



**European Bank
for Reconstruction and Development**

**Private Sector Development and EBRD
Activities in South-Eastern Europe:
*Recent Developments and Near-Term Prospects*¹**

Stability Pact for South-Eastern Europe

**Report prepared for the Working Table II
meeting in Sofia on 20-21 June 2002 and the
Regional Table in Thessaloniki, 16 Dec. 2002**

Updated 31 December 2002

¹ This paper has been prepared under the direction of Olivier Descamps, Jean-Marc Peterschmitt and Peter Sanfey, and was presented at the Stability Pact Working Table II meeting in Sofia, 20-21 June 2002. This revision incorporates recent developments on privatisation, capital flows and EBRD activities in the region. The paper has benefited from the input of staff of the EBRD's Office of the Chief Economist and Banking Department. The views expressed in this paper are those of the authors only and not necessarily of the EBRD.

1. Introduction and Summary

The importance of private sector development in south-eastern Europe (SEE) has increased significantly since the launch of the Stability Pact in Cologne on June 10, 1999. At the second regional conference for south-eastern Europe in Bucharest in October 2001, the chairmen's conclusions noted that "all participants underlined the increasing role to be played by the private sector." However, the chairmen went on to observe that "[P]rogress in creating an environment that stimulates private sector development is significant but uneven" and "[F]oreign investment flows to the region have been disappointing." In terms of the general investment climate, the region continues to lag well behind the advanced transition countries of central Europe and the Baltic states (CEB), and doubts remain about the willingness of foreign investors to fill the gap created by declining official assistance to the region. *Therefore, during the next phase of the Stability Pact, international institutions and the bilateral donor community must continue to play a crucial enabling role for private sector development and investment flows.*

This paper evaluates recent progress in private sector development in the region, reports on the progress of regional private sector initiatives by the EBRD and other IFIs, and discusses the way ahead for the near-term. Section 2 shows that progress in privatisation throughout the region has been steady and consistent over the past few years, but investors remain cautious, as foreign direct investment (FDI) levels remain well below those in central Europe and the Baltic states. Nevertheless, capital flows to the region have increased steadily over the past two years, and FDI levels have returned to those last seen in 1998. More recently however, the privatisation process has slowed in a number of countries, and enterprise and financial sector reforms remain major challenges.

Section 3 updates the status of the regional private sector initiatives. Several of these initiatives have had an important positive effect on private sector development, and support to SMEs in particular. The Trade Facilitation Programme has had a major impact in high-risk environments, micro-finance institutions have allowed to finance thousands of enterprises and programmes such as IFC Southeast Europe Enterprise Development Programme or the EBRD's Business Advisory Service and Turn Around Management programmes have contributed in a significant way to institutional development and the introduction of best practices. In all cases, the support of bilateral and multilateral donors and co-operation among the IFIs have been essential.

Section 4 summarises the contribution of the EBRD to private sector development in the region. In addition to the Bank's role in regional private sector initiatives, the EBRD is leading or co-financing 16 priority regional infrastructure projects. In summary, annual EBRD signed commitments to the region have increased steadily since 1999, with €1.2 billion expected to be signed in 2002, of which 70% is in the private sector. The project pipeline remains strong at over €1.7 billion, reflecting the improved business climate.

The paper concludes with some thoughts on the way ahead, highlighting the need to enhance the role of the private sector and PPPs in infrastructure, including municipal and environmental infrastructure, broadening the scope of trade facilitation and micro-finance programmes, and strengthening institutions through technical assistance and twinning programmes.

2. Private Sector Development and Investment in the Region

Since 1994 the EBRD has been monitoring progress in transition across a number of dimensions of reform, including small-scale and large-scale privatisation. For each dimension, a score is assigned once a year and reported in the annual *Transition Report*, published each year in November. The index ranges from 1 to 4+, where 1 indicates little or no progress in market-oriented reform, and 4+ indicates a standard similar to advanced market economies.

Charts 1 and 2 present the average transition score, for small- and large-scale privatisation respectively, for three broad regions: central Europe and the Baltics (excluding Croatia), the eight Stability Pact countries of south-eastern Europe, and the Commonwealth of Independent States (CIS, excluding Moldova).² For the SEE region, the charts tell an encouraging story of steady progress in reform, particularly with regard to large-scale privatisation where since 2000, the region has overtaken the CIS. As shown in the recently-published EBRD *Transition Report 2002*, the momentum has been maintained even in the more difficult global environment of the past year. Nevertheless, significant challenges remain. For three countries in the region – Bosnia and Herzegovina, Serbia and Montenegro and Moldova – further progress on small-scale privatisation is required to reach the score of 4- or better, while in the former two countries, large-scale privatisation is still at an early stage. More worryingly, a number of important privatisations have been postponed or delayed recently. Box 1 summarises recent progress and difficulties in the privatisation process for each country.

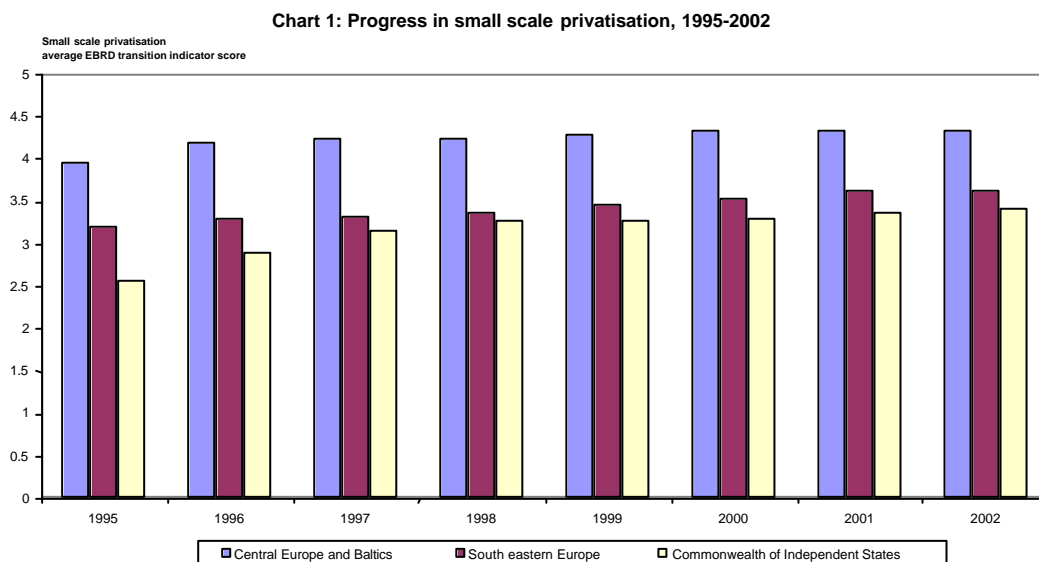
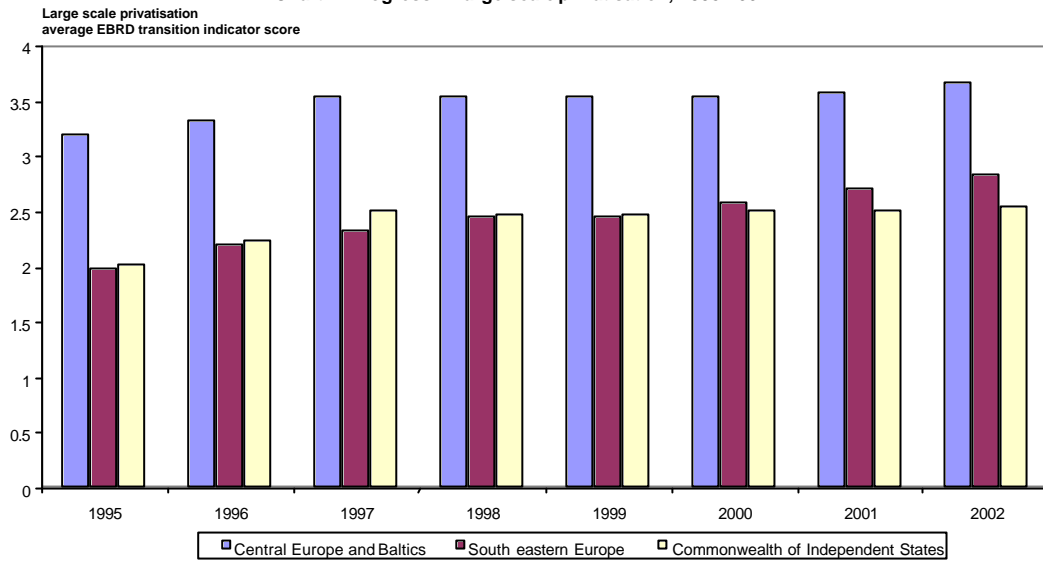


