, the depreciation of the US dollar in 2003 reduced the euro value of EBRD operations, given that many of its operations (and especially those in CIS countries) are transacted in US dollars.
- Profits after provisions rose to €378.2 million, which compares favourably to the €108.2 million amount in 2002.
- Total provisions on banking assets were €1.1 billion at the end of 2003, compared to €1.2 billion at the end of December 2002.
- Gross disbursements, at €2.1 billion, were down slightly from 2002.
- The Bank mobilized €1.4 in additional financing for every euro that it invested in 2003, compared to €1.2 in 2002.
- The private sector share of annual business volume was 79 per cent, up significantly from the 71 per cent reported in 2002.
- Administrative expenses, denominated in pounds sterling (the currency in which most of the Bank's expenses accrue), were £132.8 million, continuing a 10-year trend of no real increases in approved budgets. Indeed, actual administrative expenses in 2003 were somewhat below the approved budget for the year.
- Reserves[1] at the end of 2003 were €989.6 million, up considerably from €661.1 million at the end of 2002.

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

[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 operations, excluding Russia: Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, FYR Macedonia, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Romania, Serbia and Montenegro, Tajikistan, Turkmenistan, Ukraine and Uzbekistan. Russia is considered to be in a category of its own by the EBRD.

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 important engines for job creation and growth, and therefore poverty reduction. 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 of developing a "constituency for reform" in the transition economies that can act as a counterweight to powerful vested interests that benefit from weak state governance.

The Bank's 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 79 per cent of the EBRD's annual business volume in 2003 was in the private sector, compared to 71 per cent in 2002 and 76 per cent in 2001, continuing the Bank's trend of exceeding its 60-per-cent minimum requirement by a wide margin. In 2003, the EBRD continued its strong focus on supporting credit lines for SMEs through financial intermediaries in its countries of operations. Since the Bank's first small business program was established in 1994, more than 450,000 loans worth more than US$3.0 billion have been disbursed to small and micro businesses. In 2003, the EBRD disbursed 197,802 loans for small and micro enterprises, totalling roughly US$1.2 billion.

Activities in the Financial Sector

Financial Sector Policy—The EBRD's financial sector policy takes a country-specific approach to financial sector development, focusing on the need to promote confidence and competition in an independent financial system. The EBRD seeks to strengthen confidence in the sector primarily by helping to improve local institutions' governance and business practices. It also tries to improve financial supervision and regulation, although its activities here are constrained by its investor role in the sector and potential concerns about conflict of interest. Nonetheless, as a reputable foreign investor in the sector, the EBRD offers important insights on supervisory and regulatory requirements, which it shares with other international financial institutions operating in the region and with governments. To address competition and independence, EBRD investments attempt to increase the diversity of institutions and services available (particularly to the private sector and SMEs), facilitate foreign direct investment and strengthen the commercial orientation of state-owned financial institutions, particularly in preparation for privatization.

In 2003, the EBRD committed €1.2 billion in financing to financial sector operations. Financial sector operations represented about 32 per cent of the EBRD's entire business for 2003.

Banking Sector Activities—In 2003, the EBRD signed new loans valued at €333 million to the banking sector, and signed 10 equity transactions with 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 2003, the EBRD also stepped up its activities in the non-bank financial sector. New commitments of €83 million were made under the EBRD's micro and small enterprise program. The EBRD is one of the largest financial investors in this sector, with investments in local asset management and mutual fund companies becoming increasingly important as voluntary pension sectors in the Bank's countries of operations develop. By the end of 2003, the Bank had investments in the non-bank financial sector in most of the countries in the region, where necessary institutional and regulatory regimes had been or were in the process of being introduced. The EBRD also substantially expanded its financing of insurance companies, leasing companies and specialist mortgage lending institutions in 2003. New business totalled €295 million and was focused mainly in advanced transition countries.

Environment

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

Following consultations in London, Russia, Hungary and Azerbaijan, the EBRD revised its Environmental Policy in 2003 to cover occupational and safety issues as well as core labour standards. The revisions also expand the EBRD's public consultation process and information disclosure with respect to project environmental impact assessments. The revised policy also requires, from 2004, that the Bank publish annual environmental reports.

