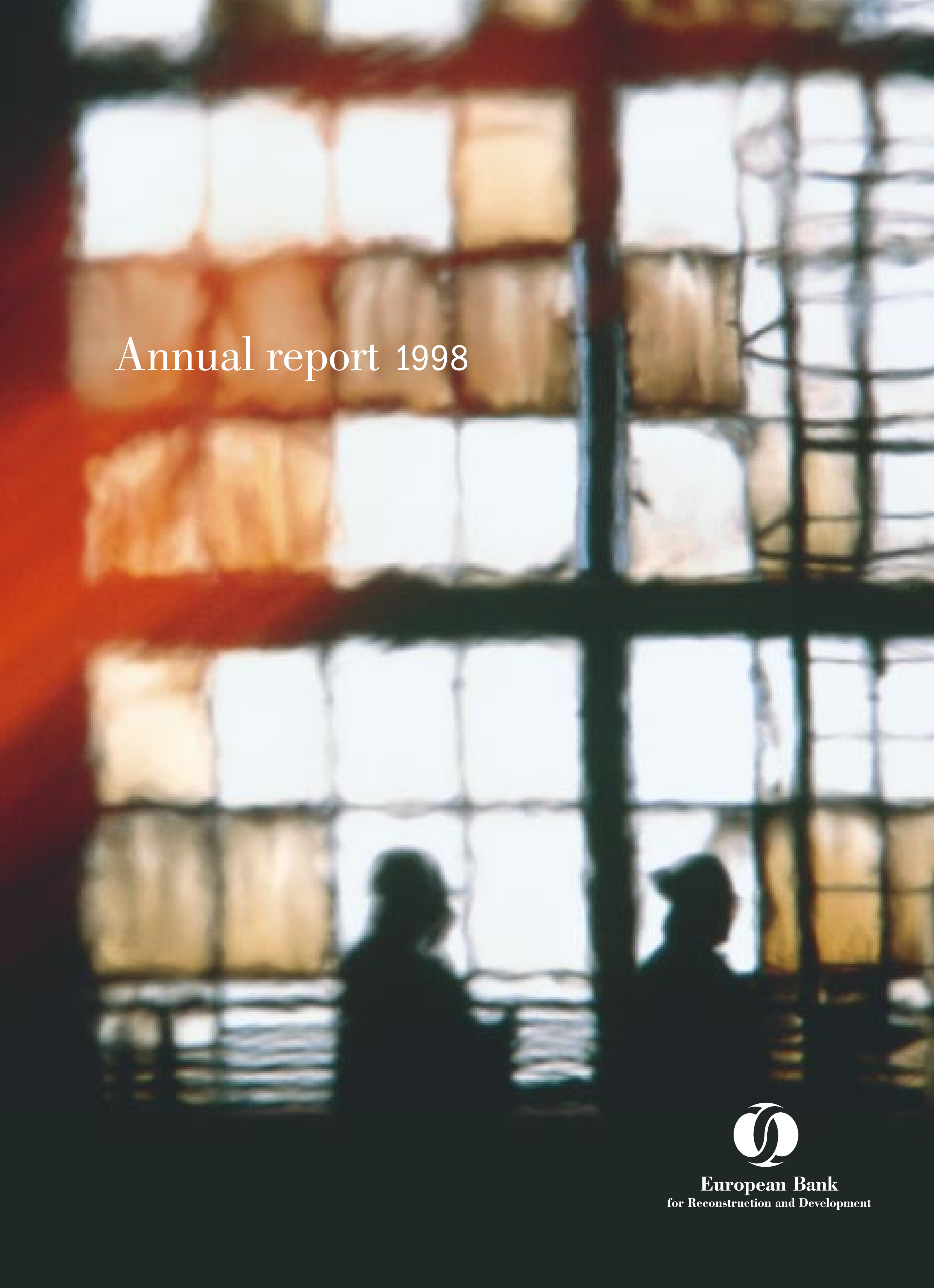
Annual report 1998



European Bank
for Reconstruction and Development

The European Bank for Reconstruction and Development (EBRD) was established in 1991. The Bank's mandate is to foster the transition towards open market-oriented economies and to promote private and entrepreneurial initiative in the countries of central and eastern Europe and the Commonwealth of Independent States (CIS) committed to and applying the principles of multiparty democracy, pluralism and market economics.

The EBRD helps its 26 countries of operations to implement structural and sectoral economic reforms, promoting competition, privatisation and entrepreneurship, taking into account the particular needs of countries at different stages of transition. Through its investments it promotes private sector activity, the strengthening of financial institutions and legal systems, and the development of the infrastructure needed to support the private sector. The Bank applies sound banking and investment principles in all of its operations.

In fulfilling its role as a catalyst of change, the Bank encourages co-financing and foreign direct investment from the private and public sectors, helps to mobilise domestic capital, and provides technical cooperation in relevant areas. It works in close cooperation with other international financial institutions, and with international and national organisations. In all of its activities, the Bank promotes environmentally sound and sustainable development.

Contents

Countries of operations
At 31 December 1998

Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Former Yugoslav Republic of Macedonia, Georgia, Hungary, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Poland, Romania, Russian Federation, Slovak Republic, Slovenia, Tajikistan, Turkmenistan, Ukraine, Uzbekistan.

1998 highlights

In 1998 the EBRD faced its greatest challenge, with the collapse of financial markets in the Russian Federation in August and continuing repercussions throughout the region. This setback has underlined that the region's remarkable achievements in transition since 1991 must be accompanied by progress in institutional reforms and good governance.

The EBRD responded proactively to the crisis, focusing on ways to safeguard existing investments and to rebuild business confidence. It continued to develop high quality projects in all countries of operations, demonstrating its key role in support of the transition process.

In 1998, the EBRD achieved its highest level of annual commitments to date, signing projects totalling ECU 2.4 billion, with a total project value of ECU 9.9 billion.

The financial crisis affected credit quality in a number of the Bank's investments. After provisions, the EBRD recorded a net loss for the year. However, due to its strong capitalisation, financial viability was not affected.

Financial results (ECU million)

	1998	**1997**	**1996**	**1995**	**1994**
Operating income	450.5	346.0	243.7	241.2	170.7
Expenses and depreciation	158.7	152.1	146.4	158.3	145.8
Operating profit before provisions	291.8	193.8	97.3	82.9	24.9
Provisions for losses	553.1	177.7	92.4	75.4	23.9
(Loss)/profit for the period	(261.2)	16.1	4.9	7.5	1.0
Authorised capital	20,000	20,000	10,000	10,000	10,000
Paid-in capital	5,084	4,877	2,965	2,965	2,965
Capital instalments received (cumulative)	3,217	2,949	2,916	2,842	2,273
Total provisions and reserves	762	508	263	165	81
Total assets	16,047	13,495	10,964	8,728	7,528

Operational results

Number of projects	**1998**	**1997**	**1996**	**1995**	**1994**
Approvals	82	143	119	134	109
Commitments	96	108	95	110	91
EBRD financing (ECU million)[1]					
Approvals	2,003	4,016	2,827	2,855	2,409
Commitments	2,373	2,315	2,188	2,000	1,878
Net disbursements	1,350	1,250	1,162	987	591
Gross disbursements	2,449	2,047	1,371	1,144	668
Resource mobilisation (ECU million)[1]					
For approvals	6,646	7,535	4,673	6,085	4,500
For commitments	7,541	4,210	3,819	4,972	3,333

[1] Figures for 1994-97 are as reported for those years. They do not reflect subsequent changes due, for example, to exchange rates, cancellations, syndications or restructuring.

Operating profit before provisions amounted to ECU 292 million for 1998, more than 50 per cent higher than in 1997.

Provisions for losses were increased by ECU 553 million. This was due mainly to specific provisions resulting from an extensive review of the effect of the financial crisis on EBRD projects in all transition countries, particularly in the banking sector. As a result, a net loss after provisions of ECU 261 million was recorded for the year.

In spite of the difficulties in the region, the Bank continued to make disbursements in each of its countries of operations and 96 projects were signed. The EBRD now has a portfolio of 551 projects with a total net value of ECU 10.2 billion, making it the largest single foreign direct investor in the region and a major contributor to the transition process.

The EBRD's ability to mobilise additional financing increased in 1998. For every ECU it invested in the year it attracted a further ECU 3.2 from other investors, compared with a cumulative average of ECU 2.6.

Banking operations contributed 64 per cent of total gross income, up from 50 per cent in 1997. Administrative expenses were well within budget at 91 per cent of the total, with no real increase recorded for the fifth consecutive year.

At the end of January, President Jacques de Larosière ended his term of office, having made an enormous contribution to the EBRD since 1993. In the summer, the Bank's Governors unanimously elected Horst Köhler as President of the EBRD with effect from 1 September.

In May the Bank held a successful Annual Meeting in Kiev, Ukraine. A Business Forum, focused on growth and investment in the region, was held alongside the Meeting and attracted over 3,000 participants.

The EBRD's commitment to the environment was strengthened by the approval of a new Municipal and Environmental Infrastructure Policy in June.

With the addition of a new office in Yerevan, Armenia, late in the year, the EBRD now has a local presence in all of its countries of operations.

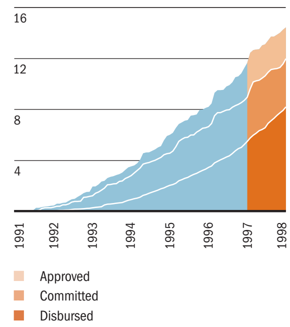
Cumulative totals at 31 December 1998

Approvals ECU 14,478 million	Financing that has been approved by the EBRD's Board of Directors, net of cancellations. Approval does not always lead to signing.
Commitments ECU 10,182 million (net) ECU 12,010 million (gross)	Financing that has been signed following approval and for which a commitment is recognised. Net figures exclude cancellations and repayments.
Disbursements ECU 5,761 million (net) ECU 8,212 million (gross)	Financing that has been disbursed following the signing of an operation. Net figures are for all disbursements to date less repayments.
Additional funds mobilised ECU 30,856 million	Resources committed by other investors as part of EBRD operations.

On 1 January 1999, when the euro replaced the national currencies of each of the 11 participating countries, the EBRD changed its reporting currency from ECU to the euro. Figures relating to 1998 and previous years are reported in ECU.

Cumulative approvals, commitments and disbursements

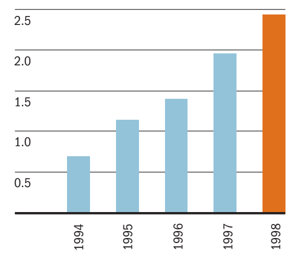
at 31 December 1998 (ECU billion)



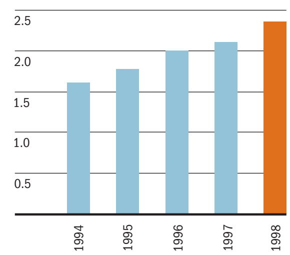
Annual commitments and disbursements

at 31 December 1998 (ECU billion)

Committed

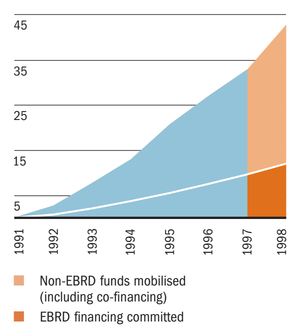


Disbursed



Cumulative funds mobilised

at 31 December 1998 (ECU billion)



Letter of transmittal

London, 9 March 1999

To Governors

In accordance with Article 35 of the Agreement Establishing the Bank and Section 11 of its By-Laws, the enclosed Annual Report of the Bank for 1998 is submitted by the Board of Directors to the Board of Governors.

The Annual Report includes the approved and audited financial statements required to be submitted under Article 27 of the Agreement and Section 13 of the By-Laws. It also contains a separate statement on the Special Funds resources, in accordance with Article 10 of the Agreement Establishing the Bank, and covers the environmental impact of the Bank's operations, as required under Article 35 of the Agreement.

President

Horst Köhler

Directors	Alternate Directors
Byongwon Bahk	Jim Short
Jan Bielecki	Bojidar Kabaktchiev
Staffan Crona	Baldur Erlingsson
Sylvain de Forges	Lucien Bernadine
Torsten Gersfelt	Tony Brown
Joaquin de la Infiesta	Carlos Escribano
Wilhelm Jaggi	Mehmet Kaytaz
Mikhail Jernov	Michail Tatianchenko
Roger Lavelle	Walter Cernoia
Heiner Luschin	Gideon Schurr
Michael McCulloch	Alex Gibbs
Patrice Muller	Tom MacDonald
Kari Nars	Rolf Næss
Philippe Petit-Laurent	Vassili Lelakis
Yuri Poluneev	Maria Sultanoiu
Enzo Quattrociocche	Pasquale Terracciano
Norbert Radermacher	Jörg Ranau
Karen Shepherd	Vacant
Bernard Snoy	Georges Heinen
Kazuhito Tatebe	Takashi Kurai
Pim van Ballekom	Dick Knook
Stefanos Vavalidis	António de Almeida
Vacant	Károly Soós

Review of the year

In 1998 the EBRD faced its toughest test since the foundation of the Bank at the start of the decade. The collapse of financial markets in the Russian Federation and the continuing repercussions throughout the region have posed a severe and ongoing challenge for transition in the Bank's countries of operations, a challenge in many ways greater than at any time since 1991.

Despite these strains, the reform process in most transition countries has remained on track. In many countries, the threat of instability has in fact further strengthened the resolve to press ahead with reforms. Nevertheless, the crisis has damaged investor confidence. It has also confirmed the continuing importance of the EBRD's role in supporting reform through sound investments.

The collapse of Russia's financial system in August 1998 had a profound effect on the EBRD's operations. The deterioration of the credit quality of investments in Russia and other countries in the region led the EBRD to take significant additional provisions by the end of the year, totalling ECU 553 million. Most of the provisions were in Russia, particularly in the financial sector. Although operating profit before provisions increased to ECU 292 million from ECU 194 million in 1997, in 1998 the Bank recorded a net loss after provisions of ECU 261 million. However, the Bank is strongly capitalised and its portfolio is prudently provisioned, allowing it to absorb this loss without threatening its financial viability.

The financial crisis in August 1998

The EBRD's region of operations experienced in 1998 the most severe economic upheaval since the beginning of the transition. Although the year started promisingly, with much of the region appearing to cope with the impact of the Asian financial crisis, the economic situation weakened progressively and signs of strain became apparent throughout the region.

In August the situation intensified dramatically, when the Russian Federation devalued its currency, defaulted on its domestic government debt and declared a moratorium on debt servicing to foreigners. The country's financial system collapsed, causing a sharp fall in the exchange rate and, soon after, a substantial acceleration of inflation to levels not seen for several years. The collapse of the payments system, the withdrawal of foreign sources of finance and increased uncertainty led to a sharp contraction in economic activity.

The crisis spread to other parts of the region, especially to neighbouring countries. Many of these have strong financial and trade links with Russia, and had difficulty in maintaining macroeconomic balance and continued access to the international capital markets following the crisis. The deteriorating global economic outlook further hurt growth prospects throughout the region, in particular in the more advanced and more open transition economies.

Nevertheless, while volatility and some indiscriminate "contagion" effects were recorded in financial markets throughout the region, the extent to which individual countries have been affected has differed sharply. As a result of the Asian and Russian financial crises, investors have become more selective. Investors' reassessment of the economic climate and risks reflects differences in the quality and depth of the transition process in each country. The crisis has underlined that the region's remarkable achievements in liberalisation and privatisation must be accompanied by progress in institutional reforms. In particular there must be an effective legal framework based on the rule of law, a transparent and competitive environment for business activity, and limits to governmental administrative discretion. The stronger the institutional foundations of market economies in the region, the easier it is for countries to absorb sudden shocks and to achieve sustained growth and macroeconomic stability.

The EBRD's response to the crisis

Since its foundation, the EBRD has demonstrated its value as an institution with a unique mandate and has developed substantial skills and experience. Therefore the Bank was able to respond rapidly to events in Russia and to their repercussions, with a focus on safeguarding existing investments and seeking ways to rebuild investor confidence. The Bank developed an operational plan for the country, which emphasised the need to concentrate on even higher standards of project selection, with an emphasis on the demonstration

Financial crisis has underlined that the region's remarkable achievements in liberalisation and privatisation must be accompanied by progress in institutional reforms

effects for other investors, and with a careful balancing of risks and returns. While endorsing this operational focus, the EBRD's Board of Directors emphasised that the long-term effectiveness of the Bank's response would depend significantly on the actions of the Russian Government and on the overall response of the international community.

Bank continues to support the transition process in all of its countries of operations

Against the background of crisis and uncertainty, the EBRD reaffirmed both its project-centred approach and commitment to support transition in all of its countries of operations. As a long-term investor, the Bank emphasised that it would not withdraw from operations in Russia or elsewhere in the region, even in the most challenging economic circumstances. The EBRD has therefore continued to develop projects and to make disbursements in each of its countries of operations.

Projects signed in 1998 with a particularly significant impact on the transition process include:

Bank Pekao (Poland)
Chirag Oil Project (Azerbaijan)
Grain Receipt Programme (Slovak Republic)
Mutnovsky Independent Power Plant (Russian Federation)
Podravka Restructuring (Croatia)
RomTelecom (Romania)
Telecommunications Emergency Reconstruction (Bosnia and Herzegovina)
Ventspils Port Rail Terminal (Latvia)

Nevertheless, the EBRD's level of activity has taken account of risk as well as governments' willingness to pursue market-oriented reform. The current financial crisis calls for governments to demonstrate their determination to consolidate achievements and to promote change. The EBRD is determined to assist and encourage them in these reforms. In so doing, it will coordinate closely with other international organisations, especially the World Bank and the International Monetary Fund, and with the European Union. The EBRD will also make greater use of its capacity to foster institutional change, particularly by harnessing its broad local knowledge through its network of Resident Offices.

Strategic lessons

Experience of the transition has taught international institutions and commercial investors alike that the process is long term, institution building is crucial, the stresses on sections of the population can be severe, and there will be delays and setbacks along the way. The recent crisis has sharply underlined the fragility of reforms where institutional and behavioural underpinning is weak. Reforms that are not credible as far as the general public is concerned tend to become unsustainable. Creating strong institutional foundations for the transition is a difficult, long-term task, in which cultural and historical factors exercise a powerful influence. It is now clear that transition and the work of the EBRD must be perceived as longer-term processes than many had previously envisaged.

Operations

While the EBRD succeeded in meeting most of its operational targets in 1998, the unfolding of the Russia crisis from mid-year onwards significantly altered the operational environment and the Bank's financial results for the year.

The Board of Directors approved 82 projects in 1998, amounting to ECU 2.0 billion. This level, though lower than in the previous year because of the exceptionally high number of projects approved in the last quarter of 1997 and the changed investment climate, brought the cumulative total of approvals to ECU 14.5 billion.

Seventh successive increase in annual commitments

In spite of the difficulties in the region, in 1998 the EBRD increased the level of both its signed commitments and disbursements relative to 1997. Signed projects in 1998 totalled ECU 2.4 billion, marking the seventh successive increase in annual commitments. The 96 signed projects brought the total resources committed by the Bank since its foundation to ECU 10.2 billion, net of repayments and cancellations. At the end of 1998, cumulative additional funds committed by other investors as part of EBRD operations amounted to ECU 30.9 billion.

ECU 2.4 billion was disbursed in 1998, 20 per cent more than in 1997. Net disbursements at the end of the year comprised ECU 4.3 billion of loans and ECU 1.4 billion of equity investments, for a total of ECU 5.8 billion.

The operational scenarios for 1998 had to be reassessed in the course of the year, as some of these had become impractical while others had lost their urgency. Certain activities – especially those dealing with institution building and better governance in the region – acquired a new significance and became even more imperative.

Operational priorities for forthcoming years are currently under review as the EBRD continues to assess the long-term implications of the Russia crisis and, in general, the new stage of the reform process throughout the region.

Operational priorities

Given that the transition process is not progressing uniformly across the region, the EBRD has continued to design and implement strategies to meet the specific needs of each country. The underlying approach remains firmly embedded within the provisions of the Agreement Establishing the Bank and led by shareholders' continuing policy guidance.

In 1998 the EBRD maintained the operational priorities established and refined by the Board of Governors over the past five years.

Focus on the private sector

In 1998 the EBRD's activities in the private sector increased to 68 per cent, up from 67 per cent at the end of 1997. This was well within the requirement in the Agreement Establishing the Bank that not more than 40 per cent of its total investments shall be in the public sector. Of the projects signed in 1998, about 80 per cent (by volume) were private sector operations, while 86 per cent of Board-approved projects were in the private sector. In the countries where the private/public sector target ratio (60/40) has not yet been met, a plan of action is established as part of the Bank's strategy for that country. In most cases progress towards meeting the target ratio was made during the year.

Broadening the geographical spread

The EBRD is committed to undertaking operations throughout the region and in 1998 projects were signed in all but two countries. The share of operations in the countries at the advanced stages of transition was 40 per cent, exceeding earlier projections; in countries at the early and intermediate stages of transition it was 37 per cent; while Russia attracted 23 per cent of the Bank's commitments during the year.

To promote its presence throughout the region, the EBRD had established offices in all 26 of its countries of operations by the end of 1998. This process was completed by the opening of the Bank's office in Yerevan, Armenia, during the year. The Resident Offices are key to the EBRD's ongoing project development and monitoring efforts. Through these offices, the Bank maintains local knowledge, keeps abreast of national developments, and participates in policy dialogue with authorities. In so doing, the Bank is seen as, and acts as, a partner for the country and a member of the local business community.

Reaching local private enterprises

The private sector share of GDP continued to grow in 1998 throughout the region, reaching or exceeding 50 per cent of economic activity in 19 of the Bank's 26 countries of operations. The EBRD continues to support this process by promoting local private sector development through its role as an investor in, or lender to, privatised companies. In addition, the Bank is reinforcing its support for local small and medium-sized enterprises (SMEs), which are crucial for the region's future economic success.

The EBRD's financial instruments were refined in 1998. The Bank further increased its commitment to operations through financial intermediaries, including credit lines, private equity funds and trade facilitation programmes. Through these operations, the Bank is able to provide funds for operations that are too small or too costly to receive direct EBRD financing. This provides local small enterprises with much-needed capital, which is not readily available from other sources. Such wholesale operations now represent 24 per cent of the EBRD's commitments.

Strengthening financial intermediaries

By strengthening markets, institutions and the regulatory framework, the EBRD helps to encourage investors, mobilise domestic savings and provide a stable investment climate.

In 1998, signed financial sector operations increased by 87 per cent by volume over 1997, bringing the EBRD's total exposure to the sector to ECU 3.6 billion. This continues to be the largest sector for Bank financing, representing 30 per cent of the total value of operations. As with wholesale funding for local private enterprises, the Bank continues to rely on financial intermediaries as an effective mechanism for channelling capital to local enterprises. Following the financial crisis in August 1998, the EBRD undertook a review of all of the facilities that it had provided to Russian banks, and disbursements were carefully monitored.

New office in Yerevan, Armenia, completes country network of Resident Offices

Increasing equity investments

A strong demand for equity investments continued in 1998. In response, the EBRD increased its equity share of new commitments to 33 per cent, compared with 19 per cent in 1997. Equity is one of the EBRD's chief instruments for seeking to enhance the impact of its investments on the transition, allowing the Bank to influence corporate governance and improve local management.

New Municipal and Environmental Infrastructure policy approved

Projects with significant environmental benefits signed in 1998 are described in the Environment section – pages 39 to 41. Notable projects include:

Enguri Hydropower Plant Rehabilitation (Georgia)
Karaganda Power Project (Kazakhstan)
Krakow Urban Transport (Poland)
Mosenergo (Russian Federation)
Stalexport (Poland)
Tashkent Solid Waste (Uzbekistan)
Ukraine Energy Service Company (Ukraine)
Zagreb Landfill Rehabilitation (Croatia)

Operating profit before provisions increased by more than 50% in 1998

Infrastructure, environment and nuclear safety

A distinctive feature of the EBRD's operations is its commitment to promote environmentally sound and sustainable development. The Bank's concern for the region's environment and natural assets is emphasised through its operations to improve municipal infrastructure and encourage energy saving.

The EBRD continued to provide strong support for the municipal and environmental infrastructure (MEI) sector in 1998. New investments totalling ECU 167 million were made in water supply, sewerage and waste-water treatment, urban transport and municipal waste management in support of projects with an overall value of ECU 440 million. EBRD commitments to the MEI sector totalled approximately ECU 700 million in debt and equity by the end of 1998.

In June 1998 the EBRD approved a new policy on municipal and environmental infrastructure, which outlines the Bank's commitment to upgrade an inadequate infrastructure, address the most serious cases of environmental damage in the region and improve living conditions. In 1998 the EBRD also continued to promote its energy efficiency programmes. Specific projects included support for energy service companies, which introduced modern technology and energy management practices in several enterprises. Many other projects included significant environmental benefits in their design.

As administrator of the Nuclear Safety Account and the Chernobyl Shelter Fund, the EBRD receives funding from donor governments and the European Community to improve short-term nuclear safety and to promote energy sector reforms, transition to a strong regulatory regime and early shutdown of the region's least-safe nuclear power plants. As well as providing technical and other services, the Bank prepares projects, which are submitted for approval to a decision-making body representing the donors. In 1998 further progress was made with the Shelter Implementation Plan, which aims to assist Ukraine in transforming the sarcophagus around the damaged reactor (Unit 4) of the Chernobyl Nuclear Power Plant into a safer and environmentally stable system.

Financial results

The EBRD recorded a loss of ECU 261.2 million for the year, compared with a profit of ECU 16.1 million in 1997. The loss was primarily due to provisions of ECU 553.1 million, which were substantially higher than anticipated. This reflected significant specific provisions taken in response to the crisis in Russia during the last five months of the year. Provisions on Banking operations at the end of the year totalled ECU 908.9 million, equivalent to 16 per cent of loans and equity disbursements outstanding.

Operating profit before provisions for 1998 was more than 50 per cent higher than in 1997, at ECU 291.8 million. This was primarily due to excellent returns from the Bank's share investment portfolio and a strong Treasury contribution.

Gross income contribution from the core Banking business continued to rise and amounted to ECU 524.2 million for the year, representing a contribution of 64 per cent of gross income in 1998, compared with 50 per cent in 1997.

A strong performance from investment activities, together with innovative financing structures at attractive borrowing rates, enabled Treasury to contribute profits of ECU 46.0 million for the year, significantly outperforming its target.

Policy and strategy review

During 1998 the EBRD's Board of Directors reviewed and approved the Bank's policies on a wide range of issues. In addition to the approval of the Municipal and Environmental Infrastructure Policy, which defines the objectives for EBRD operations in this sector (see above), the Board of Directors reviewed the Provisioning Policy, the Procurement Policies and Rules and the Regional Venture Fund investment policy. The revisions to the Procurement Policies and Rules address the issue of corrupt and fraudulent practices in the procurement process and detail how the EBRD will deal with any proven allegations of these practices. The RVF policy was modified to reflect changes in the local economic environment and the Bank's experience over the past few years.

Such a periodic review of its operating policies is intended to enable the EBRD to react to rapidly changing market conditions and to cope with crises. The Bank's response to the Russian financial crisis and its repercussions in the region was an example of the institution's flexibility to deal with even the most difficult circumstances. Furthermore, by undertaking biannual in-depth reviews of its strategic approach for each country, with interim assessments every 12 months, the Bank ensures that it remains responsive to the individual requirements of each country in which it operates.

Institutional developments

Monitoring of Article 1

The purpose of the EBRD, as outlined in Article 1 of the Agreement Establishing the Bank, is to foster the transition towards open market-oriented economies and to promote private and entrepreneurial initiative in its countries of operations committed to and applying the principles of multiparty democracy, pluralism and market economics.

As part of its periodic examination of the EBRD's operations and lending strategies, the Board of Directors reviewed in 1998 the commitment of each country of operations to Article 1 of the Agreement Establishing the Bank. In particular, the Board focused on the countries' commitment to the principles of multiparty democracy and pluralism. The questions arising from the monitoring process, especially those emerging from the review of individual country strategies, were discussed with the relevant governments. Other international institutions were also consulted, including the European Union, the Organisation for Security and Cooperation in Europe, the Council of Europe, and government officials from its member states. The EBRD is particularly vigilant in the monitoring of Article 1 as it recognises that democratic reform is the foundation of the transition process.

Changes in senior management

On 31 January 1998, after more than four years at the Bank, Jacques de Larosière completed his term as President of the EBRD. The Bank's Board of Directors paid tribute to Mr de Larosière's significant achievements during this period, highlighting his instrumental role in restoring confidence in the EBRD and ensuring the doubling of its capital base. Charles Frank, First Vice President for Banking, took over as Acting President until the end of August.

In July the Bank's Governors unanimously elected Horst Köhler as President of the EBRD, with effect from 1 September. President Köhler joined the Bank from the Association of German Savings Banks, where he also served as President. This followed a distinguished career with the German Federal Ministry of Finance, in which he held the key position of state secretary as well as representative ("sherpa") of the German Chancellor at the G-7 Summits.

John Taylor resigned his position as General Counsel in October to take up a senior position in the private sector. Mr Taylor had been with the EBRD since its inception, first as Deputy General Counsel and then as General Counsel, completing three years of distinguished service in this role. His Deputy, Emmanuel Maurice, was appointed as his replacement with effect from 17 December 1998.

Membership

The final stages of the EBRD's capital increase were completed in 1998. By the end of the year, 54 of the Bank's 60 members had participated in the increase. The total amount newly subscribed was 94.82 per cent of the ECU 10 billion capital increase approved by the EBRD's Board of Governors at the Bank's Annual Meeting in 1996. The success of the capital increase exercise was a clear indication by shareholders of their support for the Bank's mandate and the transition process.

Horst Köhler appointed as new President of the EBRD

Annual Meeting and Business Forum in Kiev attracted over 3,000 participants

1998 Annual Meeting in Kiev

In May 1998 the EBRD held a successful Annual Meeting in Kiev, Ukraine. Participants included Prime Ministers, Ministers and Central Bank Governors, other senior government officials and leading executives of international financial institutions (IFIs).

The Business Forum, which took place alongside the Meeting and attracted over 3,000 participants, aimed to promote business and investment in the EBRD's countries of operations. Its theme was *Growth and investment for a sustainable transition.* In parallel to the Bank's events, the Ukrainian government held a forum on *Ukraine: outlook to the 21st century.* This successfully demonstrated how the host country of the Bank's Annual Meeting can capitalise on the presence of the EBRD's shareholders, their business guests and the media to present itself to the international investment community.

Management of resources

Budgetary discipline

For the fifth consecutive year there was no real increase in the EBRD's general administrative expenses, which were maintained at £125.4 million – compared with £125.6 million in 1997. However, the strengthening of the pound against the ECU in 1998 caused the Bank's expenses in ECU terms to be ECU 6.1 million above those of 1997. At the same time the Bank successfully monitored a portfolio that was 13 per cent larger in terms of the number of projects and 25 per cent larger by volume, compared with 1997, showing once again a considerable improvement in productivity. As in previous years, the EBRD continued to attach significant importance to monitoring its operations, largely through the Resident Office network. The Bank's strict budgetary discipline demonstrates its determination to increase its activities at no additional administrative cost.

ZBB initiative

In 1998 the EBRD continued to implement many of the business measures identified since 1997 as part of the Zero-Based Budgeting (ZBB) initiative. Under the ZBB exercise, the Bank reviewed its work processes and identified productivity improvements, revenue enhancements and opportunities for reallocation of resources to priority activities. Noteworthy in this regard was the adoption of a simplified approval process and streamlined documentation for projects involving lower amounts of resources.

Implementation of other ZBB recommendations progressed well during the year and contributed to the development of the zero nominal growth in administrative expenses budgeted for 1999, despite the expected further increase in operations.

Staffing

At 31 December 1998, the EBRD had a total of 831 regular, special and locally hired employees in its headquarters and 241 staff in the Resident Offices, compared with 885 and 194 respectively in 1997. During the year the Bank improved its personnel management to recruit and retain the best staff. Due to the increasing complexity and challenge of operating in the region, particular attention was placed on the level and mix of skills and on providing a supportive working environment for staff confronted with additional demands. As well as focusing on training and development, the EBRD also reviewed some of its staff benefits.

The Year 2000 challenge

A Year 2000 Steering Committee was established in January 1998 to develop a Bank-wide action plan and to oversee its implementation.

All IT systems in the EBRD have now been assessed and corrected to ensure that they are Year 2000 compliant. Testing is expected to be completed by the end of March 1999. As a relatively young organisation, the EBRD's own exposure to potential Year 2000 problems is proportionally small and work is well advanced to ensure that the Bank's own systems will work properly in 2000 and beyond. The preparedness of the EBRD's clients is, however, now one of the Bank's key areas of concern.

The EBRD has raised awareness among its clients and encouraged them to confirm to the Bank that they have mobilised the necessary capital, technological and human resources to minimise the potential impact of Year 2000 risk and are addressing the issue satisfactorily. These communications have indicated positive initial awareness. Work with potential high-risk clients and sectors will continue to be pursued in 1999 to further reduce such risk. Measures taken by the EBRD include taking account of Year 2000 client preparedness in the Bank's portfolio monitoring activities and country strategy reviews, and adding compliance resolutions to the Bank's standard loan agreements.

Introduction of the euro

Following the commencement of the third stage of European Monetary Union (EMU) on 1 January 1999 when the euro replaced the national currencies of each of the 11 participating countries, the EBRD changed its reporting currency from ECU to the euro. The main impact for the Bank has been the modification of the EBRD's processing and accounting systems. During the conversion period from 1 to 3 January, all relevant ECU-denominated transactions were converted as necessary and rebooked into euro.

The Bank has agreed a detailed set of guiding principles that will be applied to relevant transactions and relationships with borrowers and counterparties during the transition period, which ends on 31 December 2001, and once the euro enters into circulation in 2002. The overall objective of these principles is to provide maximum flexibility for the EBRD's clients. The Bank will continue to monitor developments, both in the markets and in its countries of operations, so as to adapt its lending and borrowing instruments accordingly.

Challenges for the future

In contrast with previous years, which were characterised by a broadly upward trend in terms of overall economic growth and transition progress in the region, the crisis in Russia has introduced significant elements of uncertainty in the operating environment of the EBRD. It has also underlined the crucial role of the institutional underpinning of a market economy and highlighted the continuing challenges that the region faces in industrial and financial restructuring. To meet these challenges, there is a need for the Bank to continue to refine its policies and financial instruments, and to contribute further to improving the institutional framework.

The EBRD's medium-term strategy for 2000-03 will be developed following a wide-ranging review of the Bank's operational priorities, which started in late 1998. Guidance from governors at the EBRD's Annual Meeting in London in April 1999 will contribute to the development of this strategy.

The Bank will continue to finance sound investment projects that support the transition process, with the aim of enhancing the efficiency of markets, strengthening the institutions that support markets, and developing market-based skills and standards of business conduct. The Bank's strategy must be based on a recognition of these fundamental business principles.

To play its role effectively in this long-term process, the EBRD must follow the principle of sound banking so as to ensure over time its financial viability. This, in turn, will ensure financial discipline, provide an example of market-based decision-making to the transition economies, and ultimately safeguard shareholder support.

With the advance of privatisation and liberalisation, key challenges of the transition for the coming years are to build those institutions that are vital to a well-functioning market economy, to promote the development of new enterprises, and to restructure viable enterprises. In response to these challenges, the EBRD is refining its instruments and policy approaches, as described above. Fostering a sound investment climate, promoting small and medium-sized businesses, and supporting industrial restructuring will be strategic themes across a broad range of the Bank's activities in the period ahead.

Euro adopted as new reporting currency in January 1999

Operational environment

The operational environment for the EBRD continues to be characterised by very diverse conditions in its 26 countries of operations. This diversity partially reflects the different initial conditions prevailing across the region when reforms were started a decade ago. But it is also increasingly a result of divergent transition paths followed by the countries of central and eastern Europe and the CIS. The methods adopted in pursuit of the establishment of market economies have differed greatly across the region. Variation in reform policies as well as specific structural, political and cultural legacies constitute a challenging operational environment for the EBRD, in which maximum flexibility and strategic vision are required to fulfil the Bank's mandate.

The turmoil in emerging markets in 1998 has put the quality of reforms in transition economies to the test. Although a wide range of factors have determined the vulnerability of these economies to crisis, the key to preserving macroeconomic stability and sustainable growth has been the role of the state. Of particular importance is the capacity of the state to enforce laws and curb corruption, to collect taxes, to regulate banks and financial markets, to implement bankruptcies, to promote enterprise restructuring and effective corporate governance, and to build the institutional and social foundations for a well-functioning market economy. These are the fundamental challenges of the current phase of transition and they remain at the top of the agenda for all countries of the region.

Trends in the transition process

Progress in structural reform

Institutional reforms needed to complement progress in liberalisation and privatisation

The transition encompasses many dimensions, from the liberalisation of markets and the privatisation of state assets to the more complex institutional reforms of establishing well-functioning financial institutions and introducing adequate corporate governance in the enterprise sector. Initial reform efforts across the region concentrated on liberalisation and privatisation, measures that forced the state to refrain from intervening in production and exchange. By contrast, the institutional reforms characteristic of the current phase of transition, which emerged vividly in 1998, require the state to take on new roles: as a regulator, as an impartial arbiter, and sometimes as an active partner facilitating economic restructuring. The tasks associated with building market-oriented institutions are of such magnitude and complexity that they cannot be completed overnight. Although rules, procedures and organisations can often be quickly set in place, the capacity of institutions to change expectations and shape behaviour can be developed only over the long term.

The EBRD's assessment of progress in transition, published in its annual *Transition Report*, reflects the differences in the time profile of the various reform dimensions. These assessments show that the majority of transition economies have achieved very rapid progress in price and trade liberalisation as well as small and large-scale privatisation. The private sector share of GDP exceeds 50 per cent in 19 of the EBRD's 26 countries of operations. In some advanced countries, such as Hungary, the privatisation process is virtually complete. On the other hand, few countries have made similar headway in the more difficult institutional reforms, such as enterprise restructuring, addressing corporate governance, competition policy, and reforms of banking systems and securities markets. Legal systems, in particular their effectiveness, also remain underdeveloped.

Against the background of a difficult external environment, overall progress in transition in 1998 was less rapid than in previous years. Progress in reform continued strongly, however, in a number of countries, such as Armenia, Azerbaijan and Tajikistan, which have been catching-up on previously delayed reforms. In Bulgaria, the new reform momentum that gained hold after the change in government in 1997 continued in 1998. However, in countries such as Belarus, Turkmenistan and Uzbekistan, structural reforms are proceeding more gradually. Russia experienced backtracking on several dimensions following the August crisis, when administrative controls on prices and domestic trade were introduced as a short-term measure in some regions, restrictions were imposed temporarily on foreign exchange operations, and the financial system went through a major retrenchment.

Private sector development

Progress in privatisation has differed significantly among transition economies. While small-scale privatisation is virtually complete in most countries, there has been significant variation in the level of privatisation of medium-sized and large companies. By mid-1998, the Czech Republic, Hungary and the Slovak Republic had reached a degree of private ownership close to that of established market economies. In other central and east European countries, large-scale privatisation has been more sluggish, especially in Bulgaria, Croatia, FYR Macedonia and Romania, although these countries have recently intensified their privatisation efforts. In the CIS, Armenia, Georgia and Kazakhstan took new initiatives in large-scale privatisation during 1997-98 after lagging behind in previous years. By contrast, Belarus and Turkmenistan appear to have abandoned previous intentions to accelerate privatisation. Uzbekistan is also following a cautious approach to privatisation.

Over the past two years there has been an increasing shift towards trade sales and investment tenders as the preferred privatisation method. The telecommunications sector is particularly prominent, with four successful tenders concluded in 1998 (Armenia, Lithuania, Poland and Romania) and several more planned in 1999 (for instance, in Albania, Estonia, Georgia, Kyrgyzstan and the Slovak Republic). In 1997-98, strategic stakes in large manufacturing enterprises were also sold to foreign investors in Armenia (cognac), Bulgaria (copper), Estonia (shipping), Kazakhstan (oil and mining), and Latvia (gas). In Georgia, management contracts with buy-out options have been awarded to foreign investors for two large industrial enterprises. The emerging markets crisis has in many countries temporarily disrupted privatisation efforts and delayed sales of strategic stakes to foreign investors. With market confidence returning in the more advanced countries in the region, however, several large privatisations were recently announced, including the sale of Poland's largest commercial bank.

In some transition economies, the growth of the new private sector has become an important contributor to economic growth and the rising share of the private sector in GDP. In Poland, new private firms are outperforming privatised and state enterprises on all measures of performance. In Hungary, greenfield investments by international corporations are contributing over half of all export revenues. In the Caucasus, the growth of the new private sector is a key factor behind the rapid pace of recovery. In many other countries, however, entrepreneurial initiative remains stifled by weaknesses in the investment climate. Tax rules are opaque and tax rates cripple investment. The law is confused and ineffective. Complicated registration and licensing procedures discourage entry. A large proportion of private economic activity is thereby driven to the informal economy. A number of estimates suggest that the share of the unofficial economy in GDP may exceed a third in many CIS economies, including the Caucasus, Russia and Ukraine.

Legal environment

In general there has been an overall improvement in the legal environment across the region, but this improvement has been uneven. While many countries have established a fairly comprehensive commercial legal system (pledge, bankruptcy and company laws), implementation and enforcement of these new laws and regulations remains less effective. In a few countries (notably Croatia and Russia) there was a decrease in the effectiveness of the commercial legal structures, possibly due to the adoption of new and comprehensive laws that the countries are not yet equipped to put fully into practice. Overall, the creation of institutions to effectively implement commercial laws continues to lag behind the enactment of these new laws.

Growing demand for Bank's legal services and technical assistance

Similar developments can be seen in the banking, securities market and telecommunications sectors. While many countries have enacted modern, comprehensive laws and regulations in these sectors, they have yet to make the political and resource commitment necessary for the effective implementation of this legal framework. In the banking and securities markets, impediments to proper enforcement include lack of trained personnel, a failure to conduct regular supervisory examinations and an inability (due to lack of capability or to political constraints) to take prompt and frequent corrective action with respect to problematic institutions. In the same way, while most countries have taken steps to liberalise their telecommunications sector, the regulatory framework needed to ensure open and fair competition in the sector is in need of further attention and development.

In light of the financial crises in Asia and in Russia, there has been a growing recognition of the important role played by the legal institutions that underpin a modern market economy. As the EBRD has emphasised, legal institution building is crucial to a Russian recovery and the general strength of the transition process. This increased interest in legal reform has meant a growing demand for the services and technical assistance provided by the Office of the General Counsel (see box).

The EBRD continued its participation in the United Nations Commission on International Trade Law's efforts to develop international consensus on guidelines for specific commercial transactions. In particular, the EBRD participated in the experts group preparing legislative guidelines on privately funded infrastructure projects.

Legal transition

The EBRD's Legal Transition Programme (LTP) works to improve the legal environment of the Bank's countries of operations by fostering interest in, and helping define, legal reform throughout the region. Assisted by funding from a number of donors,[1] the LTP supports this goal by providing or mobilising legal technical assistance. LTP activities focus on the development of the legal rules, institutions and culture on which a vibrant market-oriented economy depends.

In the telecommunications sector, specific EBRD assistance was provided in 1998 to Belarus, Bosnia and Herzegovina, Lithuania and Poland. In Bosnia and Herzegovina the EBRD worked with the International Telecommunications Union and the Office of the High Representative, to help the authorities agree on a state telecommunications law and regulations for the establishment of the independent regulatory agency. A model of the licence for international service and a tariff policy were also agreed. In addition, the EBRD finalised funding and a consulting contract to provide telecommunications regulatory assistance to Albania. Future projects are expected to begin early in 1999 in Armenia, Kazakhstan and Ukraine.

Another growing area for legal technical assistance is the development of capital markets and improvement in corporate governance. During 1998, the EBRD finalised the funding and consulting agreements for a project to help the Czech Republic develop its Securities and Exchange Commission. A similar project is in the pipeline for the Slovak Republic for 1999. At the end of 1998, the EBRD finalised plans to work with the Russian Federal Commission for the Securities Market. Work will focus on developing specific capital market regulations and company law provisions to increase the transparency of Russian markets and to improve minority shareholder protection and other aspects of corporate governance. A similar project is expected to begin in Romania in 1999.

In 1998 the EBRD continued to provide assistance to its countries of operations in the development of secured transaction laws and the registry systems needed to effectively implement these laws. Specific assistance continued to be rendered to Hungary, Latvia and Romania, while new assistance was provided to Tajikistan. In Moldova, the EBRD and the German Agency for Technical Assistance produced a feasibility study for the introduction of a computerised pledge registry and are promoting changes to the existing pledge law. New secured transaction projects in 1999 are expected in the Czech Republic, Slovenia and Turkmenistan.

The EBRD continued to provide assistance to the Russian Government in 1998 on the implementation of its new bankruptcy law. The Bank also continued to provide assistance on the development of concession laws in the region, with a project in this area for Romania.

In addition to technical assistance, the EBRD enhanced its efforts to promote legal reform with the expansion of the Bank's legal journal, *Law in transition.* With an extended distribution list and issues in both English and Russian, *Law in transition* will be able to reach those people who make and influence legal reform in the EBRD's countries of operations.

1 Donors to the LTP comprise the European Community, France, Germany, Ireland, Italy (Central European Initiative), Japan, Luxembourg, Netherlands, Taiwan and the United Kingdom (Know How Fund).

Governance and financial discipline

Despite continued gains in labour productivity, particularly in central Europe and the Baltic states, the pace of enterprise restructuring remains slow and inconsistent in most transition economies. The most obvious indication of this is the persistence of unprofitable enterprises. In many countries, losses are concentrated among a few large enterprises. In Poland, the state-owned defence, chemicals, coal, steel and shipyard industries continue to record high losses. In the Czech Republic, two large conglomerates accounted for about a quarter of total losses in the industrial sector. In Russia, most large privatised companies in manufacturing were unprofitable even before the recent crisis. Restructuring the large loss-makers has proven to be a very difficult task, both in economic and political terms, especially in cases where these companies account for the livelihood of a whole city or region, which is a particular problem in Russia.

Poor corporate governance remains a key obstacle to enterprise restructuring and sustainable growth. Privatisation through vouchers and management-employee buy-outs has produced insider-dominated governance structures in many countries. Corporate control is often exercised by management without effective checks by independent shareholders or by the state, which often maintains residual stakes in privatised firms through its pension or privatisation funds. This has inhibited restructuring, especially reductions in the unproductive workforce. Yet there is little evidence that majority ownership by domestic outsiders has resulted in faster restructuring. Domestic banks and investment funds not only have little expertise in managing and restructuring firms, but often suffer from similar corporate governance problems themselves, most notably in the Czech Republic. There is evidence, however, that the profitability of new private enterprises and enterprises with a foreign majority owner exceeds that of state-owned and domestically privatised companies.

Weak financial discipline has remained the Achilles heel of many transition economies in the current phase of transition and is among the most important challenges for the future. Despite efforts to harden budget constraints for enterprises, there has been surprisingly little market exit of loss-making firms. Creditor-led bankruptcy is almost non-existent in

many transition economies, despite recent improvements in bankruptcy legislation in such countries as Azerbaijan, the Czech Republic, FYR Macedonia, Kyrgyzstan, Lithuania, the Russian Federation and the Slovak Republic. A common problem is the lack of institutional capacity on the part of the state to implement the law. Equally important has been the state's unwillingness to accept the employment implications of large-scale bankruptcies and to oppose existing vested interests that gained from the early stages of the privatisation process. In Russia, for instance, a range of enterprises in sectors such as defence, energy and agriculture as well as enterprises deemed of "strategic" importance have been shielded from bankruptcy by special decrees issued by the new government.

Governments have tended to move away from direct enterprise subsidies and towards greater use of indirect support through "soft budget constraints". These include low input prices and – increasingly – tolerance for tax arrears and arrears to the state utilities. In Russia and Ukraine there has also been a steep increase in barter and other non-monetary forms of payments, estimated at mid-1998 at over 50 per cent of industrial sales. Payments in kind to tax authorities and utilities often overstate the true value of the goods. Subsidised bank credits and, more often, the continued extension of credits to firms with a poor debt service record are still common in many countries, especially when there is cross-ownership between loss-making enterprises and banks. The state has also taken a prominent role in pressuring large banks (including privatised ones) to continue extending credit to loss-making enterprises.

In December 1998 the Working Group on Governance, Corruption, and Capacity Building of the Multilateral Development Banks (MDBs) met at the EBRD's headquarters. This working group was established at the last meeting of the heads of the MDBs in an effort to increase coordination and share lessons learned across regions on combating corruption and developing good governance in the EBRD's countries of operations. The Working Group's report was presented at the annual MDB meeting in January 1999.

Banking reform

The banking sector in transition economies remains generally underdeveloped, and bad loans continue to pose problems, largely due to weak lending practices maintained during the transition. However, progress on bank privatisation was made in 1998 in a number of countries, including Armenia, Bulgaria, Croatia, the Czech Republic, Kazakhstan, Poland and Romania. In some transition economies – including Albania, Azerbaijan, Belarus, Bulgaria, FYR Macedonia, Romania, Turkmenistan and Uzbekistan – extensive state influence remains a characteristic of the banking sector. While directed credits have been largely phased out, many state-owned banks continue to provide loans at artificially low interest rates to "priority" sectors, especially to agriculture.

Most transition economies made progress in adopting and implementing tighter prudential regulation over the past year. Minimum capital requirements and capital adequacy standards were gradually increased; international accounting standards and new regulations on connected lending and single-party exposure were implemented. However, a survey conducted by the EBRD in 1998 of legal experts in the region confirmed the substantial gap that exists between the extensiveness and the effectiveness of legal rules in banking and security activities, particularly in the CIS. In addition, central bank supervision remains very weak in a number of countries.