Chart 2: Progress in large scale privatisation, 1995-2002



² This division differs from the three-way division frequently used in the EBRD *Transition Report*, where Croatia is included in the CEB group, and Moldova is grouped with the rest of the CIS.

Box 1: Recent developments in enterprise privatisation

Albania: Important large privatisations were delayed during 2002 due to the lack of foreign investors' interest and political uncertainty in the country in the first half of the year. For example, the privatisation of the fixed-line state telecommunications monopoly, Albtelecom, is facing serious delays and contrary to earlier plans, will not be completed during 2002.

Bosnia and Herzegovina: The mass privatisation programme for SMEs has advanced, but large-scale privatisation is proceeding very slowly and is fraught with difficulties linked to process and transparency. The International Advisory Group for Privatisation is assisting with privatisations in the strategic sectors (56 in the Federation and 52 in the Republika Srpska) but the process is behind schedule, with many proposed tenders not yet announced. In the Republika Srpska, two recent high-profile tenders have failed because of confusion over the privatisation law.

Bulgaria: After strong progress in 1999-2000, the privatisation process slowed down temporarily in 2001, largely because of the general elections in June, but some momentum has been re-gained in recent months. A new Law on Privatisation and Post-Privatisation Control came into effect in March 2002, paving the way to a new wave of large-scale privatisation deals. The Bulgarian Privatisation Agency is in charge of the sale of 40 big companies, including the Bulgarian tobacco monopoly, Bulgartabac Holding, the Vazov Group arm plants, the district heating companies, the Bulgarian Sea Fleet and the Bulgarian River Shipping.

Croatia: In March 2002, parliament approved a plan for the partial privatisation of the Croatian Energy Company, HEP, under which 15 per cent will be sold through an initial public offering. The distribution and transmission functions will remain under the control of HEP. In November 2001, an international tender was launched for 14 hotels with an asking price of €160 million. In March 2002, parliament approved a plan for the partial privatisation of INA, the integrated oil company. Under the proposal, 25 per cent plus one share would be sold to a strategic investor.

Serbia and Montenegro: A new privatisation law was approved in Serbia in June 2001. In January 2002, the first large sales under the new law took place – the sale of three cement plants in open tenders to foreign strategic investors. By end-November 2002 approximately 140 companies had been sold under the new law, while in the SME sector, a number of auctions have already taken place. The Mass Voucher Programme in Montenegro is now complete, and tenders are underway for shares in selected strategic companies. In Kosovo, UNMIK has prepared a draft for the privatisation of 300-350 socially-owned enterprises.

FYR Macedonia: The programme to close down 40 loss-making companies is behind schedule. By end-August 2002, only eight enterprises had been sold through an international tender. In early 2002 the government decided to liquidate the chromium factory, Jugochrom, and in August 2002 announced that it would be sold to the French company, SCMM. The new government is reviewing the proposal to privatise the monopoly Electric Power Company of Macedonia (ESM). Meindl Bank of Austria is leading a consortium to act as privatisation adviser.

Moldova: Given the recent lack of investor interest, the Government is taking a more pro-active role in attracting strategic investors, by hosting a forum for investors interested in the privatisation of the 17 strategic wineries that will be put for sale. The planned sale of 51 per cent of the national, fixed line telecommunications company to a strategic investor is expected to take place soon, following a tender launched in June 2002. The government has also announced its intention to privatise two energy distribution companies (RED North and RED North-west) through direct negotiations with potential strategic investors, offering between 51 per cent and 76 per cent of the share capital.

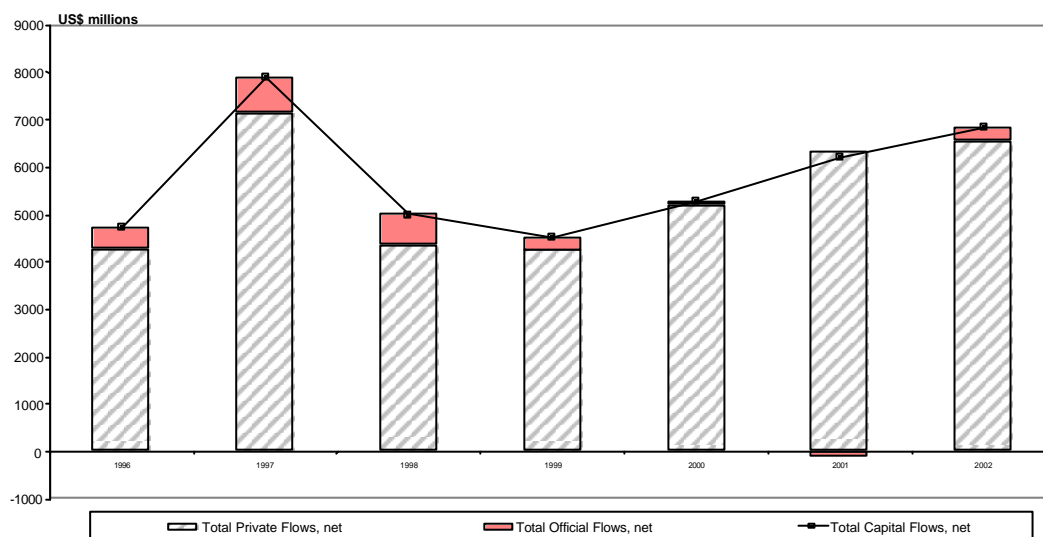
Romania: A new law, aimed at accelerating privatisation, was approved by the Parliament in April 2002. Its key stipulations are: (i) companies to be privatised will have their budget arrears, as of December 2001, written off fully or partly; (ii) creditor utilities will have 90 days to decide whether to write off the privatised enterprise's debts, reschedule them or convert them into shares; (iii) the SOEs may be sold at any prevailing price, irrespective of the initial demand expressed by the state; (iv) the government is entitled to endorse sales for €1, but the selection of the buyer will be made on the basis of other conditions such as pledged investments, or employment. Negotiations on a PSAL II program with the World Bank, worth US\$ 300 million, were finalised in December 2001 and approved by the World Bank board in September 2002. The programme aims at accelerating the privatisation of the remaining Romanian large-scale state-owned enterprises, and would involve 18 state-owned companies up for restructuring or privatisation.