Apart from the initiatives to specifically redress environmental weaknesses, many EBRD projects include environmental targets—for example, to reduce atmospheric emissions and industrial wastewater discharges and promote waste recovery, recycling and clean technologies.The EBRD contributes to international initiatives such as the "Environment for Europe" process, including the Environmental Action Plan for Central and Eastern Europe, the Danube River Basin Strategic Action Plan, and the Helsinki Commission and the Global Environment Facility, for which it is an executing agency. In 2003, the EBRD signed its first project in cooperation with the multi-donor Global Environment Facility (GEF). The project consisted of loans to participating banks in Slovenia for on-lending to private and public sector entities investing in projects that reduce water pollution flowing into the Slovene portion of the Danube River. The project is also the first private sector initiative in the GEF's portfolio of projects to reduce the pollution in international waters.

In 2003, three projects were approved for support under the recently created Northern Dimension Environmental Partnership (NDEP). The NDEP[6] provides donor funding to address severe environmental problems in northwest Russia, particularly in the areas of nuclear waste, water and wastewater treatment, and energy efficiency. Within the framework of its mandate, the EBRD supports relevant multilateral and regional agreements on the environment and sustainable development, including the Framework Convention on Climate Change and the measures agreed to in the Kyoto Protocol. Canada became an official contributor to the NDEP Support Fund at the end of 2003 and has committed €20 million. This made Canada, apart from Russia, the NDEP's sole non-European partner. Canada earmarked its contribution for the facility's "nuclear window," and this counts towards Canada's commitment to the G-8 Global Partnership program. To deal with nuclear waste, the NDEP provides full funding within an international cooperation framework designed to address the complex challenges of cleaning up the legacy of the Soviet navy's Northern Fleet.

In October 2003, together with the government of the Netherlands, the Bank launched a special EBRD Carbon Fund under the Joint Implementation (JI) mechanism of the Kyoto Protocol. This is one of the first such JI funds in Europe. Through this fund, the EBRD will purchase for the Netherlands greenhouse gas emission reductions (or carbon credits) earned through EBRD investments in renewable energy and energy efficiency projects in transition economies.

The EBRD applies environmental due diligence to all its investment and technical cooperation operations. Project sponsors are required by the Bank to undertake environmental impact assessments, analyses and audits that address potential environmental, health and safety, and socio-economic impacts of projects. Environmental impact assessments and analyses are

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

conducted when potential impacts are significant. Environmental audits are performed post-approval. In some cases, both an audit and an assessment/analysis are performed. The EBRD also requires local financial intermediaries, through which it channels funds to micro, small and medium-sized enterprises, to adopt appropriate environmental policies and procedures.

Municipal and Environmental Infrastructure

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

Over the last few years, the EBRD has increasingly relied on municipal, as opposed to 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 2003, the EBRD provided financing of more than €188 million to projects designed to improve municipal infrastructure and promote energy efficiency. About half of these projects were in EU accession countries.

Energy Sector Investments

Most of the EBRD's countries of operations suffer from severe economic and environmental problems caused by polluting energy systems and inefficient energy pricing. Under its Energy Operations Policy, the Bank promotes energy efficiency through its operations. One of the policy's key objectives is to improve environmental performance, including meeting climate change objectives and supporting renewable forms of energy.

In 2003, the Bank approved one of its largest energy sector investments to date, totalling US$310 million for two related projects: the Baku-Tbilisi-Ceyhan (BTC) pipeline from Azerbaijan through Georgia to the Turkish coast and the Azeri-Chirag-Deepwater Gunashli (ACG) Phase 1 oilfield in the Caspian Sea offshore from Azerbaijan. The EBRD's decision to finance BTC and ACG reflects the importance of both projects in unlocking the economic potential of the resource-rich Caspian Basin. In addition to improving the prospects for sustainable economic development, EBRD (and International Finance Corporation) participation in the two projects brings increased transparency and improves business and environmental standards in Azerbaijan and Georgia.