Joint Vienna Institute

In 1998 the EBRD delivered seminars on practical banking skills and enterprise management to senior managers in the EBRD's client companies and financial institution partners. These were undertaken through the Joint Vienna Institute (JVI), an international institution founded in 1992 by the EBRD, the Bank for International Settlements, the International Bank for Reconstruction and Development (World Bank), the International Monetary Fund and the Organisation for Economic Co-operation and Development. The JVI is also sponsored by the Austrian Government, the European Community and various bilateral donors.

The seminars were sponsored by the Bank's TurnAround Management Programme (see page 38), the Russia Small Business Fund (see page 27) and other EBRD teams, such as the power and energy team, with participation from EBRD lawyers. The Bank also continued to participate in the JVI's corporate governance and course design.

As of 1 January 1999, the JVI was expanded to include the World Trade Organization as a partner. In addition, all the sponsoring institutions elected to continue their involvement with the JVI for another five-year period until August 2004. The EBRD's decision was based on its view that a continuing demand for such training exists and that the JVI represents a cost-effective means of meeting this demand.

Supervisory weaknesses against the background of a growing intermediation of foreign capital flows through the domestic banking system have exacerbated the vulnerability of a number of transition economies to banking crises as a result of the collapse in investor confidence. The most glaring example is the financial crisis developing since mid-1998 in Russia, discussed below. Its effects have spilled over into other transition economies, most notably Latvia where some banks proved to have excessive exposure to the Russian state securities market. Inadequate domestic lending practices also continue to undermine the stability of banks across the region. In 1998, Croatia's fifth-largest bank collapsed, following overexposure to a single party with risky investment projects, and the Slovak Republic's third-largest bank was put under forced administration.

The non-bank financial sector remains as underdeveloped as the banking sector, despite gradual improvements in the regulatory and institutional framework. Market capitalisation on stock exchanges was relatively low in most transition economies in 1997 and decreased further in 1998 as a result of falling share prices. Many shares are illiquid and few are listed on the top tier of the market where stricter reporting requirements apply. Initial public offerings (IPOs) and capital increases through the stock market remain rare except in the context of the privatisation process.

The crisis in Russia and its implications

Events in 1998 were overshadowed by the serious downturn in economic activity in Russia, combined with the financial crisis and an effective default by the government on much of its domestic and foreign debt. The origins of the crash of Russia's financial markets lie in the country's incomplete stabilisation, allied to persistent macroeconomic imbalances and disappointingly slow structural reforms, especially enterprise reforms. Since 1995, the Russian government replaced monetary financing of the deficit with borrowing on the Treasury-bill market and on the international capital markets. In principle, this approach bought the government time to make progress in deficit reduction, structural reform and enterprise restructuring. However, channels of soft financing to enterprises remained significant. In addition, the Asian financial crisis raised the costs of borrowing and contributed to a decline in commodity prices.

As the stock of government debt grew without substantial progress in fiscal adjustments and structural reforms, domestic and foreign holders of Russian debt lost confidence in the government's repayment capacity, precipitating a devaluation of the currency on 17 August and a default on Russian domestic state securities. In a vain attempt to protect major Russian banks rocked by the devaluation and the default, the government declared a moratorium on payments of private sector debt to foreign creditors. These measures further undermined confidence and added to the financial crisis.

At the end of 1998, Russian policy-makers focused on short-term decision-making to stabilise the situation while continuing to avoid major structural and policy changes. Although a promising bank restructuring programme was approved, little progress has been made on implementation, especially the identification of the list of economically and socially important large banks to be rescued and the fate of failed financial institutions. The proposed 1999 budget, while not incorporating major new government expenditure as earlier feared, has still been criticised as unrealistic by the IMF. Agreement with the IMF over additional balance of payments support would be crucial, however, in paving the way towards restructuring Russia's external debt obligations and the return of foreign capital to Russia.

The Russian crisis has provided a stark reminder of the inter-relationship between microeconomic adjustment, the investment climate and the sustainability of macroeconomic stabilisation efforts. Russia's ultimate policy response to its ongoing deep crisis will be a key factor determining both directly (through its immediate economic impact) and indirectly (through its demonstration effects) the pace and direction of the transition process in the foreseeable future in much of the CIS.

Trends in macroeconomic developments

Economic growth

A review of the macroeconomic performance of the transition economies in 1998 reveals wide disparities. Output continued to grow strongly in a number of countries, exceeding 5 per cent in seven cases. However, economic activity in the region's largest economy, Russia, fell by an estimated 5 per cent, and prospects for a recovery in 1999 appear remote although industrial activity benefited from massive devaluation in the last months of 1998. The fallout from the Russian crisis has affected economic performance in part of the region, in particular in neighbouring CIS countries with weak economic fundamentals and strong trade links to Russia.

Fall in average growth in 1998

In central and eastern Europe and the Baltic states (CEE) the momentum behind strong economic growth evident during the first half of 1998 slowed in the second half. Average growth for the year is estimated

Trade exposure to the Russian Federation, Ukraine and Belarus

In per cent

	Share of exports of goods to Russia[1]	*Share of exports of goods to Ukraine*[1]	*Share of exports of goods to Belarus*[1]	*Total*	*Share of exports in GDP*[1]	*GDP exposure*[2]
Central and eastern Europe and the Baltic states[3]						
Bulgaria	7	3	0	**10**	47	5
Croatia	4	0	0	**4**	22	1
Czech Republic	2	1	na	**4**	43	2
Estonia	6	5	2	**13**	49	6
FYR Macedonia	2	8	1	**11**	36	4
Hungary	5	1	0	**7**	43	3
Latvia	21	4	3	**28**	32	9
Lithuania	7	9	12	**28**	44	12
Poland	4	5	1	**10**	20	2
Romania	3	1	0	**4**	24	1
Slovak Republic	3	3	0	**6**	45	3
Slovenia	4	1	0	**5**	47	2
Average	***6***	***4***	***2***	***11***	***38***	***4***
Commonwealth of Independent States						
Armenia	23	2	1	**26**	14	4
Azerbaijan	23	4	0	**28**	21	6
Belarus	59	15	–	**74**	55	41
Georgia	30	4	0	**34**	9	3
Kazakhstan	39	3	0	**42**	30	13
Kyrgyzstan	21	1	1	**23**	37	9
Moldova	63	5	2	**70**	38	26
Russia	–	9	6	**14**	20	3
Tajikistan	8	1	1	**10**	60	6
Turkmenistan	5	0	0	**5**	41	2
Ukraine	22	–	5	**27**	31	8
Uzbekistan	31	6	2	**39**	26	10
Average	***29***	***5***	***2***	***33***	***32***	***11***

Sources: IMF, *Direction of Trade Statistics Yearbook*, 1997; EBRD staff calculations.

Notes:

na not available. Totals may differ from the sum of individual columns due to rounding.

1 Exports of merchandise only. Figures from national authorities for total exports give considerably higher figures for all three Baltic countries.

2 Calculated as the total share of exports of goods to Russia, Belarus and Ukraine multiplied with the share of exports of goods in GDP. Indirect/second round effects are ignored.

3 Data for Albania and Bosnia and Herzegovina were not available from the IMF. National sources for Albania indicate only minor trade exposure to Russia.

Inflation continued to decline in a majority of the Bank's countries of operations in 1998

to have fallen to around 2.8 per cent compared with 3.6 per cent in 1997. None the less, the Slovak Republic and Slovenia have now joined Poland among the CEE countries where income levels exceed their 1989 level. Two of the countries less advanced in the transition – Albania and Bulgaria – showed a significant rebound of growth after severe crises in 1997, demonstrating the benefits of renewed commitment to stabilisation measures. In contrast, the Romanian economy continued to decline, by 4.5 per cent in 1998, reflecting underlying macroeconomic weaknesses, such as large fiscal and current account deficits, exacerbated by delays in implementing necessary structural reforms.

In the remainder of CEE, growth was remarkably resilient over the year, with the exception of the Czech economy, which had negative growth for the first time since 1992. The CEE region has benefited from the revival of domestic demand in western Europe, particularly in France and Germany. Growth fell significantly relative to the previous year, however, in the three Baltic countries.

Developments in the CIS in 1998 were affected by the recent events in Russia, and this has already had substantial implications for the remainder of the CIS. Although trade linkages have been much reduced since the beginning of transition, trade exposure (see table on page 17) meant that 1998 saw very few significant improvements (an exception being Turkmenistan following the collapse of gas exports and hence GDP in 1997). Ukraine shares many of the underlying structural weaknesses of Russia and has come under severe pressure following the devaluation of the rouble. As a result, economic recovery has been postponed yet again, and GDP is likely to have fallen around 1.5 per cent in 1998. The decline in oil and metal prices has significantly hurt Russia and all Central Asian economies, as well as Azerbaijan, albeit to varying degrees. Tajikistan also remains very volatile, given the continuing political disturbances there, and the sustainability of the reported high growth rates in Belarus is highly questionable.

Stabilisation

Inflation continued to decline in a majority of countries in 1998, helped by low commodity prices and the tightening of domestic liquidity following capital outflows from the region during the second half of the year. In CEE, achievements in the reduction of inflation in Albania and Bulgaria from high and hyper-inflationary levels respectively in 1997 are particularly notable, with the latter achieving a fall in the end-year inflation rate from over 500 per cent in 1997 to 1 per cent in 1998. Improvements in Romania have been slower to materialise, largely because of stalled economic and political reforms and rising fiscal imbalances. End-year inflation stayed close to 50 per cent in 1998. Elsewhere in CEE, inflation rates for 1998 were in single-digit or low double-digit figures. Latvia, Lithuania and FYR Macedonia now have end-year inflation rates close to or below the EU average of around 2 per cent, while Hungary and Poland, which are among the five countries of the region that have started the EU negotiation process, recorded end-year inflation considerably above this level.

In the CIS, the progressive reduction in end-year median inflation achieved over the previous years was not repeated in 1998 as the median rate increased from 13 per cent in 1997 to 18.3 per cent in 1998. Below this trend of moderately higher inflation lie very substantial cross-country differences, both in inflation rates and in the direction of change. In Armenia, Azerbaijan, Kazakhstan and Tajikistan, exchange rates held up in the face of significant pressure after the Russian crisis, and as a result these countries have experienced substantial reductions in inflation on the back of tight monetary policies and cheap imports from Russia. In the remainder of the CIS, exchange rate depreciation has driven inflation up, although only Russia and Belarus have experienced serious monetary destabilisation, with end-year inflation reaching 85 per cent and 178 per cent respectively in these two countries.

The reversal in macroeconomic stabilisation in Russia highlights the risks of a stabilisation strategy that relies almost exclusively on monetary policy and fails to address underlying fiscal imbalances. While governments may finance budget deficits temporarily through issuing securities on the region's nascent capital markets, structural reforms need to be undertaken simultaneously to help close the financing gap. Otherwise, confidence may easily break down – leading as in Russia to a currency collapse and a serious financial crisis. Against this background, the continuing fiscal imbalances across many countries in the region are a cause of concern.

Revenue collection remains the most pressing issue in much of the CIS. In countries such as Georgia and Tajikistan, both of which have suffered serious internal conflict, revenues are barely 10-15 per cent of GDP. Estimates for 1998 indicate that the number of countries in the region with fiscal deficits exceeding 5 per cent of GDP grew from six in 1997 to eight in 1998, five of which are in the CIS.

Foreign direct investment

(net inflows recorded in the balance of payments)

	1994	*1995*	*1996*	*1997 (revised)*	*1998 (estimate)*	*Cumulative FDI-inflows 1989-98*	*Cumulative FDI-inflows 1989-98 per capita*	*FDI-inflows per capita 1997*	*FDI-inflows per capita 1998*	*FDI-inflows as % of GDP in 1997*	*FDI-inflows as % of GDP in 1998*
			(in millions of US dollars)					*(in US dollars)*		*(% of GDP)*	
Albania	65	89	97	42	45	423	132	13	14	1.9	1.5
Bulgaria	105	82	100	497	240	1,162	140	60	29	4.8	1.9
Croatia	102	88	529	346	700	1,874	416	72	156	1.8	3.4
Czech Republic	749	2,526	1,388	1,275	1,600	9,073	881	124	155	2.5	2.9
Estonia	212	199	110	130	400	1,208	833	90	276	2.8	7.4
Hungary	1,146	4,453	1,983	2,085	1,700	17,134	1,694	206	168	4.6	3.6
Latvia	155	244	376	515	200	1,584	634	206	80	9.3	3.2
Lithuania	31	72	152	328	950	1,563	422	89	257	3.4	9.2
FYR Macedonia	24	13	12	30	115	194	97	14	58	0.9	3.7
Poland	542	1,134	2,768	3,041	6,600	15,066	389	79	171	2.2	4.5
Romania	341	417	263	1,224	1,900	4,370	193	54	84	3.5	4.3
Slovak Republic	250	202	251	177	360	1,614	299	33	67	0.9	1.7
Slovenia	128	176	186	321	165	1,239	619	161	83	1.8	0.8
Central and eastern Europe and the Baltic states	*3,851*	*9,694*	*8,216*	*10,011*	*14,975*	*56,503*	*368*	*65*	*98*	*2.0*	*2.8*
Armenia	3	19	22	51	140	235	63	14	38	3.1	7.6
Azerbaijan	22	282	661	1,093	1,077	3,155	415	144	142	28.4	26.2
Belarus	11	7	70	190	50	344	34	19	5	1.4	0.3
Georgia	8	6	54	189	219	477	89	35	41	3.6	4.3
Kazakhstan	635	964	1,137	1,320	1,300	5,829	383	84	86	5.9	5.9
Kyrgyzstan	45	96	46	83	52	332	72	18	11	4.9	3.1
Moldova	18	73	56	64	100	342	79	15	23	2.9	5.8
Russia	539	1,710	1,700	3,752	1,500	9,201	63	25	10	0.8	0.5
Tajikistan	12	17	20	30	12	100	17	5	2	2.7	1.0
Turkmenistan	103	233	129	108	110	762	157	23	23	5.9	5.2
Ukraine	100	400	526	600	700	2,726	54	12	14	1.2	1.7
Uzbekistan	73	-24	90	167	170	533	23	7	7	1.2	1.2
Commonwealth of Independent States	*1,568*	*3,783*	*4,511*	*7,647*	*5,430*	*24,036*	*85*	*27*	*19*	*1.3*	*1.3*
Total	**5,419**	**13,477**	**12,727**	**17,658**	**20,405**	**80,539**	**185**	**40**	**41**	**1.6**	**1.8**

Sources: IMF, central banks and EBRD estimates.

Note:

For most countries, figures cover only investment in equity capital and in some cases contributions-in-kind. For those countries (e.g. Estonia, Slovak Republic) where net investment into equity capital was not easily available, more recent data include reinvested earnings as well as inter-company debt transactions. The increasing outward FDI flows of transition economies are driving a wedge between net and gross FDI inflows. For instance, in Croatia gross inward FDI was US$ 346 million, whereas outward FDI flows amounted to US$ 150 million.

External balances and capital flows

Fiscal deficits continue to be "twinned" in a number of countries with current account deficits. External balances in the transition economies in 1998 have been subjected to a combination of external shocks, including the impact of the Asian crisis on world markets (which has put severe downward pressure on commodity prices), and more recently a dramatic swing in Russia's current account balance. After moving into deficit during the first half of the year, the devaluation of the rouble and the associated decline in demand for foreign goods has led to a positive end-year balance in Russia. This swing in Russia's external balance is expected to have a deep impact on most countries in the CIS, and some countries in CEE, and has generally led to wider current account deficits in 1998 than were earlier anticipated.

High current account deficits have been a characteristic of a large number of transition economies in recent years. Current account deficits above 7 per cent of GDP were recorded in 15 countries in 1998 against nine such cases in 1997. Current account deficits have in the past been partially driven by substantial capital inflows, reflecting growing investment opportunities across the region and trends in global capital markets. In central European countries such as Hungary and Poland, current account deficits are associated with booming investment activity and intense restructuring of domestic production. Higher investment rates are contributing to better export performance, and thereby laying the basis for a future redemption of foreign liabilities incurred during the period of reconstruction.

Financial crises in 1998 fundamentally altered conditions on international capital markets

However, with the reversal of liquidity conditions in the international capital market, only the most advanced reformers are likely to be able to continue to finance current account deficits with stable long-term flows. In many CIS countries, including Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan, Moldova and Turkmenistan, current account deficits and the loss of competitiveness *vis-à-vis* Russia have begun to trigger policy adjustments in the form of exchange rate depreciation and a tightening of the fiscal stance.

The Asian and Russian crises fundamentally altered conditions on international capital markets in 1998. While the 1990s were characterised by the rapid growth of private capital flows to emerging markets, the scale of losses made by international investors in Russia as well as in Asia is likely to moderate sharply their appetite for risk. Large institutional investors may retreat from these markets for some time. Moreover, the scramble for liquidity since mid-August has led to "technical" sales by international investors to meet margin calls, driving down asset prices and leading to an outflow of short-term funds largely across all emerging markets.

None the less, the impact has been highly differentiated both across countries and across types of capital flows. Markets discriminate between borrowers on the basis of their macroeconomic fundamentals, and may have overreacted initially in some of the more advanced transition economies, which continue to display strong fundamentals. Spreads on international bond issues by borrowers from the region are already reflecting a sharp differentiation.

With respect to the types of capital flows, in the short run, countries relying on foreign direct investment (FDI) are likely to be less affected by the present volatility in international capital markets than countries where short-term portfolio investment played a major role in external financing. FDI in particular is motivated by the long-term economic opportunities in the region and comes together with significant changes in corporate governance in the recipient enterprises. Foreign direct investors therefore have both the ability and the incentives to maintain their assets through "voice" or active involvement, rather than through "exit". Indeed, recent projections for FDI into seven major east European recipient countries do not suggest a significantly negative impact from the Russian crisis, except for Russia itself (see table on page 19). A slow-down of FDI inflows into the region is none the less a possibility, and it would become far more likely should governments delay structural reforms in response to external difficulties.

The impact on other types of capital flows is likely to be more pronounced than in the case of FDI. A number of transition economies postponed Eurobond issues planned for 1998, including Kazakhstan and Moldova. Syndicated lending will also be cut, as banks become more cautious lenders and take time to rebuild their capital – a process already in evidence during much of 1998. More immediately, a large number of countries, including the most advanced transition economies, were affected by an outflow of short-term portfolio investments in the domestic money and equity markets.

However, the withdrawal from the fixed income markets of the Czech Republic, Hungary and Poland earlier in 1998 has already been largely reversed, whereas capital outflows from countries with weaker fundamentals, such as Romania, Russia and Ukraine, are unlikely to turn around in the near future. Most other CIS countries have not attracted significant portfolio flows in the past. Official financing, including from the IFIs, should cushion somewhat the impact of external shocks to these countries' balance of payments, although countries such as Kazakhstan and Turkmenistan are also likely to experience a net outflow of short-term bank lending.

EU accession process shares common objectives with Bank's transition mandate

Accession to the European Union

Negotiations on accession to the European Union were initiated on 30 March 1998 with five countries of operations of the EBRD: the Czech Republic, Estonia, Hungary, Poland and Slovenia. The other accession countries among the EBRD's countries of operations are Bulgaria, Latvia, Lithuania, Romania and the Slovak Republic. The accession process will contribute to strengthening the institutional framework of applicant countries while fostering trade and investment in the region. For these reasons, the EBRD believes that accession to the EU will promote growth and stability in the countries concerned. The Bank recognises that the enlargement of the EU will have important implications for EBRD operations in advanced countries. The Bank's strategy also emphasises the common objectives shared by the EU accession process and the EBRD's transition mandate. In 1998 the level of EBRD investment in accession countries increased significantly.

To assist the accession to the EU, the European Commission is enhancing its financial assistance for the accession countries to promote the adoption of EU legislation. The European Commission took the initiative to coordinate with the EBRD and other IFIs to ensure that their combined activities in the accession countries achieve maximum impact. A memorandum of understanding between the EBRD, the European Commission and the World Bank, concluded on 30 March 1998, outlines principles of cooperation and establishes the eligibility and selection criteria for co-financing projects in the candidate countries. Regular high-level and Working Group meetings have been set up to facilitate cooperation and joint action. This process has already been launched for Phare, and it will also be extended to the new EU structural instruments for pre-accession and agricultural reform.

Co-investment is the main area of direct cooperation between the EBRD and the European Commission. In 1998 EU Phare co-invested ECU 60 million alongside the EBRD in environmental, municipal infrastructure and transport projects in accession countries. Further work took place during the year on the co-financing pipeline for 1999, in particular on two joint-finance facilities: the SME facility, targeting SMEs in accession countries; and the dairy facility, supporting Polish dairies in need of investments to meet EU standards. Both are expected to become operational in 1999.

The EBRD cooperates closely with the European Commission in key industrial sectors, such as steel, energy production, nuclear safety, the environment, transport and telecommunications. The Bank also continued to provide technical services to Phare and its beneficiary countries in 1998 on a cost-recovery basis. During the year EBRD bankers and lawyers advised the Czech Securities and Exchange Commission, the Agency for Industrial Development in the Slovak Republic and the Government of Romania on the design of new security and concession laws.

Review of 1998 operations

Transition checklist

The EBRD's projects are assessed in terms of how they contribute to:

- greater competition in the sector;
- stimulation of competition in other sectors;
- more widespread private ownership;
- institutions, laws and policies that promote market functioning and efficiency;
- development of skills;
- demonstration of new approaches that can be adopted elsewhere;
- setting standards for corporate governance and business conduct.

Confronted with significant challenges in its region of operations during 1998, the EBRD worked assiduously to find solutions to the issues facing the Bank while fulfilling, and in many cases exceeding, business plan objectives. The EBRD maintained a steady focus on achieving transition throughout its countries of operations and project portfolio and implemented a number of measures to further increase the effectiveness of its operations.

Through its projects and dialogue with authorities in its countries of operations, the EBRD paid particular attention to enhancing the Bank's support for the transition process. This is reflected in projects such as Podravka in Croatia, Pekao SA and the Krakow urban transport project in Poland, and the Grain Receipt Programme in the Slovak Republic. The structure of country strategies was modified to focus on specific transition objectives and to present the proposed operational strategy in relation to these objectives. Detailed assessments of how the Bank's projects will advance the transition now occur at an early stage in the project processing cycle to ensure that operations are designed to achieve the highest possible impact in the region. Detailed transition checklists have been developed to assess the contribution of individual projects to the transition of different sectors.

Outstanding commitments totalled ECU 10.2 billion, 15% higher than at the end of 1997

Overview

The EBRD's portfolio continued to grow at a sustained pace in 1998, with outstanding commitments reaching ECU 10.2 billion, an increase in the portfolio of 14.6 per cent since the end of 1997. The number of operations monitored increased by 13 per cent, from 413 at the end of 1997 to 465 at the end of 1998. Gross disbursements were ECU 2.4 billion, 20 per cent higher than in 1997. Net disbursements at the end of the year comprised ECU 4.3 billion of loans and ECU 1.4 billion of equity investments, for a total of ECU 5.8 billion.

Despite the increased uncertainty in the operating environment during the second half of 1998, the EBRD achieved the highest level of annual commitments to date with signed new commitments for the year amounting to ECU 2.37 billion, in line with the budget target of ECU 2.4 billion. The EBRD signed 96 new projects in 1998 in 24 countries (the exceptions being Armenia and Turkmenistan), achieving a significant number of commitments in those countries at the advanced stages of transition.

The EBRD's Board of Directors approved 82 projects amounting to ECU 2.0 billion in 1998. This was lower than the level recorded in 1997 due to greater operational uncertainty in 1998 and the significant number of projects approved in the last quarter of 1997.

The EBRD achieved a high level of mobilisation of 3.2 in 1998, compared with the cumulative average of 2.6. This means that the ECU 2.4 billion of direct Bank commitments mobilised a further ECU 7.5 billion, bringing the total resources committed by other investors as part of EBRD operations to ECU 30.9 billion.

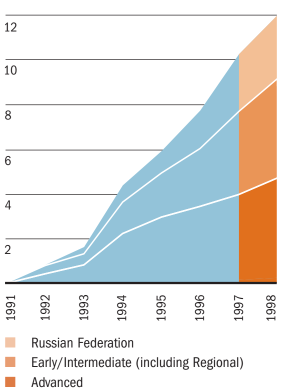
The continued focus on private sector development led to a further increase in the private sector share of the portfolio ratio. This share reached 80 per cent in 1998 against 76 per cent in 1997. The EBRD includes within this share a number of projects classified by the Bank as private sector but which include a strong involvement of the state, such as pre-privatisation transactions, sovereign-guaranteed credit lines, municipal loans and projects involving significant state undertakings. The EBRD also maintained a significant public infrastructure investment programme. Taken together, these projects accounted for 43 per cent of the 1998 programme.

The equity share of the 1998 programme reached a high level of 33 per cent, compared with a planned level of 22 per cent. This was achieved through EBRD participation in a number of large equity transactions, such as Lafarge Romcim, CS pre-privatisation equity, Telekomunikacja Polska SA and Stalexport.

In spite of earlier concerns at the beginning of the year on the achievable level of new commitments in the countries at advanced stages of transition, the EBRD channelled 40 per cent of its new investments in 1998 to these countries. The level of annual new commitments increased from ECU 556 million in 1997 to ECU 952 million in 1998. The relative share and volume of commitments in early/intermediate transition countries remained stable, with a slight decline of commitments from ECU 998 million to ECU 875 million. The share of annual new commitments accounted for by the Russia programme decreased from 32 per cent in 1997 to 23 per cent in 1998, reflecting the impact of events in Russia.

Cumulative commitments by transition stage

at 31 December 1998 (ECU billion)



Considering the significant size of the portfolio of investments that has been established since the start of the EBRD's operations, increased attention is being devoted to portfolio management. Portfolio managers have been appointed within each Banking Department team. For the first time, the preparation of the 1999 business plan included analysis to aid preparation of projects consistent with effective portfolio management. For example, this enables the EBRD to undertake a number of low-risk projects in order to balance the portfolio consequences of geographical diversification into countries at the earlier stages of transition. Following a rapid initial reaction to events in Russia, early warning procedures were initiated for neighbouring countries to assess trends, identify potential issues at an early stage and take mitigation measures in close cooperation with clients and country authorities.

A number of important innovations were introduced in 1998 with a sizeable impact on the quality and efficiency of the EBRD's work. These include the revision of the Banking team appraisal system, which introduced an enhanced focus on qualitative aspects, such as transition impact, credit quality and profit/loss awareness, and the introduction of a streamlined Operations Committee documentation and approval process in line with the ZBB recommendation (see page 10). Further, important management initiatives regarding human resources were carried out, including a skills review and strategic assessment of human resources in the Banking Department, and the further strengthening of Resident Offices in the Bank's countries of operations. There was also further consolidation of teams at headquarters and an increase in the level of private sector experience and skills in the infrastructure teams.

EBRD financing committed by country

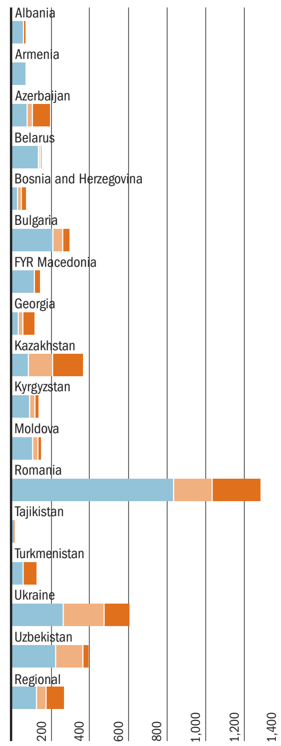
	1998			Cumulative to 31 December 1998		
	Number[1]	*ECU million*	*%*	*Number*[1]	*ECU million*	*%*
Tajikistan	1	4	<1	3	13	<1
Albania	1	7	<1	8	68	1
Armenia	–	–	–	3	69	1
Bosnia and Herzegovina	2	23	1	7	70	1
Georgia	3	59	2	9	115	1
Turkmenistan	–	–	–	4	126	1
Kyrgyzstan	1	18	1	9	136	1
FYR Macedonia	2	28	1	9	143	1
Moldova	2	15	1	11	149	1
Belarus	1	3	<1	7	151	1
Lithuania	3	39	2	13	173	1
Azerbaijan	4	88	4	9	193	2
Latvia	3	38	2	17	213	2
Estonia	7	86	4	28	247	2
Regional	6	91	4	22	266	2
Bulgaria	2	33	1	20	296	2
Slovenia	1	6	<1	19	307	3
Kazakhstan	4	157	7	7	364	3
Uzbekistan	1	29	1	12	394	3
Slovak Republic	3	44	2	18	395	3
Croatia	6	170	7	21	511	4
Czech Republic	2	87	4	24	525	4
Ukraine	6	133	6	24	605	5
Hungary	2	68	3	49	1,053	9
Romania	7	252	11	41	1,283	11
Poland	11	354	15	70	1,309	11
Russian Federation	15	541	23	87	2,837	24
Total	**96**	**2,373**	**100**	**551**	**12,010**	**100**

[1] Operations may be counted as fractional numbers if multiple sub-loans are grouped under one framework agreement.

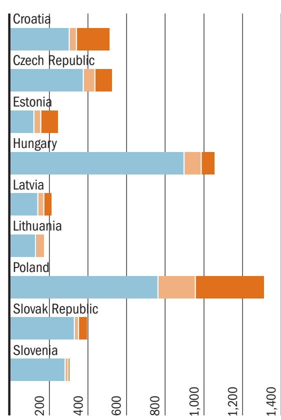
Cumulative EBRD commitments by country by year

at 31 December 1998 (ECU million)

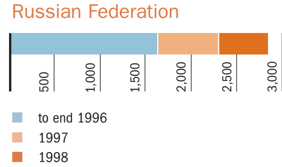
Early/Intermediate



Advanced

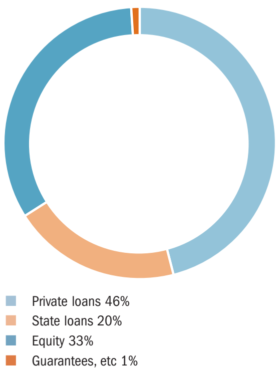


Russian Federation



EBRD financing committed by type of facility

1998



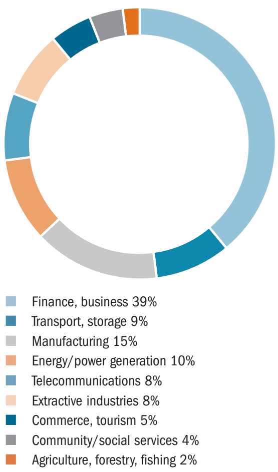
EBRD financing committed by type of facility

	1998			Cumulative to 31 December 1998		
	Number	*ECU million*	*%*	*Number*	*ECU million*	*%*
Private loans	42	1,097	46	248	5,754	48
State loans	16	470	20	113	3,693	31
Equity	37	773	33	183	2,360	20
Guarantees, etc[1]	2	33	1	7	203	2
Total	**96**	**2,373**	**100**	**551**	**12,010**	**100**

1 Guarantees and other off-balance-sheet items.

EBRD financing committed by sector

1998



EBRD financing committed by sector[1]

	1998			Cumulative to 31 December 1998		
	Number	*ECU million*	*%*	*Number*	*ECU million*	*%*
Finance, business	44	933	39	219	3,681	31
Transport, storage	10	223	9	71	2,222	19
Manufacturing	16	351	15	94	1,742	15
Energy/power generation	7	245	10	47	1,571	13
Telecommunications	4	194	8	34	1,082	9
Extractive industries	4	185	8	19	767	6
Commerce, tourism	3	111	5	24	382	3
Community/social services	5	96	4	20	265	2
Agriculture, forestry, fishing	3	36	2	21	260	2
CEALs, co-financing lines and RVFs[2]	–	–	–	2	38	<1
Total	**96**	**2,373**	**100**	**551**	**12,010**	**100**

1 These aggregated sector groups do not always match the sectors discussed in the following pages. For example, the finance, business sector includes service industry and does not equate with the financial institutions sector.

2 Central European Agency Lines, Regional Venture Funds.

Financial institutions

The EBRD aims to strengthen the financial sector in its countries of operations by investing directly in financial institutions and by providing funds to the enterprise sector via local intermediaries. The year was dominated by the financial crisis in the Russian Federation, which significantly affected the EBRD's operations in the banking sector. Despite these developments, the Bank continued to recognise the importance of supporting the financial sector and signed 44 operations during the year for a total of ECU 894 million. With these new commitments, the EBRD's portfolio in the financial sector amounts to ECU 3.6 billion, representing 30 per cent of the total value of the Bank's operations at the end of the year.

Financial institutions are a high priority for the EBRD. They play a central role in a market economy by performing a number of fundamental economic functions, such as the mobilisation and allocation of savings, the monitoring of financial assets and the provision of international and domestic payment systems. By working to modernise and develop the financial sector in the region, the Bank hopes to facilitate its operations and stimulate business growth through an increase in locally available finance, as well as through improved financial and payment services.

Operations in the Russian banking sector

The financial crisis in August 1998 had a substantial effect on the EBRD's operations in Russia's banking sector. The accelerating withdrawal of foreign capital from Russia's financial markets quickly caused increasing pressures on the asset bases of the major Russian banks and exposed weaknesses in the risk management practices of many of them. Following the Federal Government's debt default in August, the capital base of each of the Bank's investee and debtor banks in Russia was severely eroded. This was further exacerbated by the effect of the resultant sharp currency devaluation and by a less-than-effective response by the regulatory authorities.

By the end of 1998, it had become apparent that a great number of Russian banks were insolvent and that many faced severe liquidity difficulties. The EBRD's major focus in this sector during the latter part of the year was on asset protection, mainly through involvement in debt recovery and in debt-rescheduling activities.

The EBRD undertook a review of all facilities that had been provided to Russian banks and disbursements were very carefully monitored. The outlook for resumption of lending and investment activities in support of the rehabilitation and growth of the sector remains very uncertain. EBRD activities within Russia's financial sector are likely to focus for the foreseeable future on asset recovery, policy dialogue and technical assistance activities designed to ensure that a stronger and more effective regulatory structure can be put in place in a timely manner. Financing activities are likely to continue only within the context of the Russia Small Business Fund and trade facilitation (see page 27), and with those banks that emerge from the crisis during the first half of 1999 in a strong and sustainable financial condition.

Equity investments in banks

At the end of 1998, the EBRD had invested in the share capital of 51 banks in 22 countries. During the year the Bank was involved in a number of significant projects involving the privatisation of state-owned banks, providing both equity investments and pre-privatisation loans. In most cases where the EBRD is a shareholder, it will appoint one or two members to the supervisory council of the bank to promote corporate governance, management accountability, sound banking principles and proper environmental practices.

In Poland the EBRD became a shareholder in Pekao, the largest banking group in the country. The EBRD's investment of ECU 88.1 million contributed to a capital increase and will assist Pekao in achieving its objective of promoting majority private ownership. At the same time, the EBRD is helping the bank to meet capital-adequacy requirements during its privatisation and consolidation process, enhancing operational flexibility.

44 financial sector operations signed in 1998, for a total of ECU 894 million

Bank Pekao, Poland

EBRD signed operations to financial institutions

Cumulative as at 31 December 1998

	Number of projects	*ECU million*	*%*
Banks	**155**	**2,906**	**80**
Equity investments	58	547	15
Loans without sovereign guarantee	71	1,329	37
Loans with sovereign guarantee	22	923	25
Trade Facilitation Programme	4	107	3
Other financial institutions	**13**	**55**	**2**
Equity investments	13	55	2
Loans	–	–	–
Equity funds	**50**	**671**	**18**
Donor-sponsored funds[1]	13	248	7
Venture equity funds	22	185	5
Large equity funds	15	238	7
Total	**218**	**3,632**	**100**

1 In addition, the EBRD has approved a further ECU 377 million donor-sponsored funds which are as yet unsigned.

International Bank of Azerbaijan

To support the first privatisation of a rehabilitated bank in Croatia, the EBRD concluded an ECU 4.5 million equity investment and a convertible loan of ECU 5.1 million with Slavonska Banka d.d. Osijek (SBO), one of the largest banks in the country. The main objective of the EBRD's investment was to assist in the bank's privatisation and stabilisation by buying out the Croatian Rehabilitation Agency and by granting long-term financing to SBO. The strategic partner in this project is Kärntner Landes-und Hypothekenbank.

The EBRD completed its first equity investment in a bank in the Czech Republic in 1998 by purchasing shares in Ceska Sporitelna (CS), the largest bank in the country in terms of retail deposits (45 per cent of the market) and the second-largest bank in terms of total assets. The Czech Government has declared its intention to proceed swiftly with the privatisation of CS while the restructuring of the loan portfolio and the operations of the bank are carried forward. The EBRD's presence in the shareholding has enabled CS to stabilise its ownership and to strengthen the bank's liquidity and capital base.

The EBRD's first equity investment in a bank in Belarus was also completed in 1998, with the Bank becoming a 25 per cent shareholder of Priorbank. In the course of 1998, further equity investments in banks were made in Croatia, Poland, Romania, Russia, the Slovak Republic and Ukraine.

The EBRD divested from its investments in five banks in 1998. These included the sale of its equity stake in the Hungarian Foreign Trade Bank Ltd, which in 1994 had been the first financial institution in Hungary to be privatised, and a partial divestment from Poland's Bank Przemyslowo-Handlowy S.A. The EBRD had supported the latter during the first stage of privatisation in 1994, when the Bank became the second-largest shareholder with 15 per cent of the share capital.

Loans to banks

EBRD loans to banks totalled over ECU 2.2 billion by the end of 1998

At the end of 1998, the EBRD had extended loans to banks for a total amount of over ECU 2.2 billion. Over 80 per cent of these loans are credit lines to be on-lent to small and medium-sized enterprises (SMEs). The remainder include convertible loans, mortgage financing facilities, stand-by and guarantee programmes, as well as loans extended under the Russia Small Business Fund (see page 27).

Small and medium-sized enterprises

Through the majority of its loans to banks, the EBRD is able to mobilise funding for local projects that are too small for it to handle directly. Providing access to investment finance for SMEs is a crucial part of the Bank's efforts to strengthen private sector development and to stimulate competition in the enterprise sector. In addition, these facilities are intended to support the development of the banking sector by improving banks' ability to appraise new projects and to follow environmental guidelines provided by the EBRD.

The EBRD's first financial sector project in Azerbaijan was signed in 1998. A credit line of ECU 2 million was extended to the International Bank of Azerbaijan under an ECU 18 million multi-bank framework financing facility approved by the Bank's Board of Directors in December 1997.

In cooperation with the World Bank, the EBRD provided an SME recovery credit line of ECU 7 million in Albania in 1998 to help the emerging private sector. This is being channelled through two local private banks – Banca Italo-Albanese, in which the EBRD is a shareholder, and Tirana Bank.

In Ukraine a second SME credit line was concluded during the year. The financing has three components: to continue the funding of small and medium-sized private enterprises; to provide micro loans to qualified small borrowers; and to provide a framework for direct lending in the form of credit lines and secured loans. The first two components are guaranteed by the Government of Ukraine, while the EBRD will assume the credit risk of the domestic banks for the third component.

To promote micro-lending, the EBRD started an ECU 66.5 million Small Business Programme in Kazakhstan, which is similar to the Russia Small Business Fund. By the end of the year, a total of six banks had been included in the facility, which is guaranteed by the Ministry of Finance. The programme is benefiting from technical assistance funding from Chevron Corporation, one of the largest foreign direct investors in the country.

Elsewhere in Central Asia the EBRD extended a second sovereign-guaranteed credit line of ECU 17.1 million in Kyrgyzstan, the first credit line having achieved full disbursement in March 1998.

Russia Small Business Fund

The EBRD's largest micro and small loans programme, the Russia Small Business Fund (RSBF), experienced a difficult year in 1998. Before the financial crisis in August, the Fund had consolidated the progress made in 1997, with lending volumes increasing consistently and the area of operations expanding. Arrears levels were reported in July at 2.7 per cent for small loans and 1.6 per cent for micro-loans, with the Fund operating through 12 banks and in over 30 towns and regions across Russia. Following the Government's default on its domestic debt and the subsequent banking crisis, however, most of the programme's key partner banks were financially paralysed.

The EBRD is seeking to preserve the programme in several ways. First, intensive discussions are under way with the Savings Bank of the Russian Federation, Sberbank, to ensure that pre-crisis progress is not lost. In fact, by December 1998, Sberbank had managed to restore SME lending volumes to the levels that had been reached before the crisis. Second, work will continue in due course with smaller regional banks that were less affected by the crisis and that can demonstrate the necessary financial stability. Third, the EBRD is considering investing in a newly established Russia Microfinance Bank (RMB), which is to focus on providing financial services to micro and small enterprises. RMB would absorb a portion of the loan portfolios from the defunct partner banks and, most importantly, would be staffed with loan officers who have received training under the RSBF. In this way, the skills developed over the first four years of the RSBF would be preserved within the Russian banking system.

Since the crisis, micro and small enterprises in Russia have shown great resilience and adaptability. Many have proved more flexible than larger competitors and have seized opportunities and market niches that have opened up. For example, there have been many opportunities for import substitution and already the programme is seeing some very strong proposals, with higher margins and stronger cashflows than previously, in a number of sectors. These include food processing, clothing, machine tools, furniture production, construction and renovation. In analysing these clients, it is apparent that the reduction in competition from imports and the opportunities that arise in periods of economic downturn are providing profitable niche activities. This is also true for producers, traders and service sector companies that operate at the lower end of the market or that have been able to shift their product mix quickly to less expensive items.

As a result of this flexibility, there has not been the expected large increase in real arrears cases in the programme. About half of the arrears cases that have arisen are technical in nature, and linked to the failure of the banking system to make payments. A degree of optimism therefore remains, although 1999 will be a year for rebuilding rather than expansion.

Other loans

To support the development of the mortgage market, the EBRD extended financing of ECU 51.1 million to Zagrebacka Banka, the largest private bank in Croatia. The funding will be on-lent to private individuals for the purchase or renovation of residential property.

In 1998 the EBRD arranged its first major syndicated loan to a financial institution, providing financing of ECU 26 million for AS Hansapank, the largest bank in the Baltic states. The transaction was also the first syndication launched in the market after the August financial crisis (see page 46). A number of subordinated and/or convertible loans were extended by the EBRD during the year to Bank Post in Romania, Slavonska Banka in Croatia, Hansapank in Estonia, the Bank of Georgia, Kazkommertsbank in Kazakhstan, and Agricultural Bank, Bankas Hermis and Vilnius Bank in Lithuania. In most instances, these loans were the first of their kind in each country. Subordinated debt is increasingly used by the EBRD to support the recapitalisation of local financial institutions.

Trade Facilitation Programme

The EBRD's trade facilitation programme has increased the ability of local intermediaries to offer trade finance (both import and export). In 1998 the use of existing facilities, such as EBRD guarantees, declined as many banks gained access to the commercial market, but trade facilitation products continued to be important in the less advanced countries. New exposures were approved in Georgia, Kazakhstan and Uzbekistan.

A review of the EBRD's trade facilitation products was undertaken in 1998, which resulted in the approval of a new Extended Trade Facilitation Programme in January 1999. Covering all 26 countries of operations, the new programme brings together all the Bank's existing trade facilitation projects for local banks into a single streamlined programme to meet the needs of the changing environment in the region.

ECU 272 million disbursed by RSBF to over 23,500 sub-borrowers by end of 1998

Russia Small Business Fund

Trade Facilitation Programme extended to cover all of the Bank's countries of operations


Bank of Georgia

A number of important changes have been made to provide greater flexibility. These include simplifying the procedure for the issue of EBRD guarantees, extending the amount of the guarantee to up to 100 per cent of the face value of the underlying trade finance instrument, and extending EBRD cover to advance payment bonds and other instruments in addition to letters of credit.

Other financial institutions

In 1998 the EBRD continued to expand its portfolio of equity investment in the insurance and pensions sectors. The Bank was particularly involved in pension reforms in Hungary and Poland in the wake of the newly introduced three-pillar reforms in both countries in 1998. Under these reforms, the first pillar consists of a state pay-as-you-go system, the second pillar is a funded scheme, mandatory for a certain section of the working population, while the third pillar is a funded scheme for additional voluntary contributions.

The EBRD completed two transactions in Poland, becoming a shareholder of Winterthur Pension Fund Company and Energo Asekuracja S.A., a non-life company. In Hungary, the Bank completed an equity investment in Winterthur Biztosito, a local insurer. The EBRD also became a shareholder in Nordika insurance, the fifth-largest Estonian non-life insurer.

The EBRD continued to develop its strategic partnerships with Western insurance groups and signed a framework agreement with the Austrian BARC/Bundesländer Group in 1998.

Equity funds

ECU 4.6 billion mobilised for the private sector through EBRD's private equity funds

Private equity funds are the most significant source of equity financing for SMEs in the EBRD's countries of operations. The funds are a very effective intermediary for mobilising additional sources of financing, which occurs initially at the fund level as investors commit their capital. The second stage takes place at the investee company level as equity investment enables investee companies to obtain additional local debt and/or equity financing.

The importance of equity funds in the overall activity of the EBRD is growing. By the end of 1998 the EBRD had committed over ECU 670 million to 50 equity funds, making it the largest investor to this segment in its countries of operations. By fostering sound corporate governance and the application of the EBRD's environmental guidelines in the investee companies, and with their strong return potential, equity funds clearly support the Bank's mandate of additionality (supplementing rather than replacing private sector sources of financing) and promote the transition process.

Total capital raised for funds in which the EBRD participated was ECU 2.4 billion at the end of 1998. These commitments have mobilised ECU 1.7 billion from private investors in addition to ECU 270 million of technical assistance contributed by donors. As a result, equity investments totalling almost ECU 700 million have been made in over 500 companies based and operating in the region. These investments have contributed to mobilising total financing of over ECU 4.6 billion for companies in the region.

The EBRD has invested in three types of funds in terms of their structure, dimensions and investment strategy: donor-sponsored funds, venture equity funds and large equity funds.

Donor-sponsored funds

Together with several donor governments, the EBRD has established a number of private equity funds to support the privatisation and restructuring of medium-sized enterprises. These funds provide a combination of equity capital and grant-financed consulting support, which is usually the first financial assistance that these enterprises receive during or after privatisation. As well as financing post-investment consulting costs, donor grants fund management fees and "due diligence" costs.

By the end of 1998, the portfolio comprised 28 funds,[1] with a total capital of ECU 443 million, of which the EBRD had provided ECU 248 million. The funds usually target early-stage or small deals worth up to ECU 2.6 million. They include the 11 Regional Venture Funds (RVFs) in Russia and 11 Post-

[1] Due to variations in calculating commitments, the number of funds may not correspond to the number of projects listed in the table "EBRD signed operations to financial institutions" on page 25.

Privatisation Funds (PPFs) in Albania, the Baltic states, Bulgaria, Hungary, Kazakhstan, Poland, Romania, the Slovak Republic, Slovenia and Ukraine. They also include Small Equity Funds in the Baltic states, Bulgaria, Poland and Russia (Nizhny Novgorod and St Petersburg). By the end of 1998, these funds had invested in 163 projects.

In 1998 the EBRD approved investments in three new donor-sponsored funds. The most significant of these is the ECU 26.4 million Eastern Ukraine Post-Privatisation Fund, which received ECU 24.0 million from the EBRD. It is sponsored by Euroventures (Netherlands) and was provided with technical cooperation funding by the Dutch government.

The EBRD approved investments of ECU 6.0 million in the Albania Reconstruction Equity Fund and ECU 4.6 million in the Horizonte Bosnia & Herzegovina Enterprise Fund. During the year, the EBRD took a number of measures to strengthen the management of the donor-sponsored funds, including encouraging collaboration between funds.

The donor grant funding provided by the European Community and other donors continued to play a vital role in the success of the donor-supported funds, allowing the EBRD to expand the range of its investment and to be the first investor in higher-risk countries and enterprises. Technical cooperation funds provided by donors reduce the equity risk by financing pre-investment assessment and due diligence as well as post-investment management assistance to the enterprises.

Venture equity funds

Sponsored by private institutions and fund managers, venture equity funds support expansion projects and the privatisation process, targeting deals between ECU 0.8 million and ECU 4.5 million. The EBRD normally invests up to 30 per cent of the total capital of the fund and has a leading role in the investment decisions and in defining the policies of the fund. By the end of 1998, the portfolio comprised 24 funds, with total capital of ECU 808 million, of which the EBRD had provided ECU 185 million. The funds had invested in 130 companies by the end of the year.

In 1998 the EBRD invested in three new venture equity funds. The largest of these is the ECU 85.7 million Czech Direct Equity Post-Privatisation Fund, sponsored by Alliance Capital, in which the EBRD invested ECU 20.3 million. The Bank also invested ECU 8.6 million in the Central Poland Fund and ECU 17.0 million in the Polish Pre-IPO Fund.

Large equity funds

Sponsored by private institutions and fund managers, large equity funds comprise large regional funds or large country funds targeting projects of over ECU 4.5 million, with a special focus on privatisation and expansion capital. Fund structures are relatively complex with multiple managers/advisers, co-investment structures and industry networks. Hybrid funds are included in this category. These may invest a portion of their capital in listed securities, structure deals in medium-sized to large companies, target larger businesses in the telecoms, energy and infrastructure sectors, and require specific equity syndication expertise. By the end of 1998, the portfolio comprised 15 funds of this type, with total capital of ECU 1.1 billion, of which the EBRD had provided ECU 238 million. The funds had invested in 227 companies by the end of the year.

In 1998 the EBRD invested in three new large equity funds. The most significant of these is the ECU 128.6 million Advent Central & Eastern Europe II regional fund, sponsored by Advent International, with an EBRD investment of ECU 21.4 million. The Bank also invested ECU 17.1 million in the Black Sea Fund and ECU 17.1 million in the Innova/98 Fund for Poland. In response to the drive for increasing asset quality, the EBRD is concentrating increasingly on the supervision of investment policies, corporate governance and co-investment.