Foreign investors are playing a significant role in the sustainable development of the SEE region, but capital flows have been modest relative to other emerging markets.

Total private flows to SEE, worth US\$ 7.3 billion in 1997, fell to US\$ 3.5 billion in 1999, reflecting the general instability in the region. However, the two years since then have seen a significant upturn in private flows with a total for 2001 of around US\$ 6.3 billion with a further increase forecast for 2002 (See Chart 3).

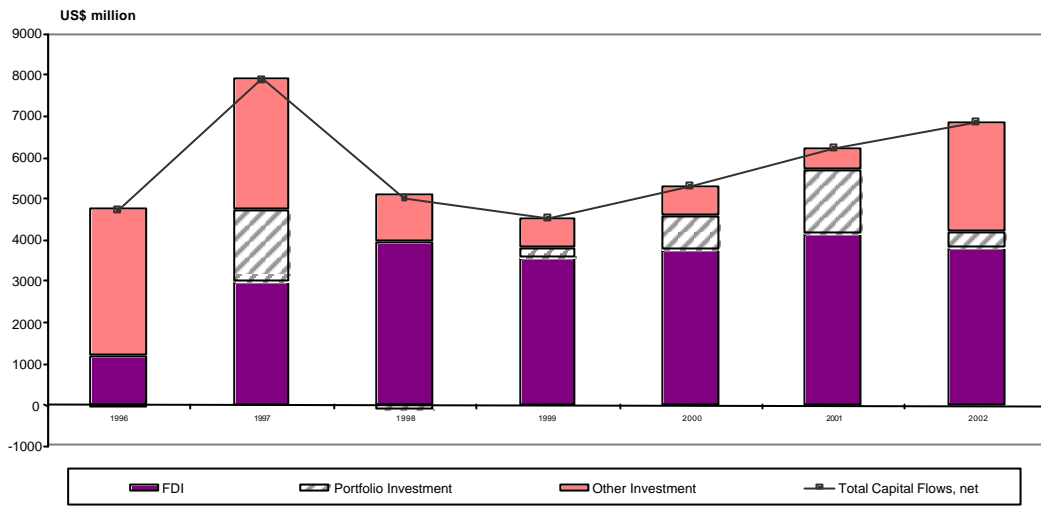
Since 1998, FDI has accounted for well over half of the capital flows (see Chart 4). However, compared with CEB, the countries of SEE have been less successful in attracting FDI, reflecting a slower pace of reform, the late start of privatisation and less market confidence about EU accession prospects (see Chart 5). Total FDI to the region in 2001 was up marginally on the previous year as some big-ticket sales took place, such as the privatisation of the telecommunications company in FYR Macedonia. The projected FDI level to SEE for 2002 is slightly down from last year's level.

Chart 3. Total net private and official flows to South-eastern Europe



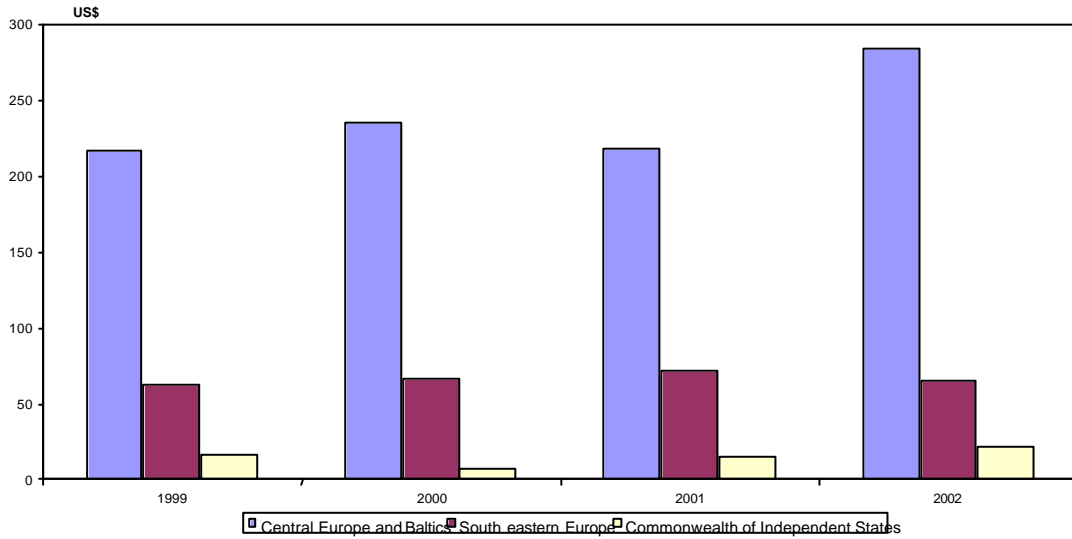
Source: World Economic Outlook Database and EBRD
 Note: Figures for 2002 are forecasts.

Chart 4. Total net capital flows to South-eastern Europe (by type)



Source: World Economic Outlook Database and EBRD
 Note: Figures for 2002 are forecasts

Chart 5: FDI flows per capita, 1999-2002



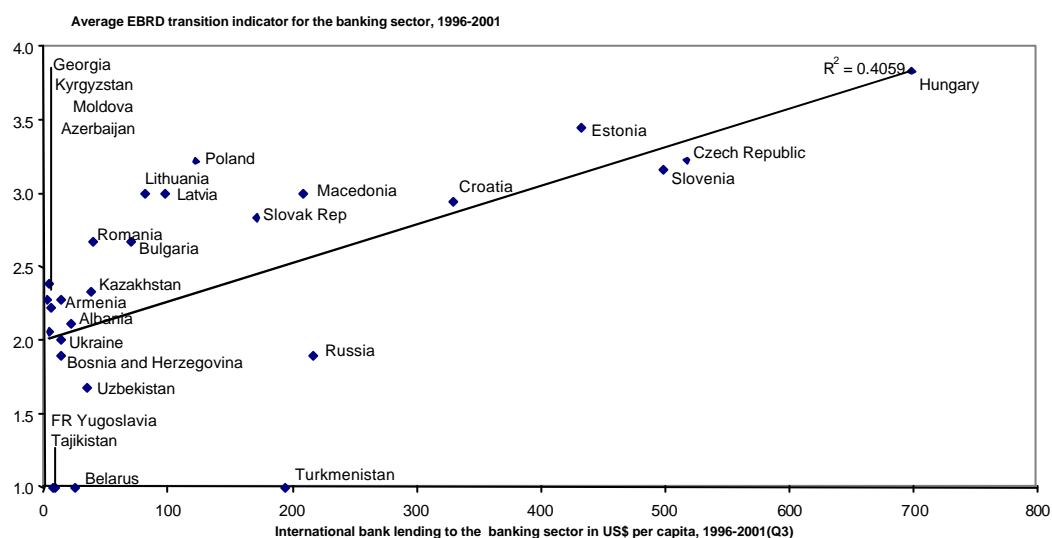
Source: EBRD Database
 Note: Figures for 2002 are forecasts