The EBRD and Nuclear Safety

Through the Nuclear Safety Account (NSA), 15 donors, including Canada and other G-7 countries, have continued to work closely with the EBRD to improve nuclear safety in countries of Central and Southeastern Europe and in the former Soviet Union. The NSA is used primarily for making essential safety improvements to older-generation, Soviet-built reactors and to help Ukraine cope with the aftermath of Chernobyl. Total pledges to the NSA are €273 million.

The Bank has continued to administer the Chernobyl Shelter Fund for securing the sarcophagus around the Unit IV reactor in Ukraine (which was destroyed by nuclear accident). The G-7 nations, the EU and other countries have pledged US$716 million (of the original estimate of US$768 million), of which Canada has pledged US$33 million. In 2003, the conceptual design for the new shelter was completed and the overall budget revised to approximately US$1 billion. The Bank launched the first major tenders for the active construction phase of the Shelter Implementation Programme.

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

Discussions between the EBRD and the government of Ukraine on financing for the completion of the Khmelnitsky Unit 2 and Rovno Unit 4 (K2R4) nuclear reactors continued during 2003. Since demanding a renegotiation of some of the loan conditions in November 2001, the government of Ukraine has largely completed the K2R4 reactors on its own. Ukraine is now suggesting that potential EBRD financing be focused on supporting safety upgrades alone. An independent assessment of the safety of Ukraine's completion work is expected to be concluded in early 2004, and it will inform the EBRD-Ukrainian financing discussions.

Addressing Corruption and Poor Governance

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

From this standpoint, the domestic policies of both Turkmenistan and Belarus were of particular concern as they are difficult to reconcile with the political and economic conditions set out in Article 1 of the Bank's Articles of Agreement. As a result, the Bank's lending programs in Turkmenistan and Belarus are restricted to the private sector. The Bank's country strategies for these two countries link the level and nature of the Bank's involvement to the extent of improvement in the political and economic situation. Without improvement in these areas, these two countries will continue to be excluded from direct EBRD investments in the state sector.

The human rights situation in Central Asia, and Uzbekistan in particular, was highlighted in 2003, when the EBRD Board of Governors held its Annual Meeting in Tashkent, Uzbekistan. Canada's acting Alternate Governor stressed the important link between human rights, the rule of law, economic reform and a climate conducive to attracting investment. In his remarks to the Annual Meeting, Bank President Jean Lemierre noted Uzbekistan's weak performance and stressed that the level of future Bank operations would depend on progress in improving human rights. Uzbekistan's progress towards the political and economic benchmarks set out by the Bank in its March 2003 country strategy for the country was monitored over the course of 2003, and an assessment of performance will be conducted in early 2004. Early indications would not lead us to expect a positive assessment.

To a large degree, the EBRD seeks to enhance good governance and transparency in its countries of operations through the projects it undertakes. Equity investments have been an important tool in this regard. The Bank's participation on the boards of directors of companies in which it invests has been instrumental in improving the transparency of their accounting and business practices and their respect for minority shareholder rights. It is hoped that the success of these companies will demonstrate the importance of applying similar practices more broadly in the region. In addition, all Bank business partners are examined to ensure they meet the highest standards of business practice. The Bank routinely seeks the services of forensic accountants and specialized firms to perform integrity checks on companies in which it might invest and on their management and shareholders. For those doing business with the EBRD, the EBRD's public procurement rules set the standards of ethics and conduct required during the procurement and execution of EBRD-financed projects.

The Bank's work in the area of legal transition also supports these goals. Under its Legal Transition Programme, the Bank has worked to improve the legal environment in its countries of operations by advancing legal reform in six areas: bankruptcy, company law/corporate governance, concessions, financial market regulation, secured transactions and telecommunications. In addition, the Bank has participated in international standard-setting efforts, including the World Bank's Insolvency Initiative, which seeks to develop international principles of bankruptcy, and the Financial Stability Forum's efforts to coordinate the development and implementation of international financial standards. The Bank also initiated a project with the Russian Federal Commission for the Securities Market to develop a Corporate Governance Code and helped the CIS Inter-Parliamentary Assembly draft a model securities law. To promote transparency the EBRD publishes an annual survey of the extensiveness and effectiveness of various commercial laws in the region in its legal journal, *Law in Transition*.