EBRD support for telecoms exceeds ECU 1 billion

Eurotel, Czech Republic

Infrastructure

Telecommunications

The EBRD continued to support the development, modernisation and privatisation of the telecommunications and media sector in 1998. During the year the Bank signed five projects, totalling approximately ECU 194 million. This brings the EBRD's telecommunications commitment to ECU 1.1 billion as of the end of 1998, or 9 per cent of the Bank's total portfolio.

In response to the critical shortage of basic telecommunications services in countries at the early and intermediate stages of transition, the EBRD was actively involved in the upgrading and privatisation process of several national operators, providing equity investments and debt financing. The Bank also demonstrated its commitment to supporting accelerated growth in the more advanced countries by participating as an investor in the IPO of Telekomunikacja Polska S.A. (TPSA), the Polish national operator. More generally, the region continued its progress in reforming and restructuring the telecommunications sector, in particular by attracting private investment and commercially minded management through strategic sales.

In 1998, several countries conducted the privatisation of their national operator, including Armenia, Lithuania, Poland and Romania. Privatisation plans are in preparation in a number of other countries (Bulgaria, FYR Macedonia, Moldova and Ukraine). The EBRD has been involved in seven of these privatisations. Furthermore, growth in the mobile sector remained strong throughout the region, with ownership of cellular phones approaching 15 per cent of the population in Estonia, 10 per cent in Hungary and the Czech Republic, and 3 per cent in Romania, which experienced one of the highest growth rates in 1998.

Three of the Bank's most significant telecommunications projects in 1998 were the RomTelecom pre-privatisation project, the emergency reconstruction project in Bosnia and Herzegovina and the IPO of TPSA.

The EBRD extended an ECU 85.7 million pre-privatisation loan to RomTelecom S.A. in January 1998, its first loan to a Romanian utility without a sovereign guarantee. Proceeds from the loan are financing part of the company's capital expenditure for 1998-99, with particular emphasis on speeding up the installation of telephone lines, improving efficiency and service quality, and providing a better service for customers. Through this unsecured corporate loan, the EBRD expressed its support for the development of Romania's telecommunications sector and RomTelecom's privatisation, which was successfully concluded at the end of the year through the sale of a 35 per cent stake to the Greek telecommunications operator OTE.

As part of a programme to rebuild the telecommunications network in Bosnia and Herzegovina, the EBRD signed an ECU 18.1 million loan, which will assist both the Federation of Bosnia and Herzegovina and Republika Srpska. The loan will finance the restoration and expansion of the local telecommunications networks, which suffered extensive damage during the war. The restoration of Bosnia and Herzegovina's telecommunications system is expected to be one of the principal catalysts for economic recovery in the country. Up to ECU 19.2 million of grant funding is being contributed by the governments of Italy, Japan, the Netherlands and Switzerland to finance complementary equipment and materials. Furthermore, an 18-month technical assistance programme totalling ECU 1.15 million is being provided to assist with the implementation of the project and to create a legal and regulatory framework that will support the integration and operation of the telecommunications sector in Bosnia and Herzegovina.

In addition, the EBRD invested ECU 64.9 million in the IPO of TPSA in November 1998. The EBRD's investment represents 8.1 per cent of the shares sold by the Polish Treasury in the IPO and 1.21 per cent of TPSA's share capital. The IPO of TPSA significantly increases the liquidity and depth of the Polish equity capital market, nearly doubling the market capitalisation of the Warsaw Stock Exchange. It is also expected to improve Poland's access to international financial markets and to attract new sources of finance to the country. As well as increasing investments, in particular in the telecommunications sector, the project will accelerate economic development. The Polish Government recently announced that it would seek a strategic partner for between 25 and 35 per cent of TPSA as part of the second stage of its privatisation.

Transport

The EBRD made significant additions to its portfolio of transport projects in 1998, covering a broad range of activity in the sector. The Bank signed 10 new operations, representing a commitment of ECU 197.8 million. This brings the total transport portfolio to ECU 1.8 billion. New operations were concentrated mainly in central Europe and the Baltic states, which accounted for 75 per cent of commitments. Over one-third of the signed projects were private sector or non-sovereign.

The main focus during the year was on railways, with four new commitments. Two of the railway projects (Hungary and Latvia) involved co-financing with the European Investment Bank, while two others (Croatia and Georgia) were co-financed with the World Bank and EU Tacis respectively. Total lending for railway projects in 1998 amounted to ECU 105 million.

The most significant transport project in 1998 was an EBRD loan of ECU 40 million to support the modernisation of Hungary's railways. By financing the refurbishment of passenger coaches and the upgrading of freight wagons, the project is helping to improve the quality of service and facilitate international trade. The loan will also enable the railways to introduce automated ticketing and to replace outdated accounting systems.

In Latvia the EBRD provided a loan of ECU 17.6 million to modernise rail track and to upgrade the rail network at the country's main sea port, Ventspils. The project will improve environmental safety by allowing some chemicals and oil products to be routed away from the most heavily populated areas.

EBRD financing of ECU 30 million is helping Croatia's national railway company, Hrvatske Zeljeznice, improve its fleet of locomotives, enhance energy efficiency and lower maintenance costs. In Georgia a similar programme of infrastructure improvements is being supported by an EBRD loan of ECU 17.1 million. The project will upgrade the Georgian section of the trans-Caucasian railway line and will help to develop an effective southern trade route to Europe.

All of the railway projects demonstrate a strong commercial approach to the sector, focusing on enhanced operational efficiency, particularly in passenger traffic. The EBRD's lead role in this sector has encouraged a number of private sponsors to consider potential operations in areas related to the railway sector.

Two private sector grain terminal projects were signed in 1998, at Gdansk, Poland, and Constanţa, Romania, comprising EBRD loans of ECU 27.9 million and ECU 6.9 million respectively. The projects will help to improve grain-handling facilities at the two seaports and to introduce a faster and cheaper supply of key agricultural commodities for the region.

In the aviation sector, three operations were signed. These included financing of ECU 7.7 million to refurbish Chisinau Airport, Moldova, and a loan of ECU 21.8 million to finance the installation of modern air traffic control equipment in Ukraine. This will help to ensure safety in Ukrainian air space and to attract additional air traffic, which will generate increased revenue.

The EBRD's largest non-sovereign urban transport operation was signed in 1998 to support improvements to the urban tram system in Krakow, Poland. The project involved close collaboration between the EBRD's Transport Team and the Municipal and Environmental Infrastructure Team (see page 40).

Power and energy utilities

The reform process in the power and energy utilities sector continued to gather momentum in 1998, with privatisation prospects improving in many of the EBRD's countries of operations. In particular, Georgia succeeded in the privatisation of its largest distribution company. In real terms, energy prices did not increase significantly in the region, and progress was made by a number of utilities, especially in the CIS countries, in collecting their energy bills in cash.

In 1998 the EBRD signed four projects in the power and energy utilities sector, totalling ECU 178.9 million. These commitments reflected the increased private investment in the Bank's countries of operations during the year as well as the region's continued commitment to implement reform. Of the Bank's commitments in 1998, 38 per cent were in the private sector.

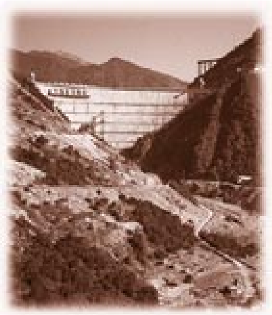
In the far eastern Russian region of Kamchatka, the EBRD signed a sovereign loan of ECU 85.7 million for the development of a 40 MW geothermal power plant located in Mutnovsky. This plant will reduce the region's dependence on expensive imported oil and thus improve the reliability of power supply. It will also lead to the decommissioning of an environmentally harmful old fossil-fuelled power plant. The project is one of the first in the region to be structured as an independent power project, whereby the project company will operate under a power purchase agreement with the local electricity utility.

Support for railways totalled ECU 105 million in 1998

MÁV – Railcar modernisation and marketing project, Hungary

Mutnovsky geothermal power plant, Russian Federation

Mosenergo hydropower plant, Russian Federation



Enguri hydropower plant, Georgia

Major private financing project signed in the power sector in Central Asia

One of the EBRD's most significant projects in 1998 was a loan of ECU 25.7 million to Mosenergo, a privatised utility in Russia, which supplies power to the greater Moscow area. The project is financing the completion of the last 200 MW unit of a 1200 MW pump storage hydropower plant and is also providing funds for general corporate purposes. This loan will allow Mosenergo to gain access to funds not available from capital markets. In addition, the financing supported the preparation and implementation of an Environmental Action Plan by the client (see page 39).

In the first significant private financing project in the power sector in Central Asia, the EBRD extended a loan of ECU 34.3 million (of which ECU 14.3 million will be syndicated to commercial banks) to a fully privatised utility, Karaganda Power Company, in Kazakhstan. This financing will enable the company to repair and strengthen its power generation and heat distribution facilities. The project will increase the reliability and efficiency of power and heat generation and delivery systems, and will improve environmental performance. The planned investments will significantly reduce particulate emissions from the thermal power stations. It is hoped that the project will help to accelerate privatisation and to encourage private sector involvement in similar projects in the future.

To support the restructuring and privatisation of Georgia's power sector, the EBRD provided a loan of ECU 33.2 million to Sakenergo, the state-owned utility, for improvements to the Enguri hydropower plant. This project will finance improvements to the existing powerhouse and urgent safety measures on one of the largest arch dams in the world, increasing the availability of non-polluting renewable energy, and improving dam and power waterway operational safety. It will also reduce energy losses, and will improve the collection of electricity bills by enhancing the commercial operation of the plant. The project was supported by the European Union, which is financing improvements to one of the plant's units through a special grant. For the environmental aspects of this project, see page 39.

Energy efficiency

The energy efficiency sector continued to grow in importance in 1998, both in terms of the variety of projects financed and their viability. This was due to increasing privatisation and deregulation of the energy sector and growing interest in emission-reducing investments related to the Kyoto protocol. During the year the EBRD signed six projects totalling ECU 47 million, bringing the Bank's overall commitment in this sector to ECU 216 million.

To improve district heating infrastructure and heat services in its countries of operations, the EBRD is developing a number of financing mechanisms, often in tandem with private investors. Publicly owned utilities, which provide the main source of heat and hot water in the region, have enormous potential for energy savings due to the antiquated infrastructure of most of these companies. As the opportunities increase for private operators to acquire or manage district heating companies, the Bank is able to assist by providing additional sources of financing.

The EBRD is currently working with private sector investors to improve district heating services in a number of Romanian cities following the success of an earlier energy conservation project in Romania. New legislation coming into effect at the beginning of 1999 should facilitate private sector involvement in district heating, and the Bank is working with a number of potential sponsors to develop projects.

Energy service companies (ESCOs) are a growing source of finance for municipalities and companies in the region. Pioneered in the region by the EBRD and Western sponsors, ESCOs implement energy conservation measures at no initial cost to the customer and guarantee energy savings, which are used by the customer to pay back the initial investment.

By investing in energy efficiency projects, ESCOs can replace the need for municipal infrastructure loans, thus meeting the Bank's goal of introducing public-private partnerships into municipal infrastructure. ESCOs also provide financing for industrial restructuring by providing energy-saving investments in manufacturing processes. They can also assist in the development and renovation of combined heat and power plants, which are much more efficient than traditional gas-fired power generation.

New EBRD commitments in 1998 included four new private sector ESCOs established in Lithuania, Poland and the Slovak Republic. These were all set up under the Bank's multi-project facilities (MPFs) with Western ESCO sponsors and included one new MPF signed with the German municipal utility MVV Energie Aktiengesellschaft. Up to the end of 1998, the Bank had participated in the establishment of eight private sector ESCOs under the MPF agreements and one with a non-MPF sponsor.

One of the EBRD's notable projects in 1998 was an ECU 25.7 million loan agreement with Ukraine to establish the first ESCO operation in the country and in the CIS as a whole. With an additional ECU 6 million of grant finance and technical assistance from the EU Tacis programme, UkrEsco is now beginning its activities in Ukraine and is expected to become fully operational during 1999. The company is state-owned but is run by a private sector Western operator funded by Tacis. The operator will have responsibility for identification, development and implementation of all of UkrEsco's projects over an initial two-year period. Subsequently, the Ukraine authorities have agreed to privatise the company according to market conditions. As well as investing the EBRD's loan and Tacis grant finance in energy efficiency projects, it is intended that UkrEsco will develop the level of skills in Ukraine and encourage other ESCOs to establish operations in the CIS markets.

Municipal and environmental infrastructure

The EBRD maintained a strong commitment to the municipal and environmental infrastructure (MEI) sector in 1998, providing a total investment of ECU 167 million in support of projects with an overall value of ECU 440 million. New investments were made in water supply, sewerage and waste-water treatment, urban transport and municipal waste management. By the end of 1998, the Bank had committed a total of approximately ECU 700 million to the MEI sector in debt and equity. The EBRD currently has a presence in about 110 municipalities across 16 countries.

The EBRD has responded flexibly to changes in the nature of the demand for investment funds. Until 1997, virtually all EBRD financing to municipal entities was provided on a sovereign basis. However, in recent years, there has been a significant fall in this form of financing due to the decentralisation of funding responsibilities for municipal infrastructure and the limiting of sovereign guarantees.

Recent EBRD financing has focused on decentralisation and private sector involvement. In 1998 over 90 per cent of commitments by value concerned private or non-sovereign municipal financing – compared with 40 per cent in 1997 and only 4 per cent in 1996 (see graph).

There has also been a change in geographical focus. In 1998, more than 75 per cent of the EBRD's financing commitments in the MEI sector were in advanced transition economies, with the EBRD providing financing to selected municipal utilities and municipalities on a private and non-sovereign public basis.

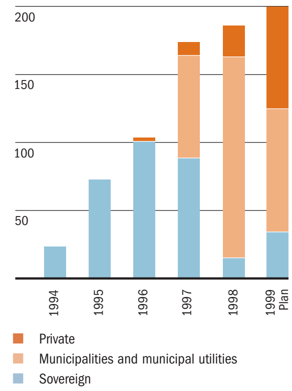
The EBRD plays a critical role in facilitating private sector involvement in the financing of municipal infrastructure, and the Bank is increasingly involved in the structuring and development of projects that have private sector investment. The Bank provided ECU 23 million in equity in 1998 to support private sector involvement in the provision of municipal infrastructure, compared with ECU 10 million in 1997.

In 1998 the EBRD signed its first municipal projects in Poland, extending loans of ECU 16 million and ECU 45 million to the cities of Wroclaw and Krakow respectively. In Wroclaw the loan is being used to repair critical municipal infrastructure damaged by the flood of July 1997, while in Krakow the EBRD is financing a fast tramway system. The project aims to improve accessibility to the city centre and to stimulate urban development (see page 40).

Prometheus ESCO, Hungary

EBRD financing commitments and project pipeline in the MEI sector

1994-99 (ECU million)

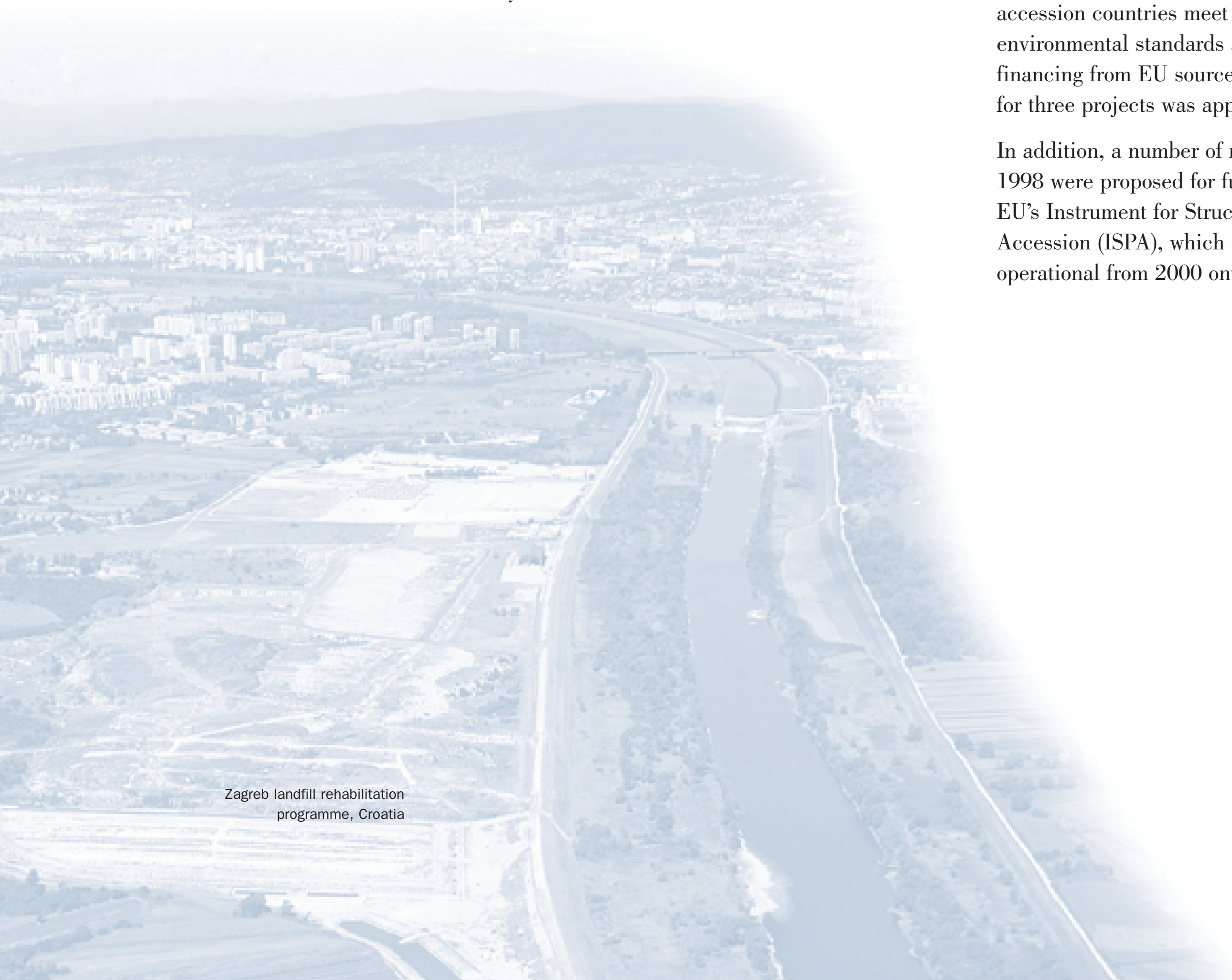


New policy approved for municipal and environmental infrastructure

In Croatia the EBRD provided a loan of ECU 88.4 million to a project company owned by the city of Zagreb to improve the city's main landfill site and to protect Zagreb's major source of drinking water from contamination. For the first time in the MEI sector, part of the EBRD loan (ECU 36 million) was syndicated to commercial banks. The project establishes a framework for effective regulation of waste collection services in the city and for involving the private sector.

Other significant projects include a sovereign-guaranteed loan of ECU 16.5 million for the municipality of Tashkent to improve and partially privatise its waste management system and an equity investment of ECU 22.7 million in the sewerage and waste-water treatment company of Budapest alongside two major international private municipal services operators.

Operations in the pipeline include a private financing project to build, under a build-operate-transfer concession agreement, a waste-water treatment plant in Slovenia and an investment programme in the water supply and waste-water sector in Ukraine. Both projects were approved by the Bank's Board of Directors in 1998 and are scheduled for signing in early 1999.



Zagreb landfill rehabilitation programme, Croatia

In June 1998, the EBRD's Board of Directors approved the Bank's first operations policy for the municipal and environmental infrastructure sector. The policy defines the following objectives for EBRD operations:

– decentralisation of municipal and environmental infrastructure provision;

– commercialisation and corporatisation of service provision;

– promotion and optimisation of private sector involvement;

– development of appropriate regulatory structures and capacity; and

– environmental improvement and energy efficiency.

The EBRD continued its close cooperation with the EU Phare programme, bilateral donors and the Project Preparation Committee (PPC), which is funded by external donors. This has enabled the EBRD to develop environmental projects that require extensive resources for their preparation and appraisal.

Cooperation with the European Commission has become particularly important as the Bank continues to provide investments to help the 10 European Union accession countries meet the requirements of the EU's environmental standards and directives. In 1998, co-financing from EU sources totalling ECU 20 million for three projects was approved by the Commission.

In addition, a number of new projects initiated in 1998 were proposed for future financing from the EU's Instrument for Structural Policies for Pre-Accession (ISPA), which is expected to become operational from 2000 onwards.

Other key sectors

Natural resources

In spite of the strong deflationary pressures that characterised the natural resources sector in 1998, the EBRD signed loans with respect to two large projects for a total of ECU 185.2 million: the Sakhalin II project to develop an oil and gas field off Sakhalin Island in eastern Russia and the Chirag early oil project in Azerbaijan and Georgia. Both loans were almost fully disbursed during the year.

The EBRD committed substantial financing to the Chirag early oil project, which is one of the EBRD's most complex operations. It comprises the development of an offshore oil field in the Caspian Sea, oil transport by sub-sea pipeline to shore, and export of oil via a pipeline north to the Russian border, and west, across Azerbaijan and Georgia, to a loading facility on the Black Sea.

The ECU 360 million financing was arranged jointly by the EBRD and the International Finance Corporation. The EBRD's commitment comprises loans of ECU 86 million, with ECU 32 million syndicated to international commercial banks. The borrowers are special-purpose companies established and wholly owned by five international oil and gas companies.

The project represents the first external financing in the Caspian Sea area and is expected to be a model for future investments in the region. As in all IFI-financed projects, strict environmental requirements are applied to the financing (see page 39).

During the year, many institutions in the natural resources sector had to work intensively on the rescheduling of several ongoing Russian oil projects that have been negatively affected by the price falls and the economic crisis. On the whole, most of the projects financed by the EBRD appear to be sound and require minimal adjustments. Even with extremely low oil prices, the returns have remained positive in most cases, demonstrating the beneficial impact of investments aimed at modernising production techniques.

The EBRD's project pipeline in the natural resources sector increased considerably in 1998 and is estimated at over ECU 1.5 billion, spread across various areas of operation. There has been renewed interest, for example, in gold and silver mining projects in a number of countries. This follows a period when low prices for precious metals and availability of funding from commercial banks significantly reduced the EBRD's operations in the sector.

Agribusiness

In recognition of the important role played by the agribusiness sector in the EBRD's countries of operations, the Bank continued to significantly expand its agribusiness portfolio in 1998, signing 13 new operations for a total investment of ECU 174 million. At the end of 1998, the Bank's agribusiness portfolio totalled almost ECU 1.5 billion invested in 94 projects.

The EBRD continued to provide financing throughout the agribusiness sector. One of the most innovative operations in 1998 was the Grain Receipt Programme in the Slovak Republic. This was developed and financed in partnership with Rabobank of the Netherlands (providing ECU 8.2 million) and a local bank, Pol'nobanka (providing ECU 8.2 million), which is also managing the programme. EBRD financing comprises ECU 8.2 million of short-term seasonal funding for Slovak grain producers. The financing is secured by agricultural commodities through a system of receipts issued by licensed warehouses. Similar systems have been successfully implemented in countries ranging from Indonesia to the United States, where such a system has been in operation for some 80 years. The EBRD intends to repeat this programme elsewhere in the region to help alleviate the general lack of working capital at the farming level and across the food chain.

In Bulgaria the EBRD financed its largest private sector agribusiness operation to date. Domaine Boyar AD, a Bulgarian wine producer and one of the most successful and largest export-oriented enterprises in the country, received debt and equity financing of ECU 18.0 million from the EBRD. The debt was partly syndicated to ING Barings (providing ECU 6.3 million), representing its first medium-term loan in Bulgaria. Further equity financing was provided by Baring Central European Investments BV and by the Dutch wine trader Baarsma. The operation will help finance the introduction of new technology in two existing wineries in Shumen and Yambol and the construction of a greenfield facility in Sliven, which will become one of the most modern wineries operating in the region. A significant part of the funding will also be used to finance the company's working capital requirements for the purchase of grapes from local growers. This operation is expected to strengthen the position of Bulgaria as one of the world's leading wine exporters.

Major financing committed to Chirag oil project in Caspian Sea

Chirag early oil project, Azerbaijan

Domaine Boyar, Bulgaria

13 new agribusiness projects signed in 1998

Podravka food company, Croatia

Hotel projects in Russia and Ukraine receive substantial EBRD support

The EBRD undertook a number of projects to improve the quality and diversity of food and drink available to consumers in the region. In Latvia, the Bank extended ECU 12.0 million to PAS Gutta, a leading Latvian fruit juice producer and exporter. In the Russian Federation, financing of ECU 15.1 million was provided to Vena brewery, which produces premium quality beers in St Petersburg.

To promote restructuring and private ownership, the EBRD continued to strengthen its cooperation with major local food processing companies. In 1998 the Bank provided Podravka, Croatia's largest food company, with an ECU 25.5 million convertible loan to support the restructuring of the company and the funding of a capital expenditure plan, including the construction of a new plant for soup and food additive manufacturing. For the environmental aspects of this project, see page 40.

During 1998 the EBRD continued to expand its MPFs with major international agribusiness companies. To date, ECU 257 million has been made available to these companies for investments in the Bank's countries of operations. A new ECU 44 million MPF was signed with the leading grain processing and trading company, Groupe Soufflet of France. Under this facility, two financing agreements were signed to build and operate modern malt processing facilities in the Russian Federation and in Poland. Other operations were signed under existing MPFs with the Italian company Parmalat and the French company Danone. Both operations concerned investments in Romania.

To finance small and medium-sized enterprises in the agribusiness sector, the EBRD continued to provide credit lines in 1998 through local agricultural banks. Current partners include OTP Bank in Hungary, Pol'nobanka in the Slovak Republic and Dalmatinska Banka and Agro-obrtnicka Banka in Croatia. The EBRD is also the joint promoter of the leading private sector equity fund operating in the region, the East Europe Food Fund, which has made equity investments totalling over ECU 45 million.

The Bank has continued to cooperate closely with the United Nations Food and Agriculture Organization, which has provided technical assistance to a number of countries and operations throughout the region.

Property, tourism and shipping

The EBRD made new inroads in the property and tourism sectors in 1998, reaffirming its catalytic role in encouraging investment in these areas. Four new transactions were completed, totalling ECU 45 million. This brings the Bank's total commitment to property, tourism and shipping projects to approximately ECU 304 million. The hotel sector was the main recipient of the EBRD's funds in 1998.

In its first major transaction in the hotel sector outside of the Visegrad countries, the EBRD extended financing of ECU 9.9 million to Continental S.A. to complete and renovate two hotels in Bucharest and in Constanţa. The project will also support the extension of Continental S.A.'s hotel network throughout Romania. The Belgian export credit agency, Office National Du Ducroire, has agreed in principle to provide parallel financing in the form of a senior loan. The project is expected to encourage further investment in Romania's tourism sector.

The EBRD helped to provide Russia with its first entirely privately owned and financed international-standard hotel by extending ECU 12.4 million to ZAO Hotel Corporation, St Petersburg. Costing a total of ECU 24.8 million, the project will be undertaken in partnership with Radisson SAS Hotels Worldwide, the US Russia Investment Fund, ZAO Moscow America and Uçgen ve Ticaret of Turkey. The 164-room first-class hotel will be built in Nevsky Prospekt and will be targeted at business travellers and tourists. The transaction underlines the EBRD's commitment to Russia at a time when long-term sources of funding for Russian projects are scarce.

The EBRD is making a significant contribution to the development, construction and operation of the first hotel in Kiev to be managed by an international operator. Costing approximately ECU 39.5 million, the 244-room four-star hotel will be financed entirely by private sector funds and managed by Radisson SAS Hotels Worldwide. The EBRD will provide an equity investment of ECU 5.1 million and a senior loan of ECU 7.4 million. A stand-by equity facility of ECU 1.1 million has also been committed.

In the property sector the EBRD committed ECU 10.6 million to Italian Romanian Industrial Development Enterprise, a Romanian special-purpose company, for the development, construction and management of modern international-standard warehouses throughout Romania. The total cost of the operation is estimated at ECU 33.3 million, of which the EBRD is providing an equity investment of ECU 2.2 million and a senior loan of ECU 8.4 million.

In 1998 the EBRD disbursed ECU 19.1 million to subsidiaries of Far Eastern Shipping Company of Vladivostok (FESCO) to finance the acquisition of three modern container ships built at the Szczecin shipyard in Poland. The new vessels will allow FESCO to provide a competitive high-quality service on the Australia-US route.

In the shipping and shipbuilding sectors the EBRD is reviewing a number of project proposals involving both privatised companies and state-owned companies preparing for privatisation, with a view to improving access to the commercial syndicated loan market and to facilitating the privatisation process.

Manufacturing and distribution

In a project to promote market-driven restructuring in Poland's steel industry, the EBRD signed an ECU 27.4 million equity investment in Stalexport S.A., the country's leading steel trading and processing company. Based in Katowice, it is one of the top 20 companies listed on the Warsaw Stock Exchange. The investment will support the company's capital expenditure programme, which includes the modernisation of its subsidiary steelworks and significant environmental and occupational health and safety improvements (see page 39). As well as raising shareholder value, the project will further privatisation of a leading Polish heavy industry company and assist the Polish authorities with an under-invested sector in preparation for EU accession.

Also in the steel sector, in the largest investment made by an international strategic investor in FYR Macedonia, the EBRD made an ECU 12.9 million loan to Makstil AD. The project aims to modernise and restore steelmaking and casting facilities and the plate mill at a plant in Skopje, in order to restore integrated production capacity for 300,000-400,000 tonnes per year and to increase the plant's overall efficiency. The modernisation plans are likely to decrease dust emissions and significantly improve energy efficiency.

In Romania, the EBRD signed an equity investment of ECU 16.0 million for the privatisation and modernisation of IMGB and FECNE, two heavy engineering plants outside Bucharest. The objectives of the project are to privatise and modernise the plants, increase revenues and profitability through export, safeguard employment, and improve the environment. The project sponsor is Kværner, a Norwegian construction, engineering and shipbuilding group, which will help raise the level of skills and expertise in the plants.

In Estonia, the Bank signed a loan of ECU 6.6 million to AS Norma, a car safety belt manufacturer. The project will enhance the company's competitive position by upgrading equipment and renovating facilities to increase efficiency, reducing overhead costs as a result of more effective real estate management, and making environmental improvements.

Stalexport, Poland

Major equity investment in Polish steel industry

Nevsky 49, Russian Federation

TAM Programme and the Baltic states BAS programme

The TurnAround Management (TAM) Programme aims to provide industrial management expertise and to develop new business skills at senior management level in the EBRD's countries of operations. Through these activities, the Programme helps to advance the transition process by making companies more competitive in the region's developing market economies.

The grant funding provided by the European Commission, the Russian Privatisation Center, the Nordic Council of Ministers and other bilateral donors has enabled the TAM Programme to undertake 507 projects in 22 countries since its launch in July 1993. To date, these donors have committed more than ECU 40 million to the Programme, which will fund more than 710 projects in total.

An analysis of the data of 213 enterprises in which TAM projects have been completed shows combined annual sales of US$ 4.8 billion, 20 per cent higher than sales at the start of the Programme for each enterprise. This has been achieved with minimal loss of jobs, the total workforce falling by less than 13 per cent, from 252,000 to 219,000. In addition, external finance totalling more than US$ 456 million has been raised by 59 of these enterprises.

In the countries that have started the EU negotiation process (the Czech Republic, Estonia, Hungary, Poland and Slovenia), TAM teams are focusing on improving production, safety, health and environmental standards to help these countries meet the requirements for EU accession.

The Baltic States Business Advisory Services (BAS) Programme complements the TAM Programme by helping smaller enterprises achieve the standards required for the Baltic states' accession to the European Union. Supervised by TAM, it provides specific assistance to enhance companies' competitiveness, marketing, financial management, implementation of ISO quality systems, and strategic planning. By the end of 1998, BAS had carried out projects with more than 550 enterprises, employing about 75,000 in total with aggregate sales of US$ 2.5 billion. A number of these enterprises are clients of local financial institutions financed by the EBRD and, as a consequence of BAS assistance, have raised US$ 25 million in external finance.

Initially funded entirely by the Nordic countries, which provided ECU 4.4 million, the BAS Programme is currently receiving ECU 2 million from the European Commission. In addition, the Nordic Council of Ministers has committed a further ECU 0.8 million to provide specific assistance to the smallest enterprises (up to 50 employees), which is the business segment with the highest growth in employment in the Baltic states. Having started in the second part of 1998, this "micro-BAS" programme already advises over 40 client enterprises.

As a result of highly satisfactory operational audits and evaluations, the BAS Programme will continue throughout 1999. Similar business advisory service programmes are being established in Bosnia and Herzegovina, Croatia, north-west Russia and Slovenia.

To support the restructuring of Estonia's textile industry, the Bank financed the capital expenditure programme of the country's second-largest cotton mill. The project will enable Baltex 2000 to complete the modernisation of a woven cotton fabric mill in Tallinn and build a knitting mill at its subsidiary, Lotus Colours 2000 in Sindi. EBRD financing consists of an ECU 6.1 million equity investment and senior loan. The project will be co-financed with Hansapank, a local commercial bank. For the environmental aspects of this project, see page 40.

To carry out operational and financial restructuring of Slovenia's largest shoe manufacturer, Alpina, the EBRD will provide ECU 4.1 million as a five-year loan and ECU 2.0 million as equity investment. Alpina produces fashion and sport shoes, and distributes through its own retail network throughout Slovenia and in Bosnia and Herzegovina and Croatia. The financing will support a restructuring and turnaround plan, which aims to increase the company's competitiveness and profitability.

In Ukraine the EBRD made an equity investment of ECU 11.3 million in AD Zarya to finance the completion and operation of a new glass container production plant and to improve an existing smaller plant. The modernisation will bring operations in line with international industry standards, as applied by the sponsors in Canada, resulting in efficient energy and water operations and raw material conservation. The project encourages the recycling of glass material as it includes a provision for the collection of broken glass bottles from major towns.

Environment

As directed by its mandate, the EBRD promotes environmentally sound and sustainable development in all of its activities. The Bank recognises that safeguarding the environment is an integral part of sound business practice. The EBRD implements its environmental mandate by financing projects in sectors such as environmental infrastructure and energy efficiency (see pages 32 and 33) and by applying environmental requirements to all of the Bank's operations.

In 1998, 11 environmental projects were signed, with a total EBRD commitment of more than ECU 196 million. Environmental components of other projects included investments in technology to reduce emissions, in waste-water treatment, and in environmental expenditure to meet commitments in projects' Environmental Action Plans (EAPs). In 1998 the EBRD further promoted energy and resource efficiency, waste recovery and recycling, and clean technologies, supplementing rather than competing with other sources of finance.

Environmental "due diligence" investigations are normally undertaken early in the project approval cycle to allow time to identify environmental concerns and opportunities, to plan mitigation and enhancement measures, and to obtain agreement on actions to be taken before project approval by the Bank's Board of Directors. Environmental requirements, relating to mitigation and enhancement measures and monitoring, are incorporated into loan agreements.

In 1998, a total of 43 environmental analyses, including five environmental impact assessments (EIAs), and 25 environmental audits were conducted on projects approved by the Board of Directors. In some cases analyses and audits were both required.

Natural resources

With the assistance of independent environmental consultants, the EBRD reviewed six EIAs and numerous studies and programmes for the Chirag early oil project in Azerbaijan and Georgia (see page 35). These focused on areas such as spill response planning, gas utilisation and seismicity. A detailed EAP was agreed with the borrowers. Public meetings were held in the two countries, and an ongoing community interaction programme forms part of the EAP. Work on Black Sea spill response planning is ongoing. The environmental requirements of the project include the adoption of modern international oil industry practices, environmental and health and safety training and awareness raising, the public availability of EIAs in libraries across Azerbaijan and Georgia, and support for national and regional environmental programmes.

In Kyrgyzstan a road accident in May 1998 resulted in cyanide intended for the Bank's Kumtor gold project being spilled into the Barskoon River. As a result, the project company has introduced measures aimed at further reducing transport risks and improving communications and emergency response. An International Scientific Commission confirmed that the spill resulted in relatively minor environmental damage. The company has generally been operating to international standards of environmental management.

Power and energy

A corporate environmental review of the Russian hydropower plant Mosenergo and its existing facilities was undertaken in 1998 (see page 32). Specific environmental mitigation measures were developed and incorporated in the project. These will promote the more efficient utilisation of existing generating capacities, avoid unnecessary fuel use and thus promote reductions in air emissions. The company is already implementing a strategic environmental programme incorporating emission control and water and waste-water treatment projects, which are consistent with best-practice technologies implemented in western Europe.

The EAP for the Enguri hydropower project (see page 32) includes measures to improve waste management and the handling and storage of oils. It also addresses various aspects of worker health and safety. A major environmental benefit of this project is that it will provide replacement capacity for existing polluting thermal generation in Georgia.

Industry

The EAPs for Stalexport, Poland's leading steel company (see page 37), include air emission abatement measures, materials handling and solid waste management, waste-water treatment, occupational health and safety, improvements in general "housekeeping" and energy conservation. Stalexport's plants will achieve compliance with Polish and EU environmental, health and safety standards within two years. In addition, at the Bank's request, Stalexport is developing a corporate environmental management system to ensure the proper management of environmental issues at both corporate and subsidiary levels in line with the guidelines of the relevant EU directives.

Environmental projects totalled almost ECU 200 million in 1998

Mosenergo hydropower plant, Russian Federation

Krakow urban transport project, Poland

Tram project in Krakow brings significant environmental benefits

Under a multi-project facility (MPF) with Samsung Electronics Co. and Samsung Corporation, the EBRD financed the modernisation of existing facilities at the Otelinox plant, a steel processing facility in Romania. Otelinox/Samsung has developed an EAP, which was agreed with the Romanian regulatory authorities. To be implemented over a one-year period, the EAP includes modernisation of a sludge storage area and the purchase and installation of monitoring equipment to allow for better control of atmospheric emissions.

Other industrial projects with significant environmental components include the modernisation plan for the Baltex 2000 cotton mill in Estonia (see page 38). This involves the construction of a pre-treatment and waste-water plant to reduce the levels of ammonium nitrate presently found in the raw water intake.

Agribusiness

EBRD direct financing in the agribusiness sector during 1998 focused on facilities producing beer, wine, fruit juices, dairy products, edible oils and chewing gum (see page 35). Environmental due diligence therefore centred on production facilities rather than agricultural production. Typical environmental issues associated with such facilities include water quality and waste-water treatment, solid waste management, odours and noise. In addition, indirect support to general agricultural production has been channelled through intermediated financing mechanisms.

One of the most important investments made in this sector was in Podravka, a major food processing company in Croatia (see page 36). An environmental audit of the company's facilities and an analysis of the environmental impact of the capital expenditure plan were conducted. An EAP was subsequently developed to ensure compliance with both national and EU standards and other environmental requirements. The EAP addressed the need for coordinated environmental management at the company's facilities. The waste-water treatment facility at Podravka's yeast plant will be upgraded to significantly reduce discharge of waste water into the municipal waste-water system. This will reduce organic loads in the Drava River, a tributary of the Danube.

Transport

The environmental investigations carried out on the EBRD's operations in the transport sector revealed that none had a significant environmental impact associated either with their construction or operation. None the less, in most cases environmental mitigation measures were incorporated into the project design, and EAPs governing project implementation were adopted.

One of the most environmentally beneficial transport operations in 1998 was the Krakow urban transport project (see page 33). An EIA was carried out during the feasibility stage by international and Polish consultants engaged by the city, in accordance with the EBRD's environmental procedures and Polish EIA regulations. The process involved public consultation through a series of meetings to discuss the results of the EIA work and possible environmental mitigation measures and through public review of the EIA report. The shift towards public transport should result in a reduction of 1-2 per cent of CO_2 emissions in the city during peak hours. In addition, by connecting the central rail and bus stations to the tram network and connecting expanding business districts with residential areas, the project is expected to reduce congestion and car use in the city centre, to increase safety and to boost tourism.

Financial intermediaries

In 1998 a large proportion of the EBRD's environmental work in the financial sector was devoted to project monitoring. Maturing projects have yielded an increasing number of financial intermediary (FI) sub-projects, many of which require the direct approval of the Bank. In addition to sub-projects, the EBRD reviews the annual reports produced by the FIs. Where new projects have arisen, these have often been with existing clients who already have experience of the Bank's environmental requirements. Depending on the nature of the new project, the client

FI may be required to extend its coverage of mandatory environmental procedures. In such cases, the EBRD must ensure that the procedures have been adequately implemented under the initial project and, if necessary, the Bank provides assistance to help the FI integrate the procedures more fully into its operational processes.

To support the implementation of its environmental requirements by client FIs, the EBRD has continued to offer environmental due diligence training programmes. These have been in operation since 1994, and are run by environmental consultants employed under framework contracts funded by EU Phare and Tacis. Over 100 FIs have now been trained by the Bank.

As part of the overall training, the EBRD continued to urge a proactive approach to environmental financing and to encourage FIs to provide small and medium-sized enterprises (SMEs) with financing for environmental improvements. This was discussed and endorsed at the October 1998 meeting of the Bank's Environmental Advisory Council (ENVAC), a forum of environmental experts from the Bank's countries of operations and OECD countries. The EBRD continued to remain closely associated with a variety of United Nations Environment Programme (UNEP) initiatives, including the UNEP Statement by Financial Institutions on Environment and Sustainable Development.

Other initiatives

Through its participation in the COP-4 climate change meeting in Buenos Aires in November 1998, the EBRD continued to indicate its interest in supporting the Kyoto Protocol's flexible mechanisms. These include Joint Implementation and the Clean Development Mechanism, which would allow investors to gain credits for reductions in greenhouse gas emissions beyond their national borders. An analysis of energy efficiency and climate change issues was included in the EBRD's 1998 *Transition Report*.

The Project Preparation Committee (PPC), whose Secretariat is located at the EBRD, continued to help match donor co-financing for environmental projects with the market-based financing available from the EBRD and other international financing institutions. Its activities were welcomed by European Ministers of Environment at the fourth "Environment for Europe" conference, held in Århus in June 1998, and its mandate was renewed.

In 1998 the PPC organised project matching events for the Caucasus and Central Asian republics in Tbilisi, Georgia, and for Ukraine and Moldova in Dniepropetrovsk, Ukraine. Through these meetings, the PPC has assisted in matching donor financing and has improved coordination on several projects. Other examples of PPC activities include facilitation of co-financing between the European Commission and the EBRD for environmental projects being developed in the "accession" countries.

ENVAC continued to advise the President and staff on policy and strategy issues related to the Bank's environmental mandate. Two formal meetings were held in 1998.

Three more titles in the *Investors' guidebook for environment, health and safety* series were published in 1998. These covered Croatia, FYR Macedonia and Slovenia; Armenia, Azerbaijan and Georgia; and Kazakhstan and Kyrgyzstan. Two further titles were published in early 1999 covering Belarus, Moldova and Ukraine; and Tajikistan, Turkmenistan and Uzbekistan. Two editions of the Bank's bulletin *Environments in transition* were published during 1998.

Karaganda power project, Kazakhstan

The EBRD functions as the administrator of the Nuclear Safety Account (NSA) and the Chernobyl Shelter Fund (CSF). It administers the two Funds in accordance with the respective Fund Rules and provides technical, project management, financial, legal and administrative services. It reports to Contributors through the Assembly of Contributors of the NSA and CSF respectively, which exercise overall supervision of the management of the respective Funds, approve six-month work programmes and the yearly financial statements, and decide on the financing of individual projects.

The EBRD receives compensation from the Funds for all costs it incurs, and for the fees and expenses of consultants it engages in connection with the administration of the Funds.

The Nuclear Safety Account

At their Munich Summit in July 1992, the G-7 heads of state and government offered the countries of the region a multilateral programme of action to improve safety in their nuclear power plants (NPPs). This was to comprise immediate measures in: operational safety improvements; near-term technical safety improvements to plants, based on safety assessments; and enhancement of regulatory regimes. It was also to create the basis for longer-term safety improvements by considering the scope for replacing less safe plants by the development of alternative energy sources and the more efficient use of energy; and by examining the potential for upgrading plants of more recent design.

The G-7 advocated setting up a supplementary multilateral mechanism to address immediate operational and technical safety improvement measures not covered by bilateral programmes, and invited the international community to contribute to the funding.

In February 1993 the G-7 officially proposed that the EBRD set up a Nuclear Safety Account, to receive contributions by donor countries to be used for grants for safety projects in the region. The EBRD's Board approved this proposal and the Rules of the NSA in March 1993. Under these rules, the Bank prepares projects and submits them for approval to the Assembly of Contributors.

As of 31 December 1998, pledges to the NSA totalling ECU 260.6 million had been made by the European Community and 14 countries: Belgium, Canada, Denmark, Finland, France, Germany, Italy, Japan, the Netherlands, Norway, Sweden, Switzerland, the United Kingdom and the United States of America. At its December 1998 meeting, the NSA Assembly of Contributors requested the Bank to extend NSA operations until 2002.

The Chernobyl Shelter Fund

At the G-7 Denver Summit of 1997, the G-7, the European Community and Ukraine endorsed the setting up of a supplementary multilateral funding mechanism to assist Ukraine in transforming the existing Chernobyl sarcophagus into a safe and environmentally stable system, with measures as described in the "Chernobyl Unit 4 Shelter Implementation Plan" dated 31 May 1997 (SIP). The G-7 and the European Community pledged US$ 300 million and called upon concerned governments and other donors to join the initiative to ensure full implementation of the SIP.

The SIP was developed in the spring of 1997 under the joint sponsorship of the EU's Tacis programme and the US Department of Energy. It is a decision-based route to choosing technical options without defining the ultimate technical decision. The principal technical goals were developed into 297 activities, which were priced and incorporated into a project schedule. This indicates that the SIP will take about eight to nine years to complete at a cost in the region of US$ 760 million.

The EBRD's Board approved the participation of the Bank in September 1997 and the Rules of the Chernobyl Shelter Fund in November 1997. The Pledging Conference in New York in November 1997, co-chaired by President Kutchma of Ukraine and US Vice President Gore, attracted 13 new donor countries to join the G-7 and the European Community in making pledges in favour of the CSF. The CSF became operational in December 1997 when the required eight contributors had entered into contribution agreements with the EBRD.

As of 31 December 1998, the European Community and 20 countries had made contributions to the SIP totalling ECU 335 million. The countries were: Austria, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Kuwait, Luxembourg, Netherlands, Norway, Spain, Sweden, Switzerland, Ukraine, the United Kingdom and the United States of America. In addition, Iceland, Poland, Portugal and the Slovak Republic donated a total of ECU 3 million. The EBRD is discussing the conclusion of contribution agreements with several other countries.

Nuclear safety

Nuclear Safety Account activities

Priority is given to those reactors presenting a high level of risk that can be significantly reduced by short-term safety improvements, and that are necessary to ensure the continuing national electricity supply in the region. This means that emphasis is put on existing RBMK and VVER 440/230 reactors and on the purchase of equipment, as opposed to studies, which a number of donors already fund. Agreements are sought with the countries concerned on conditions for transition towards new regulatory regimes based on in-depth safety assessments, development of the power sectors and the early shutdown of high-risk reactors on safety and economical grounds.

Ongoing projects

As of 31 December 1998, projects in Bulgaria, Lithuania, Russia and Ukraine had been approved by the Assembly of Contributors, and grant agreements had been signed by the relevant governments, the utilities and the EBRD.

Bulgaria

An ECU 24 million project for Units 1-4 (VVER 440/230s) at Kozloduy NPP in Bulgaria was signed in June 1993. The safety upgrading project has now been fully implemented. According to the Grant Agreement, the Bulgarian government is committed to shutting down Units 1-2 and subsequently Units 3-4 when a set of specific investments in the power subsector has been completed. These investments are delayed, however, and are not expected to be completed before 2003. On the issue of shutting down Kozloduy 1-4, the EBRD works with the objective of setting realistic but unconditional closure dates in line with the Grant Agreement and has had intensive contact with the European Community in the context of the EU pre-accession programme.

Lithuania

In February 1994, an ECU 34.8 million project of 20 short-term safety upgrades for Ignalina NPP (two RBMK 1500 reactors) in Lithuania was signed. As at the end of 1998, all equipment had been installed or was being installed, with commissioning to be completed during the first part of 1999.

In the Grant Agreement, the Lithuanian government made a commitment that operation of the two units at the plant would not be prolonged beyond the time when the reactor channels would have to be changed. Reactor channel measurements during 1998 indicated that this situation would arise on Unit 1 during the coming few years. A detailed analysis of this will be ready during the first part of 1999.

Moreover, Unit 1 will be closed in mid-May 1999 unless the Safety Authority can grant a new licence, taking into account the findings of the international safety experts whose analysis is based on the results of the NSA-financed Ignalina in-depth safety assessment. Closure is also required if it cannot be shown that continued operation is justified to meet domestic demand and, including the cost of safety upgrade, is a least-cost solution.

Lithuania is currently updating its energy strategy based on least-cost studies of Lithuania and the Baltic region.

During 1998 the EBRD cooperated extensively with the European Commission in the context of the EU pre-accession programme.

Russian Federation

Agreements were signed in June 1995 by the EBRD and the government of the Russian Federation, Leningrad NPP, Rosenergoatom (jointly with the Novovoronezh and Kola NPPs) and the Nuclear Safety Authority (RF Gosatomnadzor). A Joint Committee was set up to monitor the progress of implementation of the Agreements.

Of the total grant, Leningrad NPP (four RBMK 1000 reactors) will receive ECU 30.4 million, and Rosenergoatom with Novovoronezh and Kola NPPs (four VVER 440/230 reactors) will be granted ECU 45.1 million. These projects include 41 short-term safety upgrades. As at the end of 1998, most of the equipment had been delivered; it is expected to be commissioned during the first half of 1999.

Specific support is being provided to RF Gosatomnadzor, in the form of a grant worth ECU 0.9 million, to facilitate the licensing process of the short-term safety upgrades with the support of technical safety organisations.