It is well established that FDI and progress in transition are closely correlated (see e.g. EBRD *Transition Report Update 2002*). Other forms of capital inflows also depend on governments' reform commitment. Charts 6 and 7 relate international bank lending to EBRD transition indicators for all transition countries. First, lending to the banking sector is charted against the EBRD transition indicator for the financial sector (Chart 6), and second, international bank lending to the non-bank private sector is compared to the transition indicator for governance and enterprise restructuring (Chart 7). Two points of interest stand out. First, when it comes to lending to the banking sector, most SEE countries are "above the line", i.e. receiving less capital inflows than would be predicted by the level of banking sector reform. Second, in the non-banking sector, countries of the current and former Yugoslavia are "below the line", suggesting that enterprise reform is lagging behind in these countries and remains a serious challenge.

While Bulgaria and Romania have accessed the capital markets recently, on relatively favourable terms given heightened risks in other emerging markets, many countries in the western part of the region are relying on official aid and private transfers (see Box 2).

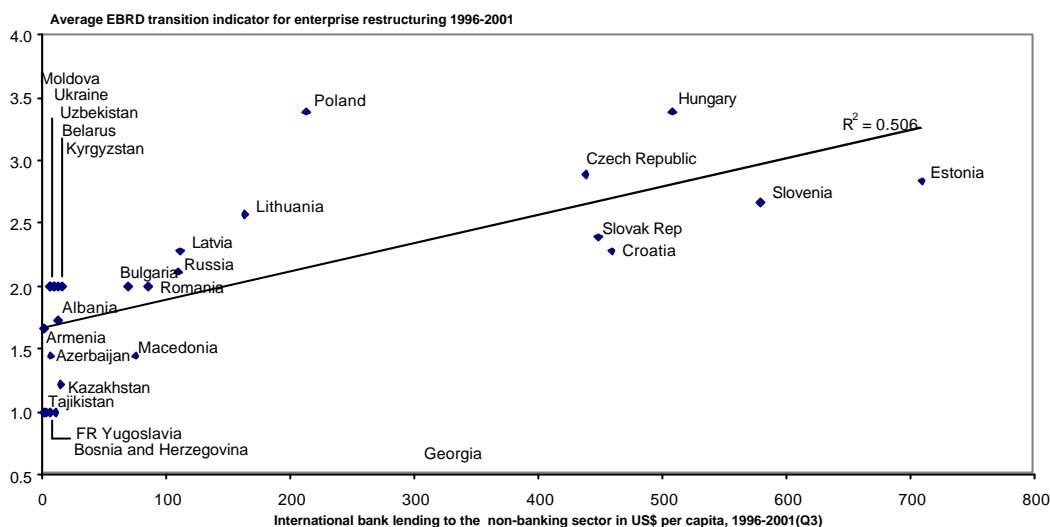
What can be done to make the region more attractive to investors? Two initiatives where recent progress has been made are worth highlighting. First, trade barriers are being dismantled gradually, with the intention of creating a free trade zone over the medium term. Box 3 summarises recent progress on bilateral trade negotiations, within the framework of the Stability Pact. Second, the Investment Compact, under the leadership of the OECD, is proving a useful vehicle for institutional reform, as countries commit to a series of targeted and measurable reform measures. The monitoring instruments developed by the Country Economic Teams in consultation with the OECD now provide a measurable benchmark through which progress in reform can be assessed on a regular basis.

Chart 6: International bank lending to the banking sector (flows per capita) and the EBRD banking sector transition indicator



Source: Bank for International Settlements and EBRD Transition Reports

Chart 7: International bank lending to non-bank private sector (flows per capita) versus restructuring transition indicator



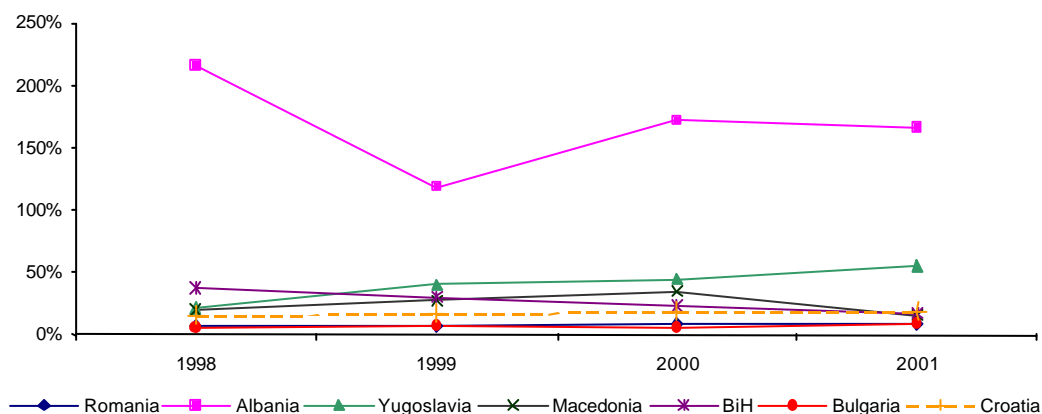
Source: Bank for International Settlements and EBRD Transition Reports

Box 2: The role of private transfers

Several countries in SEE have seen large-scale emigration during the 1990s and emigrants' private transfers (remittances) are a vital source of foreign currency revenues, as well as a means to finance small business opportunities. Accurate information about remittance levels is difficult to gather, as they are often transferred through unusual channels and are not reported. The Figure below shows estimated remittances relative to exports of goods (figures for Moldova are not available). From the graph it is clear that the country where remittances are most important is Albania, where they exceed exports by about 50% on average. Remittances are also a key source of foreign currency revenue in Serbia and Montenegro and FYR Macedonia, although they appear to be subject to considerable volatility. For example, there was a notable drop in remittances in FYR Macedonia during 2001 as a result of the turmoil during much of the year and the temporary closure of the border with Kosovo. Perhaps surprisingly, remittances are much less important in Bosnia and Herzegovina, though official aid flows have been substantial throughout the period, and they are also smaller in the accession countries, Bulgaria and Romania, as well as in Croatia.

There is evidence that a significant percentage of remittances go to productive activities, mostly micro-enterprises and small-scale farming activities. However, for the poorer countries in the region, people will continue to use remittances mostly for basic survival rather than investment projects. Private transfers will continue to be welcome, but for long-term sustainability, attracting FDI is the key challenge.