Enhancing Institutional Transparency, Accountability and Governance

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

The Bank's Public Information Policy was reviewed and revised in 2003 to enhance transparency and to expand communications with stakeholders. As a result, the scope of information made available to the public will increase through the publication of certain project evaluation documents and the posting on the Bank's Web site of a schedule of forthcoming Board of Directors discussions. In addition, the process of public consultation will be strengthened. Under its revised policy, the Bank will post on its Web site an invitation (with an accompanying management note) for the public to provide input into the preparation of each new EBRD country strategy. Bank management has also committed to translate, on a pilot basis, future approved country strategies into local languages. The Bank will also translate the three documents that constitute the framework for its interaction with the public: the *Public Information Policy*, the *Environmental Policy* and the document which established an Independent Recourse Mechanism.

In April 2003, the Bank's Executive Board approved the creation of the Independent Recourse Mechanism, which has the mandate to resolve complaints concerning Bank compliance with its own policies. This is in addition to the Manager of Outreach/NGO Relations, who serves as a point of contact between the Bank and the NGO (non-governmental organization) community.

The EBRD's strengthened framework for interaction with the public has already yielded results, with the Bank's investments in the Baku-Tbilisi-Ceyhan pipeline and Azeri-Chirag-Deepwater Gunashli Phase 1 oilfield project being prime examples. Thanks to EBRD and International Finance Corporation (IFC) participation, the development of these projects involved an unprecedented level of consultation and transparency with NGOs and affected groups in the sponsoring countries. The EBRD and IFC held public meetings in Azerbaijan and Georgia to seek input from local communities.

To be accountable to its shareholders and its stakeholders, the EBRD evaluates its projects, usually within two years after full disbursement, to assess the extent to which the projects have met their objectives. In 2003, 83 per cent of the Bank's evaluated projects received an "Excellent-Satisfactory" rating for their "transition impact" potential.

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

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

Encouraging Partnerships

The EBRD is required by its founding agreement to involve outside sources of financing in its operations. The Bank plays a key role in attracting co-financiers that might not otherwise be willing to invest in the region. Co-financing has the benefit of increasing a country's access to international capital markets, promoting foreign direct investment and allowing appropriate risk sharing. The EBRD's main co-financing partners are commercial banks, government agencies, export credit agencies and other IFIs. In 2003, the EBRD worked with 75 commercial banks on 61 projects, for total co-financing of €2.6 billion.

The EBRD also works with donor countries to provide financing for institution building and technical cooperation. Such funding has played a significant role in promoting transition. 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 2003, the EBRD worked with other IFIs on projects involving €303 million in co-financing. Key partners for the EBRD included the World Bank, the Asian Development Bank, the European Investment Bank and the IFC.

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

Human Resources

At end December 2003, the EBRD had regular staff of 946 at its Headquarters, down from 955 in 2002. Locally hired staff in the Bank's Resident Offices totalled 206, down from 218 in 2002. There are approximately twice as many male professional staff as female professional staff.

Canadian Priorities in 2003

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

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

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

The EBRD is the only multilateral financial institution that has an explicit requirement that its members be committed to and apply principles of multi-party democracy and pluralism. Canada fully supports this requirement and believes it is appropriate for the Bank to limit its participation in those countries not living up to the principles embodied in Article 1.

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

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

Managing Canada's Interests

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

Role of the Board of Directors—The Board of Directors, which is responsible for the general operations of the Bank, is composed of 23 members, of which 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 is Mr. Scott Clark. The Minister (Economic/Commercial) at the Canadian High Commission in London, Mr. David Plunkett, is the non-resident Alternate Director and represents Canada in the absence of the Canadian Director.