The NSA Agreements also provide for transition towards new regulatory regimes of 10 designated units with RBMK and VVER 400/230 reactors based on in-depth safety assessments. According to the provisions of the Agreement, longer-term operating licences will only be issued by the Russian Authorities if the plant operators can demonstrate that the safety levels of the plant comply with internationally recognised safety principles, internationally formulated safety guidelines and established practices. This licensing programme was further delayed during 1998.

Preparation of a least-cost investment plan for the development of relevant parts of the Russian power sector has been launched in the framework of the NSA Agreements. This is intended to identify alternative projects that would enable early closure of high-risk reactors. During 1998, a draft of such an investment plan was produced for the Russian North-West Region.

Ukraine

An ECU 118.1 million project for Chernobyl NPP was signed in November 1996 and is currently being implemented. This project is part of the comprehensive programme to support Ukraine's decision to close Chernobyl NPP by 2000, in accordance with the Memorandum of Understanding between Ukraine and the G-7/European Community. The NSA project addresses preparation for closure of Units 1, 2 and 3 through two pre-decommissioning facilities (liquid radioactive waste treatment and interim spent fuel storage) as well as short-term safety measures at Unit 3 prior to closure. The urgently needed safety equipment has been delivered but only partly commissioned. The tendering of the two turnkey pre-decommissioning facilities is ongoing, with contract signing scheduled for the first part of 1999.

Chernobyl nuclear power project, Ukraine

Nuclear reactors in the region

First contracts awarded for the Chernobyl Shelter Implementation Plan

Chernobyl Shelter Fund activities

In February 1998, the ratification of the Framework Agreement between Ukraine and the EBRD by RADA, the Ukrainian parliament, allowed the Bank to proceed with negotiation of specific Grant Agreements. The four agreements signed during the year with the recipients, Energoatom and the Nuclear Regulatory Authority of Ukraine, allocated ECU 154 million to the initial phase of the Shelter Implementation Plan.

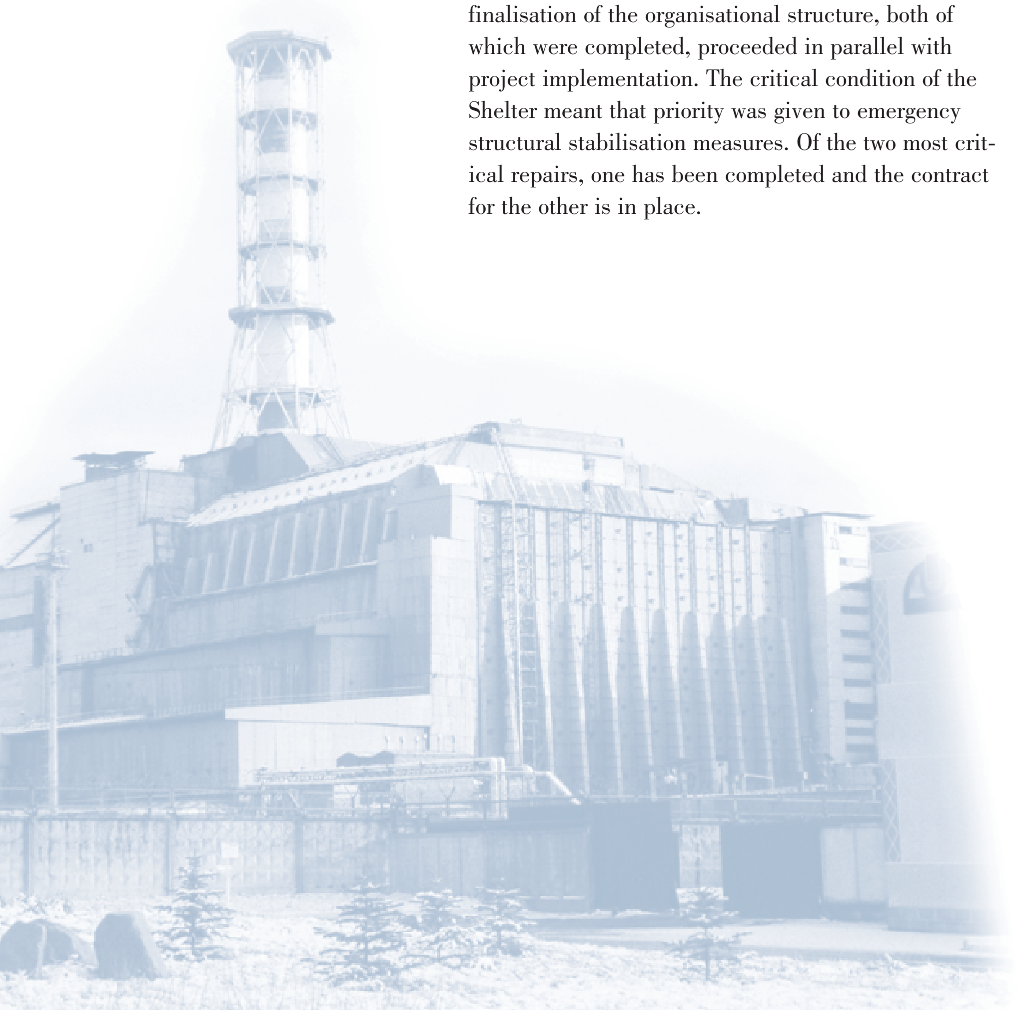
All six major contracts forming the backbone of the SIP project structure (the Project Management Unit, four engineering consultants and the licensing consultant) were awarded between April and November 1998. Open tendering and the size and character of the project attracted many competent global companies. Strict application of the EBRD's Procurement Rules for public sector operations provided a highly competitive and level playing field. The successful consortia offered a balance between international and Ukrainian expertise; this proved favourable for Ukrainian companies, whose scope of work will be more than 60 per cent of the total time required for the project.

The mobilisation of the project personnel and the finalisation of the organisational structure, both of which were completed, proceeded in parallel with project implementation. The critical condition of the Shelter meant that priority was given to emergency structural stabilisation measures. Of the two most critical repairs, one has been completed and the contract for the other is in place.

An effective partnership with the Government of Ukraine and other Ukrainian counterparts was essential for the success of the project in 1998. The Joint Ukraine/EBRD Committee dealt constructively with policy issues vital for project implementation. The tax-exempt status of the SIP was granted in December. The "nuclear guarantee" is due for signing by the Cabinet of Ministers in January 1999; this, along with the conventional insurance of the entire project (established in December), will provide equal protection to all the participants in the SIP during the course of the whole project.

The in-kind contribution of Ukraine, which is crucial as it provides project infrastructure to the SIP, will remain critically important in 1999, when the focus will shift more towards project implementation work.

In order to ensure the continuity of the project after 2000, the additional fund-raising will have to remain a high priority. The EBRD will fully support the efforts of the international community, represented by the Assembly of Contributors, to work with existing and new donors.



Other operational activities

Co-financing

The Agreement Establishing the EBRD requires the Bank to involve other sources of financing in its operations. The main co-financing partners for the EBRD are:

- commercial banks: through EBRD loan participations, assignments, bonds, parallel loans and credit lines;
- official co-financiers, such as government agencies and bilateral financial institutions providing grants, parallel loans and equity;
- export credit agencies (ECAs): through direct financing, export credit and investment insurance guarantees;
- international financial institutions (IFIs): sovereign and private sector lending for larger projects or in countries where private sources remain unavailable.

For the EBRD's countries of operations, co-financing has the dual benefit of introducing borrowers to the international capital markets and promoting foreign direct investment. The choice of co-financing partner must always take into account the specific needs and wishes of the client, and may depend on whether it is a private or public sector project as well as on specific market conditions affecting commercial and official co-financiers.

The main features of co-financing in 1998 were significant increases in both the number of co-financing partners and the funds mobilised against a background of continuing and intensifying crisis in the emerging markets. This was accompanied by a growing inability of many borrowers, particularly in countries at the early or intermediate stages of transition, to access the debt markets. As market confidence has deteriorated, lending has also affected advanced transition countries, resulting in stricter terms and conditions. In view of this, a slightly greater reliance on official sources of co-financing was evident towards the end of 1998. In particular, the EBRD maintained its strong cooperation with other IFIs and expanded its co-financing operations with these partners where possible.

Types of co-financing funds by value
1998

	ECU million
A/B loans[1] / participations	584
Parallel loans	118
ECA direct / guaranteed	270
Loans from IFIs	676
Equity	188
Grants	97
Total	**1,933**

[1] An A/B structure is where the EBRD finances a portion of the loan (the A portion) from its own funds and syndicates the remainder (the B portion) to a commercial lender.

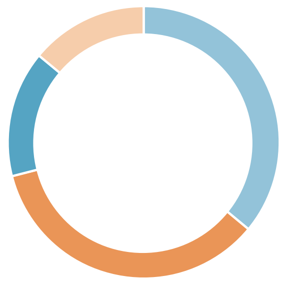
The EBRD worked with 58 commercial banks from 19 countries in 1998. Co-financing from these banks comprised ECU 584 million in participations in support of 25 projects. ECU 270 million of co-financing was provided by a total of four ECAs, either through direct lending or under their guarantee schemes. ECAs were involved in three projects in three countries.

Official co-financing institutions (excluding ECAs) were involved in 46 operations in 1998, contributing a total of ECU 915.6 million. Co-financing through other IFIs, covering both loans and equity, involved 20 operations, totalling ECU 675.8 million. Other official sources co-financed 34 operations, amounting to ECU 239.8 million.

Commercial co-financing institutions

The crisis in emerging markets, culminating in the Russian default, devaluation and debt moratorium announced on 17 August, has resulted in a significant difference between countries at advanced and less advanced stages of transition concerning the availability of commercial co-financing.

Sources of co-financing funds by value
1998



Significant increase in funding mobilised in 1998

Co-financing support for private and state sector operations
1998

	Number	*Total project cost ECU million*	*EBRD finance ECU million*	*Co-financing ECU million*	*Co-financing %*
Private sector	72	5,908	1,221	1,346	69.6
State sector	17	1,812	545	587	30.4
Total	**89**	**7,720**	**1,766**	**1,933**	**100.0**

Number of co-financing partners increased considerably in 1998

Ispat Karmet, Kazakhstan

Among commercial co-financiers, the largest proportion of co-financing in 1998 was provided by commercial banks. The year's most significant co-financing projects were spread across a variety of industrial sectors and countries, with the largest projects of the year being in Russia and pre-dating the August crisis.

One of the biggest co-financing operations in 1998 was an ECU 127.3 million project to finance the construction and operation of a can manufacturing plant in the Moscow region. Jointly arranged by the EBRD and the International Finance Corporation, an ECU 25.8 million loan was syndicated to six banks of the PLM Group, one of the largest packaging companies in Europe and a major producer of aluminium cans. Elsewhere in Russia, five commercial banks are participating in an ECU 51.6 million financing facility for the MMK steel mill in Magnitogorsk in the Urals. The EBRD is providing financing of ECU 30.1 million.

Another major co-financing project in 1998 was an ECU 376.3 million financing package for Ispat Karmet, one of the world's biggest single-site integrated steel plants and the largest commercial enterprise in Kazakhstan. Arranged jointly by the EBRD and the IFC, ECU 194.2 million of the financing package was syndicated to a group of 17 financial institutions. The EBRD is providing an ECU 116.1 million 10-year loan for its own account, an ECU 75.6 million six-year loan for the account of the 17 participating financial institutions and an ECU 43.0 million, 364-day revolving working capital facility for the account of 15 of the financial institutions. The IFC is providing an ECU 66.0 million 10-year loan for its own account and an ECU 75.6 million six-year loan for the account of the 17 participants. Ispat Karmet is the first major private industrial company in Kazakhstan to benefit from such a financing package.

In Ukraine an oil extraction operation became the first industrial project in the country to attract foreign banks in a medium-term loan. In an operation to support the production, refining and bottling of edible oil at the Dniepropetrovsk Oil Extraction Plant, the ECU 12.9 million revolving credit facility was syndicated to two commercial banks.

A notable success in 1998 was the project to support Slovalco a.s., an aluminium producer located in Ziar nad Hronom in the Slovak Republic. Jointly arranged by the EBRD and Crédit Lyonnais, the ECU 108.0 million medium-term co-financing facility consists of ECU 34.3 million from the EBRD and a syndicated amount of ECU 73.7 million, involving 10 commercial banks. At a time of financial turbulence in emerging markets and with confidence in the metals sector having deteriorated, it is noteworthy that the syndication was substantially over-subscribed. The success of this co-financing project illustrates very clearly the willingness among foreign lenders to continue to support long-term investment in the region in association with international financial institutions such as the EBRD.

In the latter part of 1998 the EBRD organised the first large-scale syndication of a financial institutions project in central and eastern Europe since the Russian crisis. The leading Estonian bank Hansapank received an ECU 76.6 million medium-term senior loan, of which ECU 51.1 million was syndicated to 12 commercial banks. The remaining ECU 25.5 million was provided by the EBRD. The project was jointly arranged and underwritten with Bankgesellschaft Berlin and Hamburgische Landesbank and sets a new benchmark not only for Estonia but also for other countries in the region.

The EBRD continues to place great emphasis on strong cooperation with ECAs, which contributed ECU 270.0 million of co-financing in 1998. The Bank maintains a close dialogue with the International Union of Credit and Investment Insurers (the Berne Union), participating in every meeting of the Union's Investment Insurance Committee and Export Credit Insurance Committee. It also cooperates closely with the OECD's Export Credit Group, where it has participated in all the meetings relating to the new consensus rules for project finance transactions.

Co-financing partners in 1998

Commercial banks

ABN AMRO Bank	Netherlands
Anglo Irish Bank Corporation	**Ireland**
Arab American Bank	**USA**
Banca Commerciale Italiana	Italy
Banca Nazionale del Lavoro	**Italy**
Bank Austria	Austria
Bank of America	USA
Bankgesellschaft Berlin	**Germany**
Banque Française du Commerce Extérieur	France
Banque Paribas	France
Bayerische Landesbank	Germany
Berliner Bank	**Germany**
BG Bank International	Denmark
BHF Bank	Germany
BNP Dresdner Bank	**France/Germany**
Canadian Imperial Bank of Commerce	Canada
The Chase Manhattan Bank	USA
Citibank NA	USA
Crédit Agricole	**France**
Crédit Lyonnais	France
Crédit Suisse First Boston	Switzerland
Creditanstalt-Bankverein	Austria
Cyprus Popular Bank	**Cyprus**
Dai-Ichi Kangyo Bank	Japan
Den Danske Bank	Denmark
Den Norske Bank	Norway
Dexia	**France**
DG Deutsche Genossenschaftsbank	**Germany**
Dresdner Bank	Germany
Erste Bank	Austria
Estonian Investment Bank	Estonia
Generale Bank	Belgium
Hamburgische Landesbank	**Germany**
Hansapank	Estonia
HypoVereinsbank	Germany
Industrial Bank of Japan	Japan
ING Barings	Netherlands
International Moscow Bank	Russian Federation
Kärntner Landes-und Hypothekenbank	**Austria**
KBC Bank	Belgium
Landesbank Rheinland-Pfalz	Germany
Landesbank Schleswig-Holstein	**Germany**
MeesPierson	Netherlands
National Westminster Bank	UK
NM Rothschild	UK
Nomura	**Japan**
Norddeutsche Landesbank	Germany
Rabobank Nederland	Netherlands
Raiffeisen Zentralbank Österreich	Austria
Royal Bank of Canada	Canada
Skandinaviska Enskilda Banken	Sweden
Société Générale	France
Sumitomo Bank	Japan
Svenska Handelsbanken	Sweden
Swiss Bank Corporation	Switzerland
Tokai Bank	**Japan**
Unibanka	**Latvia**
Union Bank of Switzerland	Switzerland

Official co-financing institutions

Baltic Investment Special Fund	Nordic countries
Compagnie Française d'Assurance pour le Commerce Extérieur (Coface)	France
Deutsche Entwicklungs Gesellschaft (DEG)	Germany
Deveurope	**France**
European Commission	Europe
Federal Office for Foreign Economic Affairs	Switzerland
Geschäftsstelle für die Exportrisikogarantie (ERG)	Switzerland
Government of Greece	**Greece**
Hermes Kreditversicherungs-Aktiengesellschaft	Germany
Investment Fund for Central and Eastern Europe (IØ Fund)	Denmark
Korean Export Import Bank	**Korea**
Kreditanstalt für Wiederaufbau (KfW)	Germany
Kuwait Fund for Arab Economic Development	**Kuwait**
Ministry of Foreign Affairs	Netherlands
Ministry of Foreign Affairs	Norway
Ministry of the Treasury	Italy
Moldova Special Fund	Switzerland
Netherlands Development Finance Company (FMO)	Netherlands
Österreichische Kontrollbank	Austria
Post-Conflict Support Fund	**Japan**
Russia Small Business Fund	G-7 and Switzerland
Swedfund	Sweden
Swedish International Development Corporate Agency (Sida)	Sweden
Western NIS Fund	**USA**

International financial institutions

European Investment Bank (EIB)	Multilateral
International Finance Corporation (IFC)	Multilateral
Islamic Development Bank (IDB)	**Multilateral**
World Bank – (IBRD/IDA)	Multilateral
World Bank – Trust Fund for Bosnia and Herzegovina	Multilateral

Organisations co-financing with the EBRD for the first time in 1998 are shown in **bold**.

IFIs and other official co-financing institutions

Among the official co-financing partners, the IFIs were predominant in 1998, co-financing 20 operations amounting to ECU 675.8 million. The European Investment Bank co-financed five operations on a sovereign basis totalling ECU 237.6 million in four sectors: railways (Hungary and Estonia), port development (Latvia), urban transport (Poland) and telecommunications (Romania). The International Finance Corporation provided a combination of equity and loans for 10 operations, amounting to ECU 300.8 million, which were mainly directed at the financial sector (Bosnia and Herzegovina, FYR Macedonia, Poland and regional equity funds), oil and gas (Russia), power and energy (Russia) and steel industry (Kazakhstan). The World Bank co-financed three operations, contributing a total of ECU 116.8 million in sovereign lending to urban solid waste management (Uzbekistan), railways (Croatia) and flood damage repair in Wroclaw (Poland). A new source of IFI co-financing was established with the Islamic Development Bank, which provided lease financing for the Mingechaur power project in Azerbaijan (ECU 11.8 million) and a concessional loan for the Turkmenistan road improvement project (ECU 8.8 million).

Other official co-financing partners contributed ECU 239.8 million for 34 operations through grants, parallel loans and equity. The European Commission, via its Phare and Tacis programmes, co-financed eight operations on a grant basis, totalling ECU 82.3 million. Italy, Japan, the Netherlands and Switzerland contributed ECU 16.0 million in grants to the Bosnia and Herzegovina telecommunications emergency reconstruction project. Italy also provided grant support to the Albania reconstruction equity fund (ECU 8.5 million). The governments of Norway and Sweden provided a total of ECU 1.8 million to the fund, Horizonte Bosnia, and to the Herzegovina Enterprise Fund. Parallel loans were provided, amounting to ECU 95.5 million, from a variety of sources, such as the Korean Export Import Bank, Kuwait Fund for Arab Economic Development, KfW and DEG (both Germany), Greece, Sida (Sweden), the EBRD's Russia Small Business Fund and the Moldova Special Fund. Equity co-investments amounted to ECU 357 million and mainly originated from the FMO (Netherlands), the Investment Fund for Central and Eastern Europe (Denmark) and the Baltic Investment Special Fund.

In the present emerging markets crisis, official co-financing partners have shown an increased interest in co-financing with the EBRD, particularly in areas where the Bank has a key role to play because of its expertise and experience in the region. For example, a regional co-financing facility for SMEs, for both equity and debt financing, was signed with the International Cooperation Development Fund (ICDF) of Taipei China. ICDF contributed ECU 10.8 million towards the Financial Intermediary Investment Special Fund of the Bank. Other potential new partners in this area are the Council of Europe Social Development Fund and the OPEC Fund for International Development.

In view of the present financial climate in large parts of the region, co-financing with other IFI partners is likely to gain in significance in the coming year. The EBRD's strong capabilities in private sector due diligence and its ability to undertake financial restructuring to underpin private/public infrastructure investments will be attractive features for other official co-financiers, whether IFIs or bilateral agencies.

Technical cooperation funds

Technical cooperation funds have an important role to play in supporting the EBRD's operational objectives of sound banking, additionality and transition impact through:

- developing and maintaining a productive investment pipeline of high quality
- assisting an efficient and effective project implementation
- supporting the development of institutional infrastructure directly relevant to the Bank's operations
- maintaining balanced support for both the private and public sectors.

The EBRD's Technical Cooperation Funds Programme (TCFP) enables the Bank to operate at the cutting edge of project financing. The technical cooperation provided through the EBRD – in the form of due diligence and procurement support, for example – mitigates risks during preparation and implementation of Bank projects. This, in turn, helps to attract other sources of external financing. Technical cooperation is also used to support development of the institutional infrastructure in the Bank's countries of operations, which has a strong effect on the transition process.

Cumulative commitments for consultant assignments funded under the Bank's TCFP reached ECU 561.3 million by the end of 1998. Commitments during the year amounted to ECU 80.3 million, down from ECU 103.0 million in the previous year. The decline in commitment level was most evident in the Russian Federation, where commitments in 1998 amounted to ECU 12.0 million, compared with ECU 30.3 million in the previous year. Disbursements in 1998 of ECU 68.0 million were just below the ECU 71.9 million disbursed in 1997. Cumulative disbursements therefore stood at ECU 350.6 million by the end of 1998.

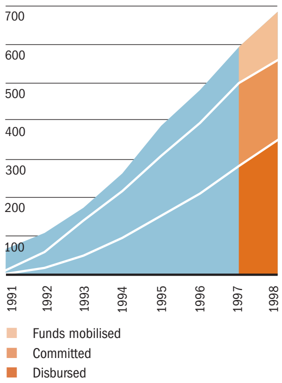
The EBRD continued to cooperate with the European Community on a number of initiatives in 1998. In October the EBRD's President, Horst Köhler, announced the formation of an EC-EBRD Working Group on Russia to help coordinate technical assistance in response to the Russian financial crisis. The Working Group made significant progress at the end of 1998 in developing joint assistance efforts in the financial institutions and legal reform sectors. In September and December the EBRD participated in EC-sponsored forums on telecommunications regulations with the EBRD's countries of operations.

In 1998 the EBRD financed 318 consultant assignments through the TCFP, bringing the total number of assignments to 2,106. The transition impact of these assignments is high since most of them are directly related to specific Bank projects. The TCFP has thus supported the generation of 267 signed EBRD projects, for which the Bank has committed financing of ECU 6.6 billion. In particular, the funding provided by the European Community, through the Bangkok Facility (ECU 43 million in 1998), financed 54 technical cooperation projects linked to the preparation or implementation of EBRD investment projects.

The focus on EBRD investment projects is reflected by the fact that 75 per cent of all commitments are related to either project implementation or project preparation. Project implementation, which includes support for the implementation of Regional Venture Funds, Post-Privatisation Funds and credit lines, accounts for 39 per cent of all commitments. The corresponding figure for project preparation is 36 per cent. Remaining funds have been committed to advisory services (21 per cent), sector studies (1 per cent) and training (3 per cent).

Cumulative technical cooperation funds mobilised, committed and disbursed 1991-98

(ECU million)



Technical Cooperation commitments by sector

Sector	*No.*	***1998*** *(ECU million)*	*No.*	***1991-98*** *(ECU million)*
Finance, business	103	34.9	685	182.0
CEALs, Co-financing lines and RVFs[1]	23	11.1	163	147.0
Transport, storage	19	8.5	193	55.1
Energy / power generation	20	6.8	239	51.5
Community / social services	64	8.5	309	48.3
Manufacturing	83	8.9	344	45.8
Telecommunications	5	0.3	101	15.9
Extractive industries	1	0.1	29	9.2
Agriculture, forestry, fishing	1	1.2	28	4.9
Commerce, tourism	–	–	10	1.0
Construction	1	<0.1	5	0.8
Total	**320**	**80.3**	**2,106**	**561.3**

[1] Central European Agency Lines, Regional Venture Funds.

Kazakhstan Small Business Programme

Many TC assignments help the transition process directly through their institution-building component (e.g. support to the development of financial institutions and strengthening of the legal framework). The TCFP is also promoting the development of a local consultant industry through increased use of local consultants.

Funding for technical cooperation is provided by the EBRD's members through regular Technical Cooperation Fund contributions, project-specific technical cooperation agreements and Special Fund contributions. All contributions by donors are made on a voluntary basis.

Technical Cooperation commitments by recipient country

		1998		**1991-98**
Country	*No.*	*(ECU million)*	*No.*	*(ECU million)*
Russian Federation	37	12.0	368	201.7
Romania	5	3.3	76	29.8
Ukraine	17	2.3	134	28.9
Kazakhstan	12	6.1	51	20.3
Poland	15	7.9	79	16.7
Albania	9	3.4	81	14.9
Estonia	19	0.8	143	14.4
Uzbekistan	5	6.0	31	13.7
Bosnia and Herzegovina	15	2.4	47	12.1
Lithuania	17	0.8	112	11.9
Slovak Republic	3	0.1	48	11.4
Belarus	16	0.9	74	11.1
Latvia	21	1.1	104	10.7
Hungary	–	–	59	10.2
Kyrgyzstan	13	3.0	58	10.1
Slovenia	6	0.3	75	9.3
Bulgaria	5	2.5	30	9.2
Moldova	13	0.7	46	8.2
Turkmenistan	4	3.1	23	8.1
Azerbaijan	9	2.2	33	7.5
Croatia	8	2.0	38	5.5
Tajikistan	–	–	17	5.4
Czech Republic	3	2.0	28	5.3
Georgia	8	1.9	33	5.2
FYR Macedonia	–	–	29	3.8
Armenia	2	0.9	22	3.4
Regional	58	14.4	267	72.5
Total	**320**	**80.3**	**2,106**	**561.3**

Includes implementation projects. Amounts are calculated in the currency of each donor fund and translated into ECU.

In 1998 the EBRD signed four new Technical Cooperation Fund Agreements, bringing the total to 56. One of these Agreements relates to the Kazakhstan Small Business Programme, where Chevron Corporation has contributed grant funds in support of activities in the Atyrau oblast, site of the giant Tengizchevroil project. This innovative contribution from the private sector is very much appreciated by the Bank.

In addition, nine existing Technical Cooperation Funds were replenished and three project-specific technical cooperation agreements were signed. Total grant resources for technical cooperation increased by ECU 90.6 million, bringing the cumulative figure to ECU 686.1 million by the end of 1998.

During the year the EBRD signed one new contribution agreement for the Technical Cooperation Special Fund (TCSF), with Canada. The TCSF is an untied facility funded through reimbursed technical cooperation funds previously allocated to private sector operations and/or through direct donor contributions. By the end of 1998 the TCSF amounted to ECU 0.7 million, of which ECU 0.6 million had been committed.

Technical Cooperation Fund Agreements

At 31 December 1998

Donor	*Date of initial Agreement*	*Currency*	*Amount including replenishments (million)*	*ECU equivalent (million)*
Austria	31 Dec 91	USD	5.00	4.29
Belgium (Federal Government)	27 Sept 94	BEF	30.00	0.74
Belgium (Flemish Government)	9 Nov 94	ECU	0.40	0.40
Belgium (Walloon Government)	16 Mar 95	BEF	15.00	0.37
Canada	24 Jan 92	CAD	7.66	4.24
Denmark	1 July 92	ECU	3.12	3.12
Denmark, Finland, Iceland, Norway, Sweden (TAM Nordic Council)	22 Sept 95	DKK	7.00	0.94
European Community (Bangkok Facility)[1]	15 Oct 91	ECU	230.99	230.99
European Community (Bosnia and Herzegovina Micro-Credit Programme)	26 June 98	ECU	1.50	1.50
European Community (Bulgaria PPF)	1 May 98	ECU	15.00	15.00
European Community (Polish SRP)	12 Dec 96	ECU	2.00	2.00
European Community (Romanian PPF)	10 Oct 96	ECU	10.00	10.00
European Community (Slovak PPF)	3 Apr 96	ECU	8.00	8.00
European Community (TAM Phare Regional)	26 June 95	ECU	5.90	5.90
Finland	13 Jan 92	FIM	24.52	4.12
Finland, Norway, Sweden (RVF for North West Russia)[2]	5 July 94	USD	20.00	17.15
France (Foreign Affairs)	1 Aug 91	FRF	19.51	2.97
France (RVF for Southern Russia)[2]	28 Feb 95	FRF	120.00	18.29
France (Treasury)	26 Mar 92	FRF	30.46	4.64
FYR Macedonia (Financial Sector)[3]	14 Feb 96	DEM	1.08	0.55
Georgia (Financial Sector)[3]	12 Dec 96	USD	0.12	0.10
Germany	11 Dec 92	DEM	10.00	5.11
Germany KfW	27 Sept 95	DEM	12.51	6.39
Greece	4 Apr 95	GRD	179.00	0.54
Iceland	3 Dec 92	ECU	0.20	0.20
Ireland	17 Sept 93	ECU	1.18	1.18
Israel	14 Apr 92	ILS	1.04	0.21
Italy	14 Apr 92	ITL	9,000.00	4.64
Italy (Albania Reconstruction Equity Fund)	28 Sept 98	USD	3.00	2.57
Italy (Central European Initiative)	14 Apr 92	ITL	41,135.00	21.22
Italy (RVF for Western Russia)[2]	6 June 95	USD	20.00	17.15
Japan	5 July 91	JPY	11,434.03	86.17
Korea, Republic of	25 Apr 93	USD	0.60	0.52
Luxembourg	26 Nov 91	ECU	0.70	0.70
Netherlands	20 Nov 91	NLG	23.88	10.83
Netherlands (Dutch Environment)	22 June 95	NLG	0.90	0.41
Netherlands (Eastern Ukraine PPF)	30 Jan 97	NLG	8.60	3.90
Netherlands (Transition)	3 Nov 97	NLG	3.00	1.36
New Zealand	10 July 92	NZD	0.33	0.17
Norway (Environment and energy)	16 Apr 91	NOK	27.60	3.11
Norway (General)	27 Apr 93	ECU	1.50	1.50
Portugal	20 Oct 92	PTE	80.00	0.40
Spain	21 July 92	ESP	566.00	3.40
Spain (Southern Ukraine PPF)	17 Jan 97	ECU	20.00	20.00

1 The Agreement amount has been amended by the EBRD to reflect the annual revision of the facility by the EC (Bangkok Facility). Included in the Agreement is ECU 1.28 million representing funds assigned to implementation projects.

2 The table lists all technical cooperation agreements that the EBRD manages directly and for which it has received contributions. Additional Regional Venture Funds are not administered by the EBRD: these are recorded as official co-financing (see page 45).

3 Contributions to these funds consist of technical assistance fees payable by the borrowers under the terms of loan agreements between the EBRD and certain financial intermediaries. The fees are payable on the interest payment dates defined in the loan agreements and are recorded as agreement and contribution amounts on the date of receipt.

Technical Cooperation Funds replenished since the initial Agreement.

Technical Cooperation Fund Agreements (continued)

At 31 December 1998

Donor	*Date of initial Agreement*	*Currency*	*Amount including replenishments (million)*	*ECU equivalent (million)*
Sweden	13 Aug 91	SEK	55.00	5.80
Sweden (TAM and BAS Programme)	11 Dec 98	ECU	1.00	1.00
Switzerland	31 Mar 92	CHF	10.50	6.53
Taipei China	16 Sept 91	USD	20.00	17.15
Turkey	17 June 92	TRL	10,000.00	0.03
United Kingdom[1]	25 Nov 91	GBP	4.82	6.84
United Kingdom – B[2]	14 Mar 94	GBP	3.81	5.40
United Kingdom – C[3]	25 Mar 94	GBP	3.96	5.62
USA	30 July 91	USD	1.27	0.91
USA (Evergreen)	3 June 94	USD	4.15	3.56
USA (RVF for Lower Volga Region)[4]	29 Sept 94	USD	20.00	17.15
USA (US Advisors)	10 Nov 97	USD	0.95	0.81
Total of Technical Cooperation Funds				**597.79**

1 The activities of the UK Fund are in the Russian Federation.
2 The activities of the UK-B Fund are in the countries of the former Soviet Union, excluding the Russian Federation.
3 The activities of the UK-C Fund are in Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, FYR Macedonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic and Slovenia.
4 The table lists all technical cooperation agreements that the EBRD manages directly and for which it has received contributions. Additional Regional Venture Funds are not administered by the EBRD: these are recorded as official co-financing (see page 45).

Special Funds				
Baltic Technical Assistance Special Fund	14 Apr 92	ECU	11.33	11.34
Russia Small Business Technical Cooperation Special Fund	18 Oct 93	ECU	58.66	49.36
EBRD Technical Cooperation Special Fund[1]	12 Sept 95	ECU	0.72	0.72
Total of Special Funds				**61.42**

1 Agreement and contribution amounts include repayments made by various beneficiaries and direct contributions from donors. These amounts are recorded as agreements and contributions on the date of receipt.

Project-specific Funds	**26.93**

Total of Technical Cooperation Funds	597.79
Total of Special Funds	61.42
Total of Project-specific Funds	26.93
Total of all technical cooperation agreements	**686.14**

Investment Cooperation Funds

At 31 December 1998

Donor	*Date of initial Agreement*	*Currency*	*Amount including replenishments (million)*	*ECU equivalent (million)*
Austria – Bosnia and Herzegovina	5 Dec 96	ATS	66.20	4.81
European Community (Maritsa Unit 8)	29 Dec 97	ECU	7.50	7.50
European Community (Micro-Enterprise Bank d.d.)	25 June 98	ECU	6.00	6.00
European Community (MUDP II)	19 Mar 98	ECU	27.40	27.40
Italy – Bosnia and Herzegovina	12 Sept 96	USD	7.50	6.43
Japan Fund for Post-Conflict Support	11 July 97	JPY	1,000.00	7.54
Norway – Bosnia and Herzegovina	24 Apr 97	NOK	60.90	6.86
Norway – Eastern Slavonija	12 Dec 97	NOK	30.00	3.38
Norway – Micro-Enterprise Bank d.d.	2 June 98	NOK	2.70	0.30
Total of Investment Cooperation Funds				**70.22**

Technical Cooperation Funds replenished since the initial Agreement.

Project evaluation

Project evaluation is the assessment of the performance of completed projects and programmes through systematic analysis of their outputs or outcomes against expected or planned results. It also involves the evaluation of categories of operations and patterns of experience.

The EBRD's project evaluation function seeks to measure how closely the Bank's operations meet a broad range of qualitative and quantitative objectives, thereby assessing the Bank's transition effectiveness. It looks for significant lessons to be learned from the EBRD's completed operations, and those of other international financial institutions, to help in shaping future operations. To learn from experience earlier during the project cycle, it also tries to gain evaluation experience with ongoing projects and existing programmes.

The independence in which project evaluation activities are carried out secures objectivity and transparency.

Assessing performance

The EBRD's Project Evaluation Department (PED) concentrates on evaluating operations one to two years after full disbursement has taken place. From the Bank's inauguration in 1991 until the end of 1998, PED prepared 76 Operation Performance Evaluation Review (OPER) reports on private and public sector investment operations, comprising 44 per cent of 172 operations ready for post-evaluation. To improve the coverage ratio of evaluated projects, PED also carries out assessments of monitoring (self-evaluation) reports of projects at the time of project evaluation and validates the evaluation findings. The OPER reports and these assessments currently comprise 147 or 85 per cent of operations ready for evaluation.

The EBRD has so far committed funds to 535 projects, of which a total of 28 per cent by number have been evaluated or assessed. Including evaluations of large technical cooperation (TC) operations, TC-related special studies and mid-term evaluations of Bank operations (eight reports in 1998), PED has produced 117 evaluation reports in total. During 1998 PED allocated more time to special studies, carrying out mid-term reviews and enhancing the evaluation of TC operations. This was made possible by reducing the number of in-depth OPER reports and introducing mini-OPER reports, which take half as much time to prepare as the in-depth reports.

The outcomes of the 1993-97 Annual Evaluation Overview Reports (AEORs), as well as the performance of investment operations evaluated or assessed during 1998, show that the portfolio comprising those operations maintains an acceptable quality. On the progress of the EBRD's transition impact, it was concluded in the AEOR of 1997 that 70 per cent of the evaluated operations had a "medium" or "high" impact on transition, although the number of projects rated "high" on transition still remains at only 20 per cent. PED recommended that more attention should be paid to transition impact during the selection process of Bank projects.

The table of overall performance ratings (shown below) indicates that the percentage of projects rated "Successful" or higher remains relatively stable at 54.4 per cent for 1993-98 compared with 53.1 per cent for 1993-97. The number of projects rated "Unsuccessful" increased slightly from 14.3 to 17.0 per cent. This increase can be partly explained through the fact that some projects were negatively affected by the Russian crisis.

Evaluation performance ratings of investment operations evaluated or assessed during 1993-98

		1993-97		***1993-98***
Performance ratings	*No.*	*%*	*No.*	*%*
Successful or higher	52	53.1	80	54.4
Partly successful	32	32.6	42	28.6
Unsuccessful	14	14.3	25	17.0
Total	**98**	**100.0**	**147**	**100.0**

The performance classification of the evaluated operations is based on five strategic performance criteria:

- the operation's impact on the transition process, including environmental considerations;
- the EBRD's additionality (the Bank may invest only if other financing is not available on reasonable terms);
- fulfilment of objectives;
- the company/project business performance; and
- the project's investment performance for the Bank.

Revised Procurement Policies approved

Ventspils port rail terminal project, Latvia

Borispol Airport, Ukraine

The transition impact of Bank investments is a significant factor in determining the overall performance rating of each operation. In the analysis, PED uses a standard set of transition indicators developed by the EBRD's Office of the Chief Economist in cooperation with PED. In order to improve the quality and reliability of the performance evaluation findings on transition, PED reviews its transition impact rating methodology on a regular basis. The evaluation findings so far reflect the positive way in which the Bank has fulfilled its mandate since its inception.

Apart from ensuring that PED identifies whether the EBRD has functioned according to its mandate (accountability), it is essential that the project evaluation process also generates important lessons from past operations. Through Bank-wide dissemination of these lessons, bankers are able to improve future operations (quality management). A substantial amount of PED staff time is allocated to disseminating evaluation findings to Bank staff as early as project appraisal, and through "lessons learned" workshops. In this way, the lessons are properly shared and can be integrated into the design and structure of new projects.

PED is closely cooperating with the evaluation departments of the other multilateral development banks (MDBs) in the Evaluation Cooperation Group (ECG). This was established in 1996 in response to the report of the Task Force on MDBs, which was created by the ministerial Development Committee. A key Task Force recommendation was that MDBs should harmonise "criteria, techniques, and practices for measuring results among evaluation units". In April 1998 the MDBs reported back to the Development Committee on the steps taken in the harmonisation process. During a recent meeting of the Presidents of the MDBs in Abidjan, a report on the progress of the working groups of MDBs, including the ECG, was adopted.

Procurement and contracting

The EBRD's Procurement Policies and Rules are based on the fundamental principles of non-discrimination, fairness and transparency. They are designed to promote efficiency and effectiveness and to minimise credit risk in the implementation of the Bank's lending and investment operations.

A clear distinction exists between procurement in public and private sector projects in terms of procedures. Procurement for a private sector project is undertaken in accordance with established commercial and industry best practices without the enforcement of any prescribed rules and procedures. Through its due diligence process, the EBRD ensures that procurement and contracting is carried out with no conflict of interest and that sound purchasing methods have been applied in the best interest of the Bank's clients.

Procurement in the EBRD's public sector operations is governed by the Bank's Procurement Policies and Rules, which stipulate that open tendering should normally be applied for a public sector project. In February 1998 the EBRD's Board of Directors approved revisions to the Procurement Policies and Rules, which specifically address how the Bank defines corrupt and fraudulent practices in the procurement process and detail how the EBRD will deal with any proven allegations of these practices. The Bank requires clients as well as firms and individuals to observe the highest standard of ethics and conduct during the procurement and execution of EBRD-financed contracts.

To help all parties involved in the tendering and contract process, the EBRD has made available a range of material, such as standard tender documents and procurement guidelines. Invitations to tender, expressions of interest, contract award information and other essential information regarding EBRD-funded contracts is published monthly by the Bank in *Procurement Opportunities*, which is also available on the Bank's Web site (www.ebrd.com). Procurement information is also provided in the *Official Journal of the European Communities* and *United Nations Development Weekly*. During 1998, some of the procurement-related material mentioned above, such as guidance notes, was added to the procurement section of the Bank's Web site.

In 1998 the EBRD signed 13 public sector operations, with a total project value of ECU 1.9 billion, compared with 16 projects totalling ECU 1.3 billion in 1997. As far as awarded contracts were concerned, more contracts were signed in 1998 than in 1997 but for a lesser value.

During the year, the EBRD funded 329 public procurement contracts with a total value of ECU 436 million. This compares with 250 in 1997 totalling ECU 546 million. In 1998, contracts were awarded to suppliers from 53 countries, including 21 of the EBRD's countries of operations. Open tendering was used for 80 per cent of these contracts by value, following 81 per cent in 1997.

In terms of contract type, the volume of contracts awarded in the public sector for works and supply & installation decreased from 45 per cent and 23 per cent respectively in 1997 to 19 per cent and 15 per cent in 1998. Conversely, the volume of goods contracts increased to 58 per cent in 1998, compared with 24 per cent the previous year. This trend is partly due to the fact that more projects are reaching the end of their project cycle. In addition, with the transition gathering momentum, less procurement through open tendering is needed, and savings are usually used to buy goods contracts rather than works or supply & installation contracts.

The EBRD's procurement department continued to provide professional advice and services for both internal and external clients. Throughout the year a number of presentations on how to work with the Bank's Procurement Policies and Rules were made to clients, suppliers and consultants, either directly or at international and national forums.

The EBRD continued to work closely with other IFI procurement support services in 1998 and participated in joint workshops convened to look at ways of harmonising the format and content of the standard tender documents from the various institutions.

Definitions of procurement methods

Open tendering: procedures under which all interested suppliers or contractors are given adequate notice of purchase requirements and equal opportunity to submit a tender.

Competitive selection: the process of selecting a consultant from proposals received from a short list of firms.

Local competitive tendering: tenders in accordance with national procedures acceptable to the EBRD in which foreign firms are allowed to participate.

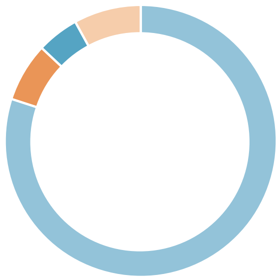
Selective tendering: procedures similar to those for open tenders except that the client preselects qualified firms which will be invited to submit tenders.

Shopping: a simplified form of competitive purchasing that requires written quotations from at least three suppliers, including foreign firms where possible.

Single tendering: procedures applied in exceptional cases where a single firm is invited to submit its tender without prior public notification.

Method of procurement for contracts awarded in the public sector in 1998

(by volume)



- Open 80%
- Competitive 7%
- Local 5%
- Selective, shopping, single, other – 2% each

Definitions of contract types

Supply of goods: contract for the provision of plant and equipment where installation and commissioning represents a small proportion of the contract value.

Works: contracts for civil construction works to an agreed design, e.g. roads and buildings, including specified plant, equipment fixtures and fittings to be incorporated in the structure.

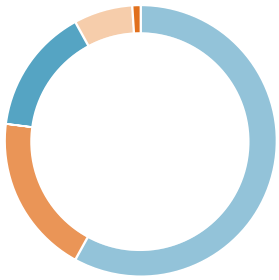
Supply and installation: contract for the provision of plant and equipment where installation represents a substantial proportion of the value of the contract.

Consultant services: hiring of consultants to provide professional advice and perform specific tasks.

Services: services excluding consultancies, e.g. training and provision of transport.

Contracts awarded in the public sector by contract type in 1998

(by volume)



- Goods 58%
- Works 19%
- Supply and installation 15%
- Consultant services 7%
- Services 1%

Financial results and Financial statements

Contents

Financial results

General overview

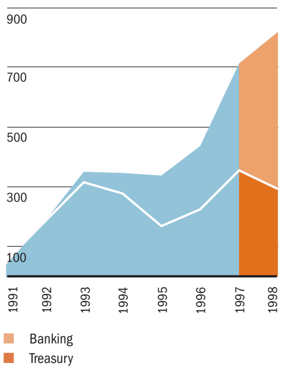
In 1998, the EBRD's operating income advanced markedly, reflecting the impact of a maturing portfolio and a strong Treasury contribution. Total operating income was ECU 450.5 million for the year, 30 per cent or ECU 104.5 million higher than in 1997.

Following the onset of the financial crisis in the Russian Federation in August 1998, the EBRD took immediate steps to set in motion an evaluation of the quality of its investments in the region. Significantly increased general and specific provisions were recorded in the latter part of the year, consistent with the application of the Bank's provisioning policy and updated information obtained from an ongoing review of the impact of the crisis on the credit quality of the Bank's investment in the region. Provisions for 1998 of ECU 553.1 million were more than treble the charge for last year (ECU 177.7 million). As a result, the EBRD recorded a loss for the year, after provisions, of ECU 261.2 million, compared with a profit of ECU 16.2 million for 1997.

In accordance with the Bank's provisioning policy, management continuously reviews the portfolio in the light of any new developments and further information, to ensure that the carrying value of loans and investments continues to be stated prudently in accordance with the EBRD's policy and management's best estimate of the recoverability of the Bank's assets.

Gross income structure

(ECU million)



The upward trend in recent years of gross income generated by Banking activities continued; these generated 64 per cent of the Bank's gross income in 1998 (1997: 50 per cent) – see the graph. Share investments accounted for over 38 per cent of this income, compared with less than 26 per cent in 1997. Of this, ECU 168.7 million represented profit from the sale of share investments, more than double the ECU 76.1 million received last year, and ECU 30.8 million was dividend income, an increase of approximately 90 per cent from ECU 16.2 million in 1997.

The EBRD's general administrative expenses, expressed in sterling, were well within budget and slightly lower than those for 1997, reflecting continuing budgetary discipline and cost controls. As a result of the strength of sterling during 1998, the Bank's general administrative expenses, when expressed in ECU, were ECU 6.1 million above the level of last year.

Total provisions on Banking projects amounted to ECU 908.9 million at the year-end, compared with ECU 409.4 million in 1997. This represented 16 per cent of disbursed outstanding loans and equity investments (1997: 9 per cent) and reflects the EBRD's commitment to provide prudently for existing and anticipated risks based on a continuing assessment of the portfolio and the associated inherent risks. Provisions attributable to projects in the Russian Federation accounted for approximately 53 per cent of total provisions and represented 38 per cent (ECU 483.0 million) of non-sovereign disbursed outstandings in that country. As a result of the loss for the year, the Bank's reserve position moved from a positive position of ECU 98.6 million at the 1997 year-end to a deficit of ECU 158.5 million as at 31 December 1998.

Banking operations

Portfolio

The Board of Directors approved 82 projects totalling ECU 2.0 billion in 1998, compared with 143 projects amounting to ECU 4.0 billion in 1997. Cumulative approvals at the end of 1998 amounted to ECU 14.5 billion, net of cancellations (1997: ECU 13.9 billion).

The total cumulative value of Board-approved projects amounted to ECU 50.6 billion at 31 December 1998 compared with ECU 43.9 billion at the end of 1997. Of this total project value, the EBRD's own financing amounted to ECU 14.5 billion and primary resource mobilisation was ECU 36.1 billion at the end of December 1998 (ECU 13.9 billion and ECU 30.0 billion respectively for 1997).

During the year, 96 projects with a value of ECU 2.4 billion were signed, compared with 108 projects with a value of ECU 2.3 billion in 1997. The increase in the relative share of private sector and equity projects continued, with 80 per cent of the new commitments signed in 1998 relating to the private sector, while 33 per cent were share investments, compared with 76 per cent and 19 per cent respectively in 1997.

Cumulative gross commitments at 31 December 1998 totalled ECU 12.0 billion and commitments outstanding (net of cancellations and repayments except those repayments against revolving loans) amounted to ECU 10.2 billion.

Project disbursements in 1998 were ECU 2.4 billion, compared with ECU 2.0 billion in 1997. ECU 599.0 million (1997: ECU 332.8 million) related to share investments, which rose to almost 25 per cent of total disbursements, up from approximately 16 per cent in 1997. Private sector gross disbursements totalled 84 per cent for the year (1997: 77 per cent private). The outstanding disbursements at the end of the year totalled ECU 5.8 billion, comprising ECU 4.3 billion of loans, ECU 1.4 billion of share investments and ECU 10.2 million of project-related debt securities.

During the year, ECU 1.1 billion was received from loan repayments and share divestments, almost 40 per cent higher than 1997 repayments. The level of prepayments, repayments ahead of schedule, against total repayments has, however, decreased to 19 per cent in 1998 compared with 31 per cent in 1997.

Risks

The EBRD's loan and share investments are reviewed on an ongoing basis by the Bank's independent Risk Management department, and credit risk ratings are assigned to individual operations, ranging from 1 (low risk) to 10 (expected loss). These ratings are project-specific and country-specific and the overall risk rating is usually taken from the higher risk of project or country. In view of the markets in which it operates and its transition mandate, the Bank expects its project-specific ratings to range from risk categories 4 to 6 in normal circumstances. The average overall risk rating of new projects signed in 1998 was 6, reflecting the risk profile associated with operations in countries in the higher risk categories.

By the end of 1998, the percentage of signed projects in overall risk categories 4 to 6 fell from more than 85 per cent at 31 December 1997 to 53 per cent. Those in risk category 7 increased to 35 per cent (1997: 11 per cent) and those in categories 8 and 9 to 9 per cent (1997: 2 per cent). This is primarily the result of the deterioration of the credit risk of Russia and other countries affected by the aftermath of the Russian crisis, and is illustrated in the graph (right).