Remittances as a Percentage of Exports



Source: IMF Country Reports

Box 3: Recent Progress in Trade Agreements

A memorandum of understanding, facilitating and liberating trade among the countries of South-eastern Europe was signed in June 2001 in Brussels within the framework of the Stability Pact. Its aim was to promote regional trade through a network of 21 bilateral agreements on free trade among Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Romania and Serbia and Montenegro by the end of 2004. Moldova, which was not formally a part of the Stability Pact at the time, has since joined this process. By end-December 2002, 19 bilateral Free Trade Agreements were in place and the remaining two agreements (excluding the ones to be signed by Moldova) were imminent. All the agreements are in conformity with World Trade Organisation regulations, and in line with respective partnership of each of the European Union countries. In principle, these agreements were expected to enable the south-eastern European countries to have a liberalised exports market with about 55 million customers and to attract more investments to the region. Alongside the preferential export conditions from the European Union the free trade regional regime is an instrument to create open economies and enhance international competition. However, the level of trade among the seven countries is fairly low, and the main trading partner of the SEE countries is already the EU.

3. Regional Private Sector Initiatives: Working Table II Status

The EBRD was given a mandate to co-ordinate the international community's efforts to promote economic development and regional integration in south-eastern Europe through Private Sector Development. On 29-30 March 2000, at the Funding Conference entitled "International Financial Institutions; Regional Private Sector Initiatives in South Eastern Europe" ten specific Regional Initiatives, selected through a process of consultation among the IFIs as having the most immediate impact were proposed. Most of the initiatives are based on existing operations or proven models, which can be extended from one country to another. These initiatives attracted total pledges of € 356 million, comprising € 102 million bilateral donor grants for co-financing and technical assistance pledges and € 253 million pledged by the IFIs themselves: the World Bank Group, EBRD, the European Commission and the Council of Europe Development Bank (CEDB).

Two years later, many of these initiatives, some of which have since been extended to Serbia and Montenegro, have had a very significant impact on the ground. This is particularly true of the trade facilitation programme and SME financing and support facilities. Their implementation demonstrates that donor resources mobilised under the Stability Pact have had a very definite impact by generating incremental resources to the operations and programmes managed by the IFIs, many of which would not otherwise have been possible.

3.1 Trade Facilitation Initiatives

3.1.1 EBRD Trade Facilitation Programme

The EBRD's Trade Facilitation Programme promotes foreign trade by providing guarantees to international confirming banks. In so doing, it takes the political and commercial payment risk of transactions undertaken by issuing banks in south-eastern Europe. The programme can guarantee any genuine trade transaction associated with exports from, imports to, and between the countries in the region. Most transactions benefit directly to SMEs of the region. The programme is proving to be very

successful with the number of transactions growing every year and the EBRD has been continuously working at expanding it further throughout the region and at increasing the range of guarantees available.

As of the end of December 2002, 29 banks from south-eastern Europe are participating in the programme, with an overall agreed coverage limit of €125 million. Countries with high perceived risk such as Bosnia and Herzegovina, FYR Macedonia and Moldova are particularly active users of the facility. Over the whole period 1999-2002, this programme has allowed to guarantee 707 trade transactions for a total value of €121 million. The annual number of guarantees issued is growing fast: from 108 transactions in 2000 to 215 in 2001 and 382 in 2002, representing a turnover of €64 million in 2002. Seventy percent of the guarantees are for transactions of less than €100k.

This programme has been made possible thanks to risk sharing mechanism between donors and the EBRD for which donors have committed €10.3 million (Switzerland, Netherlands, Germany, Norway and Austria).

3.1.2 World Bank Trade Guarantee Programme

The World Bank Trade Guarantee programme is providing support for exporting companies in the form of working capital loans and/or guarantees, contract bond support, export credit insurance, and technical assistance (matchmaking, export procedures, and quality assurance), as well as support for trade in the form of political risk guarantees/insurance.

Two facilities are in operation in Bosnia and Herzegovina. The first one is providing political risk insurance for imports in co-operation with a syndicate of private risk insurers (Emergency Industrial Re-Start Project): 28 guarantees and insurance policies for a value of US\$ 23 million were issued as of June 2002. The second one is supporting BiH exporters (Enterprise Export Facility) through various instruments: as of June 2002, 19 working capital loans have been made, two contract bonds supporting exports of US\$ 44 million were arranged and 14 exporters benefited from export credit insurance. World Bank credits supporting these two projects total US\$ 20 million and donor co-financing for the political risk insurance project is about US\$ 10 million (Netherlands, Sweden and Switzerland)

In Albania, the Private Industry Recovery Project, is providing political risk guarantees. The World Bank extended a US\$ 10 million credit supporting this guarantee facility. As of June 2002, 23 guarantee contracts for a total amount of US\$ 8.3 million have been issued. The project is currently being amended in order to allow the implementing agency, the Albanian Guarantee Agency, to also use the funds for import and export credit insurance, facilitate working capital financing and contract bonds support in cooperation with local banks, and offer technical assistance.

A similar project is expected to be approved for Serbia and Montenegro (World Bank loan of US\$ 11.8 million and Italian donor financing of €10 million) and for FYR Macedonia in the coming year.

3.2 Micro, Small and Medium-Size Enterprise Financing

3.2.1 Micro-Finance Banks

Micro-finance banks are now established in Albania, Bosnia and Herzegovina, Kosovo, Serbia and Montenegro, Bulgaria, Romania and Moldova, with another soon to be opened in FYR Macedonia. These institutions, set-up by EBRD, IFC, KfW/DEG, FMO and private investors (IMI and Commerzbank), are having a highly significant impact in allowing access to financing for entrepreneurs and small and micro businesses. On a cumulative basis to date, these banks have granted over 55,000 small loans for a cumulative value of US\$ 336 million (average loan amount around US\$ 6,100). The current loan portfolio outstanding consists of 29,000 loans for a value of US\$ 161 million. The table below provides details for each institution.

Micro-Finance Institutions – Summary data as of 31 December 2002

	FEFAD Bank	MEB Bosnia	Procredit Bulgaria	MEB Kosovo	MIRO Romania	MEB Yugoslavia	MEC Moldova ²⁾
Date operations commenced	Jan-96	Nov-97	Oct-01	Feb-00	Jan-00	Apr-01	Dec-99
Shareholders	EBRD IFC IMI KfW - Commerzbank	EBRD IFC IMI KfW FMO Commerzbank	EBRD IFC IMI DEG/KfW - Commerzbank	EBRD IFC IMI KfW FMO Commerzbank	EBRD IFC IMI DEG/KfW - Commerzbank	EBRD IFC IMI KfW FMO Commerzbank	EBRD - IMI KfW/DEG Doen Western NIS Enterprise Fund
No. of Branches/outlets	9	11	13	7	6	9	8
No. of Loan Officers	39	36	83	59	36	69	38
Total # Loans Disbursed	12,430	15,652	6,827	8,344	3,472	5,973	2,304
Total Vol. Loans Disbursed	\$80,856,357	\$78,169,567	\$41,853,206	\$56,611,058	\$19,043,960	\$49,942,690	\$11,036,695
Outstanding # of Loans	5,434	5,982	4,884	4,493	2,591	4,515	1,111
Outstanding Loan Volume	\$29,772,246	\$32,156,368	\$28,369,438	\$23,057,856	\$10,589,825	\$33,669,427	\$4,184,328
Total Deposits¹⁾	\$51,579,000	\$10,188,591	\$8,951,027	\$272,447,827	\$361,316	\$35,751,000	\$0
Arrears % > 30 days	1.98%	0.55%	0.06%	0.41%	0.54%	0.46%	0.00%