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

Functions of the Canadian Director—In addition to participating in regular Board meetings, the Canadian Director is a member of the Board of Directors' Audit Committee, which reviews the integrity and soundness of the Bank's policies and practices as well as the independence and performance of the Bank's internal controls. The Audit Committee also reviews reports of the Bank's External Auditor. The Canadian Director also participates in all meetings of the Board of Directors' Financial and Operations Policies Committee and the Budget and Administrative Affairs Committee.

Positions Taken in 2003—The Canadian Director has frequently spoken to the Board on the importance of the Bank's charter requirement that member countries be committed to market reform and multi-party democracy.
In 2003, Canada's Director spoke on the need to address issues related to the disregard for human rights and democratic principles, especially in Uzbekistan. Canada's Director also spoke strongly on the need to rigorously apply the additionality test for projects in EU-accession countries and stressed the importance of the Bank's goal of shifting operations to the south and east to early and intermediate transition economies.

To ensure EBRD operations are additional (i.e. do not replace private sector investment) and contribute to the transition process, Canada continued to advocate increased Bank efforts to find sound projects in countries that are in the early and intermediate stages of transition, respect the principles of multi-party democracy and are making efforts at reform. In our view, only by focusing on quality projects 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 increasingly focused and strategic 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, accountability to shareholders and improved internal governance, believing that the Bank should be a model of behaviour for the region.

Canadian Staff at the EBRD—Canadians are well represented on EBRD staff. At the end of 2003, there were 24 Canadian professionals on the staff of the EBRD, representing 3.8 per cent of total professional positions, in line with Canada's 3.4-per-cent share of the institution's capital. It is noteworthy that a Canadian is Director of Communications and that a Canadian also heads the Procurement and Purchasing Department.

Canada's Voting Record

Canada and other shareholders typically raise concerns and questions about specific Bank operations before they get to the Board. As a result, decisions at the Board are generally taken by consensus. Directors may, however, abstain or vote against projects in consultation with their constituencies. The Canadian Director abstained or voted against the following policies and projects in 2003:

- A €20-million equity investment in Lafarge Slovenia, a cement company in Slovenia, on the grounds of a lack of additionality; a €2-million portage equity investment in Wienerberger, for the construction of a brick factory in Romania, because of a lack of additionality; a €60-million loan to Karelsky Okatysh in Russia because of concerns about the global overcapacity in the steel industry; two projects in Uzbekistan—a US$30.5-million loan to the City of Tashkent to finance the modernization of its heating system and a US$13-million loan to Bursel Tashkent Textile, for the construction and operation of a textile plant—given concerns about Uzbekistan's lack of progress in improving its human rights record.
- The Director for Canada abstained on proposed modifications to the Bank's Public Information Policy because of concerns that the changes did not go far enough to fulfill the Bank's commitment to transparency and accountability. While he supported improvements made to the policy, he questioned management's rationale for issuing "management notes" in lieu of draft country strategies as a basis for public consultations.

Canadian Commercial Interests

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

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

In 2003, 16 contracts that totalled €2.9 million were awarded to Canadian consultants across a variety of sectors and countries.

With respect to technical cooperation, in 2003 the EBRD committed approximately €3.1 million of Canadian technical cooperation funds for projects in several countries of operations. Canada signed a new agreement with the EBRD's TurnAround Management Programme to provide €1.5 million over five years to be used to hire Canadians to work as advisors to SMEs in EBRD countries of operations. Under this agreement, Canadian advisors were awarded contracts totalling €85,000 to assist with airport modernization in Serbia. Under the CIDA-EBRD Cooperation Fund for Southeastern Europe, Canada committed approximately €634,000 to finance a public consultation and awareness program in Serbia and Montenegro, a standard-setting for charges registers in the Balkans, the provision of an air transportation advisor, as well as the provision of support for the conduct of due diligence for an EBRD Direct Investment Facility that provides equity investments to SMEs in the region. Canada committed €1.1 million through its Canadian Technical Cooperation Fund. These commitments supported transportation and environmental projects in Russia as well as the financing of a Canadian bankruptcy specialist to work within the EBRD's Legal Transition Team. After January 1, 2004, Canada will no longer fund technical cooperation assignments in the Central European and Baltic countries that are acceding to the EU. In 2004, CIDA and the EBRD will work to align more closely their technical cooperation activities with CIDA programming priorities.