Performance

Gross income of ECU 524.2 million for 1998 from the core Banking business increased by 47 per cent from ECU 357.3 million in 1997 and represented nearly two-thirds of the EBRD's gross income for the year. Profit from the sale of share investments of ECU 168.7 million accounted for 32 per cent of Banking's gross income, compared with ECU 76.1 million and 21 per cent in 1997. Interest income from loans was 53 per cent (1997: 62 per cent), fee and commission income 9 per cent (1997: 12 per cent) and dividend income was 6 per cent (1997: 5 per cent) of gross income.

The sale of a small number of the EBRD's more mature shareholdings tends to generate a significant proportion of the income received from the share investment portfolio. Consequently the contribution from this sector of the portfolio to the Bank's profit and loss account is expected to show significant variability from year to year, given its dependence on the timing of equity exits, which is primarily linked to the date that projects have come to completion. The future number of exits is expected to increase as the growing equity portfolio continues to mature. However, it is difficult to predict the potential income from these sales.

Treasury operations

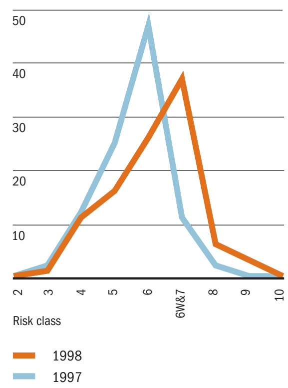
Portfolio

The value of assets under Treasury management increased during the year by ECU 1.7 billion, to ECU 8.2 billion at 31 December 1998. Assets comprised ECU 5.3 billion of debt securities and ECU 2.9 billion of placements with credit institutions.

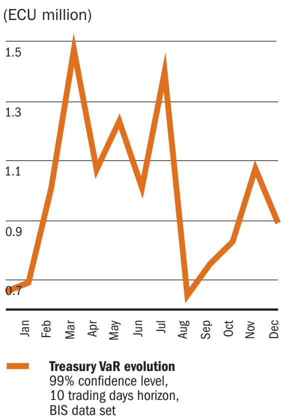
At the end of 1998, ECU 864.7 million or 10.5 per cent of total Treasury assets was managed by a total of 16 external asset managers (EAMs). These externally managed portfolios comprised ECU 391.2 million of an ECU-denominated interest rate trading programme and ECU 473.5 million of a US dollar-denominated mortgage-backed securities programme. The funds are managed by independent managers in order to obtain specialised services and investment techniques and to establish third-party performance benchmarks. These independent managers are required to comply with the same investment guidelines that the Bank applies to its internally managed funds.

Portfolio risk distribution

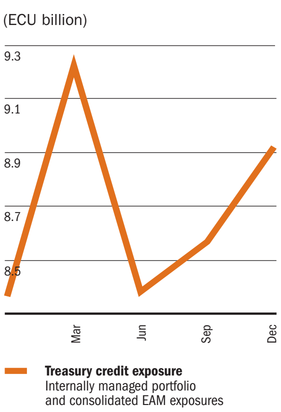
(in per cent)



Evolution of risk profiles in 1998



Evolution of Treasury credit exposure in 1998



Risks

The aggregate market exposure of the EBRD remained modest throughout the year. As at 31 December 1998, the Value at Risk (VaR) of the Bank's internally managed portfolios, calculated with reference to a 99 per cent confidence level over a 10-trading-days horizon, was ECU 0.9 million.[1]

Furthermore, as seen in the graph, over the entire year the VaR remained within the relatively narrow range of ECU 0.7 million to ECU 1.5 million, i.e. both below the 1997 average.

The contribution from foreign exchange risk was negligible most of the time. Outright interest rate positions in the main currencies were taken from time to time but rarely became sizeable. Strategies implementing a view on the change in the shape of yield curves were actively utilised. Direct exposure to interest rate volatility was extremely limited at all times, with minimal usage of interest rate options.

Market risks incurred on the externally managed portfolios additionally displayed at year-end a value-at-risk (99 per cent confidence level, 10-trading-day horizon) of ECU 1.4 million for the US dollar-denominated asset-backed securities programme and of ECU 1.1 million for the ECU-denominated interest rate trading programme.

These figures should be interpreted against the background of a total portfolio size averaging ECU 7.1 billion during the year and the value-at-risk limit of ECU 4.0 million for all Treasury funds, whether internally or externally managed. This limit was adopted with the new Treasury Authority in December 1998 (based on 95 per cent confidence level and 1-trading-day horizon, which equates to ECU 18.0 million at the 99 per cent confidence level and a 10-trading-day horizon as referred to in the graph above).

Credit exposure in the Treasury portfolio is illustrated in the graph on the left, which includes both on- and off-balance-sheet exposures. (Credit exposure is the potential loss to the Bank should a counterparty default. In the case of on-balance-sheet instruments, this loss is represented by their balance sheet value, while for off-balance-sheet instruments the exposure is the positive market value plus a prudential add-on for potential future increases in market value.)

The overall quality of Treasury credit exposure remained high, with a weighted average credit risk rating of 1.8 on the EBRD's internal scale, slightly lower than AA+ (1.7), but higher than AA (2.0). At year-end 1998, 87.8 per cent of the overall exposure was rated AA- or better (1997: 89.1 per cent). The only sub-investment grade exposures were sovereign-related debt issues from Korea.

Treasury credit exposure is spread across 27 countries. Countries with more than 7.5 per cent of the total exposure were the United States of America at 30.6 per cent and Japan at 16.0 per cent (1997: 35.3 per cent and 19.6 per cent respectively).

The quality of longer-dated exposures was higher than that of short-term credit risks, in line with the Bank's prudent tenor restrictions for managing exposures associated with lower-rated, eligible counterparties and issuers. Exposures maturing within six months had average ratings of around 2.0 (AA equivalent) while those with longer maturities had approximately 1.7 (AA+) average credit ratings.

Performance

Treasury made a strong contribution to the EBRD with the overall return at the end of the year of 76 basis points over their Libor benchmark (1997: 67 basis points). The investment return was 37 basis points over the benchmark (1997: 34 basis points), and the benefit of sub-Libor funding was 41 basis points (1997: 40 basis points).

During the third quarter, Treasury undertook a review of the securities portfolio for the purposes of classifying positions as held for either dealing or investment purposes. As a result, positions with a book value of ECU 1.2 billion were transferred from the investments book to the dealing book where, in line with the Bank's accounting policy, their book value was restated from amortised cost to a marked-to-market basis, which resulted in a minimal profit and loss impact.

Funding

Capital

Paid-in capital totalled ECU 5.1 billion at 31 December 1998, up from ECU 4.9 billion at 31 December 1997. All but six members have now subscribed to the capital increase, with instruments of subscription deposited for

[1] This number, which is based on the relatively conservative parameters recommended by the Basle Committee for Banking Supervision, is equivalent to saying that the Bank had a 1 per cent chance of experiencing a loss of at least ECU 0.9 million over a horizon of 10 trading days, due to adverse movements in interest rates and foreign exchange rates.

937,200 shares. This increases the EBRD's subscribed shares to over 1.9 million shares. The first instalment of the capital increase fell due during April 1998, and paid-in capital received increased to ECU 3.2 billion cumulative, from ECU 2.9 billion at the end of 1997.

Overdue capital of cash and promissory notes totalled ECU 10.5 million at the year-end (1997: 10.2 million) with approximately ECU 3.2 million relating to the capital increase. A further ECU 3.0 million of encashments of deposited promissory notes is also overdue, all relating to the initial capital.

Capital adequacy

The increase in the EBRD's authorised capital to ECU 20.0 billion, approved in April 1996, was intended to allow the Bank to continue to implement its manageable growth strategy on a sustainable basis without further recourse to capital replenishments. In light of its commitment to be self-sustaining, the Bank has been proactive in pursuing efforts to ensure effective and efficient use of capital.

In implementing its operational strategy, the EBRD's capital usage is guided by the Bank's statutory and financial policy parameters. In this regard, the Bank is refining its processes for assessing capital usage and capital adequacy by supplementing quantitative measures of headroom with risk assessment.[2] Further work in this area will continue as part of regular financial policy and capital reviews.

Borrowings

The EBRD's borrowing policy is governed by two key principles. First, it seeks to match the maturity profile of its assets and liabilities to minimise refinancing risk. Second, it seeks to ensure the provision of long-term funds at optimum cost effectiveness for the Bank.

Total borrowings at 31 December 1998 stood at ECU 9.7 billion, an increase of ECU 2.3 billion compared with 1997. This figure reflects the net impact of new issues, maturities and buy-backs. There were 46 new issues under the EBRD's medium- to long-term borrowing programme at an average after-swap cost of Libor minus 37 basis points. The average remaining life of medium- to long-term debt outstanding at the end of the year was 7.1 years. Notable issues included the Bank's debut US$ 600.0 million benchmark issue under its Euro Medium-Term Note Programme and the first supranational exchangeable bond issue for US$ 100 million.

Short-term issues categorised as debts evidenced by certificates saw 29 transactions achieved at an average after-swap cost of Libor minus 42 basis points.

Expenses

General administrative expenses and depreciation for the year were ECU 158.7 million, which was ECU 6.5 million higher than in 1997. Administrative expenses were well within the 1998 budget, reflecting the EBRD's continuing commitment to budget discipline, effective cost controls and a proactive cost-recovery programme.

The increase in ECU expenses in 1998 compared with 1997 was primarily due to the higher actual sterling to ECU foreign exchange rates prevailing during the year, with an average rate of 1.481 sterling to the ECU in 1998 compared with 1.454 in 1997. The actual weighted average rate achieved was lower than this due to the EBRD's policy of entering into exchange rate contracts to ensure that the largely sterling-denominated expenses, when translated into ECU for reporting purposes, are not adversely affected by movements in the ECU/sterling exchange. Consequently the weighted average sterling to ECU exchange rate of 1.2882 was achieved (1997: 1.2295) for expenses. The profit associated with this activity was ECU 21.8 million in 1998, compared with ECU 25.4 million in 1997.

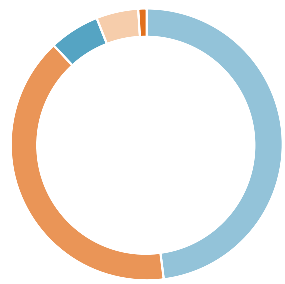
The EBRD also entered into a series of option contracts to hedge the cost of sterling required for future general administrative expenses. At 31 December 1998 the market value of these options showed a gain of ECU 17.5 million (1997: ECU 39.8 million). In accordance with the Bank's accounting policy, this has been deferred and will be recognised in the respective years.

Provisions

The EBRD's provisioning policy on non-sovereign exposures is designed so that the level of general provisions is determined by the overall credit-risk rating of individual loans and equity investments, as determined by the Bank's independent Risk Management department. For sovereign projects a uniform provision of 3 per cent on outstanding disbursed sovereign risk exposures is applied, which takes account of the Bank's preferred creditor status afforded by its members. In addition, the EBRD makes a provision against general unforeseen risks to the total portfolio of 0.75 per cent

Credit quality profile of Treasury exposure

at 31 December 1998

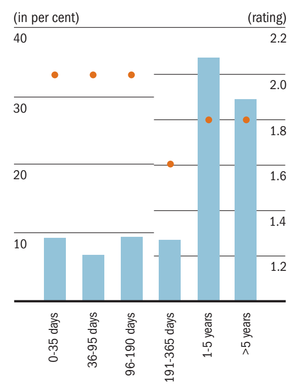


- 1 (AAA) 40%
- 1.7 to 2.5 (AA) 48%
- 2.7 to 3.3 (A) 6%
- 4 (BBB) 1%
- 5 (BB) 5%

Internally managed portfolio and consolidated EAM exposures

Credit quality of the maturity profile of Treasury exposure

at 31 December 1998



- Weighted average rating of exposure
- Percentage of overall Treasury credit exposure

Internally managed portfolio and consolidated EAM exposures

2 Headroom is the amount of funds the Bank has available to commit to new loans, equity investments and guarantees before it reaches its 1:1 gearing ratio limit. The 1:1 gearing ratio stipulates that the total amount of outstanding loans, equity investments and guarantees made by the Bank in its ordinary operations cannot exceed the total amount of its unimpaired subscribed capital, reserves and surpluses.

of signed commitments outstanding, in view of the Bank's regional concentration and the presence of a small number of large exposures in the classified portfolio. The Bank continues with its policy of making specific provisions as required on a case-by-case basis.

The latter half of 1998 witnessed the Russian crisis and its impact in the EBRD's countries of operations. The Bank followed its normal provisioning policy, which is based on a risk approach. In the aftermath of the crisis, an intense review of exposures in Russia was undertaken to determine the appropriate level of specific provisions.

The consistent application of the EBRD's provisioning policy resulted in a charge for the year of ECU 553.1 million, which is three times the charge for 1997. Of this, ECU 6.8 million related to Treasury provisions (see below). The increase in total provisions reflects the continuing growth in the portfolio of operations, the increase in the country risk of many of the countries of operations and the related increase in general portfolio risk provisions to reflect this increased risk. Included in the charge for 1998 were new specific provisions of ECU 412.9 million, with the total of such specific provisions reaching ECU 456.2 million by the end of the year.

As a result of this charge for 1998, total provisions for Banking operations reached ECU 908.9 million, which amounted to 16 per cent of the outstanding disbursed portfolio of loans and equity investments.

Included in the provisions for losses for 1998 was an ECU 6.8 million charge relating to Treasury assets. Of this amount, ECU 5.2 million related to general provisioning on Treasury investment assets, which was introduced during the year on a risk-rated basis, with no distinction made between sovereign and non-sovereign investments. The remaining ECU 1.6 million charge for the year relating to the provision on derivative financial instruments is now also included as 'Provision for losses' in the profit and loss account. Previously it was in 'Net dealing activities' (1997: ECU 0.4 million).

Outlook for 1999

The EBRD is aiming to return to profitability. The financial result will, however, remain vulnerable to the potential for further adverse developments in the portfolio and to continuing uncertainties in the operational environment in which the Bank is working.

The Bank's priority is to rebuild reserves and to take all necessary prudent measures with a view to consolidating its financial viability.

Additional reporting and disclosures

Through its reports and disclosures, the EBRD follows the reporting conventions of private sector financial institutions, in line with its policy to reflect best industry practice.

Principles of financial management and risk management

The financial policies of the EBRD follow the guiding principles of sound financial management, building on the Agreement Establishing the Bank and providing the financial framework within which the Bank pursues its mandate.

The EBRD's financial management aims to:
– pursue financial viability
– build up reserves and ensure sustainable profitability
– follow market and performance orientation in all its activities
– work within a comprehensive risk management framework
– ensure transparency and accountability at all levels and support effective corporate governance.

The EBRD is exposed to credit risk in both its Banking operations and its Treasury activities. Credit risk arises since borrowers and Treasury counterparties could default on their contractual obligations or the value of the Bank's investments could be impaired. Much the greatest credit risk is in the Banking portfolio. The EBRD's independent Risk Management unit seeks to ensure that any risks are correctly identified and appropriately managed and mitigated through a comprehensive and rigorous credit process. This is reviewed annually to determine its effectiveness and efficiency and fine-tuned, taking into account experience gained. All ordinary operations are reviewed on a regular basis to identify promptly any changes required in the assigned risk ratings.

The EBRD's main market risk exposure is that movements of interest rates and foreign exchange rates may adversely affect positions taken by the Bank, particularly in its Treasury portfolio. The Bank aims to limit and manage market risks to the extent possible in its portfolio of Treasury assets through active asset and liability management and management of foreign exchange exposures. Interest rate risks are managed through a combination of matching the interest rate profile of assets and liabilities and the use of derivative financial instruments. Through a combination of limit reporting and VaR reporting, exposures to foreign currency and interest rate risks are measured independently of the Treasury function to ensure compliance with authorised limits.

In a manner consistent with the EBRD's objective of capital preservation, particularly with respect to the Treasury portfolio, both VaR and stress-testing figures are computed in terms of risk over and above the Bank's Libor-based benchmark for investments.[3] The Bank pays particular attention to the fact that the market risk incurred should remain well within the boundaries of its appetite for risk; thus VaR trends and stress-tests are closely monitored.

The EBRD has adopted a revised Treasury Authority, i.e. the document by which the Board of Directors delegates authority to the Vice President Finance to manage the Bank's Treasury operations and which defines the risks parameters to be observed in these activities.

3 A VaR of zero, for instance, would indicate the absence of any foreign exchange risk and that the interest rate exposure on the Bank's assets matched perfectly that of its liabilities.

The new Treasury Authority refines existing rules and codifies a number of practices already introduced at the operational level. Among the main improvements are:

- the explicit definition of the role of Risk Management
- the replacement of the original duration-based limit with a value-at-risk limit, which de facto had been the EBRD's primary tool for controlling market risk for two years
- the possibility for the Bank's Treasury to manage actively foreign exchange exposures in its asset and liability management process within the overall market risk framework and the value-at-risk limit
- the possibility for the Bank to hedge its financial risks via asset or risk classes which Treasury could not otherwise invest in or be exposed to, through the purchase of put options.

Operational risk is determined by examining all aspects of risk-related exposure other than those falling within the scope of credit and market risk. This includes the risk of loss that may occur through errors or omissions in the processing and settlement of transactions, in the reporting of financial results or failures in controls.

Within the EBRD there are policies and procedures in place covering all significant aspects of operational risk, including first and foremost the Bank's high standards of business ethics and its established system of internal controls, checks and balances and segregation of duties, which protect the Bank from any initial exposure to operational risk. These are supplemented with:

- the EBRD's code of conduct
- disaster recovery/contingency planning
- policy on public access and disclosure of information
- integrity due diligence procedures
- procedures regarding corrupt practices and money laundering
- procedures to be followed in the event of fraud or suspected fraud
- information management policy
- guidelines for management of operational risk in Treasury
- procurement policies.

Use of derivatives

The EBRD's use of derivatives is primarily focused on hedging interest rate and foreign exchange risks arising within both its Banking and Treasury activities. Market views expressed through derivatives are undertaken as part of Treasury's dealing activities, which in turn are subject to overall value-at-risk limits. In addition, the Bank uses credit derivatives as an alternative to investments in specific securities to hedge certain exposures.

In the area of Treasury risk management, the EBRD has adopted the G-30 recommendations on the use of derivatives and is committed to following best industry practice. The Bank complies fully with all aspects relevant to end-users as defined by the G-30. It also has elected to comply with recommendations relating to market makers as it uses derivatives for strategic positioning within clearly defined limits.

The interest rate risks arising from derivative instruments are combined with those deriving from all other instruments dependent on interest rates. Special care is devoted to those risks that are specific to the use of derivatives, through, for example, the monitoring of volatility risk for options, spread risk for swaps and basis risk for futures.

For the purpose of controlling credit risk in its Treasury transactions, the EBRD's policy is to individually approve each counterparty and to regularly review its eligibility. Individual counterparty limits are allocated in compliance with guidelines that set a maximum size and duration of exposure based on the counterparty's credit rating. Derivative transactions in particular are normally limited to AA- or better-rated counterparties, with single A rated counterparties accepted only when exposure is fully collateralised.

The EBRD seeks to mitigate credit risks further through systematic recourse to a variety of credit enhancement techniques. Over-the-counter derivatives transactions are systematically documented with Master Agreements, providing for close-out netting, and the Bank has sought to expand the scope for applicability of this provision through documenting the widest possible range of instruments transacted with a given counterparty under a single ISDA-based Master Agreement.

Furthermore, the EBRD has continued to expand its use of collateral agreements in relation to its activity in over-the-counter derivatives. By year-end, 55 per cent of the Bank's gross exposure to derivatives counterparties was subject to collateral agreements, and negotiations for signing such agreements with all remaining active counterparties were under way.

Corporate governance

The EBRD is committed to effective corporate governance, with responsibilities and related controls throughout the Bank properly defined and delineated. Transparency and accountability are integral elements of its corporate governance framework. This structure is further supported by a system of reporting, with information appropriately tailored for and disseminated to each level of responsibility within the EBRD, to enable the system of checks and balances on the Bank's activities to function effectively.

The EBRD's governing constitution is the Agreement Establishing the Bank, which provides that the institution will have a Board of Governors, a Board of Directors, a President, Vice Presidents, officers and staff.

All the powers of the EBRD are vested in the Board of Governors representing the Bank's 60 shareholders. With the exception of certain reserved powers, the Board of Governors has delegated the exercise of its powers to the Board of Directors while retaining overall authority.

Board of Directors and Board Committees

Subject to the Board of Governors' overall authority, the Board of Directors is responsible for the direction of the EBRD's general operations and exercises the powers expressly assigned to it by the Agreement and those powers delegated to it by the Board of Governors.

The Board of Directors has established three Board Committees to assist the work of the Board of Directors:

- the Audit Committee
- the Budget and Administrative Affairs Committee
- the Financial and Operations Policies Committee.

The composition of these committees during 1998 is detailed on page 112.

The President and the Executive Committee

The President is elected by the Board of Governors. The President is the legal representative of the EBRD and, under the direction of the Board of Directors, the President conducts the current business of the Bank.

The Executive Committee is chaired by the President and is composed of members of the EBRD's senior management.

Reporting

The EBRD's corporate governance structure is supported by appropriate financial and management reporting. In its financial reporting the Bank aims to provide appropriate information on the risks and performance of its activities, and to observe best practice in the content of its public financial reports. In addition, the Bank has a comprehensive system of reporting to the Board of Directors and its committees. Detailed information is available to enable management to monitor the implementation of business plans and the execution of budgets.

Compensation policy

The EBRD has designed a market-oriented staff compensation policy, within the constraints of the Bank's status as a multilateral institution, to meet the following objectives:
– to be competitive in order to attract and retain high-calibre employees
– to take account of differing levels of responsibility
– to be sufficiently flexible to respond rapidly to the market
– to motivate and encourage excellent performance.

To help meet these objectives, the EBRD's shareholders have agreed that the Bank use market comparators for its staff compensation and that salary and bonus be driven by performance.

The bonus programme allocations are structured to recognise individual and team contributions to the EBRD's overall performance. Bonus payments, although an important element of the total staff compensation package, are limited as a percentage of base salaries. In general, bonus payments do not exceed 30 per cent of base salaries.

The EBRD's Board of Directors, the President and Vice Presidents are not eligible to participate in the bonus programme. The Board of Governors establishes the remuneration of the Board of Directors and the President, whereas the Vice Presidents' remuneration is established by the Board of Directors.

Year 2000

A Year 2000 Steering Committee was established in January 1998, chaired by the Deputy Vice President Risk Management to develop a Bank-wide action plan, building on the work started earlier in 1997 by the Information Technology (IT) department, and to oversee its implementation.

All IT systems, including those specifically developed for the EBRD and those based around standard packages, have now been assessed, corrected and either successfully tested or are currently being tested for Year 2000 compliance. This work is expected to be complete by the end of the first quarter 1999. Corrective action on end-user systems, updated infrastructure systems, including the telephone switchboard and dealer boards, is expected to be completed by mid-year 1999. The Bank's administration systems, relying as they do on processors and control systems that are equally vulnerable to the Year 2000 issue, are also under review and plans are under way, supported by the necessary budgets, to upgrade or replace non-compliant systems.

As a relatively young organisation, the EBRD's own exposure to potential Year 2000 problems is proportionally small and with work well advanced to ensure that the Bank's own systems will work properly in the year 2000 and beyond, the Bank's attention has increasingly turned to its counterparties and clients, especially those in its countries of operations. Country preparedness is now, for the Bank, one of the most significant elements of the whole Year 2000 issue.

The EBRD has raised awareness among its clients and encouraged them to confirm to the Bank that they have mobilised necessary resources to minimise the potential impact of Year 2000 risk and are addressing the issue satisfactorily. These communications have indicated positive initial awareness and further work with potential high-risk clients and sectors, including site visits, will be pursued in 1999 to mitigate and reduce risk.

Measures taken in order to reinforce this protection include taking account of Year 2000 client preparedness in the EBRD's portfolio monitoring activities and country strategy reviews, and compliance resolutions being added to the Bank's standard loan agreements.

Euro

A task force has, since May 1998, worked on the issues related to the euro as they affect the EBRD.

Following the commencement of the third stage of European Monetary Union (EMU) on 1 January 1999 when the euro replaced the national currencies of each of the 11 participating countries, the EBRD changed its reporting currency from ECU to the euro.

As the Agreement Establishing the Bank did not require amendment, the main impact of the introduction of the euro on the EBRD has been in the modification of the Bank's processing and accounting systems; this involved all ECU-denominated transactions being converted as necessary and rebooked into euro. These included loans and equity investments in the Banking portfolio and bonds, swaps and the Bank's own debt issuances, plus associated collateral positions in the Treasury portfolios.

The EBRD has adopted a detailed set of guiding principles that will be applied to relevant transactions and relationships with borrowers and counterparties both during and after the three-year transition period, which is scheduled to end on 31 December 2001. It has also been decided that in most cases it will not be necessary to redenominate the Bank's own capital market issues, as the majority of current issues are scheduled to mature within the transition period.

The overall objective of the EBRD's approach to the introduction of the euro is to provide maximum flexibility for the Bank's clients.

Consolidated financial statements

Profit and loss account

For the year ended 31 December 1998

	Note	Year to 31 December 1998 ECU 000	Year to 31 December 1997 ECU 000
Interest and similar income			
From loans		**278,907**	220,410
From fixed-income debt securities		**187,572**	287,639
Other interest		**104,606**	54,732
Interest expenses and similar charges		**(366,233)**	(365,536)
Net interest income		**204,852**	197,245
Dividend income from share investments		**30,761**	16,236
Net fee and commission income	3	**44,729**	44,059
Financial operations	4		
Net profit on sale of share investments		**168,724**	76,074
Net (loss)/profit on dealing activities		**(1,647)**	15,768
Foreign exchange		**3,087**	(3,418)
Operating income		**450,506**	345,964
General administrative expenses	5	**(143,172)**	(137,061)
Depreciation		**(15,506)**	(15,075)
Operating profit before provisions		**291,828**	193,828
Provisions for losses	6	**(553,061)**	(177,678)
(Loss)/profit for the year		**(261,233)**	16,150

Balance sheet

At 31 December 1998

	Note	ECU 000	31 December 1998 ECU 000	ECU 000	31 December 1997 ECU 000
Assets					
Placements and debt securities					
Placements with and advances to credit institutions		**2,945,224**		1,211,801	
Debt securities	7	**5,272,705**		5,335,798	
			8,217,929		6,547,599
Other assets	8		**743,853**		655,750
Loans and share investments					
Loans	9	**3,894,987**		3,462,098	
Share investments	9	**1,147,453**		842,450	
			5,042,440		4,304,548
Property, technology and office equipment	11		**43,322**		46,816
Paid-in capital receivable			**1,999,086**		1,940,425
Total assets			**16,046,630**		13,495,138
Liabilities					
Borrowings					
Amounts owed to credit institutions		**554,354**		511,536	
Debts evidenced by certificates	12	**9,171,069**		6,874,147	
			9,725,423		7,385,683
Other liabilities	13		**1,395,332**		1,133,891
Subscribed capital	14	**19,290,750**		18,369,100	
Callable capital		**(14,206,395)**		(13,492,115)	
Paid-in capital			**5,084,355**		4,876,985
Reserves			**102,753**		82,429
(Loss)/profit for the year			**(261,233)**		16,150
Members' equity			**4,925,875**		4,975,564
Total liabilities and members' equity			**16,046,630**		13,495,138
Memorandum items					
Commitments	10		**4,420,742**		4,345,399

Statement of changes in members’ equity

For the year ended 31 December 1998

	Subscribed capital ECU 000	Callable capital ECU 000	Conversion reserve ECU 000	General reserve ECU 000	Special reserve ECU 000	Accumulated loss reserve ECU 000	Subtotal reserves ECU 000	Profit/ (loss) for the year ECU 000	Total ECU 000
At 31 December 1996	9,883,750	(6,918,625)	7,269	16,283	51,311	(51,816)	23,047	4,888	2,993,060
Exchange rate differences on conversion of share capital receipts	–	–	50,703	–	–	–	50,703	–	50,703
Internal tax for the year	–	–	–	3,791	–	–	3,791	–	3,791
Qualifying fees from the prior year	–	–	–	–	22,701	(22,701)	–	–	–
Profit set aside from the prior year	–	–	–	–	–	4,888	4,888	(4,888)	–
Capital increase	8,450,350	(6,583,990)	–	–	–	–	–	–	1,866,360
Additional shares allocated – initial capital	35,000	10,500	–	–	–	–	–	–	45,500
Profit for the year	–	–	–	–	–	–	–	16,150	16,150
At 31 December 1997	18,369,100	(13,492,115)	57,972	20,074	74,012	(69,629)	82,429	16,150	4,975,564
Exchange rate differences on conversion of share capital receipts	–	–	(118)	–	–	–	(118)	–	(118)
Internal tax for the year	–	–	–	4,292	–	–	4,292		4,292
Qualifying fees from the prior year	–	–	–	–	22,371	(22,371)	–	–	–
Profit set aside from the prior year	–	–	–	–	–	16,150	16,150	(16,150)	–
Capital increase	921,650	(714,280)	–	–	–	–	–	–	207,370
Loss for the year	–	–	–	–	–	–	–	(261,233)	(261,233)
At 31 December 1998	**19,290,750**	**(14,206,395)**	**57,854**	**24,366**	**96,383**	**(75,850)**	**102,753**	**(261,233)**	**4,925,875**

The conversion reserve represents exchange rate differences arising on the conversion of share capital receipts in currencies other than ECU. It is Bank policy to enter into forward foreign exchange rate contracts to fix the known ECU value of future capital subscriptions denominated in United States dollars and Japanese yen. The differences arising on the ECU amounts obtained through these contracts and the ECU amounts determined by the fixed exchange rates are taken directly to the conversion reserve. Replacement foreign exchange contracts are entered into where scheduled receipts or encashment dates have not been met which may also require adjustments to the conversion reserve.

The general reserve consists of internal tax paid in accordance with Article 53 of the Agreement which requires that all Directors, Alternate Directors, officers and employees of the Bank are subject to an internal tax imposed by the Bank on salaries and emoluments paid by the Bank. Under the Agreement, the Bank retains the internal tax deducted for its benefit. Under Article 53 of the Agreement and Article 16 of the Headquarters Agreement, salaries and emoluments paid by the Bank are exempt from United Kingdom income tax.

The special reserve is maintained, in accordance with the Agreement, for meeting certain defined losses of the Bank. The special reserve has been established, in accordance with the Bank’s financial policies, by setting aside 100 per cent of qualifying fees and commissions received by the Bank associated with loans, guarantees and underwriting the sale of securities, until such time as the Board of Directors determines that the size of the special reserve is adequate.

In accordance with the Agreement it is intended that an amount of ECU 19.3 million, being qualifying fees and commissions earned in the year to 31 December 1998, will be appropriated in 1999 from the loss for the year to 31 December 1998 and set aside to the special reserve.

The accumulated loss reserve brought forward from prior years represents the accumulated losses after appropriations of qualifying fee and commission income to the special reserve.

Statement of cash flows

For the year ended 31 December 1998

		Year to 31 December 1998		Year to 31 December 1997
	ECU 000	**ECU 000**	ECU 000	ECU 000
Cash flows from operating activities				
Operating (loss)/profit for the year	**(261,233)**		16,150	
Adjustments for:				
Provision for losses	**553,061**		177,678	
Depreciation	**15,506**		15,075	
Realised gains on share investments	**(168,724)**		(76,074)	
Internal taxation	**4,292**		3,791	
Unrealised loss on dealing portfolio	**2,943**		1,303	
Realised gains on investment portfolio	**(4,824)**		(4,063)	
Foreign exchange movements on provisions	**(13,961)**		5,583	
Operating profit before changes in operating assets	**127,060**		139,443	
(Increase)/decrease in operating assets:				
Interest receivable and prepaid expenses	**(203,466)**		(54,290)	
Net decrease in positions held in dealing portfolio	**264,108**		69,844	
Increase in operating liabilities:				
Interest payable and accrued expenses	**142,396**		41,670	
Net cash provided in operating activities		**330,098**		196,667
Cash flows from investing activities				
Proceeds from repayment of loans	**1,004,993**		769,923	
Net placements with credit institutions	**(1,143,840)**		118,170	
Proceeds from sale of share investments	**256,334**		102,151	
Proceeds from redemptions/sale of investment securities	**3,031,712**		10,562,122	
Purchases of investment securities	**(3,091,379)**		(10,566,324)	
Funds advanced for loans and share investments	**(2,335,284)**		(2,173,518)	
Purchase of property, technology and office equipment	**(12,012)**		(9,897)	
Net cash used in investing activities		**(2,289,476)**		(1,197,373)
Cash flows from financing activities				
Capital subscriptions				
Paid-in capital received	**267,786**		32,819	
Promissory notes encashed by members	**(119,076)**		74,430	
Conversion reserve	**(118)**		50,703	
Issue of debts evidenced by certificates	**3,552,282**		2,361,674	
Redemption of debts evidenced by certificates	**(1,194,731)**		(1,053,830)	
Net cash provided by financing activities		**2,506,143**		1,465,796
Net increase in cash and cash equivalents		**546,765**		465,090
Cash and cash equivalents at beginning of year		**818,435**		353,345
Cash and cash equivalents at end of year [1]		**1,365,200**		818,435

[1] *Cash and cash equivalents comprise the following amounts maturing within 3 months:*	**1998 ECU 000**	1997 ECU 000
Placements with and advances to credit institutions	**1,788,919**	1,211,801
Amounts owed to credit institutions	**(423,719)**	(393,366)
Cash and cash equivalents 31 December	**1,365,200**	818,435

Notes to the consolidated financial statements

1 Establishment of the Bank

i Agreement Establishing the Bank
The European Bank for Reconstruction and Development ("the Bank"), whose principal office is located in London, is an international organisation formed under the Agreement Establishing the Bank dated 29 May 1990 ("the Agreement"). As at 31 December 1998 the Bank's shareholders comprised 58 countries, together with the European Community and the European Investment Bank.

ii Headquarters Agreement
The status, privileges and immunities of the Bank and persons connected therewith in the United Kingdom are defined in the Headquarters Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Bank ("Headquarters Agreement"). The Headquarters Agreement was signed in London upon the commencement of the Bank's operations on 15 April 1991.

2 Significant accounting policies

i Accounting convention
The financial statements have been prepared in accordance with the Bank's Accounting Policies, which comply with International Accounting Standards (IAS) and the principles of the European Community's Council Directive on the annual accounts and consolidated accounts of banks and other financial institutions. The following revised standards have been adopted in advance of their effective date: IAS 1 (revised 1997), Presentation of Financial Statements, IAS 17 (revised 1997), Leases, and IAS 14 (revised 1997), Segment Reporting.

The Bank's balance sheet is stated in accordance with the historical cost convention with the exception of debt securities and related derivatives held for dealing purposes, which are held at market prices, and freehold property, which is held at fair market value. Financial assets and liabilities are included on the balance sheet when associated risks and rewards have been assumed.

ii Foreign currencies
In accordance with Article 35 of the Agreement, the Bank uses the European Currency Unit (ECU) as the unit of measure for the presentation of its financial statements. For future accounting periods the unit of measurement for the presentation of the Bank's financial statements will be the euro, following its replacement of the ECU from 1 January 1999.

Monetary assets and liabilities denominated in foreign currencies are translated into ECU at spot rates as at 31 December 1998. Non-monetary items are expressed in ECU at the exchange rates ruling at the time of the transaction. Revenue and expense items are translated into ECU at the month-end rate in which they occurred, except for sterling expenses, which are hedged and converted at the weighted average hedge rate.

Exchange gains and losses and hedging costs arising on contracts entered into as hedges of specific revenue or expense transactions and of anticipated future transactions are deferred, and included in 'Other assets' or 'Other liabilities', until the date of such transactions, at which time they are included in the determination of such revenue and expenses. All other exchange gains and losses relating to hedge transactions are recognised in the income statement in the same period as the exchange differences on the items covered by the hedge transactions. Costs on such contracts, which are no longer designated as hedges, are included in the profit and loss account.

iii Capital subscriptions
Under the Agreement, capital subscriptions by members shall be settled either in ECU, United States dollars or Japanese yen. Capital subscriptions in United States dollars or Japanese yen are settled at fixed exchange rates as defined in Article 6.3 of the Agreement.

Outstanding promissory notes held in United States dollars and Japanese yen at the balance sheet date are translated into ECU at market rates as at 31 December 1998 in accordance with the Bank's policy detailed in (ii) above. The differences between these ECU values and those determined by the fixed exchange rates are included in 'Other assets' or 'Other liabilities'.

iv Debt securities
Debt securities intended to be held for the long term or to maturity are carried on an amortised cost basis less any provisions. The amortised premium or discount on acquisition is recognised in interest income. Securities held for dealing purposes are marked to market and the resultant gain or loss is immediately taken to the profit and loss account and included, together with the interest income arising from and the interest expense of funding these securities, within 'Net (loss)/profit on dealing activities'.

v Share investments
Share investments are carried at cost less any provisions.

Share investments providing the Bank with an option to redeem its investment for an interest-based return with creditworthy counterparties have the risk characteristics associated with debt instruments and, accordingly, are classified and accounted for as loans. Dividends received on an investment (accounted for as a loan) are not recognised as income but deferred until the investment is disposed of when they will be netted off against the proceeds of disposal.

The Bank has considered the definition of associates in both IAS 28 and the European Community's Council Directive on the annual accounts and consolidated accounts of banks and other financial institutions, in relation to its share investments. The Bank considers that, in general, even where 20 per cent or more of the equity is held, these share investments do not come within the definition of associates, since the Bank does not normally exert significant influence over the operations of the investee companies. Accordingly, such investments are also carried at cost less provisions. Details of the Bank's share investments that exceed 20 per cent of the investee share capital and where the historical cost exceeds ECU 10.0 million are provided in note 9.

vi Provisions for losses and general portfolio risks
Provisions made are classified as specific, general or portfolio as follows:

Specific provisions are made against identified loans and advances representing a prudent estimate of that part of the outstanding balance that might not be recovered. For share investments, specific provisions are made as an estimate of any permanent diminution in value.

General provisions in respect of possible losses on non-sovereign risk assets that are not specifically identified at year-end are applied in two stages: at commitment and at disbursement. General provisions in respect of sovereign risk assets are established at the time of disbursement. For Regional Venture Funds and Post-Privatisation Funds the first stage provision is itself applied in two stages: at the signing of the framework agreement and then at the commitment of the individual sub-investment.

Portfolio risks provisions are made in respect of losses which, although not specifically identified, are judged to be inherent in the portfolio of contractual commitments (including guarantees), loans and share investments at the balance sheet date. This provision is also made when the framework agreement is signed for Regional Venture Funds and Post-Privatisation Funds.

Provisions made, less any amounts released during the period, are charged to the profit and loss account. The Bank's provisions are detailed in note 6. When a loan is deemed uncollectable or there is no possibility of recovery of a share investment, the principal is written off against the related provision. Subsequent recoveries are credited to the profit and loss account if previously written off.

vii Property, technology and office equipment
Property, technology and office equipment is stated at cost less accumulated depreciation. Depreciation is calculated on the straight-line method to write off the cost of each asset to their residual values over the estimated life as follows:

Freehold property: Nil
Improvements on leases of less than 50 years unexpired: Unexpired periods
Technology and office equipment: 1 year

Freehold property is carried at fair market value. The property is valued at regular intervals of five years and if necessary the carrying value in the financial statements will be adjusted accordingly.

viii Accounting for leases
Leases of equipment where the Bank assumes substantially all the benefits and risks of ownership are classified as finance leases. The assets are treated as if they had been purchased outright at the values equivalent to the estimated value of the underlying lease payments during the periods of the lease. The corresponding lease commitments are included under 'Other liabilities'. The interest element of the finance charge is charged to the profit and loss account over the lease period. The equipment acquired under such leasing contracts is capitalised and depreciated in accordance with (vii) above.

Leases of assets under which all the risks and benefits of ownership are effectively retained by the lessor are classified as operating leases. The Bank has entered into such leases for most of its office accommodation, both in London and in the Bank's countries of operations. Payments made under operating leases are charged to the profit and loss account on a straight-line basis over the period of the lease. When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which the termination takes place.

ix Interest, fees and commissions and dividends
Interest is recorded on an accruals basis. For loans on which the Bank has allowed interest and fee payments to be deferred or capitalised, income may however be recognised when received based on the underlying performance of the project. The Bank does not recognise income on loans where collectability is in doubt, or payments of interest or principal are overdue more than 180 days for a sovereign loan and 60 days for a non-sovereign loan. Interest on such non-accrual loans is thereafter only recognised as income when actual payment is received.

Front-end fees are recorded as income when the agreement is signed or the loan becomes effective, whichever is the later date. Commitment fees and fees received in respect of services provided over a period of time are recorded as income over the period during which the commitment exists or the services are provided. Other fees and commissions are taken to income on a cash basis. Issuance fees and redemption premiums or discounts are amortised over the period to maturity of the related borrowings.

Dividends are recognised when received.

x Staff retirement plan
The Bank has a defined contribution scheme and a defined benefit scheme to provide retirement benefits to substantially all of its staff. Under the defined contribution scheme, the Bank and staff contribute equally to provide a lump sum benefit upon retirement. The defined benefit scheme is funded entirely by the Bank and benefits are based on years of service and a percentage of final gross base salary as defined in the scheme. All contributions to the schemes and all other assets and income held for the purposes of the schemes are kept by the Bank separately from all of its other assets and can be used only for providing the benefits under the schemes. Actual contributions made to the defined contribution and defined benefit schemes are charged to the profit and loss account and transferred to the schemes' independent custodians. Contributions made to the defined benefit scheme equate to the current service costs as advised by qualified external actuaries. Actuarial surpluses are amortised over the expected remaining working lives of the employees.

xi Taxation
In accordance with Article 53 of the Agreement, within the scope of its official activities, the Bank, its assets, property and income are exempt from all direct taxes and all taxes and duties levied upon goods and services acquired or imported, except for those parts of taxes or duties that represent charges for public utility services.

xii Government grants
Government grants relating to fixed asset expenditure considered as part of the initial establishment of the Bank are recognised in the profit and loss account on a straight-line basis over the same period as that applied for depreciation purposes. Other grants are matched against the qualifying expenditure in the period in which it is incurred. The balance of grants received or receivable that have not been taken to the profit and loss account is carried in the balance sheet as deferred income within 'Other liabilities'.

xiii Derivative financial instruments
In the normal course of business the Bank is a party to contracts for derivative financial instruments including currency and interest rate swap agreements, futures, options and forward exchange rate contracts. These instruments are used to hedge interest rate risk and currency exposures associated with the Bank's assets and liabilities and anticipated future cash flows in foreign currencies and to recognise market views in Treasury's investment activities. The Bank also acts as an intermediate provider of these instruments to its clients, hedging itself against any related exposures by offsetting transactions with third parties. Derivative transactions, which are treated in the accounts as hedges, must eliminate or substantially reduce the risk of loss from the position being hedged, be designated as a hedge at inception and continue to be effective throughout the hedge period. Profits and losses arising from hedging instruments are recognised on the same basis as those arising on the items being hedged. Derivatives associated with the Bank's treasury dealing activities are marked to market with the associated gains and losses being immediately taken to the profit and loss account under 'Net dealing activities'. The Bank sets aside a provision on its swap and over-the-counter options portfolio allowing for credit risks, closeout costs and ongoing administration costs.

xiv Subsidiary company
The consolidated annual financial statements include the Bank's investment in The Minotaur Fund Limited, a mutual fund company incorporated with limited liability in Bermuda, in which the Bank owns 100 per cent of the shares. This company is dormant.

3 Net fee and commission income

The main components of net fee and commission income are as follows:	**1998 ECU 000**	1997 ECU 000
Front-end fees	**17,308**	21,193
Commitment fees	**16,216**	16,295
Management fees	**3,082**	1,929
Other	**8,123**	4,642
Net fee and commission income	**44,729**	44,059

4 Financial operations

	1998 ECU 000	1997 ECU 000
Net profit on sale of share investments	**168,724**	76,074

The net profit on the sale of share investments in 1998 reflects the disposal of investments in Hungary, Poland and the Russian Federation and the partial disposal of investments in Poland, Bulgaria, the Slovak Republic and Regional funds.

The net profit on the sale of share investments in 1997 reflects the disposal of investments in the Czech Republic, Estonia, Latvia and Poland and the partial disposal of investments in the Baltic States, Hungary, Poland, Ukraine and Regional funds.

Net (loss)/profit on dealing activities	1998 ECU 000	1997 ECU 000
Investment portfolio	**4,824**	4,063
Dealing portfolio	**(6,471)**	11,705
Net (loss)/profit on dealing activities	**(1,647)**	15,768

Net loss on dealing activities represents, in the case of the Bank's investment portfolio, the realised gains arising on disposal of debt securities in that portfolio.

In the case of the dealing portfolio, net loss includes both realised and unrealised gains or losses together with associated interest income and expense.

5 General administrative expenses

	1998 ECU 000	1997 ECU 000
Personnel costs (i) (ii)	**89,288**	84,868
Overhead expenses net of government grants (iii)	**53,884**	52,193
General administrative expenses	**143,172**	137,061

(i) The average numbers of staff included in personnel costs during the year were: regular staff of 794 (1997: 786), contract staff of 101 (comprising special contract staff of 76 and interns/short-term staff of 25), locally hired staff in Resident Offices of 205, and Board of Directors personnel of 76. Of these, 39 staff were externally funded.

Staff numbers at 31 December 1998 were: regular staff of 789 (1997: 804), contract staff of 93 (comprising special contract staff of 73 and interns/short-term staff of 20), locally hired staff in Resident Offices of 209, and Board of Directors personnel of 78. Of these, 36 staff were externally funded.

In addition, 188 Project Bureau staff (1997: nil) were engaged by the Russian Venture Funds and Russia Small Business Fund on projects in the Russian Federation.

(ii) Personnel costs for the year include pension costs of ECU 12.1 million (1997: ECU 10.4 million). See note 22 for more details relating to the staff retirement schemes.

(iii) During the year, government grants of ECU 2.1 million were taken to the profit and loss account (1997: ECU 2.1 million).

The Bank has a policy of entering into exchange rate contracts to ensure that the largely sterling-denominated expenses, when translated into ECU for reporting purposes, are not adversely affected by any strengthening of sterling against the ECU. The application of this policy has the impact of reducing general administrative expenses by ECU 21.8 million in 1998 (1997: ECU 25.4 million). Also the Bank has entered into a series of option contracts to hedge the cost of sterling required for future general administrative expenses. Hedges are in place for approximately 62 per cent of the estimated expenditure for 1999 and 32 per cent of the estimated expenditure for 2000 and 2001. At 31 December 1998 the market value of these options shows a gain of ECU 17.5 million, which, in accordance with the Bank's accounting policy, has been deferred and will be recognised in the respective years.

6 Provisions for losses and general portfolio risks

Profit and loss charges	Loans ECU 000	Share investments ECU 000	Total loans and share investments ECU 000	Guarantees and other ECU 000	Treasury provisions ECU 000	**1998 Total ECU 000**	1997 Total ECU 000
Provision charge this year:							
General provisions on							
Outstanding disbursements	49,640	47,261	96,901	(146)	6,819	**103,574**	43,265
Outstanding commitments	15,243	6,258	21,501	–	–	**21,501**	17,689
Guarantees	–	–	–	1,206	–	**1,206**	(982)
General sovereign risk provisions	4,766	–	4,766	–	–	**4,766**	47,360
Specific provisions	252,490	160,360	412,850	–	–	**412,850**	57,757
Portfolio risk	6,536	2,491	9,027	137	–	**9,164**	12,589
For the year ended 31 December 1998	**328,675**	**216,370**	**545,045**	**1,197**	**6,819**	**553,061**	
For the year ended 31 December 1997	126,498	51,533	178,031	(353)			177,678

1997 Treasury provisions of ECU 0.4 million were included in 'Net (loss)/profit on dealing activities'.

Movement in provisions	Loans ECU 000	Share investments ECU 000	Total loans and share investments ECU 000	Guarantees and other ECU 000	Treasury provisions ECU 000	**Total ECU 000**
At 1 January 1998	248,684	158,124	406,808	2,605	4,510	**413,923**
Provision charges	328,675	216,370	545,045	1,197	6,819	**553,061**
Foreign exchange adjustments	(11,241)	(2,429)	(13,670)	(79)	(212)	**(13,961)**
Release against loans written off	(5,607)	(27,432)	(33,039)	–	–	**(33,039)**
At 31 December 1998	**560,511**	**344,633**	**905,144**	**3,723**	**11,117**	**919,984**
Analysed between:						
General provisions on outstanding disbursements	111,780	109,262	221,042	428	11,117	**232,587**
General sovereign risk provisions	52,126	–	52,126	–	–	**52,126**
Specific provisions	282,468	173,726	456,194	–	–	**456,194**
Provisions for losses deducted from assets	446,374	282,988	729,362	428	11,117	**740,907**
General provisions on outstanding commitments	51,298	47,485	98,783	–	–	**98,783**
General provision on guarantees	–	–	–	1,533	–	**1,533**
Portfolio risk	62,839	14,160	76,999	1,762	–	**78,761**
Provisions for general portfolio risks	114,137	61,645	175,782	3,295	–	**179,077**
At 31 December 1998	**560,511**	**344,633**	**905,144**	**3,723**	**11,117**	**919,984**

General provisions are based on a risk-rated approach for non-sovereign risk assets applied in two steps. An initial amount of 50 per cent of the provision is made at the time of commitment and the remaining 50 per cent at disbursement. For all sovereign risk assets a 3 per cent provision is made on outstanding disbursements which takes account of the Bank's preferred creditor status afforded by its members. In the case of Regional Venture Funds and Post-Privatisation Funds, the first 25 per cent is taken when the framework agreement is signed. The second 25 per cent is taken when the individual sub-investment is signed and the remaining 50 per cent of the provision is again taken on disbursement. The provision based on commitments is included, together with a portfolio risk provision applied at a rate of 0.75 per cent against all commitments net of repayments, in 'Other liabilities'. General provisions made at disbursement together with specific provisions are shown as a deduction from the loans and share investments asset categories.