¹⁾ All deposits as of 30 September 2002 (MEC, as a finance company, is not allowed to take deposits)

²⁾ MEC-Moldova currently operates as a microfinance company but is expected to become a bank in 2003

Donor support towards these institutions in the form of technical assistance represented over € 14 million, contributed by USA (€ 11.1 million through US/EBRD SME Financing Facility), KfW, FMO, EU, Luxembourg, Germany, Norway and DOEN. EBRD's own investment commitments to these institutions represent €23.5 million

3.2.2 EBRD/EU SME Facility

The EU/EBRD SME Facility is intended for all ten accession countries, including Bulgaria and Romania. It is providing financing for SMEs through participating banks and leasing companies, together with technical assistance to improve the banks' lending skills and with a performance incentive designed to offset the costs of entering the business of lending to what normally is perceived as the riskiest segment of the enterprise sector.

As of end 2002, the EBRD has committed in Romania and Bulgaria a total of €128 million in loans while the EU has provided €23 million grants for technical assistance and performance fees. There are currently six banks participating in the Programme in Romania (Alpha Bank, Banca Transilvana, Romanian Commercial Bank, Banca

Agricola Raiffeisen, Banc Post and Volksbank) and four banks in Bulgaria (Union Commercial Bank, Hebros Bank, Raiffeisen Bank and United Bulgarian Bank). These ten participating banks have extended over 2,292 loans to SMEs for a total amount of around €75 million.

3.2.3 Small Equity Funds

With the support of the Italian Treasury, the EBRD has set-up two dedicated equity funds targeted at high-potential SMEs in two high-risk environments: Albania and Kosovo. The structure of the funds combines EBRD investments with donor grants to provide a risk mitigation cushion as well as technical assistance (assistance to investee companies and share of the fund's management fee). The funds have been successful in developing a portfolio rapidly by investing creatively using equity or simple but robust quasi-equity structures.

The Albanian Reconstruction Equity Fund is capitalised with US\$ 14 million (US\$ 7 million from EBRD and US\$ 7 million from Italy) and benefits from Italian technical cooperation grants of US\$ 3 million. As of end December 2002, the fund has invested in 11 local enterprises for a total commitment of US\$ 4.7 million.

More recently, the Kosovo Equity Reconstruction Fund started operating. The Fund is capitalised with €4 million (half EBRD, half Italy) and benefits from Italian technical assistance grants of €1,350k. As of end December 2002, the fund has invested in 6 enterprises for a total commitment of €2.8 million.

3.3 SME Support Initiatives

3.3.1 IFC Southeast Europe Enterprise Development Programme

Southeast Europe Enterprise Development (SEED) is a multi-donor initiative managed by the IFC to strengthen small and medium enterprises in Bosnia and Herzegovina, Albania, FYR Macedonia and Serbia and Montenegro. The five year, USD 25 million facility offers a variety of services both to local SMEs directly and to local organisations that support them. SEED also works closely with the World Bank Group and other international institutions to improve the difficult operating environment for SMEs in these target economies. Headquartered in Sarajevo, SEED has offices in Banja Luka, Belgrade, Skopje, and Tirana. SEED is funded by Austria, Canada, Greece, the Netherlands, Norway, Slovenia, Sweden, Switzerland, the United Kingdom and IFC.

SEED works along three service lines: enterprise-level investment services; capacity building of enterprises and of local service providers such as business associations, chambers of commerce, training / economic institutions and consultants who serve SME's needs; and improvement of the business enabling environment. During fiscal year 2002, SEED investment services delivered 31 Internal Enhancement Plans and 20 Investment Plans. Fourteen projects were financed for USD 9.1 million. SEED also completed 49 capacity building projects (to business development service providers or SMEs/group of SMEs), training more than 1,000 local service providers and nearly 1600 SMEs employees/managers. Finally, SEED has undertaken 30 "business enabling environment initiatives", which included surveys/studies, publications and input into donor / government strategies on SME development and poverty reduction.

3.3.2 Business Advisory Service Programme

The Business Advisory Service (BAS) Programme is managed and delivered by the independent and non profit Turn Around Management Group (TMG) based at the EBRD HQ in London. BAS is an established and proven multi-donor programme which co-funds specific consultancy projects with micro, small and medium sized enterprises, improving their quality and competitiveness. BAS is using predominantly (>75%) local accredited consultants, thereby enabling an increase in the capacity and competence of the local consultancy industry. In south-eastern Europe, BAS is operating successfully in Croatia, Bosnia and Herzegovina, Bulgaria and, since June 2002, in FYR Macedonia. Using simple procedures and a cost effective structure, BAS allows effective support of large numbers of enterprises, focusing on practical inputs with clear objectives such as financial information systems, market research and development, quality management systems, engineering studies, and business plans. Such projects provide benefits with a relatively short 'pay-back' time and enterprises typically recoup costs in about one year. Ex-post evaluation of BAS impact on enterprises shows measurable benefits in profitability, productivity, sustainable employment and creation of new jobs. As at 31 January 2003 there are 113 BAS projects in progress in the south-eastern Europe (37 in Bosnia Herzegovina, 18 in Bulgaria, 32 in Croatia, 26 in FYR Macedonia).

Committed donor funding (from EU, Italy-CEI, UK, Taipei-Taiwan, Austria, Germany and the Balkan region Special Fund) amounts to €5.8 million. An additional €20 million is requested from donors to ensure continuation of existing operations in south-eastern Europe for the period 2003-2004 as well as starting up operations in Yugoslavia (Serbia/Montenegro) and Romania, where feasibility studies have shown that BAS Programmes would be viable, and establishing Programmes in Albania, Kosovo and Moldova if feasibility studies (yet to be carried out) are positive.

3.3.3 Turn Around Management Programme

The Turn Around Management (TAM) Programme is also managed by TMG. TAM is an established and proven multi-donor programme providing industry specific advisors to potentially viable small and medium sized enterprises, enhancing the knowledge, confidence and capabilities of their management and assisting transition to success in market driven economies. TAM projects improve management skills, cash-flow, quality, productivity local and export marketing, and increase profitability. Operating successfully for nearly a decade, TAM is currently active in all countries of south-eastern Europe (success rate of 80%). TAM is using an international network of 'industry specific' senior advisors and technical experts, mostly former industry managers to deliver in a cost effective manner service to a large number of enterprises. TAM applies a high degree of conditionality on enterprise performance: advice to unresponsive enterprises is stopped, reducing the exposure and potential waste of donor funds. As at 31 January 2003, 183 TAM projects have been implemented in the SEE region (6 in Albania, 10 in Bosnia and Herzegovina, 22 in Serbia and Montenegro, 11 in Croatia, 8 in FYR Macedonia, 34 in Bulgaria, 79 in Romania and 13 in Moldova), 123 of which have been completed.