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

Promoting Canada's Interests

Members of the Canadian Office made a number of visits to Canada and the EBRD's countries of operations in 2003 to meet with business people, conduct seminars, speak at conferences and consult with government officials. A highlight for the year was the September investor outreach visit to Toronto, Montréal and Calgary, where the Canadian Director and the First Vice President for Banking met with representatives of the Canadian business and investment communities to explain the role of the EBRD and showcase opportunities for Canadian companies.

The following events in 2003 supported by the Canadian Director's office also promoted Canada's commercial interests:

- The Director, Advisor and representatives from the Bank's Infrastructure and Commercial Co-financing Units travelled to Ottawa, Winnipeg, Calgary and Vancouver in June to meet with Canadian consultants and officials on opportunities to mobilize technical cooperation funds at the EBRD.
- The EBRD's Deputy Chief Economist travelled in December to Toronto and Ottawa to present to business and government officials the key findings of the Bank's 2003 *Transition Report* on developments in the business and economic environments of the Bank's countries of operations.
- The Director and Advisor met in December with representatives of Canadian companies at the Paris Pollutec 2004 conference and trade show to explain how to do business with the EBRD.
- Officials from the Canadian Director's office participated with representatives of the EBRD's Co-financing and Trade Facilitation programs in Export Development Canada's Programme on Financing Trade and Investment in Russia, the CIS and the Balkans, which was held in Toronto and Ottawa in December and targeted to the Canadian banking and export communities.

Members of the Canadian Office met with approximately 90 Canadians in 2003, including business people, representatives of financial intermediaries, representatives from all levels of government, NGO representatives, consultants and academics.

Challenges Ahead

In assisting its countries of operations over the second decade of transition, the EBRD will face significant challenges in expanding and managing its portfolio. In particular, the advanced transition countries, most notably those acceding to the EU, are increasingly able to obtain private sector financing. This suggests the need to focus the Bank's activities on those areas that represent real additionality and have sufficient transition impact to warrant the use of Bank resources.

In Russia, given the volatility of oil prices, priority will need to be given to promoting investment in a wide range of sectors, including the financial sector. In the early and intermediate transition economies, the challenge will be to find quality projects in a high-risk environment that is characterized by a lack of market-supporting institutions. Given that the Bank's focus will be shifting more to the south and east, the Bank will be reviewing how it operates in early and intermediate transition countries, with a view to increasing both the effectiveness and the volume of its activities in these countries. The Bank must continue to work in close partnership with other international financial institutions. Expanded cooperation will also be necessary to develop high-transition impact projects with explicit social and poverty alleviation benefits in order to strengthen the willingness of governments in some of the least advanced transition economies to move forward with politically difficult but essential reforms, particularly the restructuring or closure of large state-owned enterprises.

The transition experience of the Bank provides clear lessons for the future. Countries that have achieved more rapid and comprehensive reforms—particularly in liberalizing markets and trade, respecting government budget constraints, fostering the private sector by removing obstacles to the entry and exit of enterprises, and promoting democratic reforms—have laid solid foundations for sustaining progress in reform. Transition is deepest in those countries that have made progress on economic and democratic reforms. In these economies, market-supporting institutions have tended to develop. These institutional frameworks—predictable fiscal and regulatory environments, secure property rights, an impartial judiciary and sound financial supervision and regulation—combined with appropriate macroeconomic policies, will lay 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.

Good governance will continue to play a critical role in the future success of the region and, in this regard, the EBRD will need to find ways to conduct its business to promote its Article 1 commitment to the principles of multi-party democracy and pluralism. Attention to governance issues in Central Asia, and in Uzbekistan in particular, will be centre stage in 2004, as the Bank will assess that country's progress towards meeting key political benchmarks. Specifically, the Bank will be looking for evidence of greater political openness and media freedom, the free functioning of independent civil society groups and implementation of the recommendations of the UN Special Rapporteur on Torture. This assessment will also include a stock-taking of the country's progress towards meeting the EBRD's economic benchmarks. The level of future Bank operations in Uzbekistan will depend on this assessment being positive. Canada will continue its vigorous support for Bank efforts to address issues related to the rule of law, human rights and democratic principles.