Significantly increased general and specific provisions were recorded in the latter part of the year, consistent with the Bank's provisioning policy and updated information obtained from an ongoing review of the impact of the financial crisis in the Russian Federation on the credit quality of the Bank's investments in the region.

General provisions on Treasury investments assets were introduced during the year on a risk-rated basis with no distinction made between sovereign and non-sovereign investments and are deducted from 'Debt securities'. In previous years the profit and loss charge relating to the provision on derivative financial instruments (1998: ECU 1.6 million, 1997: ECU 0.4 million) was included in 'Other interest', and the balance sheet value was deducted from 'Other liabilities'.

7 Debt securities

Analysis by issuer	**1998 Book value ECU 000**	1997 Book value ECU 000
Governments	**777,079**	603,690
Public bodies	**653,558**	915,310
Other borrowers	**3,842,068**	3,816,798
At 31 December	**5,272,705**	5,335,798

Analysis by portfolio		
Investment portfolio	**3,183,590**	4,300,013
Dealing portfolio		
Internally managed funds	**1,128,528**	18,020
Externally managed funds	**950,406**	985,958
	2,078,934	1,003,978
Banking bonds	**10,181**	31,807
At 31 December	**5,272,705**	5,335,798

8 Other assets

	1998 ECU 000	1997 ECU 000
Interest receivable	**385,624**	185,930
Treasury-related	**297,661**	413,016
Other	**60,568**	56,804
At 31 December	**743,853**	655,750

9 Loans and share investments

Outstanding disbursements:	Loans ECU 000	Share investments ECU 000	Total loans and share investments ECU 000
At 1 January 1998	3,615,719	946,441	4,562,160
Disbursements	1,849,958	599,042	2,449,000
Repayments, prepayments and disposals at cost	(1,004,993)	(87,610)	(1,092,603)
Foreign exchange adjustments	(113,716)	–	(113,716)
Written off	(5,607)	(27,432)	(33,039)
At 31 December 1998	**4,341,361**	**1,430,441**	**5,771,802**
Provisions at 31 December 1998	(446,374)	(282,988)	(729,362)
Total net of provisions at 31 December 1998	**3,894,987**	**1,147,453**	**5,042,440**
Total net of provisions at 31 December 1997	3,462,098	842,450	4,304,548
Committed but not yet disbursed:			
At 31 December 1998	**3,677,589**	**539,953**	**4,217,542**
At 31 December 1997	3,674,710	458,890	4,133,600

At 31 December 1998 the Bank had 16 loans amounting to ECU 289.8 million (1997: ECU 117.6 million) in non-accrual status due to overdue interest and principal repayments. Specific provisions amounting to ECU 143.6 million (1997: ECU 7.5 million) have been made against these loans.

The Bank has committed but not yet disbursed loans and share investments of ECU 4.2 billion and has, in addition, granted ECU 203.2 million in guarantees (1997: ECU 211.8 million) which together total ECU 4.4 billion (1997: ECU 4.3 billion) of undrawn commitments (see the analysis by instrument in note 10).

Listed below are all share investments where the Bank owned more than 20 per cent of the investee share capital at 31 December 1998 and where the Bank's total investment exceeded ECU 10.0 million. Significant shareholdings are normally only taken in anticipation of, wherever possible, subsequent external participation.

	% Ownership
Budapest Bank	32.5
Framlington Russian Investment Fund	24.9
Korado	44.3
Lafarge	31.0
Polish Private Equity Fund	33.3
Schooner Capital	34.9
Stalexport	31.2
United Bulgarian Bank	35.0

10 Analysis of operational activity

Analysis by country	**Outstanding disbursements 1998 ECU 000**	Outstanding disbursements 1997 ECU 000	**Committed but not yet disbursed 1998 ECU 000**	Committed but not yet disbursed 1997 ECU 000
Albania	**28,826**	33,789	**30,954**	24,250
Armenia	**46,738**	53,689	**12,620**	28,610
Azerbaijan	**98,510**	30,246	**94,010**	80,421
Belarus	**108,703**	92,327	**17,190**	51,263
Bosnia and Herzegovina	**17,240**	6,171	**53,238**	42,968
Bulgaria	**186,075**	164,014	**87,927**	93,717
Croatia	**260,156**	196,813	**190,496**	133,145
Czech Republic	**140,123**	115,090	**146,032**	135,443
Estonia	**178,533**	108,383	**24,150**	30,903
Former Yugoslav Republic of Macedonia	**79,255**	79,207	**43,554**	61,364
Georgia	**39,984**	28,701	**72,675**	39,651
Hungary	**460,693**	562,532	**256,407**	221,825
Kazakhstan	**91,202**	38,293	**237,051**	162,786
Kyrgyzstan	**80,842**	84,093	**48,274**	39,825
Latvia	**80,119**	73,289	**94,032**	89,936
Lithuania	**121,406**	90,772	**30,171**	32,081
Moldova	**55,391**	50,791	**85,859**	85,444
Poland	**723,695**	485,568	**366,261**	351,816
Romania	**625,484**	384,513	**499,878**	566,374
Russian Federation	**1,469,767**	1,127,432	**1,102,843**	1,097,512
Slovak Republic	**226,574**	244,792	**28,636**	34,396
Slovenia	**156,456**	173,303	**75,422**	137,784
Tajikistan	**2,081**	1,540	**10,867**	7,518
Turkmenistan	**27,430**	30,152	**94,801**	101,808
Ukraine	**220,538**	149,301	**366,180**	349,443
Uzbekistan	**146,299**	117,896	**206,980**	242,733
Regional	**109,863**	71,270	**144,234**	102,383
At 31 December	**5,781,983**	4,593,967	**4,420,742**	4,345,399

Analysis by instrument				
Loans	**4,341,361**	3,615,719	**3,677,589**	3,674,710
Share investments	**1,430,441**	946,441	**539,953**	458,890
Debt securities (Banking bond)	**10,181**	31,807	**–**	–
Guarantees	**–**	–	**203,200**	211,799
At 31 December	**5,781,983**	4,593,967	**4,420,742**	4,345,399

Analysis by sector				
Commerce and tourism	**257,319**	154,302	**108,100**	168,050
Community and social services	**49,880**	41,777	**200,810**	127,787
Energy/power generation	**386,149**	312,453	**1,041,224**	985,959
Extractive industries	**437,684**	315,101	**160,057**	97,262
Finance/business	**2,045,428**	1,534,469	**1,272,420**	1,083,875
Manufacturing	**823,381**	718,269	**555,092**	652,924
Primary industries	**101,900**	82,577	**39,461**	37,819
Telecommunications	**639,954**	513,369	**162,512**	218,313
Transport	**1,040,288**	921,650	**881,066**	973,410
At 31 December	**5,781,983**	4,593,967	**4,420,742**	4,345,399

11 Property, technology and office equipment

	Property ECU 000	Technology and office equipment ECU 000	Total ECU 000
Cost			
At 1 January 1998	65,436	47,139	112,575
Additions	1,633	10,379	12,012
Disposals	(26)	(990)	(1,016)
At 31 December 1998	**67,043**	**56,528**	**123,571**
Depreciation			
At 1 January 1998	22,379	43,380	65,759
Charge	6,659	8,847	15,506
Disposals	(26)	(990)	(1,016)
At 31 December 1998	**29,012**	**51,237**	**80,249**
Net book value			
At 31 December 1998	**38,031**	**5,291**	**43,322**
At 31 December 1997	43,057	3,759	46,816

Additions include ECU 2.3 million computer equipment purchased under a finance lease, with related depreciation of ECU 0.5 million. The related minimum payments under these finance leases amount to ECU 1.3 million and are all due within 12 months of the balance sheet date. These future payments are included in 'Other liabilities'.

12 Debts evidenced by certificates

The Bank's outstanding debts evidenced by certificates and related swaps at 31 December 1998 are summarised below:

	Principal at nominal value ECU 000	Unamortised premium/ (discount) ECU 000	Adjusted principal value ECU 000	Currency swaps payable/ (receivable) ECU 000	**1998 Net currency obligations ECU 000**	1997 Net currency obligations ECU 000
Australian dollars	215,959	2,019	217,978	(217,978)	**–**	–
Belgian francs	99,041	–	99,041	(99,041)	**–**	–
Canadian dollars	108,037	–	108,037	(108,037)	**–**	–
Czech koruna	14,215	–	14,215	(14,215)	**–**	26,261
Deutsche marks	182,388	(486)	181,902	–	**181,902**	193,987
Dutch guilders	147,390	(12,120)	135,270	(135,270)	**–**	–
European currency units	722,500	–	722,500	812,512	**1,535,012**	662,610
French francs	–	–	–	–	**–**	90,374
Gold bullion	698,295	–	698,295	(698,295)	**–**	–
Greek drachmas	197,094	–	197,094	(197,094)	**–**	–
Hong Kong dollars	968,588	–	968,588	(968,588)	**–**	–
Hungarian forints	11,889	–	11,889	–	**11,889**	13,327
Italian lire	741,060	(27,046)	714,014	(255,813)	**458,201**	100,950
Japanese yen	1,299,210	–	1,299,210	(713,661)	**585,549**	540,110
New Taiwan dollars	521,601	–	521,601	(521,601)	**–**	–
Polish zloty	48,927	–	48,927	(48,927)	**–**	–
Russian roubles	97,418	421	97,839	(97,839)	**–**	–
South African rands	359,551	3,853	363,404	(363,404)	**–**	–
South Korean won	67,598	–	67,598	(67,598)	**–**	–
Spanish pesetas	432,706	–	432,706	(432,706)	**–**	–
Sterling	1,006,426	–	1,006,426	(559,417)	**447,009**	184,138
Swedish kronor	26,375	–	26,375	(26,375)	**–**	–
United States dollars	1,236,940	1,220	1,238,160	4,713,347	**5,951,507**	5,062,390
At 31 December	**9,203,208**	**(32,139)**	**9,171,069**	**–**	**9,171,069**	**6,874,147**

During the year the Bank redeemed prior to maturity ECU 267.4 million of bonds and medium-term notes generating a net gain of ECU 5.4 million.

13 Other liabilities

	1998 ECU 000	1997 ECU 000
Interest payable	**356,679**	153,741
Treasury-related	**754,064**	730,840
Other	**105,512**	98,106
Provision for losses on contractual commitments	**179,077**	151,204
At 31 December	**1,395,332**	1,133,891

14 Subscribed capital

	1998 Number of shares	**1998 Total ECU 000**	1997 Number of shares	1997 Total ECU 000
Authorised share capital	**2,000,000**	**20,000,000**	2,000,000	20,000,000
of which				
Subscriptions by members – initial capital	**991,875**	**9,918,750**	991,875	9,918,750
Subscriptions by members – capital increase	**937,200**	**9,372,000**	845,035	8,450,350
Subtotal – subscribed capital	**1,929,075**	**19,290,750**	1,836,910	18,369,100
Not yet subscribed	**50,000**	**500,000**	142,165	1,421,650
Shares to be allocated [1]	**4,675**	**46,750**	4,675	46,750
Unallocated shares	**16,250**	**162,500**	16,250	162,500
At 31 December	**2,000,000**	**20,000,000**	2,000,000	20,000,000

[1] Shares potentially available to the countries previously forming part of Yugoslavia.

The Bank's capital stock is divided into paid-in shares and callable shares. Each share has a par value of ECU 10,000. Payment for the paid-in shares subscribed to by members is made over a period of years determined in advance. Article 6.4 of the Agreement provides that payment of the amount subscribed to the callable capital shall be subject to call, taking account of Articles 17 and 42 of the Agreement, only as and when required by the Bank to meet its liabilities. Article 42.1 provides that in the event of termination of the operations of the Bank, the liability of all members for all uncalled subscriptions to the capital stock shall continue until all claims of creditors, including all contingent claims, shall have been discharged.

By Resolution No. 59, adopted on 15 April 1996, the Board of Governors approved a doubling of the Bank's authorised capital stock from ECU 10 billion to ECU 20 billion, subject to the terms and conditions of that Resolution. Of the increase in authorised capital stock of ECU 10 billion, 22.5 per cent is in the form of paid-in shares, to be paid for in eight equal annual instalments, and the balance (77.5 per cent) is in the form of callable shares. Under the Resolution, 31 December 1997 was established as the final date for members to subscribe to the capital increase. A further extension to 31 December 1998 was authorised by the Board of Governors. At 31 December 1998, 54 members had deposited instruments of subscription with the Bank for an aggregate of 937,200 shares as detailed in the following statement of capital subscriptions.

The number of unallocated shares originally provided for in the Agreement was 125 shares. By Resolution No. 15 of the Board of Governors, shares totalling 15,500, which were originally allocated for subscription by the former German Democratic Republic, were added to unallocated shares. Of these, 1,000 shares were allocated to Albania in the final quarter of 1991 and 1,000 shares each were allocated to Estonia, Latvia and Lithuania in the first quarter of 1992. The remaining unallocated shares (11,625) were doubled in number as a result of the capital increase. By Resolution No. 63 of the Board of Governors, adopted on 9 May 1997, 3,500 additional shares from the initial capital stock were allocated to the Republic of Korea. Upon the effectiveness of this special increase in subscription, the Republic of Korea became entitled to and took up a further 3,500 additional shares under the capital increase. As a result, the total number of shares remaining unallocated at the year-end was 16,250.

By Resolutions Nos. 21, 27 and 37 of the Board of Governors, the 60,000 shares that had been subscribed to by the former USSR were allocated to countries (other than the Baltic States) which previously formed part of the USSR. By Resolutions Nos. 30, 31, 34, 35, 53 and 56 of the Board of Governors, 8,125 of the 12,800 shares subscribed to by the former Yugoslavia were allocated to Croatia (3,646 shares), Slovenia (2,098 shares), the Former Yugoslav Republic of Macedonia (691 shares) and Bosnia and Herzegovina (1,690 shares). The remaining 4,675 shares await allocation to countries of former Yugoslavia in due course.

A statement of capital subscriptions showing the amount of paid-in and callable shares subscribed to by each member, together with the amount of unallocated shares, overdue subscriptions and restrictions of voting rights, is set out in the following table. This also shows which members have subscribed to the capital increase. Under Article 29 of the Agreement, the voting rights of members which have failed to pay any part of the amounts due in respect of their capital subscription obligations are proportionately reduced for so long as the obligation remains outstanding. Overdue encashments of promissory notes deposited by members are detailed in note 15.

Subscribed capital (continued)

Statement of capital subscriptions
At 31 December 1998

Members	Capital increase shares subscribed (number)[1]	Total shares (number)	Voting rights restricted votes[2]	Voting rights resulting votes	Total capital ECU 000	Callable capital ECU 000	Paid-in subscribed capital amounts not yet due ECU 000	Paid-in subscribed capital amounts due but not yet received ECU 000	Paid-in subscribed capital amounts received ECU 000
Members of the European Union									
Austria	22,800	45,600	–	45,600	456,000	336,300	44,887	–	74,813
Belgium	22,800	45,600	–	45,600	456,000	336,300	44,887	–	74,813
Denmark	12,000	24,000	–	24,000	240,000	177,000	23,625	–	39,375
Finland	12,500	25,000	–	25,000	250,000	184,370	24,614	–	41,016
France	85,175	170,350	–	170,350	1,703,500	1,256,335	167,685	–	279,480
Germany	85,175	170,350	–	170,350	1,703,500	1,256,335	167,685	–	279,480
Greece	6,500	13,000	–	13,000	130,000	95,870	12,801	–	21,329
Ireland	3,000	6,000	–	6,000	60,000	44,250	5,906	–	9,844
Italy	85,175	170,350	–	170,350	1,703,500	1,256,335	167,685	–	279,480
Luxembourg	2,000	4,000	–	4,000	40,000	29,500	3,937	–	6,563
Netherlands	24,800	49,600	–	49,600	496,000	365,800	48,825	–	81,375
Portugal	4,200	8,400	–	8,400	84,000	61,950	8,269	–	13,781
Spain	–	34,000	–	34,000	340,000	238,000	–	–	102,000
Sweden	22,800	45,600	–	45,600	456,000	336,300	44,887	–	74,813
United Kingdom	85,175	170,350	–	170,350	1,703,500	1,256,335	167,685	–	279,480
European Community	30,000	60,000	–	60,000	600,000	442,500	59,063	–	98,437
European Investment Bank	30,000	60,000	–	60,000	600,000	442,500	59,063	–	98,437
Other European countries									
Cyprus	1,000	2,000	–	2,000	20,000	14,750	1,969	–	3,281
Iceland	1,000	2,000	–	2,000	20,000	14,750	1,969	–	3,281
Israel	6,500	13,000	–	13,000	130,000	95,870	12,801	–	21,329
Liechtenstein	200	400	–	400	4,000	2,950	394	–	656
Malta	100	200	–	200	2,000	1,470	201	–	329
Norway	12,500	25,000	–	25,000	250,000	184,370	24,614	–	41,016
Switzerland	22,800	45,600	–	45,600	456,000	336,300	44,887	–	74,813
Turkey	11,500	23,000	–	23,000	230,000	169,620	22,645	–	37,735
Countries of operations									
Albania	1,000	2,000	158	1,842	20,000	14,750	1,969	381	2,900
Armenia	500	1,000	30	970	10,000	7,370	989	68	1,573
Azerbaijan	–	1,000	700	300	10,000	7,000	–	1,500	1,500
Belarus	2,000	4,000	–	4,000	40,000	29,500	3,938	–	6,562
Bosnia and Herzegovina	1,690	3,380	1,000	2,380	33,800	24,930	4,339	2,503	2,028
Bulgaria	7,900	15,800	–	15,800	158,000	116,520	15,558	–	25,922
Croatia	3,646	7,292	–	7,292	72,920	53,780	7,175	–	11,965
Czech Republic	8,533	17,066	–	17,066	170,660	125,861	16,799	–	28,000
Estonia	1,000	2,000	–	2,000	20,000	14,750	1,856	–	3,394
Former Yugoslav Republic of Macedonia	691	1,382	102	1,280	13,820	10,200	1,356	177	2,087
Georgia	1,000	2,000	758	1,242	20,000	14,750	1,969	1,181	2,100
Hungary	7,900	15,800	–	15,800	158,000	116,520	15,558	–	25,922
Kazakhstan	2,300	4,600	288	4,312	46,000	33,920	4,533	648	6,899
Kyrgyzstan	1,000	2,000	458	1,542	20,000	14,750	1,969	1,281	2,000
Latvia	1,000	2,000	–	2,000	20,000	14,750	1,969	–	3,281
Lithuania	1,000	2,000	–	2,000	20,000	14,750	1,969	–	3,281
Moldova	1,000	2,000	192	1,808	20,000	14,750	1,969	281	3,000
Poland	12,800	25,600	–	25,600	256,000	188,800	25,200	–	42,000
Romania	4,800	9,600	–	9,600	96,000	70,800	9,450	–	15,750
Russian Federation	40,000	80,000	–	80,000	800,000	590,000	78,750	–	131,250
Slovak Republic	4,267	8,534	–	8,534	85,340	62,939	8,400	–	14,001
Slovenia	2,098	4,196	–	4,196	41,960	30,940	4,130	–	6,890
Tajikistan	1,000	2,000	864	1,136	20,000	14,750	1,969	1,897	1,384
Turkmenistan	100	200	3	197	2,000	1,470	201	–	329
Ukraine	8,000	16,000	–	16,000	160,000	118,000	15,750	–	26,250
Uzbekistan	2,100	4,200	126	4,074	42,000	30,970	4,140	283	6,607
Unallocated shares reserved for countries previously forming part of Yugoslavia	–	4,675[3]	–	–	46,750	32,730	11,216	–	2,804
Non-European countries									
Australia	–	10,000	–	10,000	100,000	70,000	–	–	30,000
Canada	34,000	68,000	–	68,000	680,000	501,500	66,937	–	111,563
Egypt	1,000	2,000	125	1,875	20,000	14,750	1,969	281	3,000
Japan	85,175	170,350	–	170,350	1,703,500	1,256,335	167,685	–	279,480
Korea, Republic of	10,000	20,000	–	20,000	200,000	147,500	19,687	–	32,813
Mexico	–	3,000	–	3,000	30,000	21,000	–	–	9,000
Morocco	–	1,000	33	967	10,000	7,000	–	–	3,000
New Zealand	–	1,000	–	1,000	10,000	7,000	–	–	3,000
United States of America	100,000	200,000	–	200,000	2,000,000	1,475,000	196,830	–	328,170
Capital subscribed by members	**937,200**	**1,929,075**	**4,837**	**1,919,563**	**19,290,750**	**14,206,395**	**1,857,213**	**10,481**	**3,216,661**
Unallocated shares		20,925			209,250				
Authorised and issued share capital		**1,950,000**			**19,500,000**				

[1] These shares are included in the column 'Total shares'. Once a member has subscribed to the capital increase voting rights and total capital rise accordingly.

[2] Voting rights not exercisable due to non-payment of amounts due in respect of the member's obligations in relation to paid-in shares.

[3] The voting rights attached to these shares have been suspended pending their reallocation. Total votes before restrictions amount to 1,924,400.

15 Promissory notes issued by member countries

Currency of issue	Total received ECU 000	Exchange gain/(loss) ECU 000	Amount drawn down ECU 000	**1998 Amount outstanding ECU 000**	1997 Amount outstanding ECU 000
European currency units	741,574	–	(672,481)	**69,093**	3,900
Japanese yen	144,919	4,645	(135,877)	**13,687**	–
United States dollars	412,792	(4,319)	(359,863)	**48,610**	8,415
At 31 December	**1,299,285**	**326**	**(1,168,221)**	**131,390**	12,315

Under the Agreement, payment for the paid-in shares of the original capital stock subscribed to by members was to be made in five equal annual instalments. Of each instalment, up to 50 per cent was payable in non-negotiable, non-interest-bearing promissory notes or other obligations issued by the subscribing member and payable to the Bank at par value upon demand. Under Resolution No. 59, payment for the paid-in shares subscribed to by members under the capital increase is to be made in eight equal annual instalments, and a member may pay up to 60 per cent of each instalment in non-negotiable, non-interest-bearing promissory notes or other obligations issued by the member and payable to the Bank at par value upon demand.

The promissory notes or other obligations are denominated in ECU, United States dollars or Japanese yen. In accordance with a policy adopted by the Board of Directors for the drawdown of promissory notes or other obligations deposited by members in connection with their initial subscriptions, each such promissory note or other obligation deposited in 1992 or later has been drawn down in three equal annual instalments. The policy adopted in connection with subscriptions to the capital increase calls for the drawdown of promissory notes or other obligations in five equal annual instalments.

Promissory notes or other obligations denominated in United States dollars or Japanese yen have been translated into ECU either at the rates of exchange ruling at the dates of draw down, or, if outstanding at the year end, at market rates ruling at 31 December 1998.

Eight members are overdue in the encashment of their deposited promissory notes as follows:

Member	1991 Note ECU 000	1992 Note ECU 000	1993 Note ECU 000	1994 Note ECU 000	1995 Note ECU 000	Additional capital[1] ECU 000	**1998 Total ECU 000**
Azerbaijan	100	200	300	–	–	–	**600**
Bosnia and Herzegovina	–	–	–	–	–	338	**338**
Former Yugoslav Republic of Macedonia	–	–	–	–	10	118	**128**
Georgia	–	100	300	300	300	–	**1,000**
Moldova	–	–	–	–	200	–	**200**
Morocco	–	–	–	–	100	–	**100**
Tajikistan	–	300	200	100	–	–	**600**
Turkmenistan	–	–	–	–	10	–	**10**
At 31 December	100	600	800	400	620	456	**2,976**

[1] Relates to shares allocated to countries forming part of the former Yugoslavia, partially overdue in 1997 and partially in 1998.

In addition there is an outstanding encashment of ECU 1.4 million relating to shares previously held by the former Yugoslavia but not yet allocated.

The outstanding promissory note encashments detailed above are additional to the ECU 10.5 million capital due, but not yet received, detailed in the table to note 14. This includes non-receipt of promissory notes of value ECU 1.7 million.

16 Net currency position

	ECU ECU 000	Japanese yen ECU 000	Sterling ECU 000	United States dollars ECU 000	Other currencies ECU 000	**Total ECU 000**
Assets						
Placements with and advances to credit institutions	75,767	177,817	231,900	2,174,129	285,611	**2,945,224**
Debt securities	573,413	1,497,329	269,142	2,459,273	473,548	**5,272,705**
Other assets	30,073	70,029	43,392	408,514	191,845	**743,853**
Loans	271,394	2,262	289	2,678,760	942,282	**3,894,987**
Share investments	–	–	–	–	1,147,453	**1,147,453**
Property, technology and office equipment	43,322	–	–	–	–	**43,322**
Promissory notes issued by members	69,093	13,687	–	48,611	–	**131,391**
Subscribed capital	1,046,922	200,174	–	620,599	–	**1,867,695**
Total assets	2,109,984	1,961,298	544,723	8,389,886	3,040,739	**16,046,630**
Liabilities						
Amounts owed to credit institutions	(174,262)	(128,112)	(5,097)	(215,703)	(31,180)	**(554,354)**
Debts evidenced by certificates	(722,500)	(1,299,210)	(1,006,426)	(1,238,160)	(4,904,773)	**(9,171,069)**
Other liabilities	(563,630)	(62,700)	(83,166)	(489,716)	(196,120)	**(1,395,332)**
Total liabilities	(1,460,392)	(1,490,022)	(1,094,689)	(1,943,579)	(5,132,073)	**(11,120,755)**
Net assets/(liabilities)	**649,592**	**471,276**	**(549,966)**	**6,446,307**	**(2,091,334)**	**4,925,875**
Off balance sheet instruments	3,142,209	(470,521)	550,371	(6,540,761)	3,318,702	–
Currency position at 31 December 1998	**3,791,801**	**755**	**405**	**(94,454)**	**1,227,368**	**4,925,875**
Currency position at 31 December 1997	4,145,813	(1,322)	1,132	(22,286)	852,227	4,975,564

In addition to the Bank's functional currency, ECU, currencies individually disclosed are those in which the Bank primarily raises funds (see note 12) and which expose the Bank to exchange rate risk. Amounts aggregated under 'Other currencies' and which, after allowing for off balance sheet instruments, expose the Bank to exchange rate risk, primarily derive from the currency risks undertaken through the Bank's share investments in countries of operations where currency hedges were not readily available.

17 Liquidity position

Liquidity is a measure of the extent to which the Bank may be required to raise funds to meet its commitments associated with financial instruments. The Bank's commitment to maintaining a strong liquidity position is embodied in policies which require a minimum target liquidity ratio, based on a multi-year context, of 45 per cent of its next three years' net cash requirements, with full coverage of all committed but undisbursed project financing together with a requirement that 40 per cent of its net Treasury investments mature within one year. This policy is implemented by maintaining liquidity in a target zone, above the required minimum level, of 90 per cent of the next three years' net cash requirements.

The table below provides an analysis of assets, liabilities and members' equity into relevant maturity groupings based on the remaining period from the balance sheet date to the contractual maturity date. It is presented under the most prudent consideration of maturity dates where options or repayment patterns allow for early repayment possibilities. Therefore, in the case of liabilities the earliest possible repayment date is shown, while for assets it is the latest possible repayment date.

Those assets and liabilities that do not have a contractual maturity date are grouped together in the 'Maturity undefined' category.

	Up to and including 1 month ECU 000	Over 1 month and up to and including 3 months ECU 000	Over 3 months and up to and including 1 year ECU 000	Over 1 year and up to and including 5 years ECU 000	Over 5 years ECU 000	Maturity undefined ECU 000	**Total ECU 000**
Assets							
Placements with and advances to credit institutions	1,423,777	365,142	1,122,019	–	34,286	–	**2,945,224**
Debt securities	235,150	339,761	410,320	2,221,440	2,066,034	–	**5,272,705**
Other assets	370,376	37,377	296,368	25,040	14,692	–	**743,853**
Loans	90,540	95,979	494,728	2,062,011	1,315,635	(163,906)	**3,894,987**
Share investments	–	–	–	–	–	1,147,453	**1,147,453**
Property, technology and office equipment	–	–	–	–	–	43,322	**43,322**
Paid-in capital receivable:							
Promissory notes issued by members	–	1,751	31,615	93,644	–	4,382	**131,392**
Due but not yet received	–	–	–	–	–	10,481	**10,481**
Called but not yet due	–	–	263,714	1,054,855	527,428	11,216	**1,857,213**
Total assets	2,119,843	840,010	2,618,764	5,456,990	3,958,075	1,052,948	**16,046,630**
Liabilities							
Amounts owed to credit institutions	(315,009)	(108,710)	(2,523)	–	(128,112)	–	**(554,354)**
Debts evidenced by certificates	(469,325)	(544,047)	(1,206,924)	(4,429,532)	(2,521,241)	–	**(9,171,069)**
Other liabilities	(320,480)	(26,096)	(239,917)	(172,212)	(92,788)	(543,839)	**(1,395,332)**
Members' equity	–	–	–	–	–	(4,925,875)	**(4,925,875)**
Total liabilities and members' equity	(1,104,814)	(678,853)	(1,449,364)	(4,601,744)	(2,742,141)	(5,469,714)	**(16,046,630)**
Liquidity position at 31 December 1998	**1,015,029**	**161,157**	**1,169,400**	**855,246**	**1,215,934**	**(4,416,766)**	**–**
Cumulative liquidity position at 31 December 1998	**1,015,029**	**1,176,186**	**2,345,586**	**3,200,832**	**4,416,766**	**–**	**–**
Cumulative liquidity position at 31 December 1997	101,065	466,282	1,200,464	2,015,254	4,611,201	–	–

18 Interest rate risk

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. The length of time for which the rate of interest is fixed on a financial instrument indicates to what extent it is exposed to interest rate risk. The table below provides information on the extent of the Bank's interest rate exposure based either on the contractual maturity date of its financial instruments or, in the case of instruments that reprice to a market rate of interest before maturity, the next repricing date. Securities that comprise the Bank's dealing portfolio are assumed to reprice within the 'Up to and including 1 month' category.

Repricing interval	Up to and including 1 month ECU 000	Over 1 month and up to and including 3 months ECU 000	Over 3 months and up to and including 1 year ECU 000	Over 1 year and up to and including 5 years ECU 000	Over 5 years ECU 000	Non-interest-bearing funds ECU 000	**Total ECU 000**
Assets							
Placements with and advances to credit institutions	1,423,777	365,142	1,122,019	–	34,286	–	**2,945,224**
Debt securities	2,334,979	631,078	777,562	835,754	693,332	–	**5,272,705**
Other assets	197,795	–	385,623	–	–	160,435	**743,853**
Loans	506,651	1,206,313	2,025,300	44,212	276,420	(163,909)	**3,894,987**
Non interest-earning assets including subscribed capital called, not yet due	–	–	–	–	–	3,189,861	**3,189,861**
Total assets	4,463,202	2,202,533	4,310,504	879,966	1,004,038	3,186,387	**16,046,630**
Liabilities							
Amounts owed to credit institutions	(315,009)	(108,710)	(2,523)	–	(128,112)	–	**(554,354)**
Debts evidenced by certificates	(658,926)	(649,336)	(1,333,131)	(4,183,469)	(2,346,207)	–	**(9,171,069)**
Other liabilities	(341,943)	–	(356,679)	–	–	(696,710)	**(1,395,332)**
Members' equity	–	–	–	–	–	(4,925,875)	**(4,925,875)**
Total liabilities and members' equity	(1,315,878)	(758,046)	(1,692,333)	(4,183,469)	(2,474,319)	(5,622,585)	**(16,046,630)**
Net assets	3,147,324	1,444,487	2,618,171	(3,303,503)	(1,470,281)	(2,436,198)	**–**
Derivative financial instruments	(888,591)	(777,029)	(3,108,164)	3,303,503	1,470,281	–	**–**
Interest rate risk at 31 December 1998	2,258,733	667,458	(489,993)	–	–	(2,436,198)	**–**
Cumulative interest rate risk at 31 December 1998	**2,258,733**	**2,926,191**	**2,436,198**	**2,436,198**	**2,436,198**	**–**	**–**
Cumulative interest rate risk at 31 December 1997	1,544,065	3,467,778	2,820,461	2,820,461	2,820,461	–	**–**

The Bank's interest rate risk measurement is complemented by accepted market techniques including Value-at-Risk ("VaR"), spread risk and volatility risk on which frequent management reporting takes place. At 31 December 1998, the Bank's VaR, calculated with reference to a 99 per cent confidence level over a 10-trading-days horizon, was ECU 0.9 million (1997: ECU 0.7 million). At 31 December 1998 the VaR on the Bank's two externally managed investment programmes was ECU 1.4 million on the US dollar asset-backed securities programme and ECU 1.1 million on the ECU-denominated global bond programme.

19 Credit-related information on Treasury derivative financial instruments

	31 December 1998 ECU 000	31 December 1997 ECU 000
Credit derivatives[1]	**2,223,998**	1,935,932
Swaps and over-the-counter option agreements:[2]		
Pre netting/collateral agreements	**1,034,766**	616,931
Post netting/collateral agreements	**650,496**	352,799

1 These amounts represent the maximum possible loss to the Bank in the event that its credit derivative agreements become actionable by its counterparties and no recovery is achievable on the specified assets.

2 These amounts represent the replacement cost to the Bank in the event of non-performance by the counterparties to those swap and over-the-counter option agreements that have a positive value to the Bank.

The Bank is highly selective in its choice of counterparties and considers that non-performance does not represent a significant risk. Derivative transactions in particular are normally limited to AA- or better-rated counterparties, with single A rated counterparties accepted only when exposure is fully collateralised.

20 Estimated realisable value information

Presented below is information on the estimated realisable values of the Bank's financial assets and liabilities. This represents the estimated approximate amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Where an active market exists for a particular instrument, quoted prices have been used. Where an active market does not exist, estimated values have been derived from internal pricing models based on discounted cash flow techniques, except in the case of share investments (see (d) below).

The following should be noted in the presentation of estimated realisable values set out below:

(a) the value of short-term financial instruments, i.e. those maturing within one year, approximates to the value stated in the Bank's balance sheet.

(b) the value in respect of debt securities and debts evidenced by certificates incorporates the estimated realisable value of associated derivative instruments. For the Bank's issues of debts evidenced by certificates that are private placements, information is available only for those issues in which the Bank has subsequently repurchased part of the issue.

(c) the balance sheet value of loans is stated net of provisions, which approximates to their estimated realisable value. Due to the fact that the Bank manages its interest rate risk on a portfolio basis, it is not possible to identify the specific derivative instruments which hedge the interest rate risk on the Bank's loan portfolio. Consequently, the stated amount of the loan portfolio does not allow for the estimated value of any associated hedging derivative instrument.

(d) the value of share investments that are traded on a recognised stock exchange is determined using quoted stock exchange prices. The Bank's quoted share investments are generally in markets which are relatively illiquid and volatile and the value presented below makes no additional allowance for this. In all other cases value is assumed to correspond with the Bank's historical cost, net of provisions.

	Balance sheet value 1998 ECU 000	Estimated realisable value adjustment 1998 ECU 000	**Estimated realisable value 1998 ECU 000**	Estimated realisable value 1997 ECU 000
Assets				
Placements with and advances to credit institutions	2,945,224	–	**2,945,224**	1,211,801
Debt securities	5,272,705	(60,599)	**5,212,106**	5,248,090
	8,217,929	(60,599)	**8,157,330**	6,459,891
Loans	3,894,987	–	**3,894,987**	3,462,098
Share investments	1,147,453	219,227	**1,366,680**	1,140,656
Other non-financial assets	2,786,261	–	**2,786,261**	2,642,991
Total assets	16,046,630	158,628	**16,205,258**	13,705,636
Liabilities				
Amounts owed to credit institutions	(554,354)	–	**(554,354)**	(511,536)
Debts evidenced by certificates	(9,171,069)	8,746	**(9,162,323)**	(6,862,328)
	(9,725,423)	8,746	**(9,716,677)**	(7,373,864)
Other non-financial liabilities	(1,395,332)	–	**(1,395,332)**	(1,133,891)
Members' equity	(4,925,875)	–	**(4,925,875)**	(4,975,564)
Total liabilities and member's equity	(16,046,630)	8,746	**(16,037,884)**	(13,483,319)
Net estimated realisable value at 31 December			**167,374**	222,317

Debt securities held in the Bank's investment portfolio are intended to be held to maturity and are consequently stated in the balance sheet at amortised cost. The estimated realisable value adjustment for debt securities as at 31 December 1998 is primarily due to the Bank's exposure in sovereign related debt issues from Korea.

21 Operating lease commitments

The Bank leases its headquarters building in London and certain of its Resident Office buildings in countries of operations. These are standard operating leases and include renewal options, periodic escalation clauses and are non-cancellable in the normal course of business without the Bank incurring substantial penalties. The most significant lease is that for the headquarters building. Rent payable under the terms of this lease is reviewed every five years and is based on market rates. After such a review rent may stay the same or be increased. The Bank has a break clause effective in the year 2006, which allows the Bank to terminate the lease. The headquarters lease requires the Bank to restore the premises to their original condition. A reserve, to cover the estimated full cost of this reinstatement, is built up monthly, based on an estimate by the Bank's quantity surveyors. The costs associated with restoring the Resident Offices are not considered material and therefore no equivalent provision is made.

The Bank has entered into sublease arrangements for two floors of its headquarters building. The terms of the subleases mirror the terms of the Bank's head lease. The total minimum future lease payments expected to be received under these assignments is ECU 22.2 million as at 31 December 1998. Income from sublease payments for the year amounted to ECU 3.0 million.

Minimum future lease payments under long-term non-cancellable operating leases are shown below.

Payable:	**1998 ECU 000**	1997 ECU 000
Not later than one year	**21,579**	23,510
Later than one year and not later than five years	**83,100**	88,505
Later than five years	**56,246**	81,033
At 31 December	**160,925**	193,048

22 Staff retirement scheme

An actuarial valuation of the defined benefit scheme is performed every three years by a qualified actuary using the projected unit method. The most recent valuation was at 31 August 1997. The key assumptions used were a real rate of investment return of 4 per cent and a real increase in salaries of 3 per cent. This actuarial valuation showed that the market value of the scheme assets, using year-end exchange rates, was ECU 37.3 million (1997: ECU 39.5 million) and the present value of the projected retirement benefits was ECU 33.9 million (1997: ECU 36.0 million).

The pension charge recognised for the year was ECU 12.1 million (1997: ECU 10.4 million) and is included in general administrative expenses in the profit and loss account (note 5). This included a credit of ECU 0.2 million in respect of the amortisation of the actuarial surplus which is being recognised over 13.5 years, the expected remaining working lives of the relevant employees. The pension charge recognised under the defined contribution scheme was ECU 3.7 million (1997: ECU 4.1 million) and in the defined benefit scheme was ECU 8.4 million for the year ended 31 December 1998 (1997: ECU 8.5 million) and are both included in general administrative expenses.

23 Segment information

Business segments
For management purposes the business of the Bank is comprised primarily of Banking and Treasury operations. Banking activities represent investment in projects which, in accordance with the Agreement Establishing the Bank, are made for the purpose of assisting the countries of operations in their transition to a market economy, while applying sound banking principles.

The main investment products are loans, share investments and guarantees. Treasury activities include raising debt finance, investing surplus liquidity, managing the Bank's foreign exchange and interest rate risks, and assisting clients in asset and liability management matters.

Primary reporting format – business segment	**31 December 1998 Banking ECU 000**	**31 December 1998 Treasury ECU 000**	**31 December 1998 Aggregated ECU 000**	31 December 1997 Banking ECU 000	31 December 1997 Treasury ECU 000	31 December 1997 Aggregated ECU 000
Interest income	**279,984**	**291,101**	**571,085**	222,364	340,417	562,781
Other income	**244,214**	**1,440**	**245,654**	134,979	13,740	148,719
Total segment revenue	**524,198**	**292,541**	**816,739**	357,343	354,157	711,500
Less interest expenses and similar charges [1]	**(239,416)**	**(238,539)**	**(477,955)**	(187,221)	(304,497)	(491,718)
Less general administrative expenses	**(132,291)**	**(10,881)**	**(143,172)**	(126,233)	(10,828)	(137,061)
Less depreciation	**(14,048)**	**(1,458)**	**(15,506)**	(13,869)	(1,206)	(15,075)
Segment result before provisions and allocation of capital	**138,443**	**41,663**	**180,106**	30,020	37,626	67,646
Allocation of capital benefit [1]	**100,550**	**11,172**	**111,722**	113,564	12,618	126,182
Net profit after the allocation of capital before provisions	**238,993**	**52,835**	**291,828**	143,584	50,244	193,828
Provisions	**(546,242)**	**(6,819)**	**(553,061)**	(177,678)	–	(177,678)
Net profit after provisions and the allocation of capital	**(307,249)**	**46,016**	**(261,233)**	(34,094)	50,244	16,150
Segment assets	**5,218,808**	**8,828,736**	**14,047,544**	4,460,188	7,094,525	11,554,713
Paid-in capital receivable			**1,999,086**			1,940,425
Total assets			**16,046,630**			13,495,138
Segment liabilities	**5,218,808**	**8,828,736**	**14,047,544**	4,460,188	7,094,525	11,554,713
Members' equity receivable			**1,999,086**			1,940,425
Total liabilities			**16,046,630**			13,495,138
Capital expenditure	**10,883**	**1,129**	**12,012**	8,868	1,029	9,897

1 Segmental interest expense and the capital benefit from above together total ECU 366.2 million, which is the Bank's 'Interest expenses and similar charges' as reported in the profit and loss account.

Secondary reporting format – geographical segment
Banking operations in the countries of operations are divided into three regions for internal management purposes.

	Segment revenue 1998 ECU 000	Segment revenue 1997 ECU 000	**Segment assets 1998 ECU 000**	Segment assets 1997 ECU 000
Banking				
Advanced countries [1]	**266,528**	189,185	**2,292,225**	2,042,450
Early / Intermediate countries [1]	**157,431**	93,045	**1,798,563**	1,326,976
Russian Federation	**100,239**	75,113	**1,128,020**	1,090,762
Total allocated	**524,198**	357,343	**5,218,808**	4,460,188

A secondary geographic segment for Treasury is not considered useful.

1 Advanced countries are: Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic and Slovenia. Early/Intermediate countries are: Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, FYR Macedonia, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Romania, Tajikistan, Turkmenistan, Ukraine, Uzbekistan and Regional.

24 Other fund agreements

In addition to the Bank's operations and the Special Funds programme, the Bank administers numerous bilateral and multilateral grant agreements to provide technical assistance and investment support in the countries of operations. These agreements focus primarily on project preparation, project implementation (including goods and works), advisory services and training. The resources provided by these fund agreements are held separately from the ordinary capital resources of the Bank and are subject to external audit.

At 31 December 1998 the Bank administered 56 technical cooperation fund agreements (1997: 53) for an aggregate of ECU 597.8 million (1997: ECU 511.8 million) which includes ECU 231.0 million for the Tacis and Phare programmes of the European Commission under the Bangkok Facility. Of this pledged amount, funds received at 31 December 1998 totalled ECU 389.5 million. The total uncommitted balance of the funds at 31 December 1998 was ECU 116.2 million. In addition, the Bank administered 56 project-specific technical cooperation agreements for an aggregate amount of ECU 26.9 million.

The Bank also administered seven investment cooperation fund agreements during the year for an aggregate amount of ECU 35.3 million and two EU Pre-accession Preparation Funds for an aggregate amount of ECU 34.9 million for the specific purpose of co-financing EBRD projects.

Also, the Bank administered the EBRD – Japan Special Earmarked Fund which was established in 1994 as a mechanism to channel the Japanese contributions to the Russia Small Business Programme.

Following a proposal by the G-7 countries for a multilateral programme of action to improve safety in nuclear power plants in the countries of operations, the Nuclear Safety Account ("the NSA") was established by the Bank in March 1993. The NSA funds are in the form of grants and are used for funding immediate safety improvement measures. At 31 December 1998, 15 contributors had made pledges up to a total amount of ECU 260.6 million, using the fixed exchange rates defined in the Rules of the NSA.

At their Denver Summit in June 1997, the G-7 and the European Union endorsed the setting up of the Chernobyl Shelter Fund ("the CSF"). The CSF was established on 7 November 1997, when the Rules of the CSF were approved by the Board, and became operational on 8 December 1997, when the required eight contributors had entered into contribution agreements with the Bank. The objective of the CSF is to assist Ukraine in transforming the existing Chernobyl sarcophagus into a safe and environmentally stable system. At 31 December 1998, 20 contributors had made pledges up to a total amount of ECU 279.0 million using the fixed exchange rates defined in the Rules of the CSF.

Auditors' report to the European Bank for Reconstruction and Development

We have audited the balance sheet of the European Bank for Reconstruction and Development as of 31 December 1998, and the related profit and loss account, and statement of cash flows for the year then ended, on pages 65 to 82. The preparation of these financial statements is the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as of 31 December 1998, and of the results of its operations and its cash flows for the year then ended, in accordance with International Accounting Standards and the overall principles of the European Community's Council Directive on the Annual Accounts and Consolidated Accounts of Banks and Other Financial Institutions.

Arthur Andersen

Arthur Andersen
London, 9 March 1999

The Baltic Investment Special Fund

Profit and loss account

For the year ended 31 December 1998	Note	Year to 31 December 1998 ECU 000	Year to 31 December 1997 ECU 000
Interest and similar income			
From loans		**660**	774
Other interest		**1,102**	735
Net fee and commission income		**2**	41
Net profit on sale of share investments		**–**	3,009
Foreign exchange		**(585)**	74
Other operating expenses	3	**(142)**	(23)
Transfer of interest income to The Baltic Technical Assistance Special Fund		**–**	(1,090)
Operating profit before provisions		**1,037**	3,520
Provisions for losses	4	**35**	(338)
Profit for the year		**1,072**	3,182

Balance sheet

At 31 December 1998	Note	ECU 000	31 December 1998 ECU 000	ECU 000	31 December 1997 ECU 000
Assets					
Placements with credit institutions			**29,670**		19,149
Other assets	5		**413**		5,763
Loans and share investments					
Loans	6	**9,112**		11,475	
Share investments	6	**6,379**		2,868	
			15,491		14,343
Contributions due but not yet received	8		**1,397**		3,322
Contributions pledged but not yet due	8		**–**		3,500
Total assets			**46,971**		46,077
Liabilities					
Other liabilities			**41**		23
Provisions for general portfolio risks	4		**371**		567
Contributions	8		**41,500**		41,500
Reserves			**3,987**		805
Profit for the year			**1,072**		3,182
Contributors' resources			**46,559**		45,487
Total liabilities and contributors' resources			**46,971**		46,077
Memorandum items					
Commitments	7		**3,911**		7,076

Statement of changes in contributors' resources

For the year ended 31 December 1998	Contributions ECU 000	Special reserve ECU 000	Accumulated profit/(loss) ECU 000	Profit for the year ECU 000	Total ECU 000
At 31 December 1996	41,500	146	(408)	1,067	**42,305**
Profit set aside from the prior year	–	–	1,067	(1,067)	**–**
Profit for the year	–	–	–	3,182	**3,182**
At 31 December 1997	41,500	146	659	3,182	**45,487**
Qualifying fees from the prior year	–	27	(27)	–	**–**
Profit set aside from the prior year	–	–	3,182	(3,182)	**–**
Profit for the year	–	–	–	1,072	**1,072**
At 31 December 1998	**41,500**	**173**	**3,814**	**1,072**	**46,559**

No fees and commissions qualifying to be set aside to the special reserve were earned in the year to 31 December 1998. Therefore, there is no need, in accordance with the Agreement, to set aside an amount to the special reserve.

Statement of cash flows

For the year ended 31 December 1998	ECU 000	Year to 31 December 1998 ECU 000	ECU 000	Year to 31 December 1997 ECU 000
Cash flows from operating activities				
Operating profit for the year	**1,072**		3,182	
Adjustments for:				
Provisions for losses	**(35)**		338	
Realised gains on share investments	**–**		(3,009)	
Foreign exchange movements on provisions	**(20)**		23	
Operating profit before changes in operating assets	**1,017**		534	
Decrease/(increase) in operating assets:				
Interest receivable	**119**		(84)	
Other assets	**5,231**		(5,142)	
Increase/(decrease) in other liabilities	**18**		(16)	
Net cash provided/(used) by operating activities		**6,385**		(4,708)
Cash flows from investing activities				
Proceeds from repayment of loans	**2,890**		3,714	
Proceeds from sale of share investments	**–**		6,031	
Funds advanced for loans and share investments	**(4,179)**		(4,817)	
Net cash (used)/provided by investing activities		**(1,289)**		4,928
Cash flows from financing activities				
Contributions	**5,425**		708	
Net cash provided by financing activities		**5,425**		708
Net increase in cash and cash equivalents		**10,521**		928
Cash and cash equivalents 1 January		**19,149**		18,221
Cash and cash equivalents 31 December		**29,670**		19,149

Notes to the financial statements

1 Creation of the Special Fund

The Baltic Investment Special Fund ("the Fund") was created by and is administered under the terms of an Agreement dated 14 April 1992 ("the Fund Agreement") between the European Bank for Reconstruction and Development ("the Bank") and the Governments of the Kingdom of Denmark, the Republic of Finland, the Republic of Iceland, the Kingdom of Norway and the Kingdom of Sweden ("the Nordic countries").

The Fund was established in accordance with Article 18 of the Agreement Establishing the Bank. The objective of the Fund is to promote private sector development through support for small and medium-sized enterprises in Estonia, Latvia and Lithuania ("the Baltic States").

2 Significant accounting policies

i Accounting convention
The financial statements have been prepared under the historical cost convention and comply with International Accounting Standards.

ii Foreign currencies
Monetary assets and liabilities denominated in currencies other than ECU are translated into ECU at spot rates as at 31 December 1998. Non-monetary items are expressed in ECU at the exchange rates ruling at the time of transaction.

Exchange gains or losses arising from the translation of assets, liabilities and transactions during the year are taken to the profit and loss account.