Total donor funding committed to support TAM (from the EU and a large number of bilateral donors) amounts to €12.1 million. The required donor funding for the period 2003 - 2004 is an additional €3 million. There is a current pipeline of eligible TAM projects across the Region and many prospective enterprises are recorded in all countries. While further EU funding for TAM is now available for Bulgaria and Romania, no other broadly-based framework funding is available for the other countries, so that TAM is presently having to continue to operate on a project-by-project basis with bilateral donors.

3.4 Other Initiatives

3.4.1 MIGA Political Risk Guarantee

MIGA has been actively supporting south-eastern Europe regional private sector initiatives. The Agency is currently working on the establishment of a donor supported regional political risk guarantee trust fund, notably to support SMEs. Donor consultations are taking place on the preparation of this facility (indicative size: €10-20 million). Several projects for which investors have applied for a guarantee have already been identified (financial, infrastructure and manufacturing sectors).

Under a regional political risk guarantee fund MIGA would be able to support investment/lending into the region. MIGA can issue guarantees against the risks of Transfer Restriction, War and Civil Disturbance, Expropriation, and Breach of Contract. Foreign loans and investments insured under a Fund would also include franchising and leasing type of agreements, including management contracts and technical assistance, and others.

MIGA is also pursuing other initiatives in the region which include the administration of the EU funded political risk guarantee trust fund in Bosnia and Herzegovina.

3.4.2 South-Eastern Europe Construction Industry Capacity Building

The objective of this initiative is to identify the capacity constraints and other problems faced by the local construction industry contractors and suppliers in the region with the objectives of (i) developing capacity enhancement initiatives, including financial product recommendations for IFIs and commercial banks, (ii) optimising participation in business opportunities generated, and (iii) disseminating knowledge about tendering and procurement processes to local construction firms.

A study was commissioned utilising grant funds from the UK (€256k) and completed at the end of 2001. The final report (executive summary available from the EBRD upon request) gives a detailed overview of the constraints facing local construction industry contractors and recommends actions to overcome these. Many of these actions require further donor support. In parallel, local seminars for the construction industry were held to disseminate knowledge about tendering and procurement processes to local construction firms.

In conclusion, most Regional Private Sector Initiatives have been successfully implemented and have shown substantial and significant results in terms of supports to private enterprises, particularly SMEs in the region providing both financial support, advisory and institutional building. None of these initiatives would have been possible

without the leverage provided by the generous commitments of the multilateral and bilateral donors and the pooling of efforts between IFIs and the donor community. Going forward, donors are urged to review their commitments to Private Sector Development in the region and to consider additional support to some of the Regional Private Sector Initiatives identified above. The EBRD is committed to its role as coordinator of Private Sector Development programmes under the Stability Pact and looks forward to continued excellent collaboration with the other IFIs, the EU and the bilateral donor community.

4. The Role and Activities of the EBRD in South-Eastern Europe

South-eastern Europe benefited from a renewed level of interest from private investors and bilateral donors in 2001 and 2002. Through its activities in the region, the EBRD sought to further encourage this interest by cooperating closely with other multilateral institutions and by undertaking an extensive investment programme. The Bank helped to finance the privatisation and restructuring of large industrial enterprises, the development of critical infrastructure projects and support for a large number of small enterprises. The EBRD has therefore continued to successfully implement its action plan for south-eastern Europe and its commitments to the Stability Pact. The Bank's objectives fall in three main areas: (i) regional private sector initiatives; (ii) regional infrastructure finance; and (iii) increased EBRD business volume in the region.

4.1 Regional Private Sector Initiatives

As noted earlier, under the Stability Pact, the EBRD was requested to lead and coordinate regional initiatives that would promote private sector development in the region. Several of these initiatives such as trade facilitation, micro-finance institutions and other dedicated SME financing schemes are led and implemented directly by the EBRD. A detailed status of each initiative is presented in the previous section. The impact of these initiatives on SME support and development have been considerable.

More broadly, the EBRD is indirectly supporting SMEs and the private sector at large in south-eastern Europe through its significant involvement in the financial sector. As of 31 December 2002, the EBRD's cumulative volume of commitments with banks (equity, credit lines and guarantee products) and other non-bank financial institutions, including private equity funds in the region represents a total of EUR 1.15 billion. It is noteworthy that, as of end 2002, private equity funds active in the region and in which the EBRD has participated, have a total committed capital of over €446 million to invest in enterprises of the region, of which EUR 286 million has been disbursed and invested.

4.2 Infrastructure Finance

Infrastructure is a key focus of the Stability Pact. The EBRD is one of the IFIs actively involved in this sector and is directly leading or co-financing 21 projects out of a list of 51 projects recognised by the Stability Pact as priority infrastructure project for the region. The list of projects comprise of Quick Start infrastructure projects agreed at the Regional Funding Conference held in Brussels in March 2000 in support of the Stability Pact, and the list of regional infrastructure projects presented at the second Regional Conference held in Bucharest in October 2001. Following the Infrastructure

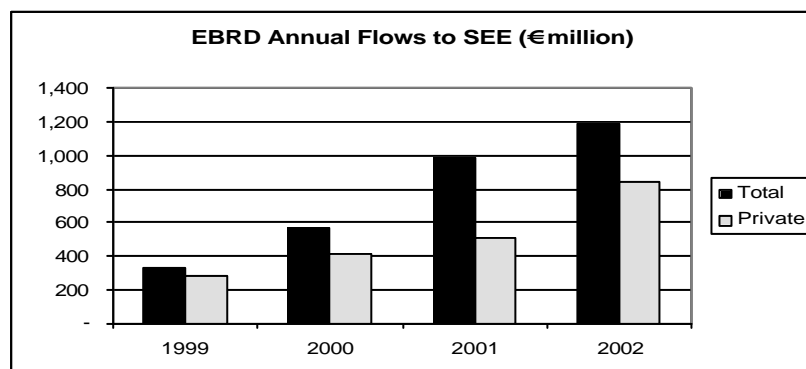
Steering Group's meeting of November 21, 2002 five new projects were included on the list. Substantial progress has been made in getting the projects started. The number of projects started by the beginning of 2003 has doubled compared to December 2001.

- The three projects led by the EBRD under the initial list are signed and under implementation: Macedonia Environmental Action Programme with 6 municipalities: €20.8 million EBRD finance; Albania Elbasan-Librazd Road: €17 million (revised project financing signed in Dec 2002 - works ready to start in 2003); Croatia Rijeka Water Supply: €7.5 million. In addition the EBRD co-financed three more projects: a €50 million Power Sector loan under WB lead in Bosnia Herzegovina and two EIB led projects in the road sector in FYR Macedonia which are currently being finalised: Skopje Bypass (proposed EBRD financing: €25 million) and Skopje-Thessaloniki Road (proposed EBRD financing: €15 million).
- Furthermore, the EBRD leads or participates in 15 more priority projects, which are currently under preparation or already signed. These projects (power in Albania, Croatia, Serbia and Montenegro and Romania, railways in Bosnia and Herzegovina and Serbia and Montenegro, roads in Croatia and Romania, water and wastewater in Croatia and Romania, air navigation services in Croatia, Serbia and Montenegro and Macedonia) have a total value of over €1.7 billion, for which EBRD is providing finance of over €660 million.
- As of 31 December 2002, the EBRD's overall cumulative infrastructure commitments to the region amounted to €2.1 billion for 68 projects in the transport, municipal, power and energy efficiency sectors (total project value €7.4 billion). At the same date, the overall pipeline of new infrastructure projects under consideration in the region stood at 19 projects amounting to €3.2 billion for which the EBRD is considering to commit €830 million in financing.