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

Finally, good governance within the EBRD itself is also important. Since the EBRD, as a multilateral institution, is not regulated, the Bank must push itself more to adopt and maintain the highest industry standards. To this end, a process is underway to review the Bank's governance standards with a view to strengthening them where needed. In particular, in light of recent problems in the private sector, the role of the Audit Committee is being examined to ensure that it is guided by the best and most appropriate standards.

Contacting the Office of the Director for Canada

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

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

Mr. C. Scott Clark, Director	Tel: +44 20 7338 6457
Mr. David Plunkett, Alternate Director[1]	Tel: +44 20 7338 6507
Ms. Michelle Kaminski, Advisor[2]	Tel: +44 20 7338 6458 E-mail: kaminskm@ebrd.com
Ms. Sandy Ferguson, Advisor[3]	Tel: +44 20 7338 6509 E-mail: fergusos@ebrd.com
Ms. Alicja Krivicky, Executive Secretary	Tel: +44 20 7338 6507 E-mail: krivicka@ebrd.com Fax: +44 20 7338 6062

[1] Resident at the Canadian High Commission in London.

[2] Responsible for policy matters.

[3] Responsible for business development and investor liaison.

For More Information on the EBRD

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

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

http://www.ebrd.com/

Requests for information can be addressed to:

Publications Desk
European Bank for Reconstruction and Development
One Exchange Square
London, EC2A 2JN
United Kingdom
(Fax: +44 20 7338 7544)

Annex 1

The Bank's Financial Activities

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

Ordinary Capital Resources

At the end of 2003, the total authorized capital of the Bank was €20 billion. Canada has subscribed to 3.4 per cent—or €680 million (C$958 million)—of the Bank's authorized capital. Canadian contributions to the Bank's capital are made in US dollars (at a pre-determined euro/US$ exchange rate).

In 2003, Canada made its sixth purchase of shares under the first capital increase (which came into effect on April 3, 1997, and doubled the initial €10-billion capital base). Under the first capital increase, 77.5 per cent of Canada's share is "callable," meaning that the Bank can request these resources in the unlikely event that it requires them to meet its financial obligations to bondholders; the balance, or 22.5 per cent, is "paid-in." Payments are being made in eight equal annual installments (40 per cent in cash and 60 per cent in non-interest-bearing demand notes encashed over five years). The 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 paid-in contributions to the Bank do increase the Government's financing requirements.

Canadian Payments to the EBRD

Year	Notes	Cash	Encashment of notes	Total cash outlay
		(in US dollars)		
1991	11,903,502	11,903,502	11,903,502	23,807,004
1992	11,903,502	11,903,502	3,967,834	15,871,336
1993	11,903,502	11,903,502	7,935,668	19,839,170
1994	11,903,502	11,903,502	11,903,502	23,807,004
1995	11,903,502	11,903,502	11,903,502	23,807,004
1996	–	–	7,935,668	7,935,668
1997	–	–	3,967,834	3,967,834
1998	7,287,199	4,858,132	1,457,440	6,315,572
1999	7,287,199	4,858,132	2,914,879	7,773,011
2000	7,287,199	4,858,132	4,372,319	9,230,451
2001	7,287,199	4,858,132	5,829,759	10,687,891
2002	7,287,199	4,858,132	7,287,198	12,145,331
2003	7,287,199	4,858,132	7,287,199	12,145,331
Total	103,240,702	88,666,304	88,666,305	177,332,609

Market Borrowings

At the end of 2003, total EBRD borrowings stood at €14.2 billion with an average maturity of 8.8 years at an average cost of funds of LIBOR (London Inter-Bank Offered Rate) minus 41 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:

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 10-year project is roughly US$1 billion, of which US$716 million has been pledged so far. Canada has pledged US$33 million, including US$0.8 million of bilateral assistance for ventilation stack repair.