For future accounting periods the unit of measurement for the presentation of the Fund's financial statements will be the euro, following the replacement of ECU from 1 January 1999.

iii Share investments
Share investments are carried at cost less provisions.

iv Provisions for losses and general portfolio risks
Specific provisions are made against identified loans representing a prudent estimate of that part of the outstanding balance that might not be recovered. For share investments, specific provisions are made as an estimate of any permanent diminution in value. General provisions in respect of possible losses on non-sovereign risk assets that are not specifically identified at year end are applied in two stages: at commitment and at disbursement. Portfolio risks provisions are made in respect of losses which, although not specifically identified, are judged to be inherent in the portfolio of contractual commitments (including guarantees), loans and share investments at the balance sheet date. Provisions made, less any amounts released during the year, are charged to the profit and loss account. The Fund's provisions are detailed in note 4. When a loan is deemed uncollectable or there is no possibility of recovery of a share investment, the principal is written off against the related provision. Subsequent recoveries are credited to the profit and loss account if previously written off.

v Interest, fees and commissions and dividends
Interest and commitment fees are recorded on an accruals basis. The Fund does not recognise income on loans where collectability is in doubt or payments of interest or principal are overdue more than 180 days for a sovereign loan and 60 days for a non-sovereign loan. Interest on such non-accrual loans is thereafter only recognised as income when actual payment is received. Front-end fees are recorded as income when the agreement is signed or the loan becomes effective, whichever is the later date. Commitment fees received in respect of services provided over a period of time are recorded as income over the period during which the commitment exists or the services are provided.

Dividends are recognised when received.

vi Derivative financial instruments
In the normal course of business the Fund is a party to contracts for derivative financial instruments including currency swap agreements. These instruments are used to manage the Fund's currency exposure on assets.

Profits and losses arising from financial instruments entered into for hedging purposes are matched against those arising on items being hedged.

3 Other operating expenses

Other operating expenses comprise administrative expenses directly relating to the Fund and include fees payable to the Bank for operating the Fund, calculated at 2.5 per cent of each contribution instalment received.

4 Provisions for losses and general portfolio risks

Profit and loss charges	Loans ECU 000	Share investments ECU 000	**1998 Total ECU 000**	1997 Total ECU 000
Provision charge this year:				
General provisions on				
Outstanding disbursements	(105)	260	**155**	374
Outstanding commitments	(29)	(149)	**(178)**	289
Specific provisions	–	–	**–**	(350)
Portfolio risks	(22)	10	**(12)**	25
For the year ended 31 December 1998	**(156)**	**121**	**(35)**	
For the year ended 31 December 1997	120	218		338

Movement in provisions	Loans ECU 000	Share investments ECU 000	**Total ECU 000**
At 1 January 1998	450	1,039	**1,489**
Provision charges	(156)	121	**(35)**
Foreign exchange adjustments	(18)	(2)	**(20)**
At 31 December 1998	**276**	**1,158**	**1,434**
Analysed between:			
General provisions on outstanding disbursements	194	869	**1,063**
Provisions for losses deducted from assets	194	869	**1,063**
General provisions on outstanding commitments	8	209	**217**
Portfolio risks	74	80	**154**
Provisions for general portfolio risks	82	289	**371**
At 31 December 1998	**276**	**1,158**	**1,434**

General provisions are based on a risk-rated approach for non-sovereign risk assets applied in two steps. An initial amount of 50 per cent of the provision is made at the time of commitment and the remaining 50 per cent at disbursement. The provision based on commitments is included, together with a general portfolio risk provision applied at a rate of 0.75 per cent against all commitments net of repayments, in 'Provisions for general portfolio risks'. General provisions made at disbursement together with specific provisions are shown as a deduction from the loans and share investments asset categories.

5 Other assets

	1998 ECU 000	1997 ECU 000
Interest receivable	**353**	472
Proceeds from sale of share investments	**–**	5,245
Other	**60**	46
At 31 December	**413**	5,763

6 Loans and share investments

Outstanding disbursements:	Loans ECU 000	Share investments ECU 000	**Total ECU 000**
At 1 January 1998	11,788	3,477	**15,265**
Disbursements made	643	3,771	**4,414**
Repayments	(2,890)	–	**(2,890)**
Foreign exchange adjustments	(235)	–	**(235)**
At 31 December 1998	**9,306**	**7,248**	**16,554**
Provisions as at 31 December 1998	(194)	(869)	**(1,063)**
Total net of provisions at 31 December 1998	**9,112**	**6,379**	**15,491**
Total net of provisions at 31 December 1997	11,475	2,868	14,343
Committed but not yet disbursed:			
At 31 December 1998	**430**	**3,481**	**3,911**
At 31 December 1997	1,081	5,995	7,076

7 Analysis of operational activity

Analysis by country	**Outstanding disbursements 1998 ECU 000**	Outstanding disbursements 1997 ECU 000	**Committed but not yet disbursed 1998 ECU 000**	Committed but not yet disbursed 1997 ECU 000
Estonia	**4,459**	6,273	**42**	42
Latvia	**1,294**	2,392	**114**	120
Lithuania	**5,153**	4,723	**274**	919
Regional	**5,648**	1,877	**3,481**	5,995
At 31 December	**16,554**	15,265	**3,911**	7,076

8 Contributions

Contributions pledged by the Nordic countries are set out below:	**1998 ECU 000**	1997 ECU 000
Cumulative contributions received		
Denmark	**8,940**	7,140
Finland	**8,629**	8,048
Iceland	**388**	388
Norway	**7,732**	6,240
Sweden	**14,414**	12,862
	40,103	34,678
Contributions due but not yet received		
Denmark	**–**	960
Iceland	**39**	–
Norway	**–**	810
Sweden	**1,358**	1,552
	1,397	3,322
Contributions pledged but not yet due		
Denmark	**–**	840
Finland	**–**	581
Iceland	**–**	39
Norway	**–**	682
Sweden	**–**	1,358
	–	3,500
At 31 December	**41,500**	41,500

Total contributions	**ECU 000**	**%**
Denmark	**8,940**	**21.6**
Finland	**8,629**	**20.8**
Iceland	**427**	**1.0**
Norway	**7,732**	**18.6**
Sweden	**15,772**	**38.0**
At 31 December	**41,500**	**100.0**

9 Net currency position

	ECU ECU 000	Deutsche marks ECU 000	Lithuanian litas ECU 000	United States dollars ECU 000	Other currencies ECU 000	**Total ECU 000**
Assets						
Placements with credit institutions	25,142	–	–	4,528	–	**29,670**
Other assets	180	83	–	150	–	**413**
Loans	–	4,429	–	4,683	–	**9,112**
Share investments	–	–	1,408	–	4,971	**6,379**
Contributions due but not yet received	1,397	–	–	–	–	**1,397**
Total assets	26,719	4,512	1,408	9,361	4,971	**46,971**
Liabilities						
Other liabilities	(41)	–	–	–	–	**(41)**
Provisions for general portfolio risks	(371)	–	–	–	–	**(371)**
Total liabilities	(412)	–	–	–	–	**(412)**
Net assets	26,307	4,512	1,408	9,361	4,971	**46,559**
Derivative financial instruments						
Cross currency swaps	2,175	(1,577)	–	(598)	–	–
Currency position at 31 December 1998	**28,482**	**2,935**	**1,408**	**8,763**	**4,971**	**46,559**
Currency position at 31 December 1997	31,566	5,658	1,600	4,786	1,877	45,487

10 Liquidity position

	Up to and including 1 month ECU 000	Over 1 month and up to and including 3 months ECU 000	Over 3 months and up to and including 1 year ECU 000	Over 1 year and up to and including 5 years ECU 000	Over 5 years ECU 000	Maturity undefined ECU 000	**Total ECU 000**
Assets							
Placements with credit institutions	29,670	–	–	–	–	–	**29,670**
Other assets	136	199	18	–	–	60	**413**
Loans	–	–	373	8,933	–	(194)	**9,112**
Share investments	–	–	–	–	–	6,379	**6,379**
Contributions due but not yet received	–	–	1,397	–	–	–	**1,397**
Total assets	29,806	199	1,788	8,933	–	6,245	**46,971**
Liabilities							
Other liabilities	–	(41)	–	–	–	–	**(41)**
Provisions for general portfolio risks	–	–	–	–	–	(371)	**(371)**
Contributors' resources	–	–	–	–	–	(46,559)	**(46,559)**
Total liabilities and contributors' resources	–	(41)	–	–	–	(46,930)	**(46,971)**
Liquidity position at 31 December 1998	**29,806**	**158**	**1,788**	**8,933**	**–**	**(40,685)**	**–**
Cumulative liquidity position at 31 December 1998	**29,806**	**29,964**	**31,752**	**40,685**	**40,685**	**–**	**–**
Cumulative liquidity position at 31 December 1997	24,521	24,801	28,345	39,574	40,133	–	–

11 Segment information

In accordance with IAS 14, the primary segment of the Fund is product and the secondary segment is geographical. At 31 December 1998, the activities of the Fund were comprised primarily of a single product (banking operations) and one geographic region (the Baltic States). Consequently, no additional disclosure is required.

Auditors' report to the European Bank for Reconstruction and Development

We have audited the balance sheet of The Baltic Investment Special Fund as of 31 December 1998, and the related profit and loss account, and statement of cash flows for the year then ended, on pages 83 to 87. The preparation of these financial statements is the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Fund as of 31 December 1998, and of the results of its operations and its cash flows for the year then ended, in accordance with International Accounting Standards.

Arthur Andersen
London, 9 March 1999

The Baltic Technical Assistance Special Fund

Statement of movements in fund balance

For the year ended 31 December 1998	Note	**Year to 31 December 1998 ECU 000**	Year to 31 December 1997 ECU 000
Balance brought forward		**2,649**	3,470
Contributions received	3	**566**	833
Interest and similar income		**104**	111
Transfer of interest income from The Baltic Investment Special Fund		**–**	1,090
		3,319	5,504
Disbursements	4	**(1,987)**	(2,805)
Other operating expenses	5	**(35)**	(50)
Balance of fund available		**1,297**	2,649

Balance sheet

At 31 December 1998	Note	**31 December 1998 ECU 000**	31 December 1997 ECU 000
Assets			
Placements with credit institutions	6	**1,064**	2,564
Other assets		**246**	96
Total assets		**1,310**	2,660
Liabilities			
Unallocated fund balance	7	**(935)**	(164)
Allocated fund balance	4	**2,232**	2,813
		1,297	2,649
Other liabilities		**13**	11
Total liabilities		**1,310**	2,660

Notes to the financial statements

1 Creation of the Special Fund

The Baltic Technical Assistance Special Fund ("the Fund") was created by and is administered under the terms of an Agreement dated 14 April 1992 ("the Fund Agreement") between the European Bank for Reconstruction and Development ("the Bank") and the Governments of the Kingdom of Denmark, the Republic of Finland, the Republic of Iceland, the Kingdom of Norway and the Kingdom of Sweden ("the Nordic countries").

The Fund was established in accordance with Article 18 of the Agreement Establishing the Bank. The objective of the Fund is to promote the development of a market economic system in Estonia, Latvia and Lithuania. In this respect, the Fund focuses on the development of small and medium-sized enterprises in the private sector.

2 Significant accounting policies

i Accounting convention
The financial statements have been prepared under the historical cost convention. Contributions and disbursements are accounted for on a cash basis. Interest income and operating expenses are accounted for on an accruals basis.

ii Foreign currencies
Disbursements in currencies other than ECU are translated into ECU at exchange rates ruling at the time of the transaction.

For future accounting periods the unit of measurement for the presentation of the Fund's financial statements will be the euro, following the replacement of ECU from 1 January 1999.

iii Completed projects
A project is defined as completed when all consultants involved have satisfied all contractual obligations and all invoices related to the project have been submitted for payment.

On completion of a project any committed amounts not disbursed are reassigned to the unallocated fund balance.

3 Contributions

Contributions pledged by the Nordic countries are set out below:	**1998 ECU 000**	1997 ECU 000
Contributions received during the year		
Denmark	**72**	248
Finland	**64**	172
Iceland	**4**	11
Norway	**277**	–
Sweden	**149**	402
At 31 December	**566**	833
Contributions due but not yet received		
Denmark	**21**	–
Norway	**–**	202
At 31 December	**21**	202
Contributions pledged but not yet due		
Denmark	**–**	93
Finland	**–**	64
Iceland	**–**	4
Norway	**–**	75
Sweden	**–**	149
At 31 December	**–**	385

Outstanding contributions were received from Denmark on 12 January 1999.

4 Allocated fund balance and disbursements

The allocated fund balance represents all commitments approved by the Bank under the terms of the Fund Agreement net of cumulative disbursements.	**Commitments approved ECU 000**	**Disbursements ECU 000**	**Allocated fund balance ECU 000**
Projects in operation			
At 1 January 1998	7,666	4,853	2,813
Movement in the year	(818)	(237)	(581)
At 31 December 1998	**6,848**	**4,616**	**2,232**
Completed projects			
At 1 January 1998	3,906	3,906	–
Movement in the year	2,224	2,224	–
At 31 December 1998	**6,130**	**6,130**	**–**
Total projects			
At 1 January 1998	11,572	8,759	2,813
Movement in the year	1,406	1,987	(581)
At 31 December 1998	**12,978**	**10,746**	**2,232**

5 Other operating expenses

Other operating expenses comprise administrative expenses directly related to the Fund and include fees payable to the Bank for operating the Fund, calculated at 5 per cent of each contribution instalment received.

6 Placements with credit institutions

All placements with credit institutions are call deposits and are denominated in ECU.

7 Unallocated fund balance

The unallocated fund balance will be funded from the contributions due but not yet received, the net income retained in the fund and transfers of net income from The Baltic Investment Special Fund.

Auditors' report to the European Bank for Reconstruction and Development

We have audited the balance sheet of The Baltic Technical Assistance Special Fund as of 31 December 1998, and the related movements in the fund balance for the year then ended, on pages 88 and 89. The preparation of these financial statements is the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Fund as of 31 December 1998, and the movements in the fund balance for the year then ended, on the basis set out in note 2.

Arthur Andersen

Arthur Andersen
London, 9 March 1999

The Russia Small Business Investment Special Fund

Profit and loss account

For the year ended 31 December 1998	Note	Year to 31 December 1998 ECU 000	Year to 31 December 1997 ECU 000
Interest and similar income			
From loans		**2,349**	2,062
Other interest		**1,170**	1,235
Interest expenses and similar charges		**(203)**	(282)
Foreign exchange		**(2,103)**	4,213
Other operating expenses	3	**(241)**	(147)
Operating profit before provisions		**972**	7,081
Provisions for losses	4	**(30,806)**	(7,910)
Loss for the year		**(29,834)**	(829)

Balance sheet

At 31 December 1998	Note	ECU 000	31 December 1998 ECU 000	ECU 000	31 December 1997 ECU 000
Assets					
Placements with credit institutions			**30,953**		20,866
Other assets			**925**		841
Loans and share investments					
Loans	5	**13,112**		15,072	
Share investments	5	**1,345**		880	
			14,457		15,952
Contributions due but not yet received	6		**4,287**		–
Contributions pledged but not yet due	6		**2,144**		1,196
Total assets			**52,766**		38,855
Liabilities					
Other liabilities			**1,425**		699
Provisions for losses on guaranteed parallel investments	4		**30,011**		–
Contributions	6		**58,707**		45,699
Reserves			**(7,543)**		(6,714)
Loss for the year			**(29,834)**		(829)
Contributors' resources			**21,330**		38,156
Total liabilities and contributors' resources			**52,766**		38,855
Memorandum items					
Commitments	7		**67,259**		65,486

Statement of changes in contributors' resources

For the year ended 31 December 1998	Contributions ECU 000	Accumulated loss ECU 000	Loss for the year ECU 000	Total ECU 000
At 31 December 1996	45,688	(3,041)	(3,673)	**38,974**
Exchange rate difference on conversion of contributions pledged but not yet received	11	–	–	**11**
Loss set aside from the prior year	–	(3,673)	3,673	**–**
Loss for the year	–	–	(829)	**(829)**
At 31 December 1997	45,699	(6,714)	(829)	**38,156**
Contributions replenishment	12,997	–	–	**12,997**
Exchange rate difference on conversion of contributions pledged but not yet received	11	–	–	**11**
Loss set aside from the prior year	–	(829)	829	**–**
Loss for the year	–	–	(29,834)	**(29,834)**
At 31 December 1998	**58,707**	**(7,543)**	**(29,834)**	**21,330**

Statement of cash flows

For the year ended 31 December 1998	ECU 000	Year to 31 December 1998 ECU 000	ECU 000	Year to 31 December 1997 ECU 000
Cash flows from operating activities				
Operating loss for the year	**(29,834)**		(829)	
Adjustments for:				
Provisions for losses	**30,806**		7,910	
Foreign exchange movements on provisions	**(829)**		882	
Guaranteed parallel investments written off	**(20)**		–	
Operating profit before changes in operating assets	**123**		7,963	
Increase in operating assets:				
Interest receivable	**(84)**		(471)	
Increase in other liabilities	**726**		69	
Net cash provided by operating activities		**765**		7,561
Cash flows from investing activities				
Proceeds from repayment of loans	**5,449**		1,370	
Funds advanced for loans and share investments	**(3,900)**		(18,952)	
Net cash provided/(used) by investing activities		**1,549**		(17,582)
Cash flows from financing activities				
Contributions	**7,773**		4,791	
Net cash provided by financing activities		**7,773**		4,791
Net increase/(decrease) in cash and cash equivalents		**10,087**		(5,230)
Cash and cash equivalents 1 January		**20,866**		26,096
Cash and cash equivalents 31 December		**30,953**		20,866

Notes to the financial statements

1 Creation of the Special Fund

The creation of the Russia Small Business Investment Special Fund ("the Fund") was approved by the Board of Directors ("the Board") of the European Bank for Reconstruction and Development ("the Bank") at its meeting of 18 October 1993 and is administered, *inter alia,* under the terms of Rules and Regulations of such Special Fund approved also by the Board on that date. The Fund became operational in 1994 when commitments by donors totalled US$ 3.0 million and the pilot phase of the programme was further extended during that year. An amendment to the Rules and Regulations was approved by the Board on 14 July 1994 to change the denomination of the Fund from ECU to United States dollars. The full-scale phase of the Russia Small Business Fund Programme was approved by the Board at its meeting of 30 August 1995 and a revised version of the Rules and Regulations of the Fund, in connection with the full-scale phase, was approved by the Board on 1 April 1996.

The Fund was established in accordance with Article 18 of the Agreement Establishing the Bank. The objective of the Fund is to assist the development of small businesses in the private sector in Russia.

2 Significant accounting policies

i Accounting convention
The financial statements have been prepared under the historical cost convention and comply with International Accounting Standards.

ii Foreign currencies
Monetary assets and liabilities denominated in currencies other than ECU are translated into ECU at spot rates as at 31 December 1998. Non-monetary items are expressed in ECU at the exchange rates ruling at the time of the transaction.

Contributions received are translated into ECU at the exchange rates ruling at the time of the transaction. Outstanding contributions are translated into ECU at spot rates as at 31 December 1998.

Exchange gains or losses arising from the translation of assets, liabilities and transactions during the year are taken to the profit and loss account.

For future accounting periods the unit of measurement for the presentation of the Fund's financial statements will be the euro, following the replacement of ECU from 1 January 1999.

iii Share investments
Share investments are carried at cost less provisions.

iv Provisions for losses
Specific provisions are made against identified loans representing a prudent estimate of that part of the outstanding balance that might not be recovered. For share investments, specific provisions are made as an estimate of any permanent diminution in value. Additional general provisions are made in respect of possible losses which, although not specifically identified, are judged to be inherent in the portfolio of contractual commitments (including guarantees), loans and share investments at the balance sheet date. Provisions made, less any amounts released during the year, are charged to the profit and loss account. The Fund's provisions are detailed in note 4. When a loan is deemed uncollectable or there is no possibility of recovery of a share investment, the principal is written off against the related provision. Subsequent recoveries are credited to the profit and loss account if previously written off.

v Interest and dividends
Interest is recorded on an accruals basis. The Fund does not recognise income on loans where collectability is in doubt or payments of interest or principal are overdue more than 180 days for a sovereign loan and 60 days for a non-sovereign loan. Interest on such non-accrual loans is thereafter only recognised as income when actual payment is received.

Dividends are recognised when received.

3 Other operating expenses

Other operating expenses comprise administrative expenses directly related to the Fund and include fees payable to the Bank for operating the Fund, calculated at 3 per cent of each contribution instalment received.

4 Provisions for losses

Profit and loss charges	Loans ECU 000	Share investments ECU 000	Total loans and shares ECU 000	Guarantees ECU 000	**1998 Total ECU 000**	1997 Total ECU 000
Provision charge this year:						
General provisions on outstanding disbursements	(1,133)	465	(668)	–	**(668)**	7,910
Specific provisions	1,443	–	1,443	30,031	**31,474**	–
For the year ended 31 December 1998	**310**	**465**	**775**	**30,031**	**30,806**	
For the year ended 31 December 1997	7,320	590	7,910	–		7,910

Movement in provisions	Loans ECU 000	Share investments ECU 000	Total loans and shares ECU 000	Guarantees ECU 000	**Total ECU 000**
At 1 January 1998	15,073	880	15,953	–	**15,953**
Provision charges	310	465	775	30,011	**30,786**
Foreign exchange adjustments	(829)	–	(829)	–	**(829)**
At 31 December 1998	14,554	1,345	15,899	30,011	**45,910**
Analysed between:					
General provisions on outstanding disbursements	14,554	1,345	15,899	–	**15,899**
Provisions for losses deducted from assets	14,554	1,345	15,899	–	**15,899**
Provisions for losses on guaranteed parallel investments	–	–	–	30,011	**30,011**
At 31 December 1998	14,554	1,345	15,899	30,011	**45,910**

In accordance with Section 5.04 (i) of the Rules and Regulations of the Fund, the Fund will bear losses arising on investments financed by the Fund and parallel investments by the Bank up to a maximum aggregate amount of US$ 75.0 million. Thereafter losses will be borne equally by the Fund and the Bank. Consequently, a general provision of 50 per cent is made for both loans and share investments at disbursement. In 1998, a specific provision totalling ECU 30.0 million was made following an assessment of the weaknesses of the financial positions of a number of the participating banks in the Russia Small Business Programme.

5 Loans and share investments

Outstanding disbursements:	Loans ECU 000	Share investments ECU 000	**Total ECU 000**
At 1 January 1998	30,145	1,760	**31,905**
Disbursements	4,608	930	**5,538**
Repayments	(5,449)	–	**(5,449)**
Foreign exchange adjustments	(1,638)	–	**(1,638)**
At 31 December 1998	**27,666**	**2,690**	30,356
Provisions at 31 December 1998	(14,554)	(1,345)	**(15,899)**
Total net of provisions at 31 December 1998	**13,112**	**1,345**	**14,457**
Total net of provisions at 31 December 1997	15,072	880	**15,952**
Committed but not yet disbursed:			
At 31 December 1998	**23,354**	**2,708**	**26,062**
At 31 December 1997	10,562	3,802	14,364

All loans and share investments are for projects in Russia.

At 31 December 1998 the Fund had three loans amounting to ECU 1.5 million (1997: nil) in non-accrual status due to overdue interest and principal repayments. Specific provisions amounting to ECU 1.4 million (1997: nil) have been made against these loans.

6 Contributions

Contributions pledged from the donor countries are set out below:	**1998** **ECU 000**	1997 ECU 000
Cumulative contributions received		
Canada	**2,707**	761
France	**5,323**	5,323
Germany	**9,843**	5,698
Italy	**8,401**	6,719
Japan	**21,162**	21,162
Switzerland	**2,360**	2,360
United States of America	**2,480**	2,480
	52,276	44,503
Contributions due but not yet received		
United States of America	**4,287**	–
	4,287	–
Contributions pledged but not yet due		
France	**2,144**	–
Germany	**–**	1,196
	2,144	1,196
At 31 December	**58,707**	45,699

Total contributions	**ECU 000**	**%**
Canada	**2,707**	**4.6**
France	**7,467**	**12.7**
Germany	**9,843**	**16.8**
Italy	**8,401**	**14.3**
Japan	**21,162**	**36.0**
Switzerland	**2,360**	**4.0**
United States of America	**6,767**	**11.6**
At 31 December	**58,707**	**100.0**

7 Commitments

At 31 December 1998, commitments included guarantees of ECU 41.2 million (1997: ECU 51.1 million) and loan and share investment commitments not yet disbursed of ECU 26.1 million (1997: ECU 14.4 million). The amount for guarantees represents the Fund's possible exposure in the event of losses arising on guaranteed parallel investments financed by the Bank as detailed in note 4 above.

8 Net currency position

	ECU ECU 000	Russian roubles ECU 000	United States dollars ECU 000	**Total** **ECU 000**
Assets				
Placements with credit institutions	9	–	30,944	**30,953**
Other assets	–	–	925	**925**
Loans	–	–	13,112	**13,112**
Share investments	–	1,345	–	**1,345**
Contributions due but not yet received	–	–	4,287	**4,287**
Contributions pledged but not yet due	2,144	–	–	**2,144**
Total assets	2,153	1,345	49,268	**52,766**
Liabilities				
Other liabilities	(144)	–	(1,281)	**(1,425)**
Provisions for losses on guaranteed parallel investments	–	–	(30,011)	**(30,011)**
Total liabilities	(144)	–	(31,292)	**(31,436)**
Currency position at 31 December 1998	**2,009**	**1,345**	**17,976**	**21,330**
Currency position at 31 December 1997	(16,055)	1,760	52,451	38,156

The Fund uses the ECU as the unit of measure for the presentation of its financial statements but the activities of the Fund are denominated in United States dollars.

9 Liquidity position

	Up to and including 1 month ECU 000	Over 1 month and up to and including 3 months ECU 000	Over 3 months and up to and including 1 year ECU 000	Over 1 year and up to and including 5 years ECU 000	Maturity undefined ECU 000	**Total ECU 000**
Assets						
Placements with credit institutions	30,953	–	–	–	–	**30,953**
Other assets	213	606	106	–	–	**925**
Loans	4,953	1,606	3,649	17,458	(14,554)	**13,112**
Share investments	–	–	–	–	1,345	**1,345**
Contributions due but not yet received	–	–	4,287	–	–	**4,287**
Contributions pledged but not yet due	–	–	2,144	–	–	**2,144**
Total assets	36,119	2,212	10,186	17,458	(13,209)	**52,766**
Liabilities						
Other liabilities	–	(144)	–	–	(1,281)	**(1,425)**
Provisions for losses on guaranteed parallel investments	–	–	–	–	(30,011)	**(30,011)**
Contributors' resources	–	–	–	–	(21,330)	**(21,330)**
Total liabilities and contributors' resources	–	(144)	–	–	(52,622)	**(52,766)**
Liquidity position at 31 December 1998	**36,119**	**2,068**	**10,186**	**17,458**	**(65,831)**	**–**
Cumulative liquidity position at 31 December 1998	**36,119**	**38,187**	**48,373**	**65,831**	**–**	**–**
Cumulative liquidity position at 31 December 1997	21,156	21,405	30,936	52,465	–	**–**

10 Segment information

In accordance with IAS 14, the primary segment of the Fund is product and the secondary segment is geographical. At 31 December 1998, the activities of the Fund were comprised primarily of a single product (banking operations) and one geographic region (Russia). Consequently, no additional disclosure is required.

Auditors' report to the European Bank for Reconstruction and Development

We have audited the balance sheet of The Russia Small Business Investment Special Fund as of 31 December 1998, and the related profit and loss account, and statement of cash flows for the year then ended, on pages 90 to 94. The preparation of these financial statements is the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Fund as of 31 December 1998, and of the results of its operations and its cash flows for the year then ended, in accordance with International Accounting Standards.

Arthur Andersen
London, 9 March 1999

The Russia Small Business Technical Cooperation Special Fund

Statement of movements in fund balance

For the year ended 31 December 1998	Note	Year to 31 December 1998 ECU 000	Year to 31 December 1997 ECU 000
Balance brought forward		**21,825**	7,439
Contributions received	3	**1,600**	23,545
Interest and similar income		**885**	996
Transfer of contributions from The Russia Small Business Investment Special Fund		**–**	375
		24,310	32,355
Disbursements	4	**(9,330)**	(12,138)
Other operating expenses	5	**(50)**	(721)
Foreign exchange		**(289)**	2,329
Balance of fund available		**14,641**	21,825

Balance sheet

At 31 December 1998	Note	31 December 1998 ECU 000	31 December 1997 ECU 000
Assets			
Placements with credit institutions	6	**14,627**	21,750
Other assets		**54**	97
Total assets		**14,681**	21,847
Liabilities			
Unallocated fund balance		**12,675**	9,191
Allocated fund balance	4	**1,966**	12,634
		14,641	21,825
Other liabilities		**40**	22
Total liabilities		**14,681**	21,847

Notes to the financial statements

1 Creation of the Special Fund

The creation of The Russia Small Business Technical Cooperation Special Fund ("the Fund") was approved by the Board of Directors ("the Board") of the European Bank for Reconstruction and Development ("the Bank") at its meeting of 18 October 1993 and is administered, *inter alia,* under the terms of Rules and Regulations of such Special Fund approved also by the Board on that date. An amendment to the Rules and Regulations was approved by the Board on 14 July 1994 to change the denomination of the Fund from ECU to United States dollars. The full-scale phase of The Russia Small Business Programme was approved by the Board at its meeting of 30 August 1995 and a revised version of the Rules and Regulations of the Fund, in connection with the full-scale phase, was approved by the Board on 1 April 1996.

The Fund was established in accordance with Article 18 of the Agreement Establishing the Bank. The objective of the Fund is to finance technical cooperation for the design and implementation of the pilot, extended pilot and full-scale phase operations of The Russia Small Business Investment Special Fund.

2 Significant accounting policies

i Accounting convention
The financial statements have been prepared under the historical cost convention. Contributions and disbursements are accounted for on a cash basis. Interest income and operating expenses are accounted for on an accruals basis.

ii Foreign currencies
Monetary assets and liabilities in currencies other than ECU are translated into ECU at spot rates as at 31 December 1998. Transactions in currencies other than ECU, including disbursements, are translated into ECU at month-end exchange rates. Commitments are translated into ECU at spot rates as at 31 December 1998.

Exchange gains and losses arising from the translation of assets, liabilities and transactions during the year are taken to the statement of movements in fund balance.

For future accounting periods the unit of measurement for the presentation of the Fund's financial statements will be the euro, following the replacement of ECU from 1 January 1999.

iii Completed projects
A project is defined as completed when all consultants involved have satisfied all contractual obligations and all invoices related to the project have been submitted for payment.

On completion of a project any committed amounts not disbursed are reassigned to the unallocated fund balance.

3 Contributions

Contributions pledged by the donor countries are set out below:	**1998** **ECU 000**	1997 ECU 000
Contributions received during the year		
Canada	**–**	2,849
France	**–**	1,261
Germany	**1,561**	–
United Kingdom	**39**	889
United States of America	**–**	18,546
At 31 December	**1,600**	23,545
Contributions pledged but not yet due		
France	**2,144**	–
Germany	**–**	299
At 31 December	**2,144**	299

4 Allocated fund balance and disbursements

The allocated fund balance represents all commitments approved by the Bank under the terms of the Fund Agreement net of cumulative disbursements.	**Commitments approved ECU 000**	**Disbursements ECU 000**	**Allocated fund balance ECU 000**
Projects in operation			
At 1 January 1998	28,050	15,416	12,634
Movement in the year	(11,529)	(861)	(10,668)
At 31 December 1998	**16,521**	**14,555**	**1,966**
Completed projects			
At 1 January 1998	10,770	10,770	–
Movement in the year	10,191	10,191	–
At 31 December 1998	**20,961**	**20,961**	**–**
Total projects			
At 1 January 1998	38,820	26,186	12,634
Movement in the year	(1,338)	9,330	(10,668)
At 31 December 1998	**37,482**	**35,516**	**1,966**

5 Other operating expenses

Other operating expenses comprise administrative expenses directly related to the Fund and include fees payable to the Bank for operating the Fund, calculated at 3 per cent of each contribution instalment received.

6 Placements with credit institutions

All placements with credit institutions are call deposits and are denominated in United States dollars.

Auditors' report to the European Bank for Reconstruction and Development

We have audited the balance sheet of The Russia Small Business Technical Cooperation Special Fund as of 31 December 1998, and the related movements in the fund balance for the year then ended, on pages 95 and 96. The preparation of these financial statements is the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Fund as of 31 December 1998, and the movements in the fund balance for the year then ended, on the basis set out in note 2.

Arthur Andersen

Arthur Andersen
London, 9 March 1999

The Moldova Micro Business Investment Special Fund

Profit and loss account

For the year ended 31 December 1998	Note	Year to 31 December 1998 ECU 000	Year to 31 December 1997 ECU 000
Interest and similar income			
From loans		**83**	26
Other interest		**28**	63
Net fee and commission income		**3**	6
Foreign exchange		**(52)**	159
Other operating expenses	3	**(10)**	(39)
Operating profit before provisions		**52**	215
Provisions for losses	4	**(281)**	(303)
Loss for the year		**(229)**	(88)

Balance sheet

At 31 December 1998	Note	31 December 1998 ECU 000	31 December 1997 ECU 000
Assets			
Placements with credit institutions		**366**	892
Other assets		**32**	20
Loans	5	**570**	319
Total assets		**968**	1,231
Liabilities			
Other liabilities		**5**	39
Contributions	6	**1,261**	1,261
Reserves		**(69)**	19
Loss for the year		**(229)**	(88)
Contributor's resources		**963**	1,192
Total liabilities and contributor's resources		**968**	1,231
Memorandum items			
Commitments	7	**1,372**	1,287

Statement of changes in contributor's resources

For the year ended 31 December 1998	Contributions ECU 000	Accumulated profit/(loss) ECU 000	Loss for the year ECU 000	Total ECU 000
At 31 December 1996	1,261	–	19	**1,280**
Profit set aside from the prior period	–	19	(19)	**–**
Loss for the year	–	–	(88)	**(88)**
At 31 December 1997	1,261	19	(88)	**1,192**
Loss set aside from the prior year	–	(88)	88	**–**
Loss for the year	–	–	(229)	**(229)**
At 31 December 1998	**1,261**	**(69)**	**(229)**	**963**

Statement of cash flows

For the year ended 31 December 1998	ECU 000	Year to 31 December 1998 ECU 000	ECU 000	Year to 31 December 1997 ECU 000
Cash flows from operating activities				
Operating loss for the year	**(229)**		(88)	
Adjustments for:				
Provisions for losses	**281**		303	
Foreign exchange movements on provisions	**(31)**		3	
Operating profit before changes in operating assets	**21**		218	
Increase in operating assets:				
Interest receivable	**(12)**		(15)	
(Decrease)/increase in other liabilities	**(34)**		38	
Net cash (used)/provided by operating activities		**(25)**		241
Cash flows from investing activities				
Proceeds from repayment of loans	**55**		–	
Funds advanced for loans	**(556)**		(612)	
Net cash used by investing activities		**(501)**		(612)
Net decrease in cash and cash equivalents		**(526)**		(371)
Cash and cash equivalents 1 January		**892**		1,263
Cash and cash equivalents 31 December		**366**		892

Notes to the financial statements

1 Creation of the Special Fund

The Moldova Micro Business Investment Special Fund ("the Fund") was created by and is administered under the terms of an Agreement dated 3 September 1996 ("the Fund Agreement") between the European Bank for Reconstruction and Development ("the Bank") and the Government of Switzerland (the "Government" or the "Swiss Government") .

The Fund was established in accordance with Article 18 of the Agreement Establishing the Bank. The objective of the Fund is to assist the development of micro businesses through support for small and medium-sized enterprises in the Republic of Moldova.

2 Significant accounting policies

i Accounting convention
The financial statements have been prepared under the historical cost convention and comply with International Accounting Standards.

ii Foreign currencies
Monetary assets and liabilities denominated in currencies other than ECU are translated into ECU at spot rates as at 31 December 1998. Non-monetary items are expressed in ECU at the exchange rates ruling at the time of the transaction.

Contributions received are translated into ECU at the exchange rates ruling at the time of the transaction.

Exchange gains or losses arising from the translation of assets, liabilities and transactions during the year are taken to the profit and loss account.

For future accounting periods the unit of measurement for the presentation of the Fund's financial statements will be the euro, following the replacement of ECU from 1 January 1999.

iii Provisions for losses
Specific provisions are made against identified loans representing a prudent estimate of that part of the outstanding balance that might not be recovered. General provisions are made in respect of possible losses which, although not specifically identified, are judged to be inherent in the portfolio of contractual commitments (including guarantees) and loans at the balance sheet date. Provisions made, less any amounts released during the year, are charged to the profit and loss account. The Fund's provisions are detailed in note 4. When a loan is deemed uncollectable the principal is written off against the related provision. Subsequent recoveries are credited to the profit and loss account if previously written off.

iv Interest, fees and commissions
Interest is recorded on an accruals basis. The Fund does not recognise income on loans where collectability is in doubt or payments of interest or principal are overdue more than 180 days for a sovereign loan and 60 days for a non-sovereign loan. Interest on such non-accrual loans is thereafter only recognised as income when actual payment is received. Commitment fees received in respect of services provided over a period of time are recorded as income over the period during which the commitment exists or the services are provided.

3 Other operating expenses

Other operating expenses comprise administrative expenses directly related to the Fund and include fees payable to the Bank for operating the Fund, calculated at 3 per cent of each contribution received.

4 Provisions for losses

Profit and loss charges	**Loans ECU 000**
Provision charge this year:	
General provisions on	
Outstanding disbursements	**281**
For the year ended 31 December 1998	**281**
For the year ended 31 December 1997	303

Movement in provisions	**Loans ECU 000**
At 1 January 1998	**319**
Provision charges	**281**
Foreign exchange adjustments	**(31)**
At 31 December 1998	**569**

In accordance with Section 5.04 of the Rules and Regulations of the Fund, the Fund will bear losses arising on investments financed by the Fund and parallel investments by the Bank up to a maximum of 75 per cent of the Fund value. Thereafter losses will be borne equally by the Fund and the Bank. Consequently, a general provision of 50 per cent is made for loans at disbursement.

5 Loans

Outstanding disbursements:	**Loans ECU 000**
At 1 January 1998	**638**
Disbursements	**590**
Repayments	**(55)**
Foreign exchange adjustments	**(34)**
At 31 December 1998	**1,139**
Provisions at 31 December 1998	**(569)**
Total net of provisions at 31 December 1998	**570**
Total net of provisions at 31 December 1997	319
Committed but not yet disbursed:	
At 31 December 1998	**178**
At 31 December 1997	87

All loans are for projects in Moldova.

6 Contributions

Contributions payable per the Fund Agreement were received in full from the Swiss Government in 1996.

7 Commitments

At 31 December 1998, commitments included guarantees and loan commitments not yet disbursed. The amount for guarantees represents the Fund's possible exposure in the event of losses arising on guaranteed parallel investments financed by the Bank as detailed in note 4 above. The guarantee is limited to the aggregate amount contributed to the Fund.

8 Net currency position

	ECU ECU 000	United States dollars ECU 000	**Total ECU 000**
Assets			
Placements with credit institutions	–	366	**366**
Other assets	–	32	**32**
Loans	–	570	**570**
Total assets	–	968	**968**
Liabilities			
Other liabilities	(5)	–	**(5)**
Total liabilities	(5)	–	**(5)**
Currency position at 31 December 1998	**(5)**	**968**	**963**
Currency position at 31 December 1997	(358)	1,550	1,192

The Fund uses the ECU as the unit of measure for the presentation of its financial statements but the activities of the Fund are denominated in United States dollars.

9 Liquidity position

	Up to and including 1 month ECU 000	Over 1 month and up to and including 3 months ECU 000	Over 1 year and up to and including 5 years ECU 000	Maturity undefined ECU 000	**Total ECU 000**
Assets					
Placements with credit institutions	366	–	–	–	**366**
Other assets	1	31	–	–	**32**
Loans	–	–	1,139	(569)	**570**
Total assets	367	31	1,139	(569)	**968**
Liabilities					
Other liabilities	–	(5)	–	–	**(5)**
Contributor's resources	–	–	–	(963)	**(963)**
Total liabilities and contributor's resources	–	(5)	–	(963)	**(968)**
Liquidity position at 31 December 1998	**367**	**26**	**1,139**	**(1,532)**	**–**
Cumulative liquidity position at 31 December 1998	**367**	**393**	**1,532**	**–**	**–**
Cumulative liquidity position at 31 December 1997	896	873	1,511	–	–

10 Segment information

In accordance with IAS 14, the primary segment of the Fund is product and the secondary segment is geographical. At 31 December 1998, the activities of the Fund were comprised primarily of a single product (banking operations) and one geographic region (Moldova). Consequently, no additional disclosure is required.

Auditors' report to the European Bank for Reconstruction and Development

We have audited the balance sheet of The Moldova Micro Business Investment Special Fund as of 31 December 1998, and the related profit and loss account, and statement of cash flows for the year then ended, on pages 97 to 99. The preparation of these financial statements is the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Fund as of 31 December 1998, and of the results of its operations and its cash flows for the year then ended, in accordance with International Accounting Standards.

Arthur Andersen

Arthur Andersen
London, 9 March 1999

The EBRD Technical Cooperation Special Fund

Statement of movements in fund balance

For the year ended 31 December 1998	Note	Year to 31 December 1998 ECU 000	Year to 31 December 1997 ECU 000
Balance brought forward		**615**	247
Contributions received	3	**21**	452
Interest and similar income		**19**	12
		655	711
Disbursements	4	**(240)**	(84)
Other operating expenses	5	**(19)**	(12)
Balance of fund available		**396**	615

Balance sheet

At 31 December 1998	Note	31 December 1998 ECU 000	31 December 1997 ECU 000
Assets			
Placements with credit institutions	6	**401**	618
Other assets		**1**	2
Total assets		**402**	620
Liabilities			
Unallocated fund balance		**97**	447
Allocated fund balance	4	**299**	168
		396	615
Other liabilities		**6**	5
Total liabilities		**402**	620

Notes to the financial statements

1 Creation of the Special Fund

The creation of The EBRD Technical Cooperation Special Fund ("the Fund") was approved by the Board of Directors ("the Board") of the European Bank for Reconstruction and Development ("the Bank") at its meeting of 12/13 September 1995 and is administered under the terms of Rules and Regulations of such Special Fund approved also by the Board on that date. The Fund became active in June 1996, following the receipt of the first contribution.

The Fund was established in accordance with Article 18 of the Agreement Establishing the Bank. The objective of the Fund is to serve as a facility for financing technical cooperation projects in the Bank's countries of operations.

2 Significant accounting policies

i Accounting convention
The financial statements have been prepared under the historical cost convention. Contributions and disbursements are accounted for on a cash basis. Interest income and operating expenses are accounted for on an accruals basis.

ii Foreign currencies
Disbursements in currencies other than ECU are translated into ECU at exchange rates ruling at the time of the transaction. Commitments net of disbursements made, in currencies other than ECU, are translated at spot rates as at 31 December 1998.

For future accounting periods the unit of measurement for the presentation of the Fund's financial statements will be the euro, following the replacement of ECU from 1 January 1999.

iii Completed projects
A project is defined as completed when all consultants involved have satisfied all contractual obligations and all invoices related to the project have been submitted for payment.

On completion of a project any committed amounts not disbursed are reassigned to the unallocated fund balance.

3 Contributions received

Contributions received during the year include repayments made by various private sector beneficiaries. In accordance with the Rules and Regulations of the Fund, contributions may only be received from Donors which have signed a Contribution Agreement with the Bank. As at 31 December 1998, nine Donors have signed such an agreement as follows:

Canada
Finland
Ireland
Israel
Norway
Portugal
Sweden
Switzerland
United Kingdom

4 Allocated fund balance and disbursements

The allocated fund balance represents all commitments approved by the Bank under the terms of the Fund Agreement net of cumulative disbursements.

	Commitments approved ECU 000	Disbursements ECU 000	Allocated fund balance ECU 000
Projects in operation			
At 1 January 1998	252	84	168
Movement in the year	157	26	131
At 31 December 1998	**409**	**110**	**299**
Completed projects			
At 1 January 1998	–	–	–
Movement in the year	214	214	–
At 31 December 1998	**214**	**214**	**–**
Total projects			
At 1 January 1998	252	84	168
Movement in the year	371	240	131
At 31 December 1998	**623**	**324**	**299**

5 Other operating expenses

Other operating expenses comprise administrative expenses directly related to the Fund and include fees payable to the Bank for operating the Fund. The fee is set at a level such that it should not exceed interest income net of direct costs.

6 Placements with credit institutions

All placements with credit institutions are call deposits and are denominated in ECU.

Auditors' report to the European Bank for Reconstruction and Development

We have audited the balance sheet of The EBRD Technical Cooperation Special Fund as of 31 December 1998, and the related movements in the fund balance for the year then ended, on pages 100 and 101. The preparation of these financial statements is the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Fund as of 31 December 1998, and the movements in the fund balance for the year then ended, on the basis set out in note 2.

Arthur Andersen
London, 9 March 1999

The Financial Intermediary Investment Special Fund

Profit and loss account

For the year ended 31 December 1998	Note	Year to 31 December 1998 ECU 000	Period to 31 December 1997 ECU 000
Interest and similar income			
Other interest		**110**	29
Foreign exchange		**(217)**	68
Other operating expenses	3	**(65)**	(14)
Operating (loss)/profit before provisions		**(172)**	83
Provisions for losses	4	**–**	(62)
(Loss)/profit for the period		**(172)**	21

Balance sheet

At 31 December 1998	Note	31 December 1998 ECU 000	31 December 1997 ECU 000
Assets			
Placements with credit institutions		**4,246**	1,063
Other assets		**15**	2
Share investments	5	**1,470**	1,470
Contributions pledged but not yet due	6	**6,859**	–
Total assets		**12,590**	2,535
Liabilities			
Other liabilities		**51**	760
Provisions for general portfolio risks	4	**17**	17
Contributions	6	**12,673**	1,737
Reserves		**21**	–
(Loss)/profit for the period		**(172)**	21
Contributors' resources		**12,522**	1,758
Total liabilities and contributors' resources		**12,590**	2,535
Memorandum items			
Commitments	5	**243**	240

Statement of changes in contributors' resources

For the year ended 31 December 1998	Contributions ECU 000	Accumulated profit ECU 000	Profit/(loss) for the period ECU 000	Total ECU 000
Contribution agreements	1,737	–	–	**1,737**
Profit for the period	–	–	21	**21**
At 31 December 1997	1,737	–	21	**1,758**
Contribution agreement	10,936	–	–	**10,936**
Profit set aside from the prior period	–	21	(21)	**–**
Loss for the year	–	–	(172)	**(172)**
At 31 December 1998	**12,673**	**21**	**(172)**	**12,522**

Statement of cash flows

For the year ended 31 December 1998	ECU 000	Year to 31 December 1998 ECU 000	ECU 000	Period to 31 December 1997 ECU 000
Cash flows from operating activities				
Operating (loss)/profit for the period	**(172)**		21	
Adjustment for:				
Provisions for losses	**–**		62	
Operating (loss)/profit before changes in operating assets	**(172)**		83	
Increase in operating assets:				
Interest receivable	**(13)**		(2)	
Increase in other liabilities	**41**		10	
Net cash (used)/provided by operating activities		**(144)**		91
Cash flows from investing activities				
Funds advanced for share investments	**(750)**		(765)	
Net cash used by investing activities		**(750)**		(765)
Cash flows from financing activities				
Contributions	**4,077**		1,737	
Net cash provided by financing activities		**4,077**		1,737
Net increase in cash and cash equivalents		**3,183**		1,063
Cash and cash equivalents 1 January		**1,063**		–
Cash and cash equivalents 31 December		**4,246**		1,063

Notes to the financial statements

1 Creation of the Special Fund

The creation of The Financial Intermediary Investment Special Fund ("the Fund") was approved by the Board of Directors ("the Board") of the European Bank for Reconstruction and Development ("the Bank") at its meeting of 16 December 1996 and is administered, *inter alia,* under the terms of Rules and Regulations of such Special Fund approved by the Board on that date. The Fund became operational on 22 May 1997 following the receipt of the first contributions.

The Fund was established in accordance with Article 18 of the Agreement Establishing the Bank. The objective of the Fund is to support financial intermediaries in the Bank's countries of operations by investing in their capital.

2 Significant accounting policies

i Accounting convention
The financial statements have been prepared under the historical cost convention and comply with International Accounting Standards.

ii Foreign currencies
Monetary assets and liabilities denominated in currencies other than ECU are translated into ECU at spot rates as at 31 December 1998. Non-monetary items are expressed in ECU at the exchange rates ruling at the time of the transaction.

Contributions received are translated into ECU at the exchange rates ruling at the time of the transaction. Outstanding contributions are translated into ECU at spot rates as at 31 December 1998.

Exchange gains or losses arising from the translation of assets, liabilities and transactions during the year are taken to the profit and loss account.

For future accounting periods the unit of measurement for the presentation of the Fund's financial statements will be the euro, following the replacement of ECU from 1 January 1999.

iii Share investments
Share investments are carried at cost less provisions. Dividends are recognised when received.

iv Provisions for losses and general portfolio risks
For share investments, specific provisions are made as an estimate of any permanent diminution in value. General provisions in respect of possible losses on non-sovereign risk assets that are not specifically identified at year end are applied in two stages: at commitment and at disbursement. Portfolio risks provisions are made in respect of losses which, although not specifically identified, are judged to be inherent in the portfolio of contractual commitments and share investments at the balance sheet date. Provisions made, less any amounts released during the year, are charged to the profit and loss account. The Fund's provisions are detailed in note 4. When there is no possibility of recovery of a share investment, the principal is written off against the related provision. Subsequently recoveries are credited to the profit and loss account if previously written off.

3 Other operating expenses

Other operating expenses comprise administrative expenses directly relating to the Fund and include fees payable to the Bank for operating the Fund, calculated in accordance with Contribution Agreements with individual Donors.