4.3 Increased Business Volume

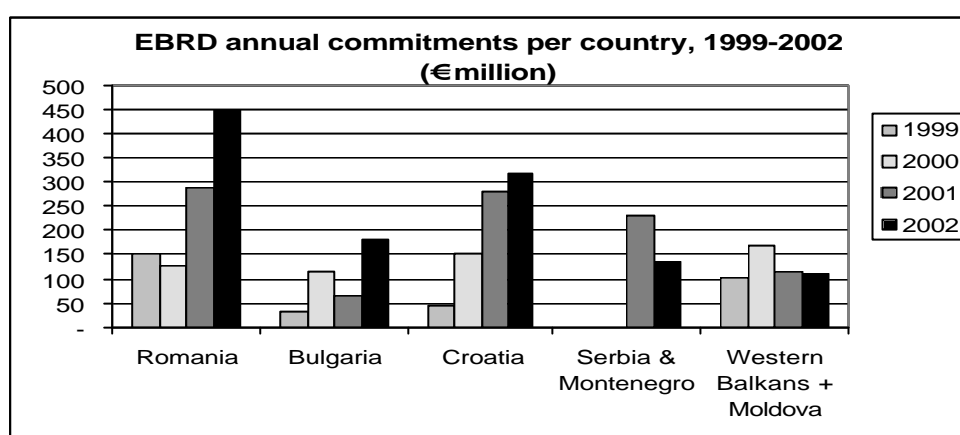
The EBRD is experiencing increased investor interest in the region, suggesting that increased stability and business confidence, governments' commitment to reform-oriented policies and efforts towards an improvement of the investment climate are providing effective encouragement. Highlights include:

- Annual signed commitments by the EBRD in the region have been steadily increasing from €335 million in 1999 to €1.2 billion in 2002 (a 3.5 times increase compared to 1999), of which €840 million (71%) represent private sector commitments.



Strong portfolio growth is taking place particularly in Croatia, Romania, Bulgaria and Serbia and Montenegro.

EBRD Annual Commitments (EUR million)								
Country	1999		2000		2001		2002	
	Total	Private	Total	Private	Total	Private	Total	Private
Albania	41	1	2	2	18	18	42	1
Bosnia and Herzegovina	7	7	61	11	52	11	39	9
Bulgaria	35	25	116	116	65	65	182	91
Croatia	47	47	153	153	281	138	318	246
FYR Macedonia	47	47	65	44	33	33	20	9
Moldova	7	7	43	35	10	10	10	10
Romania	151	151	126	50	288	210	447	432
Serbia & Montenegro	-	-	-	-	233	16	135	43
Total SEE	335	285	566	411	980	501	1,192	840



- Alongside its own investment financing in the region and for the year 2002, the EBRD has mobilised € 306 million in commercial co-financing (in the form of syndication and parallel lending from private commercial banks), up from €98 million in 2001, and €816 million in official co-financing (co-investment by other IFIs and bilateral donors, excluding technical cooperation), up from €287 million in 2001, further demonstrating increasing appetite by co-financiers for the region.
- As of 31 December 2002, the EBRD had cumulative commitments in the region close to € 5.3 billion among 228 projects (representing € 16.8 billion of total project value), with private sector commitments accounting for 58 per cent. The outstanding portfolio at the same date is €3.8 billion.

EBRD Cumulative Business Volume - 31 December 2002				
Country	Total Commitments		Private Sector Commitments	
	# projects	EUR million	EUR million	%
Albania	15	157	65	41%
Bosnia and Herzegovina	18	230	46	20%
Bulgaria	39	667	403	60%
Croatia	44	1,180	796	68%
FYR Macedonia	16	258	146	57%
Moldova	19	181	97	53%
Romania	63	2,251	1,461	65%
Serbia & Montenegro	15	367	57	16%
Total SEE	228	5,290	3,072	58%

Note: Including share of commitments to regional funds

- At the end of 2002, the EBRD's project pipeline – deals under preparation but not yet signed – remains strong at €1.8 billion (of which two thirds are private).

5. Conclusions and the way ahead

Private sector development lies at the heart of the new phase of the Stability Pact. This paper has argued that, notwithstanding recent progress in political stability and institutional reform, the region continues to suffer from the legacy of a decade of turmoil and conflict. Foreign investors remain cautious about the region's prospects for profitable investment opportunities, and in some countries the privatisation process is in danger of losing momentum. Capital flows to the region are increasing, but much more needs to be done to create the right investment climate both for local and foreign investors. For these reasons, the IFIs and the bilateral donor community must continue to play a very active enabling role for private sector development in the region. As outlined above, the EBRD has made a major contribution to the region's progress in recent years, but much of the EBRD's impact has depended on the generous financial and technical support of bilateral donors.

Looking ahead, one priority is to speed up the implementation of existing projects, including but not limited to infrastructure, so that the benefits of major investments can become apparent to the public, many of whom are dissatisfied with the perceived slow pace of reform. More generally, a number of concrete, project-related products and concepts should be explored and implemented where appropriate. These include:

- *Public-private partnerships in infrastructure*: the Bank has had some experience of successful PPP implementation, including the Sofia Water Concession project. PPPs are based on the sharing of investment risk, responsibility and returns between public and private entities and international institutions such as the EBRD can play a key role by assuming risks that commercial banks would not take. Nevertheless, the appropriate regulatory framework must be in place before public administrations can contemplate a PPP programme.
- *Enhanced SME and micro-finance support*: donor support continues to be essential in order to broaden and expand the projects specifically dedicated to SME financing and support, including capacity-building and development of SME support networks.
- *Trade facilitation*: the Trade Facilitation programme has been very successful so far and the EBRD is seeking to broaden the scope of the programme. Several new features are being explored: the provision of support for longer-term maturities for the import of capital equipment needed in the region to improve the industrial base, the introduction of revolving loan facilities to banks in order to fund trade related advances to local companies, and risk-sharing with commercial banks.
- *Institution-building*: this is a key area of weakness where efforts should be focused: strengthening of local banks, of regulatory bodies, of utilities, of public services are key to successfully serving the needs of the private sector, implementing projects efficiently and attracting new investors in all sectors. Two areas where the region

lags behind central Europe and the Baltic states are legal transition and standards of corporate governance. The EBRD is working on both areas to enhance standards and performance in both areas. Commercial law is a particular focus for the EBRD's legal reform efforts; for example, the Bank has assisted in the development of modern pledge laws in Bulgaria and Romania which are based on the EBRD's Model Law on Secured Transactions

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