Nuclear Safety Account (NSA)—This facility was established in 1993 to help finance the closure of the Chernobyl nuclear power plant and to improve safety conditions at nuclear power plants in countries of operations until the plants can be closed. The NSA complements other bilateral and multilateral nuclear safety technical assistance and functions in parallel with multilateral efforts to achieve broader energy sector reform in the region. Canada has contributed C$19.5 million to the total fund of €273 million. Canada's contribution has been completely disbursed.

Russia Small Business Fund (RSBF)—The purpose of this fund is to establish a facility for small business finance and micro lending in various regions of Russia. The RSBF was established in 1993 as a pilot project and became permanent in 1995. Canada has contributed C$11.3 million towards the US$300-million fund.

CIDA-EBRD Cooperation Fund for Southeastern Europe (CFSEE)—By 2002, Canada had contributed $10 million in support of the EBRD's South Eastern Europe Action Plan, to be used for technical cooperation and co-financing activities. These funds, tied to Canadian consultants, were used in Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Romania, and Serbia and Montenegro. In 2003, an additional $6 million was added to the CFSEE, which will focus on CIDA priority sectors and countries of focus until 2010.

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

TurnAround Management (TAM) Programme—The TurnAround Management Programme was established in 1993 to match senior industrial advisors from market-driven economies with chief executives of selected firms in the region. The objective is to provide industrial management know-how and develop business skills so that these companies can become competitive and profitable. In 2003, Canada signed a new agreement with the TAM Programme to provide $2.5 million over five years to be used to hire Canadians to work as advisors. This brought Canada's total contribution to the TAM Programme to $3,050,000.

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

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

Northern Dimension Environment Partnership (NDEP)—NDEP is a partnership among the Russian Government, international financial institutions and bilateral donors to address environmental problems in northwest Russia, including nuclear waste disposal. Canada has contributed €20 million to the NDEP's nuclear window.

Annex 2

Doing Business With the EBRD

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

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

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

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

Canadian Consultants: The EBRD's Web site contains technical cooperation notifications and invitations for expressions of interest for consultancy services pertaining to both public and private sector projects. The EBRD is currently working on an e-Procurement initiative. This initiative will involve the selection of consultants through a web based process.

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

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

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

Annex 3

EBRD Membership as at December 31, 2003

	Share of the Bank's capital		Share of the Bank's capital
	(%)		(%)
European Members		**Countries of Operations**	
Austria	2.28	Albania	0.10
Belgium	2.28	Armenia	0.05
Cyprus	0.10	Azerbaijan	0.10
Denmark	1.20	Belarus	0.20
Finland	1.25	Bosnia and Herzegovina	0.17
France	8.52	Bulgaria	0.79
Germany	8.52	Croatia	0.36
Greece	0.65	Czech Republic	0.85
Iceland	0.10	Estonia	0.10
Ireland	0.30	FYR Macedonia	0.07
Israel	0.65	Georgia	0.10
Italy	8.52	Hungary	0.79
Liechtenstein	0.02	Kazakhstan	0.23
Luxembourg	0.20	Kyrgyzstan	0.10
Malta	0.01	Latvia	0.10
Netherlands	2.48	Lithuania	0.10
Norway	1.25	Moldova	0.10
Portugal	0.42	Poland	1.28
Spain	3.40	Romania	0.48
Sweden	2.28	Russia	4.00
Switzerland	2.28	Serbia and Montenegro	0.47
Turkey	1.15	Slovak Republic	0.43
United Kingdom	8.52	Slovenia	0.21
European Union	3.00	Tajikistan	0.10
European Investment Bank	3.00	Turkmenistan	0.01
		Ukraine	0.80
Non-European Members		Uzbekistan	0.21
Australia	0.50		
Canada	**3.40**		
Egypt	0.10		
Japan	8.52		
Korea, Republic of	1.00		
Mexico	0.15		
Mongolia	0.01		
Morocco	0.05		
New Zealand	0.05		
United States	10.00		