4 Provisions for losses and general portfolio risks

Profit and loss charges	**1998 Share investments ECU 000**	1997 Share investments ECU 000
Provision charge this year:		
General provisions on		
Outstanding disbursements	–	45
Outstanding commitments	–	4
Portfolio risks	–	13
For the year ended 31 December 1998	**–**	
For the period ended 31 December 1997		62

Movement in provisions	**Share investments ECU 000**
At 1 January 1998	**62**
Provision charges	**–**
Foreign exchange adjustments	**–**
At 31 December 1998	**62**
Analysed between:	
General provisions on outstanding disbursements	**45**
Provisions for losses deducted from assets	**45**
General provisions on outstanding commitments	**4**
Portfolio risks	**13**
Provisions for general portfolio risks	**17**
At 31 December 1998	**62**

General provisions are based on a risk-rated approach for non-sovereign risk assets applied in two steps. An initial amount of 50 per cent of the provision is made at the time of commitment and the remaining 50 per cent at disbursement. The provision based on commitments is included, together with a general portfolio risk provision applied at a rate of 0.75 per cent against all commitments net of repayments, in 'Provisions for general portfolio risks'. General provisions made at disbursement together with specific provisions are shown as a deduction from the share investments asset category.

5 Share investments

Outstanding disbursements:	Share investments ECU 000
At 1 January 1998	**1,515**
Disbursements	**–**
At 31 December 1998	**1,515**
Provisions as at 31 December 1998	**(45)**
Total net of provisions at 31 December 1998	**1,470**
Total net of provisions at 31 December 1997	1,470
Committed but not yet disbursed:	
At 31 December 1998	**243**
At 31 December 1997	240

All share investments are for projects in Slovenia.

6 Contributions

Contributions pledged by the donor countries are set out below:	1998 ECU 000	1997 ECU 000
Cumulative contributions received		
Taipei China	**4,077**	–
United States of America	**1,737**	1,737
	5,814	1,737
Contributions pledged but not yet due		
Taipei China	**6,859**	–
	6,859	–
At 31 December	**12,673**	1,737

Total contributions	ECU 000	%
Taipei China	**10,936**	**86.3**
United States of America	**1,737**	**13.7**
At 31 December	**12,673**	**100.0**

7 Net currency position

	ECU ECU 000	Netherlands guilders ECU 000	Slovenian tolars ECU 000	United States dollars ECU 000	Total ECU 000
Assets					
Placements with credit institutions	–	255	–	3,991	**4,246**
Other assets	–	1	–	14	**15**
Share investments	–	–	1,470	–	**1,470**
Contributions pledged but not yet due	–	–	–	6,859	**6,859**
Total assets	–	256	1,470	10,864	**12,590**
Liabilities					
Other liabilities	(47)	–	–	(4)	**(51)**
Provisions for general portfolio risks	(17)	–	–	–	**(17)**
Total liabilities	(64)	–	–	(4)	**(68)**
Currency position at 31 December 1998	**(64)**	**256**	**1,470**	**10,860**	**12,522**
Currency position at 31 December 1997	(63)	862	765	194	1,758

The Fund uses the ECU as the unit of measure for the presentation of its financial statements but the activities of the Fund are denominated in United States dollars.

8 Liquidity position

	Up to and including 1 month ECU 000	Over 1 month and up to and including 3 months ECU 000	Maturity undefined ECU 000	**Total ECU 000**
Assets				
Placements with credit institutions	4,246	–	–	**4,246**
Other assets	15	–	–	**15**
Share investments	–	–	1,470	**1,470**
Contributions pledged but not yet due	–	–	6,859	**6,859**
Total assets	**4,261**	**–**	**8,329**	**12,590**
Liabilities				
Other liabilities	–	(51)	–	**(51)**
Provisions for general portfolio risks	–	–	(17)	**(17)**
Contributors' resources	–	–	(12,522)	**(12,522)**
Total liabilities and contributors' resources	**–**	**(51)**	**(12,539)**	**(12,590)**
Liquidity position at 31 December 1998	**4,261**	**(51)**	**(4,210)**	**–**
Cumulative liquidity position at 31 December 1998	**4,261**	**4,210**	**–**	**–**
Cumulative liquidity position at 31 December 1997	315	305	–	–

9 Segment information

In accordance with IAS 14, the primary segment of the Fund is product and the secondary segment is geographical. At 31 December 1998, the activities of the Fund were comprised primarily of a single product (banking operations) and one geographic region (Slovenia). Consequently, no additional disclosure is required.

Auditors' report to the European Bank for Reconstruction and Development

We have audited the balance sheet of The Financial Intermediary Investment Special Fund as of 31 December 1998, and the related profit and loss account, and statement of cash flows for the year then ended, on pages 102 to 105. The preparation of these financial statements is the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Fund as of 31 December 1998, and of the results of its operations and its cash flows for the year then ended, in accordance with International Accounting Standards.

Arthur Andersen

Arthur Andersen
London, 9 March 1999

Projects approved in 1998

at 31 December 1998

Albania

Albania Reconstruction Equity Fund

The first Albanian non-banking financial institution to provide medium to long-term financing for SMEs.

Finance • FI • Shares
Approved 15 September
Funds approved 6.0 • Total Investment 14.6

Armenia

ArmenTel Privatisation

To expand and modernise the national telecoms network. This represents the first utility privatisation in Armenia, and by far the largest direct foreign investment.

Telecommunications • B/0 • Shares
Approved 21 July
Funds approved 66.5 • Total Investment 250.9

Azerbaijan

Chirag Oil Project

For the "early oil" phase of production in the Chirag oilfield, by an international consortium, to increase Azerbaijan's production and export of crude oil.

Oil and gas production • A/1 • Loan
Approved 14 July

AMOCO Caspian Sea Finance Ltd

Signed 17 December
Funds approved 28.2 • Total investment 513.4

LUKOIL Overseas

Signed 30 December
Funds approved 16.5 • Total investment 302.0

Turkish Petroleum

Signed 17 December
Funds approved 11.2 • Total investment 203.5

UNOCAL

Signed 17 December
Funds approved 16.6 • Total investment 303.6

Early Oil Finance Co

Signed 17 December
Funds approved 13.2 • Total investment 241.1

Bosnia and Herzegovina

Telecommunications Emergency Reconstruction Project

To re-establish access to telecoms services in war-damaged areas. The project will also prepare the way for sector restructuring and eventual privatisation.

Telecommunications • B/0 • Loan
Approved 28 April • Signed 3 June
Funds approved 18.1 • Total investment 43.8

Bulgaria

Domaine Boyar A.D.

Modernisation and expansion of the production facilities of two wineries and construction of a third greenfield winery. This is the first major private investment in Bulgaria's wine sector.

Food • B/1 • Loan and shares
Approved 30 June • Signed 29 July
Funds approved 18.0 • Total investment 52.8

Celhart AD

Rehabilitation and modernisation of kraft paper and sack production facilities of the sole kraft paper producer in Bulgaria.

Forest and paper • B/1 • Loan and shares
Approved 15 September • Signed 12 November
Funds approved 13.2 • Total investment 39.3

Croatia

Slavonska Banka d.d. Osijek

To achieve final privatisation and stabilisation of the major commercial bank in Slavonija, a region badly affected by the war. This is the first privatisation of a rehabilitated bank in Croatia.

Finance • FI • Loan and shares
Approved 7 April • Signed 17 July
Funds approved 9.6 • Total investment 20.8

Zagrebacka Banka – Mortgage Finance Facility

To enable Croatia's largest bank to make long-term housing loans to private customers, allowing more people to buy or renovate their homes.

Finance • FI • Loan
Approved 7 April • Signed 27 April
Funds approved 51.1 • Total investment 102.2

Podravka Restructuring

Investment in Podravka d.d, a food company based in Koprivnica, to support restructuring and to finance a plant for the production of Vegeta seasoning.

Food • B/1 • Shares
Approved 2 June • Signed 10 July
Funds approved 25.5 • Total investment 149.7

Zagreb Landfill Rehabilitation Programme

New waste disposal facilities to improve, to EU environmental standards, one of the largest uncontrolled landfills in Europe, which has been in use for over 30 years.

Environment • B/1 • Loan
Approved 14 July • Signed 18 November
Funds approved 48.8 • Total investment 88.4

Croatian Railways Modernisation and Restructuring Project

Priority investments to improve competitiveness, supported by railway restructuring and commerciali-sation measures to improve financial and operational performance.

Rail track and structures • B/0 • Loan
Approved 1 December • Signed 8 December
Funds approved 30.0 • Total investment 200.6

Bank Austria Kreditanstalt Croatia d.d. – Capital Increase

Participation in capital increase.

Finance • FI • Shares
Approved 15 December • Signed 23 December
Funds approved 4.4 • Total investment 4.4

Czech Republic

CS Pre-Privatisation Equity

The investment should stabilise the ownership structure of the second-largest Czech bank, enhancing its attractiveness to potential investors before privatisation.

Finance • FI • Shares
Approved 2 June • Signed 9 June
Funds approved 67.0 • Total investment 70.4

Guide
The three lines following project descriptions show:

Sector • Environmental screening category • Type of financing
Date of Board approval • Date of signing if before 9 March 1999
EBRD funds approved • Total project investment (in ECU million)

Loans are calculated at exchange rates current at 31 December 1998.

Shares are converted to ECU at exchange rates current at the date of disburse-ment. This may lead to a discrepancy between EBRD funds and total investment.

The totals may not add up to the sum of the component parts due to rounding.

Environmental screening categories

The project requires:

A – a full environmental screening impact assessment
B – an environmental assessment
C – no environmental impact assessment or environmental analysis
0 – no environmental audit
1 – an environmental audit

FI – Financial institutions

Estonia

Eesti Uhispank Line of Credit

Long-term credit line.

Finance • FI • Loan
Approved 28 April • Signed 29 April
Funds approved 16.6 • Total investment 20.4

AS Norma

To increase competitiveness by modernising equipment and renovating facilities at a car safety belt manufacturer. It will also improve environmental standards.

Light manufacturing • B/1 • Loan
Approved 28 April • Signed 29 May
Funds approved 6.6 • Total investment 7.7

Hansapank Convertible Sub Debt

Increase of subordinate loan.

Finance • FI • Shares
Approved 8 September • Signed 16 September
Funds approved 5.1 • Total investment 5.1

Hansapank Syndicated Loan

Senior bank-to-bank loan to AS Hansapank.

Finance • FI • Loan
Approved 10 November • Signed 17 November
Funds approved 25.5 • Total investment 76.6

Baltex 2000

To enable Baltex 2000 to complete the modernisation of a woven cotton fabric mill in Tallinn and to build a knitting mill at its subsidiary, Lotus Colours 2000, in Sindi.

Textile manufacturing • B/1 • Loan and shares
Approved 24 November • Signed 4 December
Funds approved 8.7 • Total investment 28.9

FYR Macedonia[1]

Stopanska Banka a.d.

Privatisation and restructuring of the country's largest bank, with over 1.5 million retail savings and deposit accounts and 35 per cent of the country's banking assets.

Finance • FI • Loan and shares
Approved 19 May • Signed 10 June
Funds approved 15.3 • Total investment 20.4

Makstil

To modernise steelmaking and casting facilities and the plate mill at a plant in Skopje. This investment will be the largest made by an international strategic investor in FYR Macedonia.

Heavy manufacturing • B/1 • Loan
Approved 15 September • Signed 24 November
Funds approved 12.9 • Total investment 60.0

[1] The Board also approved ECU 21.5 million for the Macedonian Telecommunications privatisation project, which is currently on hold.

Georgia

Omnibus TFP – Tbilisi Business Centre "TBC" Bank, Georgia

Trade Facilitation LOC Guarantee Facility.

Finance • FI • Loan
Approved 10 March • Signed 17 March
Funds approved 1.7 • Total investment 1.7

Bank of Georgia Senior Convertible Loan

Loan to Georgia's second-largest bank, to be used to fund medium and long-term investment projects of SMEs. The project is expected to support competition in the banking sector.

Finance • FI • Loan
Approved 2 June • Signed 16 July
Funds approved 6.0 • Total investment 6.0

Ksani Glass Packaging Factory

Modernisation of glass packaging facilities. The project will assist in privatisation, and improve productivity, product competitiveness, energy efficiency and environmental practices.

Heavy manufacturing • B/1 • Loans and shares
Approved 2 June
Funds approved 7.1 • Total investment 22.0

Trans-Caucasian Rail Link Project

Priority investment and restructuring measures to assist the commercialisation of Georgian railways by improving the main international transit route from Baku to the Georgian ports.

Rail track and structures • B/0 • Loan
Approved 10 November • Signed 22 December
Funds approved 17.1 • Total investment 28.5

Enguri Hydropower Plant Rehabilitation Project

To alleviate Georgia's critical power shortage and to enhance the environmental benefits of the Enguri power facility, the country's most important power plant.

Energy generation • B/1 • Loan
Approved 1 December • Signed 22 December
Funds approved 33.2 • Total investment 58.9

Hungary

The Second Hungary Venture Fund

Investment in a new fund whose investment strategy is to make direct equity investments in technology-oriented companies, primarily in Hungary.

Finance • FI • Shares
Approved 16 June
Funds approved 18.2 • Total investment 91.0

Budapest Waste-Water Services Privatisation

To enhance the financial and operational performance of the Budapest Municipal Sewerage Company, expanding private participation into another key sector of Hungary's economy.

Gas and sanitary services • C/1 • Shares
Approved 24 November • Signed 29 December
Funds approved 22.7 • Total investment 75.7

Kazakhstan

Kazkommertzbank Senior Convertible Loan

To provide medium-term credit resources for Kazakhstan's private sector, and to strengthen the country's largest private sector bank.

Finance • FI • Loan
Approved 28 April • Signed 7 July
Funds approved 34.3 • Total investment 34.3

Karaganda Power Project

Programme to repair and upgrade the power generation and heat distribution facilities in Kazakhstan's second-largest city, improving environmental performance.

Energy generation • B/1 • Loan
Approved 13 October • Signed 17 December
Funds approved 34.3 • Total investment 53.2

TuranAlem: Trade Facility

Sub-project of Kazakhstan Trade Facilitation Programme.

Finance • FI • Loan
Approved 27 October • Signed 28 October
Funds approved 4.3 • Total investment 4.3

Kyrgyzstan

SME Line of Credit II

A guaranteed apex credit line. The National Bank of Kyrgyzstan will borrow and on-lend the funds to qualifying private Kyrgyz banks, which will in turn on-lend the funds to private SMEs.

Finance • FI • Loan
Approved 30 June • Signed 28 July
Funds approved 17.1 • Total investment 17.1

Latvia

PAS Gutta

To strengthen the liquidity and working capital of one of the largest fruit juice producers in the Baltic states region, and to prepare its Moscow and Kiev plants for local production.

Food • B/1 • Loan
Approved 27 October • Signed 27 November
Funds approved 12.0 • Total investment 35.2

Ventspils Port Rail Terminal Project

For the construction of a new rail yard and connecting link at the port of Ventspils, as part of an investment programme to be co-financed by the EIB, EU-Phare and Latvia Railways.

Transport services • B/0 • Loan
Approved 24 November • Signed 30 November
Funds approved 17.6 • Total investment 920.8

Nelss Sawmill Modernisation

A long-term loan to Latvia's biggest sawmill, to finance replacement of existing saw machinery by a new modern line, increasing productivity and eliminating manufacturing bottlenecks.

Forest and paper • B/1 • Loan
Approved 15 December
Funds approved 6.9 • Total investment 10.8

Lithuania

Bankas Hermis Subordinated Convertible Loan

To strengthen the capital base of one of Lithuania's leading commercial banks in a rapid expansion phase, and provide it with longer-term financial resources.

Finance • FI • Loan
Approved 7 April • Signed 30 July
Funds approved 9.2 • Total investment 9.2

PPF – Baltic PPF – Utenos Trikotazas

Spinning and weaving operation in Lithuania.

Finance • FI • Shares
Approved 16 June • Signed 17 June
Funds approved 3.1 • Total investment 2.9

PPF – Baltic PPF – Trinyciai

Sub-investment of the Baltic PPF.

Finance • FI • Loan and shares
Approved 16 June • Signed 17 June
Funds approved 2.7 • Total investment 2.7

PPF – Baltic PPF – Kauno Pieno Centras

Ice cream manufacturer in Lithuania.

Finance • FI • Shares
Approved 30 June • Signed 23 September
Funds approved 2.5 • Total investment 2.6

Agricultural Bank Subordinated Loan

To strengthen the bank's capital base, boost its liquidity, maintain sufficient financing to continue its restructuring process and leverage its resources to increase lending to customers.

Finance • FI • Loan
Approved 21 July • Signed 13 August
Funds approved 7.7 • Total investment 10.2

Vilniaus Bankas Subordinated Loan

The loan will enable the largest private sector bank in Lithuania to expand its business operations and sustain its projected growth while retaining healthy capital adequacy.

Finance • FI • Loan
Approved 21 July • Signed 14 August
Funds approved 10.2 • Total investment 10.2

Moldova

Chisinau Airport

Refurbishment of the passenger terminal of Moldova's busiest airport, to enable it to process passenger traffic in accordance with international standards.

Airports and air navigation systems • B/0 • Loan
Approved 19 May • Signed 25 June
Funds approved 7.7 • Total investment 10.3

Moldovan Metallurgical Works

Working capital financing facility to a successful modern steel plant. Objectives are to enhance its competitive position and profitability, and to facilitate expected privatisation.

Heavy manufacturing • C/1 • Loan
Approved 15 September
Funds approved 12.9 • Total investment 12.9

Moldova-Agroindbank – Senior Convertible Loan

To support shareholder restructuring and institutional development of Moldova's largest commercial bank. It will use the finance to expand its loan portfolio and increase competitiveness.

Finance • FI • Loan
Approved 15 December • Signed 18 December
Funds approved 6.9 • Total investment 6.9

Poland

Pre-IPO L.P.

The creation of a co-investment facility which will invest, in parallel with an existing fund, in direct equity investments in Polish SMEs.

Finance • FI • Shares
Approved 10 March • Signed 2 April
Funds approved 17.0 • Total investment 41.3

Wroclaw Municipal Infrastructure Flood Damage Repair Project

For improvements to flood-damaged municipal transport infrastructure and creditworthiness enhancement for Wroclaw, the Polish city most damaged by flooding in July 1997.

Environment • B/0 • Loan
Approved 28 April • Signed 29 April
Funds approved 16.0 • Total investment 36.0

Bank Pekao S.A. – Grupa Pekao S.A.

Equity investment in Poland's largest banking group, to finance expected growth in its interest-earning assets and investments in technology as well as modernisation of its organisation.

Finance • FI • Shares
Approved 16 June • Signed 29 June
Funds approved 88.1 • Total investment 85.7

Krakow Urban Transport Project

To enable Poland's third-largest city to finance a fast tram link running along its north-south axis. The long-term financing is based on a direct loan to the city with no sovereign guarantee.

Transport services • A/0 • Loan
Approved 8 September • Signed 2 October
Funds approved 45.0 • Total investment 121.8

MPF – Slodownia Soufflet – Polska SARL

Polish malting plant.

Food • B/0 • Loan
Approved 29 September • Signed 30 October
Funds approved 9.1 • Total investment 26.6

Telekomunikacja Polska S.A.

The EBRD will act as a cornerstone investor in the IPO of Poland's dominant telecoms operator. The project will complete an essential element in the government's liberalisation programme.

Telecommunications • C/1 • Shares
Approved 27 October • Signed 17 November
Funds approved 64.9 • Total investment 1,028.9

MVV ESCO MPF

Multi-project facility to finance energy service companies.

Energy distribution • FI • Loan and shares
Approved 1 December
Funds approved 18.7 • Total investment 67.2

MVV ESCO Poland

First sub-project under MVV ESCO MPF.

Energy distribution • FI • Loan and shares
Approved 1 December • Signed 14 December
Funds approved 7.3 • Total investment 25.9

MPF Lafarge: Lafarge Polska Capital Increase

Capital Increase of MPF holding company in Poland.

Wholesale and retail trade • C/0 • Shares
Approved 15 December • Signed 17 December
Funds approved 6.2 • Total investment 28.2

Romania

Ion Tiriac Bank Capital Increase

Participation in capital increase.

Finance • FI • Loan and shares
Approved 10 February • Signed 20 February
Funds approved 17.8 • Total investment 17.6

PPF – Romanian PPF – ADESGO, S.A.

To support the growth and consolidation of a women's clothing company.

Finance • C/0 • Loan and shares
Approved 28 April • Signed 10 July
Funds approved 1.6 • Total investment 2.7

Continental Hotels

To enable a private Romanian company to complete and refurbish hotels in Constanţa and Bucharest and to upgrade other hotels across Romania being acquired via privatisation.

Tourism and leisure • B/0 • Loans and shares
Approved 19 May • Signed 24 June
Funds approved 9.9 • Total investment 27.9

IMGB/FECNE Privatisation

Privatisation and modernisation of two heavy engineering plants. The sponsor, international engineering group Kværner, will help raise the level of skills and expertise in the plants.

Heavy manufacturing • B/1 • Loans and shares
Approved 19 May • Signed 24 September
Funds approved 23.5 • Total investment 73.4

Bank Post Subordinated Convertible Loan

To support the scheduled privatisation of a major state-owned commercial bank by encouraging investor interest, helping to promote a sound private banking system in Romania.

Finance • FI • Loan
Approved 16 June • Signed 10 July
Funds approved 8.6 • Total investment 8.6

Italo-Romanian Industrial Development Enterprise (IRIDE)

The company will run a programme of international-standard warehouse projects, relieving the severe shortage of such facilities in Romania and improving efficiency in the supply chain.

Housing • B/0 • Loan and shares
Approved 27 October • Signed 17 December
Funds approved 10.6 • Total investment 33.3

Samsung MPF – Otelinox

Privatisation of stainless and special alloy steel plant.

Heavy manufacturing • FI • Shares
Approved 10 November • Signed 18 December
Funds approved 15.4 • Total investment 62.1

MobiFon (CONNEX GSM) Phase II

Expansion of existing loan facilities to design, construct and operate a country-wide GSM 900 cellular network in Romania. The project has increased following strong demand for services.

Telecommunications • B/0 • Loan
Approved 24 November • Signed 20 January 99
Funds approved 25.7 • Total investment 150.1

Russian Federation

Fiat-GAZ Joint Venture

To establish a company in Nizhny Novgorod to make Fiat cars for the domestic market. This represents the first large foreign direct investment in the Russian car manufacturing sector.

Manufacturing • B/1 • Loans and shares
Approved 13 January
Funds approved 102.9 • Total investment 480.2

Tolmachevo Airport Upgrading Project

To undertake urgently required improvements to the domestic terminal departure hall and to purchase relevant airport equipment at Novosibirsk.

Airports and air navigation systems • B/0 • Loan
Approved 10 February • Signed 30 June
Funds approved 8.6 • Total investment 14.2

Chernogorneft II

To develop part of Samotlor oilfield, one of the world's largest. The financing complements an earlier transaction, and should stabilise and increase oil production.

Oil and gas • A/1 • Loan
Approved 7 April
Funds approved 68.6 • Total investment 102.9

Den Norske Bank Murmansk

The EBRD will take a 30% stake in a new wholesale bank to support the financial institutions sector in north-west Russia, with the introduction of competitive banking products and services.

Finance • FI • Shares
Approved 2 June • Signed 26 June
Funds approved 4.5 • Total investment 12.9

Nevsky 49, St Petersburg

To construct and operate a 164-room international-standard business and tourist hotel on Nevsky Prospect. The project will be the first fully privately financed new hotel construction in Russia.

Tourism and leisure • B/0 • Loan
Approved 16 June • Signed 9 December
Funds approved 12.4 • Total investment 24.8

SBS-Agro Credit Line Facility

To enable a leading commercial bank to finance investment projects in the private sector, mainly in the agribusiness and related industrial sector.

Finance • FI • Loan
Approved 21 July
Funds approved 25.7 • Total investment 42.9

Astoria Hotel

To refurbish an ageing 436-room hotel complex in St Petersburg to international standards, stimulating greater competition and supporting the business and tourism sectors.

Tourism and leisure • B/0 • Loan and shares
Approved 21 July
Funds approved 12.9 • Total investment 58.0

Permtex LLC Oil Reserve Development

To develop oil reserves located in the Perm region. Permtex's commitment to setting good standards for corporate governance is an example for oil producers in the region.

Oil and gas production • A/1 • Loan
Approved 24 November
Funds approved 21.4 • Total investment 176.6

New Telephone Company (NTC)

Loan to new telephone company in Vladivostok.

Telecommunications • B/0 • Loan
Approved 15 December
Funds approved 14.6 • Total investment 43.7

Slovak Republic

Bucina Zvolen a.s.

Loan to upgrade and expand a wood processor's core production facility and modernise its energy system. Benefits include improvements in waste product usage/recycling.

Forest and paper • B/1 • Loan
Approved 16 June • Signed 19 June
Funds approved 14.6 • Total investment 14.6

Grain Receipt Programme

To introduce secured lending for the seasonal working capital needs of farmers by using warehouse receipts. The programme will be managed by a local bank, Pol'nobanka.

Finance • FI • Loan
Approved 8 September • Signed 22 September
Funds approved 16.9 • Total investment 51.1

Slovenia

Maribor Waste-Water Treatment Plant

To build a plant enabling Maribor's waste water to be treated to EU standards. This will be the first such plant to be financed under a BOT (build-operate-transfer) structure in the region.

Environment • A/0 • Loan
Approved 24 November
Funds approved 14.8 • Total investment 43.4

Alpina d.d.

To carry out operational and financial restructuring of the country's largest shoe manufacturer, to increase the company's competitiveness and profitability.

Light manufacturing • C/1 • Loan and shares
Approved 1 December • Signed 22 December
Funds approved 6.1 • Total investment 6.1

Tajikistan

Obi-Zulol Water

Installation and operation of a water and soft drinks bottling plant in Ura-Tyube. Objectives include increasing the availability of safe drinking water in Tajikistan.

Food • B/0 • Loan and shares
Approved 30 June • Signed 4 September
Funds approved 4.5 • Total investment 10.8

Ukraine

Micro, Small and Medium-Sized Enterprise Credit Line II

To help promising Ukrainian private banks to become effective financial intermediaries and competitive institutions, by improving credit skills and assisting in institutional development.

Finance • FI • Loan
Approved 28 April • Signed 8 May
Funds approved 75.7 • Total investment 113.8

Zaporizhzhia Water Utility Development and Investment Programme

For critical investment in the water supply and waste-water sector in Zaporizhzhia, which should bring environmental benefits and improve services.

Gas and sanitary services • B/0 • Loan
Approved 27 October
Funds approved 25.7 • Total investment 41.4

Procter & Gamble Ukraine

Expansion of the company's manufacturing and distribution in Ukraine.

Chemical manufacturing • B/1 • Shares
Approved 10 November • Signed 30 December
Funds approved 25.7 • Total investment 117.2

Radisson SAS Kiev Hotel

To build and operate a 244-room business hotel in Kiev, easing the acute shortage of such accommodation. This will be Ukraine's first fully privately financed new hotel of this standard.

Tourism and leisure • B/0 • Loan and shares
Approved 1 December • Signed 12 December
Funds approved 13.6 • Total investment 39.5

Uzbekistan

Tashkent Solid Waste Management Rehabilitation Project

The project will upgrade the city's basic infrastructure for municipal and industrial solid waste management. It will address urgent environmental problems and public health hazards.

Environment • B/1 • Loan
Approved 1 December • Signed 16 December
Funds approved 16.5 • Total investment 35.2

Regional

Agri Equipment Multi Project Facility

MPF to support financing facilities for agricultural equipment.

Food • FI • Loan and shares
Approved 27 January
Funds approved 100.0 • Total investment 300.0

MBA Loan Programme Phase II

Replica of existing student financing scheme.

Education • C/0 • Loan
Approved 27 January • Signed 7 December
Funds approved 2.6 • Total investment 5.1

EBRD Direct Investment Facility (DIF)

To provide equity funding to private sector businesses in countries at the early stages of transition.

Finance • B/I • Shares
Approved 24 February
Funds approved 25.7 • Total investment 25.7

Russian Communications & Information Technology Fund

A private equity investment fund targeting the media and communications sector in the countries of the CIS and the Baltic states.

Telecommunications • FI • Shares
Approved 19 May
Funds approved 8.6 • Total investment 85.8

Innova/98 L.P.

Investment in a direct equity fund for SMEs, principally in Poland and also in the Czech Republic, Hungary and Romania.

Finance • FI • Shares
Approved 19 May • Signed 10 June
Funds approved 17.1 • Total investment 107.2

TPG II Co-Investment

Co-investment alongside TPG II (primarily in the CIS).

Light manufacturing • FI • Shares
Approved 21 July
Funds approved 53.6 • Total investment 203.6

European Broadcasting Systems

Holding company to purchase broadcast television stations.

Telecommunications • B/0 • Shares
Approved 29 September • Signed 17 December
Funds approved 25.7 • Total investment 103.2

AIG New Europe Fund

A direct equity fund investing in central Europe, sponsored by the American International Group (AIG), to focus on industry consolidations and development of regional market leaders.

Finance • FI • Shares
Approved 24 November
Funds approved 42.9 • Total investment 271.8

Emerging Europe Capital Investors LDC

Regional fund for central Europe.

Finance • FI • Shares
Approved 1 December
Funds approved 25.7 • Total investment 32.2

Total funds approved	**2,003.0**
Total project investment	**8,649.4**

Governors

Governors and Alternate Governors

31 December 1998

Member	Governor	Alternate Governor
Albania	Ermelinda Meksi	Adriana Berberi
Armenia	Armen R Darbinian	Tigran Sargisian
Australia	Peter Costello	Kathy Sullivan
Austria	Rudolf Edlinger	Hans-Dietmar Schweisgut
Azerbaijan	Elman S Roustamov	Fuad Akhundov
Belarus	Valeriy I Kokorev	Nikolai P Zaichenko
Belgium	Jean-Jacques Viseur	Jean-Paul Arnoldi
Bosnia and Herzegovina	Neven Tomic	–
Bulgaria	Muravei Radev	Martin Zaimov
Canada	Paul Martin	Donald W Campbell
Croatia	Borislav Skegro	Josip Kulisic
Cyprus	Christodoulos Christodoulou	Antonis Malaos
Czech Republic	Ivo Svoboda	Josef Tosovský
Denmark	Marianne Jelved	Michael Dithmer
Egypt	Ahmad Ahmad Goueli	Youssef Boutros-Ghali
Estonia	Mart Opmann	Agu Lellep
Finland	Sauli Niinistö	Leif Fagernäs
FYR Macedonia	Taki Fiti	Zlatka Popovska
France	Dominique Strauss-Kahn	Jean Lemierre
Georgia	Teimuraz Mamatsashvili	Konstantin Zaldastanishvili
Germany	Oskar Lafontaine	Heiner Flassbeck
Greece	Yannos Papantoniou	Stefanos Avgouleas
Hungary	Zsigmond Járai	Werner Riecke
Iceland	Finnur Ingólfsson	Thórdur Fridjónsson
Ireland	Charlie McCreevy	Paddy Mullarkey
Israel	Jacob A Frenkel	Ben-Zion Zilberfarb
Italy	Carlo A Ciampi	Mario Draghi
Japan	Kiichi Miyazawa	Masaru Hayami
Kazakhstan	Anvar Saidenov	Serik Akhanov
Republic of Korea	Kyu Sung Lee	Chol-Hwan Chon
Kyrgyzstan	Marat Sultanov	Ourkaly Issaev
Latvia	Roberts Zile	Ainars Slesers
Liechtenstein	Michael Ritter	Roland Marxer
Lithuania	Algirdas Semeta	Jonas Niaura
Luxembourg	Jean-Claude Juncker	Jean Guill
Malta	John Dalli	Emanuel Ellul
Mexico	José A Gurría	Martin Werner
Moldova	Ion Sturza	Dumitru Ursu
Morocco	Fathallah Oualalou	Abdelfettah Benmansour
Netherlands	Gerrit Zalm	Jozias van Aartsen
New Zealand	Don McKinnon	Richard Grant
Norway	Gudmund Restad	Harriet E Berg
Poland	Hanna Gronkiewicz-Waltz	Krzysztof Ners
Portugal	António de Sousa Franco	Fernando Teixeira dos Santos
Romania	Decebal Traian Remes	Mugur Isarescu
Russian Federation	Viktor V Geraschenko	Alexei L Kudrin
Slovak Republic	Brigita Schmögnerová	Vladimír Masár
Slovenia	Mitja Gaspari	Meta Bole
Spain	Rodrigo Rato	Elena Pisonero
Sweden	Erik Åsbrink	Kari Lotsberg
Switzerland	Pascal Couchepin	Rudolf Ramsauer
Tajikistan	Murotali M Alimardonov	Nauruz A Valiev
Turkey	Yener Dinçmen	Cüneyt Sel
Turkmenistan	Hudaiberdy A Orazov	Alexander Grishin
Ukraine	Igor O Mityukov	Victor A Yushchenko
United Kingdom	Gordon Brown	Clare Short
United States of America	Robert Rubin	Stuart Eizenstat
Uzbekistan	Rustam S Azimov	Abdurafik A Akhadov
European Community	Yves-Thibault de Silguy	Giovanni Ravasio
European Investment Bank	Sir Brian Unwin	Wolfgang Roth

Chairman of the Board of Governors

Governor for Greece (Yannos Papantoniou)

Vice Chairmen of the Board of Governors

Governor for Norway (Gudmund Restad)
Governor for Bulgaria (Muravei Radev)

All the powers of the EBRD are vested in the Board of Governors. The Board of Governors has delegated many of its powers to the Board of Directors, which is responsible for the direction of the general operations of the Bank and, among other activities, establishes policies and takes decisions concerning loans, equity investments and other operations in conformity with the general directions of the Board of Governors.

The President chairs the Board of Directors. Under the direction of the Board, the President conducts the business of the Bank and, as head of staff, is responsible for its organisation and for making staff appointments.

Directors

Directors and Alternate Directors

31 December 1998

Directors	Alternate Directors	Constituencies
Byongwon Bahk	Jim Short	Korea/Australia/New Zealand/Egypt
Jan Bielecki	Bojidar Kabaktchiev	Poland/Bulgaria/Albania
Staffan Crona	Baldur Erlingsson	Sweden/Iceland/Estonia
Sylvain de Forges	Lucien Bernadine	France
Torsten Gersfelt	Tony Brown	Denmark/Ireland/Lithuania/FYR Macedonia
Joaquin de la Infiesta	Carlos Escribano	Spain/Mexico
Wilhelm Jaggi	Mehmet Kaytaz	Switzerland/Turkey/Liechtenstein/Uzbekistan/Kyrgyzstan/Azerbaijan/Turkmenistan
Mikhail Jernov	Michail Tatianchenko	Russian Federation/Belarus/Tajikistan
Roger Lavelle	Walter Cernoia	European Investment Bank
Heiner Luschin	Gideon Schurr	Austria/Israel/Cyprus/Malta/Kazakhstan[1]
Michael McCulloch	Alex Gibbs	United Kingdom
Patrice Muller	Tom MacDonald	Canada/Morocco
Kari Nars	Rolf Næss	Finland/Norway/Latvia
Philippe Petit-Laurent	Vassili Lelakis	European Community
Yuri Poluneev	Maria Sultanoiu	Ukraine/Romania/Moldova/Georgia/Armenia
Enzo Quattrociocche	Pasquale Terracciano	Italy
Norbert Radermacher	Jörg Ranau	Germany
Karen Shepherd	–	United States of America
Bernard Snoy	Georges Heinen	Belgium/Luxembourg/Slovenia
Kazuhito Tatebe	Takashi Kurai	Japan
Zdenek Tuma	Károly Soós	Czech Republic/Hungary/Slovak Republic/Croatia
Pim van Ballekom	Dick Knook	Netherlands
Stefanos Vavalidis	António de Almeida	Greece/Portugal

Composition of Board of Directors' Committees

31 December 1998

Audit Committee

Kari Nars (Chairman)
Torsten Gersfelt (Vice Chairman)
Byongwon Bahk
Jan Bielecki
Roger Lavelle
Heiner Luschin
Michael McCulloch

Financial and Operations Policies Committee

Enzo Quattrociocche (Chairman)
Mikhail Jernov (Vice Chairman)
Staffan Crona
Sylvain de Forges
Wilhelm Jaggi
Philippe Petit-Laurent
Karen Shepherd
Bernard Snoy

Budget and Administrative Affairs Committee

Patrice Muller (Chairman)
Pim van Ballekom (Vice Chairman)
Joaquin de la Infiesta
Yuri Poluneev
Norbert Radermacher
Kazuhito Tatebe
Zdenek Tuma
Stefanos Vavalidis

Board Steering Group

Wilhelm Jaggi (Chairman)
Michael McCulloch (Vice Chairman)
Torsten Gersfelt
Mikhail Jernov
Patrice Muller
Kari Nars
Enzo Quattrociocche
Pim van Ballekom
Antonio Maria Costa (Secretary General)

The Audit Committee considers the appointment and scope of work of the external auditors; and reviews financial statements and general accounting principles, policy and work of the Internal Auditor, expenditure authorisation, control systems, procurement policy and project evaluation.

The Financial and Operations Policies Committee reviews financial policies including borrowing policy, general policies relating to operations, and procedures and reporting requirements.

The Budget and Administrative Affairs Committee considers general budgetary policy, proposals, procedures and reports. It also considers personnel, administrative and organisational matters, and administrative matters relating to Directors and their staff.

The Board Steering Group was established in 1994 to improve coordination between the Board of Directors and management on arrangements for meetings of the Board, Committees and workshops.

[1] Also Bosnia and Herzegovina (effective from 4 March 1999).

Contacting the EBRD

9 March 1999

President	Horst Köhler

Banking

Front Office	
First Vice President	Charles Frank
Deputy Vice Presidents	David Hexter/Jean-François Maquet
Director, New Products, Policies & Issues	Gavin Anderson

Country Teams	**Team Director**
Bulgaria/Albania/FYR Macedonia/ Slovenia/Armenia/Georgia/Azerbaijan	Olivier Descamps
Central Asia	Kazuya Murakami
Hungary	Peter Reiniger
Poland/Czech Republic/Slovak Republic/ Baltic States	Alain Pilloux
Russian Federation	Reinhard Schmoelz
Ukraine/Romania/Moldova/Croatia/ Bosnia and Herzegovina/Belarus	Lindsay Forbes (acting)

Sector Teams	**Team Director**
Agribusiness	Hans Christian Jacobsen
Energy Efficiency	Bernard Jamet
Financial Institutions	Kurt Geiger, Rogers LeBaron, Dragica Pilipovic-Chaffey
Municipal and Environmental Infrastructure	Johan Bastin
Natural Resources	Vittorio Jucker
Power/Energy Utilities	Ananda Covindassamy
Property/Tourism/Shipping	Edgar Rosenmayr
Telecommunications	Peter Reiniger
Transport	Roy Knighton

Operations Support Units	**Head of Unit**
Environmental Appraisal	Tim Murphy
TurnAround Management Programme	Michael McAlister

Finance

Vice President	Steven Kaempfer
Deputy Vice President	Noreen Doyle

Strategic and Corporate Planning and Budgeting

Director	Josué Tanaka
Head, Financial Policy and Strategic Planning	Evelyn Cox
Head, Corporate Planning	Magdi Bona

Accounting and Reporting

Director	Nigel Kerby
Head of Financial Accounting	Julie Williams
Head of Funds Accounting	Marie-France Forgues
Head of Treasury Accounting	Terry Cullen

Operations and Information Technology

Head of Operations and Information Technology	Christopher Holyoak
Director of Operations	Peter Franklin
Acting Director of IT	Tim Goldstone

Risk management

Director	Noreen Doyle
Risk Controller	Jean-André Sorasio
Head of Credit	Bob Harada
Head of Portfolio Review	Mike Williams
Head of Syndications	Lorenz Jorgensen
Co-Head, Special Assets	Charles Wrangham, Oliver Greene

Treasury

Treasurer	Marcus Fedder
Deputy Treasurer	Andrew Donaldson
Head of Investments – Credits	Constantine Kazantzidis
Head of Investments – Interest Rates	Bart Mauldin
Head of Analytics/ External Asset Management	Jaakko Kärki
Head of Funding	Ayesha Shah
Head of Asset & Liability Management	Axel van Nederveen
Director, Client Risk Management	Debbie Berger
Director, New Business Development Japan	Rurika Naito

Personnel and Administration

Vice President	Miklós Németh
Director of Personnel	Franco Furno
Director of Administration	John McNess

Project Evaluation, Operation Support and Nuclear Safety

Vice President	Joachim Jahnke

Project Evaluation

Director	Fredrik Korfker

Official Co-financing and Consultants

Director	Ullrich Kiermayr

Procurement and Technical Support

Interim Head	Ian Nightingale

Nuclear Safety

Director	Lars Larsson

Office of the Secretary General

Secretary General	Antonio Maria Costa
Deputy Secretary General	Nigel Carter

Office of the General Counsel

General Counsel	Emmanuel Maurice
Assistant General Counsel	Norbert Seiler

Office of the Chief Economist

Chief Economist	Nicholas Stern
Deputy Chief Economist	Ricardo Lago
Director of Policy Studies	Steven Fries
Director, Transition Strategies	Hans Peter Lankes

Internal Audit

Head of Internal Audit	Tarek Rouchdy

Communications

Director	Barbara Clay

President's Office

Director	Axel Bertuch-Samuels

Local offices

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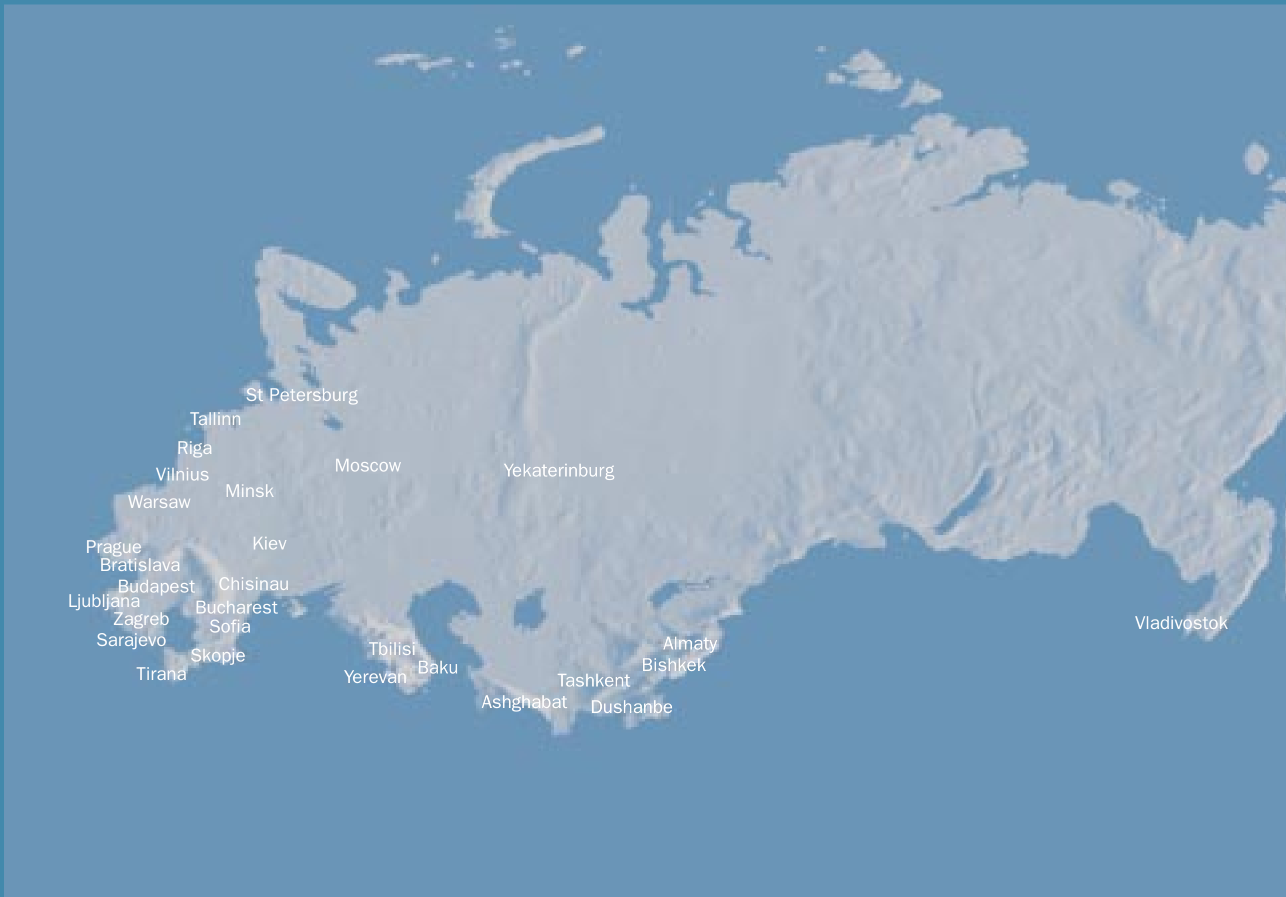
Head of Office: Martyn Nicholls
Deputy Head of Office: Paul Burton



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Deputy Head of Office: Jyldyz Galieva

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Fax: +371 7 830 301
Head of Office: Urmas Paavel

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Fax: +370 2 224 666
Head of Office: Urmas Paavel

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Mission Advisers: Marina Cotruta / Maxim Kakareka

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Head of Office: Salvatore Candido
Deputy Head of Office: Serban Ghinescu

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Further information

Publications

The EBRD provides a range of publications, policy papers, summaries of country strategies and information sheets. Periodicals include: *Alternative sources of finance for small and medium-sized projects* (listing financial intermediaries); *Environments in transition* (the EBRD's environmental programme, including project updates); *Law in transition* (the EBRD's legal journal). All free items are listed in the *Guide to publications* and are available from the Publications Desk at the EBRD (Tel: +44 171 338 7553; Fax: +44 171 338 6102).
Most are also posted on the EBRD's Web site: http://www.ebrd.com

The *Transition Report* is an annual publication examining the problems of transition, and the macroeconomic and legal progress of the EBRD's countries of operations (published November, £30); also the *Transition Report Update* (published April, £15).
Available from the EBRD and from The Stationery Office Publications Centre, PO Box 276, London SW8 5DT, UK (Tel: +44 171 873 8200).

Annual Meeting

The EBRD's Annual Meeting includes a business programme which is open to potential investors in the region.
For details contact the Annual Meetings Management Unit (Tel: +44 171 338 7319; Fax: +44 171 338 7320).
The 2000 Annual Meeting is to be held in Riga, Latvia.

Guide for readers

Exchange rates

Non-ECU currencies have been converted, where appropriate, into ECU on the basis of the exchange rates current on 31 December 1998. (Approximate ECU exchange rates: DM 1.96, FFr 6.56, ¥132.70, £0.70, US$ 1.17.)

Operation counting

Operations may be counted as fractional numbers if multiple sub-loans are grouped under one framework agreement. Totals in tables may not add due to rounding.

The region

References to "the region" include all the EBRD's 26 countries of operations (see contents page).

Transition stage

The EBRD classifies its countries of operations by their progress towards a market economy.
The Russian Federation and Regional projects are treated separately.
Early/Intermediate: Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, FYR Macedonia, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Romania, Tajikistan, Turkmenistan, Ukraine, Uzbekistan.
Advanced: Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic, Slovenia.

Abbreviations and acronyms

The Bank, EBRD The European Bank for Reconstruction and Development
CEAL Central European Agency Line
CEE Central and eastern Europe and the Baltic states
CIS Commonwealth of Independent States
CSF Chernobyl Shelter Fund
EAP Environmental Action Plan
EC European Community
ECA Export credit agency
ECLAT Export Credit Loan Arrangement Technique
ECU European Currency Unit
EIB European Investment Bank
ENVAC Environmental Advisory Council
ESCO Energy service company
ESE Early Stage Equity
EU European Union
FDI Foreign direct investment
FIDP Financial Institutions Development Programme
FYR Macedonia Former Yugoslav Republic of Macedonia
G-7 Group of 7 (Canada, France, Germany, Italy, Japan, UK and USA)
GDP Gross Domestic Product
IFC International Finance Corporation
IFI International financial institution
IMF International Monetary Fund
IPO Initial public offering
ISDA International Swaps and Derivatives Association
JEXIM Export Import Bank of Japan
Libor London Interbank Offered Rate
LTP Legal Transition Programme
MPF Multi-Project Facility
MSEs Micro and small enterprises
NPP Nuclear power plant
NSA Nuclear Safety Account
OECD Organisation for Economic Cooperation and Development
Phare Poland and Hungary: Aid for Economic Restructuring (EU)
PPF Post-Privatisation Fund
RSBF Russia Small Business Fund
RVF Regional Venture Fund
SIP Shelter Implementation Plan
SMEs Small and medium-sized enterprises
SRP Special Restructuring Programme
Tacis Technical Assistance for CIS countries (EU)
TAM TurnAround Management Programme
TC Technical cooperation
TCFP Technical Cooperation Fund Programme
USAID US Agency for International Development
VaR Value at Risk
ZBB Zero-Based Budgeting

Published by the
European Bank for Reconstruction and Development.

Compiled and edited by the Publications Unit, Communications Department. French, German and Russian language versions translated by the Translation Unit. Designed and produced by the Design Unit. Printed in England by Royle Print Ltd.

Cover and interior printed on environmentally responsible paper. Munken Lynx is manufactured using elemental chlorine-free (ECF) pulps sourced from renewable and managed forests and holds the Nordic Swan Environmental label. Consort Curam contains a minimum 10% recycled fibre and a minimum of 10% de-inked pulp; all the virgin pulp has been bleached without chlorine dioxide and the manufacturing process is totally acid-free.

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Cover: Flash of flame, Huta Warszawa
steel factory, Warsaw, Poland.